Study on the State of Corporate Governance in India

Gatekeepers of Corporate Governance – Auditors

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Table of Contents

Executive Summary .............................................................................................................................. 2

Literature Review ................................................................................................................................. 3

Auditors as Gatekeepers ....................................................................................................................... 5

1. Regulatory Framework Governing Auditors in India ................................................................. 5

  1.1) Legal Status ................................................................................................................................. 5
  1.2) Role of ICAI in Maintaining Audit Standards & Quality ............................................................ 7
  1.3) Comptroller and Auditor General (CAG) ................................................................................. 8
    1.3.1) Audit of Public Sector Undertakings ................................................................................ 9
  1.4) Robustness of Legal Framework ............................................................................................. 10

2. Assessing The Quality of Audit In India ......................................................................................... 10

  2.1) Effectiveness of an Auditor ....................................................................................................... 10
  2.2) Size of an audit firm as a measure or proxy for audit quality ...................................................... 12
  2.3) Time taken to complete the audit from the date of closing of financial year ....................... 14
  2.4) Use of Notes to Accounts in Audit Reports ............................................................................ 15
  2.5) Three Pillars ensuring quality of financial information .............................................................. 15
    2.5.1) Quality of Accounting Standards ......................................................................................... 16
    2.5.2) Quality of Accounts Prepared by Companies: ..................................................................... 18
    2.5.3) Quality of Enforcement/ Oversight .................................................................................... 19
      a) Corporate Accounts ................................................................................................................. 19
      b) Auditors ........................................................................................................................................ 20

Peer Review Mechanism ................................................................................................................... 20

Disciplinary Proceedings (section 21B of the Chartered Accountants Act) ........................................... 21

Quality Review Board (QRB) ............................................................................................................. 22

3. Recommendations ........................................................................................................................... 23

4. Conclusion ......................................................................................................................................... 26

Annexure I – Global Rules/ Laws Governing Auditors ...................................................................... 28
Executive Summary

This section examines the role of auditors as one of the important gatekeepers of corporate governance.

Because of the centrality of the auditor’s role in upholding the integrity of financial information, auditors are regarded as gatekeepers to the entire public securities markets and, as it were, ‘keeping the faith’ of investors, regulators and other stakeholders. Financial statements that go through an external audit rigor are the touchstone for all the stakeholders in a market economy. These financials form the basis of all the investment and financial decisions of the stakeholders. The external auditors by virtue of their independence and professional competence are considered as principal gatekeepers or conscience keepers.

We have examined the effectiveness of the auditor firstly by analyzing audit reports on various indicators. We then examine the quality of oversight and enforcement, quality of accounting standards as the operating environment and the quality of accounts itself that is prepared by companies.

We found that the quality of legal framework, accounting standards and the oversight/enforcement process is of high quality and comparable with best global standards. However, there is a large disconnect between rules and regulations and its actual implementation. This is especially evident in regulatory role of ICAI whether in the disciplinary process, peer review mechanism or the quality review board.

A regulatory process has not been as responsive as the demands of current markets and the oversight mechanism has lagged behind the market needs. The quality of an audit is directly linked to the quality of financial statements; we found that since the proportion of promoter-led companies in India is very high, there is greater likelihood of managerial discretion which may raise information risk of the company.

We also found a disconnect between globally accepted accounting standards and the standards that are actually notified for use due to a number of carve-ins and carve-outs to standards like IFRS to make them acceptable to Indian business environment, thus rendering comparability of accounting statements across borders difficult. These changes in turn will create hurdles, when the Indian accounting standards converge with IFRS over a period of time.
Literature Review

Gatekeepers are individuals, institutions or agencies that are interposed between investors and managers/owners in order to play a watchdog role to reduce agency costs. If gatekeepers are absent or do their job inefficiently then, it is reasonable to believe, there will be fewer checks on managers/owners to behave in a manner consistent with placing investors’ interests above self-interest. In other words, market efficiency will be lower which, in turn, would raise the cost of capital.

Kraakman (1986) defines gatekeepers as ‘parties who are in a position to prevent misconduct by others by withholding their co-operation’.

Scholars like Kraakman and Coffee further define gatekeepers as reputational intermediaries who provide verification and certification services to investors. But they also acknowledge that the role of gatekeepers as reputational intermediaries who can more easily be deterred than the principals they serve has been developed in theory but less often examined in practice. Gatekeepers essentially assess or vouch for corporate clients’ own statements or a specific transaction—if this sounds like duplication, it is; however, this duplication is necessary because it is generally accepted that a gatekeeper has a lesser incentive to lie than the client and…regards the gatekeeper’s word as being more credible.

Hamdani defines gatekeepers as ‘parties who sell a product or provide a service that is necessary for clients wishing to enter a particular market or engage in certain activities’.

Therefore, bankers, auditors and analysts are gatekeepers for clients wishing to enter the capital market. Extending the argument, for clients who wish to raise money through shares, the capital market regulator (Securities Exchange Board of India) is a major gatekeeper. Lending to the corporate sector is one of the main planks of a commercial bank; therefore, the banking sector regulator (Reserve Bank of India) is another gatekeeper to ensure corporate governance through the regulatory mechanism of prudential lending norms and monitoring use of money, among other things.

Having a network or series of gatekeepers is, however, no guarantee that corporate wrongdoing will be detected or avoided. In a wave of corporate scandals starting from Enron, we have seen instances of multiple gatekeeping failure in which wrongdoing went undetected through several layers. ‘The failure of this network of gatekeepers was a recurring theme in business scandals. In too many instances, the gatekeepers in pursuit of their own financial self-interest compromised the values and standards of their profession in

3 ‘Understanding Enron: It’s About the Gatekeepers, Stupid’, John C.Coffee, Jr., Columbia Law School, page 5
the recent round of corporate scandals, the first tier—the managers—failed and then the gatekeepers failed as well\(^5\).

In fact, some scholars believe that, theoretically at least, the services of gatekeepers can be performed either from within or outside the corporation\(^6\). Of course the law mandates that certain gatekeepers must be external to the organization such as auditors but there are other gatekeepers like lawyers or internal auditors who may serve their function just as effectively if they worked from within the corporation.

Accountability of a gatekeeper requires a certain quantum of liability s/he must bear. As far as individual gatekeepers are concerned (such as auditors, lawyers, etc.), every country has some rules to punish errant behaviour. However, there are few (if any) instances of accountability of gatekeepers who are institutions; for instances, if SEBI or RBI fails to detect or deter abuse of governance norms by companies or banks, the investor has little recourse to hold them accountable. Gatekeepers’ liability may not always be created for the gatekeepers’ own ways—although this is also a possibility—but for the wrongs attributed to the corporation that could have been deterred or at least minimised by precautions taken by gatekeepers.

Andrew Tuch’s study shows that incentive problems will arise if gatekeepers are not capable of bearing the full liability imposed on them. In other words, gatekeepers’ incentives to take precautions are diluted where they are protected from full liability arising from their activities\(^7\).

A similar assertion is made by Steven Shavell in an optimal deterrence theory which prescribes the legal rules that optimally deter socially harmful conduct and discusses the dilution of incentives arising from a wrongdoer’s inability to pay for the losses it causes\(^8\).

A gatekeeper may even be shielded from the full effects of a liability regime by insolvency, although it rarely occurs in practice (Arthur Anderson being a notable example). Some categories of gatekeepers may collaborate with each other to adopt risk-shifting arrangements; for example, ‘comfort letters’ exchanged among bankers, analysts, auditors, etc. Likewise, communications among regulators (such as between SEBI and RBI) may also be termed as risk-shifting or risk-sharing arrangements. The objective of such an exercise may be varied—allocating liability or getting additional knowledge of the clients’ affairs or information exchange.

Auditors as Gatekeepers

Auditors constitute one of the most important components of gatekeepers who are charged with maintaining corporate governance norms in companies.

Because of the centrality of the auditor’s role in vouching for the integrity of such financial information, auditors are regarded as gatekeepers to the entire public securities markets and, as it were, ‘keeping the faith’ of investors, regulators and other stakeholders. Financial statements that go through an external audit rigor are the touchstone for all the stakeholders in a market economy. These financials form the basis of all the investment and financial decisions of the stakeholders through price determination of equity shares. The External auditors by virtue of their independence and professional competence are considered as principal gatekeepers or conscience keepers.

1. Regulatory Framework Governing Auditors in India

Auditing is defined as an independent examination of financial information of any entity, whether profit oriented or not, irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.

External auditor / Statutory auditor is an independent individual or firm engaged to express an opinion on whether the financial statements are free of material misstatements and whether they show a true and fair view of the financial position of the company.

1.1) Legal Status

Auditing profession is governed by The Institute of Chartered Accountants of India, a statutory body established under an act of the Indian Parliament whose mandate includes pre-qualification education, setting accounting and auditing standards, code of ethics for professional conduct and continued professional development. As per the Companies Act, 1956 only a member of ICAI, holding a certificate of practice can be named as an auditor of a Company and such an auditor may be an individual or a partnership firm with all the partners being practicing members of Institute of Chartered Accountants of India.

This indicates that the law holds an auditor personally responsible for conducting an audit; also such a person must be free from any constraints while conducting the audit which is why the Companies Act specifies persons who may not be appointed as an auditor such as a body corporate, an employee of the entity, a debtor, etc. since such persons either cannot be held personally liable or cannot function without encumbrance.

Every company incorporated under the Companies Act is required to get its accounts audited by a Chartered Accountant in practice to ensure true and fair view of the accounts and such an audit is called a ‘statutory audit’. Statutory Audit ensures reliability of annual accounts of the company for various users of financial information of a company. To ensure that auditors spend sufficient time on each client and therefore maintain the quality of assurance, the law prescribes limits on the number of audits that a single person may carry out.
The first auditor of a company is appointed by the board of directors while subsequent years’ auditors are appointed by the shareholders in a general meeting. A casual vacancy not caused by resignation may be filled by the board of directors but a vacancy due to resignation of an auditor has to be filled up only by the shareholders in a general meeting. The central government can step in to appoint an auditor when shareholders of a company fail to appoint one.

The board of directors has no power to remove an auditor; that power rests with the shareholders in an annual general meeting. But if the shareholders want to remove an auditor before expiry of his/her term, they have to seek prior approval of the central government for it. Even so, a special notice must be given to all shareholders for calling a meeting in which an auditor is to be removed or if the company does not want to re-appoint the retiring auditor.

In case of companies where a public financial institution or state government holds more than 25% of the share capital, the statutory auditor must be appointed by special resolution (by 2/3rds majority of shareholders). In so-called government companies (where not less than 51% of shares is held by central or state government or jointly) and in statutory corporations (set up under a special act of Parliament), the auditor is appointed by the Comptroller and Auditor General of India through an empanelment process of the ICAI.

The process of appointing auditors in public sector banks is also subject to stringent checks; such banks may choose auditors from a list of auditors vetted by the CAG and ICAI through a stringent empanelment process and the final selection must be approved by the RBI. Once appointed, an auditor usually works on that branch for three to four years which is a provision to safeguard his/her independence.

An auditor may be removed by the bank only with the prior approval of the RBI. In addition to these strict provisions for appointment and removal, there are several rights of the auditor that are protected by the Companies Act in order to ensure that s/he conducts the audit fearlessly, independently and have access to all information necessary.

Some of these rights are:

a) Right to collect information to be given in Balance Sheet and Profit and Loss Account\(^9\).
b) Right of access to books and vouchers.\(^{10}\)
c) Right to obtain information and explanations.\(^{11}\)
d) Right to visit branch office and access to branch accounts\(^{12}\).
e) Right to signature for authentication.\(^{13}\)
f) Auditors report to be read at the Annual General Meeting\(^{14}\)

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\(^9\) Section 211 of the Companies Act, 1956
\(^{10}\) Sub section (1) of Section 227 of the Companies act, 1956
\(^{11}\) Sub section (1) of Section 227 of the Companies act, 1956
\(^{12}\) Sub section (2) of Section 228 of the Companies Act, 1956
\(^{13}\) Section 229 of the Companies Act, 1956
Study on the State of Corporate Governance in India
Gatekeepers of Corporate Governance – Auditors

- Right to receive notice\textsuperscript{15}
- Right to attend general meeting\textsuperscript{16}

Under the Indian legal system, the office of the auditor enjoys high protection where appointment and removal must be transparent and clear with little room for arbitrariness. Apart from protecting the office of the auditor, Indian law also protects against negligence of the auditor.

An auditor is liable to make good the loss that members or investors of a company may suffer as a result of negligence on his part in the due performance of his duties. If there is fraud on his part, the auditor will be liable in tort. Claims may also arise from the auditor failing to detect defalcations or discover errors that may have put the company to loss.

However, it is necessary to prove the following before an auditor is held liable for fraud:

- The statement signed by him was untrue in fact;
- That the auditor knew that it was untrue or was recklessly ignorant whether it was true or not;
- That the statement was made with the intent that the other party should act on it; and
- That the other party did in fact rely on it and consequently suffered damage.

The shareholders can hold auditors for the losses suffered by them in case it can be established that they relied upon the auditors for making investments.

1.2) Role of ICAI in Maintaining Audit Standards & Quality

Institute of Chartered Accountants of India (ICAI) is the apex body in India that regulates the accounting and auditing profession. ICAI has brought out various Statements, Auditing and Assurance Standards, Accounting Standards and Guidance Notes, which are mandatory for a practicing Chartered Accountant to follow while discharging his professional duty of attestation of financial statements.

A Chartered Accountant who does not follow these standards in discharging the duty of attestation is considered guilty of professional misconduct and is liable for disciplinary action and punishment under the ICAI Act, which may include an official reprimand, removing his/her name from the register of members for a period of time, approaching the High Court for meting out punishment of a more serious nature, etc.

The Chartered Accountants Act, 1949 also contains provisions to ensure independence of the statutory auditors. It prohibits acceptance of fees, which are either linked to profits or otherwise dependent on the finding or the results of engagement. It is an act of misconduct for a Chartered Accountant to express an opinion on the financial statements of a business

\textsuperscript{14} Section 230 of the Companies Act, 1956
\textsuperscript{15} Section 231 of the Companies Act, 1956
\textsuperscript{16} Section 231 of the Companies Act, 1956
in which he or his firm or a partner of his firm has a substantial interest unless disclosure of such interest is made.

A chartered accountant in practice is considered to be guilty of professional misconduct if he accepts a position as auditor previously held by another Chartered Accountant without communicating with him in writing. The objective is not to obtain a no objection certificate from the outgoing auditor but to know the reasons for change in auditor to be able to safeguard his own interest, the legitimate interest of the public and the independence of the auditor besides finding out if there are any professional or other reasons for not accepting the appointment.

The work of a chartered accountant involves maintaining up-to-date knowledge of professional matters and a continuous process of learning new developments and processes of auditing. ICAI has set up a Continuous Professional Enhancement Committee to help maintain highest standards of professional services. This initiative of ICIA provides inputs to members by way of seminars, lectures, background material and educating in use of electronic media.

Continuous Professional Enhancement (CPE) requirement is mandatory for members in practice, with effect from 1st January, 2003 (presently set at 6 hours per annum and 25 hours in a block of 3 years).

1.3) Comptroller and Auditor General (CAG)

The CAG is responsible for oversight of financial health of Public Sector Units. The organisations subject to the audit of the Comptroller and Auditor General of India are:-

- All the Union and State Government departments and offices including the Indian Railways and Posts and Telecommunications.
- About 1500 public commercial enterprises controlled by the Union and State governments, i.e. government companies and corporations.
- Around 400 non-commercial autonomous bodies and authorities owned or controlled by the Union or the States.
- Over 4400 authorities and bodies substantially financed from Union or State revenues
- The Central PSUs listed on Bombay Stock Exchange (excluding Public Sector Banks and State Level Public Enterprise) have a market capitalisation of Rs 15.45 trillion as on April 30, 2011 constituting 22.37% of the total market capitalisation at BSE.\(^\text{17}\)

\(^{17}\) Source: (http://www.dnb.co.in/TopPSU2011/PSU_updates.asp)
1.3.1) Audit of Public Sector Undertakings

Under Section 619 of the Companies Act, 1956, the statutory auditor of a government company including deemed government company, is appointed by the CAG who also conducts a supplementary audit of the company and issues comments or supplements the audit report of the statutory auditor.

ICAI draws up a panel of firms of practicing chartered accountants to form part of a databank of firms who can conduct audits of PSUs. CAG may choose firms from this databank based on certain parameters on a suitability grid such as experience, numbers of partners/qualified personnel and years of association with the firm, past performance, etc. However, CAG does not whet the suitability of firms or check the veracity of declarations made by candidates during the empanelment process.

PSU firms form a major sector of the Indian economy and it is important to maintain a high standard of audit of its financial information. The quantity and quality of resources at the command of an audit firm determines the quality of audit of the PSU. Therefore, a more rigorous enquiry of suitability of firms must be undertaken by the CAG as the hiring entity.

CAG has also taken the following additional steps for independence of the auditor:

- Acceptance of non-audit assignments by the statutory auditors is prohibited for the year of audit and for one year after the firm ceases to be the statutory auditor.
- Rotation of auditors after every 4 years.

The CAG plays an oversight role by monitoring the performance of the statutory auditors and ensuring that the same is done properly and effectively.

The statutory auditors are required to submit the Audit Report to the CAG under Section 619(4) of the Companies Act, 1956. The certified accounts of selected government companies along with report of the statutory auditors are reviewed by CAG. Based on review through supplementary audit, significant audit observations are reported under Section 619 (4) of the Companies Act, 1956 to be placed before the Annual General Meeting.

CAG has introduced the system of three-phased audit in order to improve the total quality of engagement in their audits of public sector undertakings (79 in 2008-2009 and 114 in 2009-2010).

The objective of a three-phased audit is to:

- Establish an effective communication and a coordinated approach amongst the statutory auditors, management and the CAG audit team for removal of inconsistencies and doubts relating to the financial statements presented by the PSUs.
- Identify and highlight errors, omissions, non-compliances etc., before the approval of the financial statements by the management of the PSUs and
provide an opportunity to the statutory auditors and the managements of the PSUs to examine such issues for taking timely remedial action.

- To reduce the time taken for CAG’s audit after the approval of financial statements by the management of the PSUs

This approach has brought improvement in the quality of financial statements, which CAG has quantified for 2011 fiscal for 61 PSUs as:

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profitability</td>
<td>Rs 2,273 crores</td>
</tr>
<tr>
<td>Assets/ Liabilities</td>
<td>Rs 11,470 crores</td>
</tr>
<tr>
<td>Amendments to Notes to Accounts</td>
<td>Rs 4,041 crores</td>
</tr>
<tr>
<td>Classification Mistakes</td>
<td>Rs 5,070 crores</td>
</tr>
</tbody>
</table>

The quantum of change due to the changes made in the approach of audit makes the new process both productive and effective in safeguarding assets of public sector companies.

1.4) Robustness of Legal Framework

From this overview of legal provisions and the regulatory mechanism pertaining to auditors it is evident that the Indian legal system takes protection of the office of the auditor and maintaining its independence very seriously. Auditors in India are assured of full legal support and backing while carrying out their duties as gatekeepers.

Combined with a robust legal environment, the monitoring and regulatory functions of ICAI ensure that the country has a strong structure which adequately supports the independent functioning of the auditor. If regulators mete out punishments or sanctions that are inadequate, it will not be for lack of statutory authority but may point to inadequate implementation, perhaps even lack of will.

2. Assessing The Quality of Audit In India

2.1) Effectiveness of an Auditor

Independence is central to the effectiveness of auditors as gatekeepers. The issue of auditor-gatekeeper independence has been a constant concern for policy makers.

A factor that provides assurance of a gatekeeper’s independence is the risk of loss of reputational capital. An auditor has several clients, each of whom pays it a fee for providing assurance services. Therefore, the market can reasonably assume that rather than risk reputational capital, an auditor will give up the client or at least blow the whistle on improper conduct of the firm.
Assumption of independence of auditor is a powerful signal to the market about good conduct of the company’s performance. But independence can also be of various degrees.

Choy et al distinguish between ‘strong independence’—where an auditor’s compensation is completely independent of whether he/she agrees with clients in a final offer of auditor-client negotiation—and ‘weak independence’ where the auditor would suffer some form of financial loss if he/she disagrees with the client\(^\text{18}\).

The authors examine how financial and non-financial incentives affect choices made by an auditor-gatekeeper, whose decisions affect the welfare of investors and concluded that:

a) Even weak independence leads to effective gatekeeper in that the gatekeeper represents the third party (investor) as well as the third party would represent him/herself.

b) Strong independence leads to high levels of rejection (of collusion proposed by the client) even if it hurts the third party

c) Where there is absolute gatekeeper independence, the gatekeeper pays more attention to the proposed action (of collusion)

The study is useful for policy makers to weigh the costs and benefits of degree of auditor independence.

There are other scholars who assert that auditors’ independence is not impaired by his/her financial interests such as provision of non-audit service, low-balling and quasi-rent. Such scholars\(^\text{19}\) believe that in a competitive market auditors’ financial interests do not impair independence.

But is market mechanism a sufficient safeguard against collusion between auditor and client or sufficient insurance of auditor vigilance towards wrongdoing? Should there not be a certain degree of legal liability imposed on gatekeepers for negligence of their duty of care? Some scholars argue that strong reputational bonds built over the years by gatekeepers like (especially large) auditors are powerful enough to ensure the right level of gatekeeping effort on their part and are sceptical about the role that explicit and mandatory legal liability can play to provide proper incentives to such gatekeepers\(^\text{20}\).

Economies vary in their approaches to enforce vigilance on the part of the auditor but ‘most legal systems (do not) currently adopt a strict liability regime for gatekeepers such as auditors..., but impose on them various standards of professional behaviour and liability is contingent on the violation or breach of those standards; that is, most legal systems use a negligence-like liability regime\(^\text{21}\).
The public outcry following major global financial scandals appears to have one thing in common—the investing public holds the auditor accountable for certifying truthfulness and accuracy of financial information put out by a company. In the general clamour for increased liability of an auditor, however, it is often forgotten that an auditor does not certify financial information of a company (unless it is for a designated certificate of a specific matter) but puts a stamp on the financial information giving ‘a true and fair view’ of the state of affairs of the company.

An audit is a complex process based on accepted standards which also involves interpretation and estimation and where the end result is an ‘opinion’ of the auditor. Although auditing is guided by detailed standards, guidance notes and case laws, the procedures followed are not very transparent which makes the assessment of audit quality very difficult.

For instance, an audit conducted in accordance with auditing standards can rarely uncover management fraud that involves override of management controls, misrepresenting information or falsifying documentation. A routine audit is not designed to spot forgeries or uncover side deals that management may have with a third party. Such frauds can be uncovered only through a forensic audit and it is not practical or feasible to conduct every audit with a forensic bent of mind.

Even in cases of misstatements subsequently found or re-statements, it requires highly specialised expertise and the considered judgement of the court to decide whether an auditor was negligent in duties or merely a victim of collusive fraud between management and third parties.

There are several studies that have tried to assess audit quality using different parameters. Most studies are able to capture only market perceptions of audit quality rather than an auditor’s actual ability to detect and report accounting mis-statements. This is also because of the time lag between when audit services are offered and when (if) an audit failure becomes apparent. In the meantime the market often relies on an auditor’s reputation as proxy for audit quality.

### 2.2) Size of an audit firm as a measure or proxy for audit quality

Some studies use size of an audit firm as proxy for audit quality. Krishnan (2003), Zhou & Elder, 2001 found that the relationship between audit quality and size of the firm usually supports the hypothesis that the two are positively associated. DeAngelo (1981) found that auditor size is measured by the number of clients; she argues that since auditors earn client-specific quasi-rents, auditors with more clients have more to lose by failing to report discovered mis-statements.

The attestation of a company’s financial information provided by an auditor is to a large extent dependent on his/her reputation for doing a thorough audit unhampered by conflicts of interest. Reputation is often linked in various studies to size of the audit firm, the premise being that the bigger the firm, the more it has to lose and therefore the quality of audit must be superior.

Davidson & New, 1993 found evidence of better quality by Big 8 (or 6 or 4, depending on when the study was conducted), Nichols and Smith, 1983 found no difference attributed by
market in terms of audit quality of Big 8/6/4 and non-Big 8/6/4, Lam and Chang, 1994 found no difference between the two groups in terms of errors in earnings forecast, Petroni and Beasley, 1996 find no systematic difference in claim loss reserve accuracy or bias between clients of either group while Tate, 2001 finds that Big 5 auditors are less likely than non-Big 5 to issue qualified opinions regarding clients’ deficiencies in internal control or to report significant deficiencies in internal control.

However, Li Dang, Brown and McCullough, 2004 found that market’s ability to evaluate audit quality is not affected by auditor reputation and that the market appears to assess audit quality accurately.

In May 2010, The Sponsoring Committee of Treadway Commission (COSO), in their report on analysis of fraudulent financial reporting in USA over 10 years, concluded that ‘fraud goes undetected by auditors of all types and sizes. Big 6 / Big4 firms audited 79 % of the fraud companies during the fraud period’.

This study has analysed BSE 500 companies to examine whether size can be considered a proxy for audit quality in India

There are broadly two categories of audit firms in India:

- Big 4 Audit Firms in India (along with their affiliates)
  - PricewaterhouseCoopers, Deloitte Haskins & Sells, Ernst & Young and KPMG
- Non-Big 4 Small and Medium Sized Firm (Firms other than above category of Big 4 audit firms)

BSE 500 companies for the year ended March 2011 were audited by a total of 198 registered audit firms. This includes four (4) Big 4 firms (including its affiliate firms) and approximately 196 non-Big 4 firms.

An analysis of financial statements for the year ended 31st March 2011 companies forming part of Bombay Stock Exchange 500 shows that companies are almost evenly balanced between Big 4 and non-Big 4 auditors.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Number of Companies</th>
<th>Percentage of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non Big 4</td>
<td>270</td>
<td>54</td>
</tr>
<tr>
<td>Big 4</td>
<td>230</td>
<td>46</td>
</tr>
<tr>
<td>Total</td>
<td>500</td>
<td>100</td>
</tr>
</tbody>
</table>

A second analysis of auditors of Bombay Stock Exchange (BSE) top 100 companies shows similar results as BSE 500 companies:

A closer analysis of the companies audited by non-big 4 auditors reveals large public sector companies and public sector banks. This is in accordance with the policy of Comptroller and Auditor General of India (CAG) whereby auditors for PSUs and PSBs are chosen from a panel of auditors who may not necessarily be a Big 4 firm. It may be noted that Central
public sector institutions consist of over 22% of market capitalisation of Bombay Stock Exchange.

Some of the private sectors of the economy particularly large companies tend to have one of the Big 4 as their auditor, if they have global operations or have raised capital in a global market. We also observe that as a norm multinational companies in India tend to appoint the Indian representative of their global auditor as the statutory auditor in India.

We conclude that in India companies, unlike the western markets, which have a high level of concentration amongst the Big 4 firms, do not consider that the size of the audit firm as a measure or proxy for audit quality. V.K Shunglu’s paper on “Proposal to secure greater transparency and accountability in Financial Reporting” suggests that the sphere of oversight on auditors who audit the BSE 500 listed companies, should move to SEBI and like the SEC of the USA should monitor and review financial statements and other public filings as well as the quality of those auditors who attest the BSE 500 companies.

2.3) Time taken to complete the audit from the date of closing of financial year

We looked at a sample of 40 companies, chosen through a random statistical sampling method, from BSE 100 to determine the time taken to complete the audit and whether this can serve as a proxy for determining the quality of audit process.

The average time taken by an audit firm to complete the statutory audit is 30 to 60 days although several firms completed it within 30 days of close of financial year.

Auditors usually perform detailed reviews at the end of each quarter and hence do not spend a lot of time to complete the final audit. However the annual audit is not a summation of various limited quarterly reviews; the books of account are not necessarily hard closed at the time of each such review and there may be several aspects that require a broader time horizon than quarter end to assess the total impact.

Additionally, the length of an audit depends on the scope of the company’s operations, state and complexity of the company’s records, the responsiveness of company’s employees and results of prior audits.

While there are no defined parameters about ideal time for completing the audit a time frame of 60-90 days seems to be sufficient and where audit is completed within 30 days, there may be chances of increased errors or mis-statements that go undetected. Certain companies in our sample took more than 90 days to complete the audit, which somewhat defeats the purpose of an audit for an investor since the data becomes too historical to be of much use.

<table>
<thead>
<tr>
<th>Number of Companies</th>
<th>0-30 days</th>
<th>30-60 days</th>
<th>60-90 days</th>
<th>&gt;90 days</th>
</tr>
</thead>
<tbody>
<tr>
<td>In 2009-2010</td>
<td>11</td>
<td>20</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>In 2008-2009</td>
<td>12</td>
<td>17</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>
2.4) Use of Notes to Accounts in Audit Reports

We observed from our study of 100 audit reports of BSE100 companies that notes to accounts are used as a regular feature and often such notes are voluminous running into several pages. Some explanations are extremely technical and difficult to understand by a regular user. Other accounting policy disclosures do not portray the complete picture. Certain items having a material impact on the financials have been only explained in the notes without qualifying the auditor’s report even though it ought to be qualified.

Notes to the Financial Statements are additional notes and information added to the end of the financial statements to supplement the reader with more information. Notes to Financial Statements should help the understand computation of specific items in the financial statements and provide a more comprehensive assessment of a company’s financial condition.

However we observe that sometimes notes to financial statements are used by the auditor and management to load the statements with a lot of information that may add little to further understanding and may be construed more as a smokescreen to confuse the reader. Therefore, excessive or complex Notes to Accounts may be considered a tool of compromise between the management and the auditor and thus detract from the quality of the audit report.

2.5) Three Pillars ensuring quality of financial information

It is difficult to arrive at any formula or a set of proxy measures that can accurately determine the quality of an audit. An audit operates within the universe of several factors, effectiveness of each of which determines the ultimate quality of financial information and their audit.

Li, et al(Li and Shroff (2009) in ‘Financial Reporting Quality and Economic Growth’) say that ‘financial reporting quality may not be a critical growth factor for countries that are heavily invested in low information uncertainty industries (e.g. mature industries or industries with more tangible assets than intangible assets). However, as a country moves upward along
the chain of industrial evolution and focuses more on industries with greater information uncertainty, such as high-growth or high-tech industries (see Smith and Watts 1992), a high-quality financial reporting system can play a pivotal role in fostering faster economic growth. "India by virtue of having high growth and hi tech industries, the quality of financial systems is crucial to sustain growth and development.

Bhattacharyya, Daok and Welker (2002) put out three measures that determine the quality of financial reporting measures in an economy and in their opinion three legs upon which financial information rests are quality of accounting standards in a country, the effectiveness of implementation of these standards through an auditing mechanism and the legal framework of the country. These determine the quality and efficacy of financial statements that form the base of capital market transactions.

Therefore, the three planks that determine efficacy of financial information and audit quality are:

- Quality of Accounting Standards
- Quality of Accounts Prepared by Companies
- Quality of Enforcement/Oversight: a) on corporate accounts, b) on auditors

2.5.1 Quality of Accounting Standards

Accounting standards serve as a template for how accounting information is recorded, reported and interpreted. A uniform set of accounting standards (at least in each market) is necessary to determine how financial information should be calculated and reported.

The better the quality of accounting standards, higher is the perception of good quality financial information. Such information is readily accepted by users to make informed decisions that ultimately enhance the relevance of accounting information. It goes without saying that high quality accounting standards must be clear, precise and leave little scope for interpretation.

An OECD cross-country study of 35 countries (India was not among these countries) compared the quality of accounting standards and found that the value relevance of accounting earnings is positively associated with the quality of accounting standards.

That is, high quality accounting standards can provide better protection to investors through reliable financial reports. The study also found that high quality, acceptability and effective enforcement of accounting standards are complementary variables and put together they better enhance the value relevance of earnings22. India accounting standards are prepared by the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) and these standards are to be followed by all

establishments. As a global financial market became more prevalent, there was a need for international standards that are acceptable all over the world and understood uniformly.

The International Accounting Standards Committee, although in existence since 1971, was recognised as The International Accounting Standards Board in 2001 and began developing internationally acceptable accounting standards called IFRS. IFRS allows for aspects of local culture to be embedded in the standards and therefore each country may have slightly different rules, which however, fall under the umbrella of IFRS. EU countries have already adopted these standards and the SEC of US has agreed in principle to adopt them, although the roll-out date is not fixed yet; Japan has deferred adoption till 2016.

Convergence of Indian standards with internationally accepted IFRS is a stated goal of ICAI. In the meantime, it bridges the gap between Indian standards and IFRS by issuing new standards and ensuring that existing Indian standards reflect changes in international thinking. As at 31 January 2012, there were 35 such standards designated as ‘IND AS’; however, its implementation will be in a phased manner as per the roadmap of the Ministry of Corporate Affairs, presumably depending on resolution of issues with various government departments and agencies, such as tax authorities.

The converged IND AS rolled out so far has several carve-outs and carve-ins, which may further delay adoption of IFRS or render it vastly different from the international version. Major points of departure from international standards are:

- Treatment of foreign exchange loss: as per IFRS, the entire loss/profit on assets and liabilities on balance sheet date must be charged to the profit and loss account. IND AS allows for either charging into profit and loss account or to capital account to be amortised over the time frame of the concerned asset or liability
- Agricultural income: IND AS dealing with this is not yet notified
- Construction industry: IFRS requires percentage completion reporting, a practice not followed under Indian standards
- Under Indian standards investments need be valued at cost; IFRS allows for measurement both at cost as well as fair value, whichever is appropriate

IFRS is a principles-based set of standards rather than rule-based that is currently followed by several domestic standards, including India. IFRS calls for professional judgement to be used on a consistent basis to comply with the intent and spirit of standards.

This is the challenge that Indian reporters will have to handle—exercising judgement and defending their stand to stakeholders. It will call for new skill sets to be developed for both account preparers and auditors to work in the changing environment. The quality of accounting standards finally adopted by India will determine the quality of financial information and also the quality of gatekeepers in the economy.
2.5.2 Quality of Accounts Prepared by Companies:

Financial information is compiled and statements prepared by companies and then submitted for audit to an external agency. An auditor is expected to give an opinion on whether such financial information gives a true and fair view of the state of affairs of the company and only after such information has been prepared. Therefore, the quality of an audit depends to a large extent on the quality of financial information prepared by the company. Accounting standards have a degree of inherent flexibility built in and the quality of accounting standards depends on how aggressively this flexibility is used.

Bhattacharya, et al\textsuperscript{23} say ‘Reported earnings in a country could be opaque because of a complex interaction among, at least, three factors: managerial motivation, accounting standards, and the enforcement of accounting standards (e.g., audit quality). It could be that earnings are opaque because managers are motivated to manipulate earnings, and they can do this either because accounting standards allow substantial flexibility, or accounting standards do not exist to specify accounting principles related to some areas of business activity, or accounting standards, though rigorous, are weakly enforced.

It could also be that earnings are opaque, not because managers manipulate earnings, but simply because accounting standards do not call for accounting treatments that transparently reflect underlying business activity, and management is not willing or able to overcome these deficiencies by voluntarily providing more informative earnings reports.’

A study by Leuz, et al\textsuperscript{24} puts India in the lowest cluster of countries, in a scale of three, based on earnings management score, which is based on level of disclosures, discretionary accruals and lower enforcement regime. Though the authors assign highest scores for quality of minority rights but for legal enforcement for deviations and quality of disclosures, they assign only average scores to the country, bringing down the overall score for the quality and efficacy of financial information,

Managers have to take several accounting decisions during the ordinary course of business that are permitted by recognised accounting standards; however, some of which are subject to discretion. There are over 10 accounting standards, where discretion of management in interpretation is allowed and hence the scope of discretionary earnings gets accentuated.

The problems in India associated with financial information as they relate to:

\textsuperscript{23} Bhattachraya, Doauk, Welker ‘World Price of Opacity’
\textsuperscript{24} Leuz, Nanda and Wyocki titled ‘Earnings management and Investor Protection’
• earnings aggressiveness i.e. accrual of earnings when they do not exist
• loss avoidance i.e. postponing recording of transactions that are losses
• earnings smoothening i.e. avoiding spikes to meet expected results are well above the global average and given the low level of enforcement by regulators including lack of rigorous periodic review of financial statements for application of GAAP and auditing standards, such opacity will persist.

In 2011, the average holdings of promoters in Indian companies across various sectors was over 50% whereas institutions held below 15% and individuals even lower. (National Stock Exchange) When a large proportion of listed companies are controlled by a dominant shareholder group, the presumption of influence on discretionary use of managerial power on decisions is inevitable, which impacts the perception of quality of financial information.

Bhattacharya et al\textsuperscript{25} conclude that an increase in our measure of overall earnings opacity from the 25th percentile rank to the 75th percentile rank is associated with a 2.8 percent increase in the cost of equity measured using dividend yields. This for India means that if financial opacity is a regular feature—especially considering the prevalence of promoter-driven companies—the cost of equity capital is expected to be unreasonably high.

### 2.5.3 Quality of Enforcement/ Oversight

**a) Corporate Accounts**

Companies are required to file their annual financial statements with the Registrar of Companies (ROC) and listed companies have to additionally file these with stock exchanges where the scrip is listed. The Registrar of Companies is empowered by the Companies Act to call for information or explanation in relation to financial statements besides imposing penalties for non-compliance; however, we found very few cases of prosecution under these provisions\textsuperscript{26}. This could of course indicate that there are no major issues that require investigation and further explanation from companies; or it could indicate that the ROC does not scrutinise the financial statements that are routinely filed by companies.

Ministry of Corporate Affairs has recently (April 2011) made electronic filing of financial statements compulsory for all companies, using XBRL software. This should

\textsuperscript{25} Ibid see footnote 23

\textsuperscript{26} Source: aggregate of cases under www.watchoutinvestors.com
make scrutiny of statements easier for the ROC because financial information submitted online is computer readable and easily comparable against a dashboard. However, the system is still very recent and till date there is no information in public domain about such scrutiny by ROC.

Another initiative by the Ministry of Corporate Affairs is the Early Warning System (EWS). EWS is a software-based fraud-detecting system that scans financial information of companies based on a few financial and non-financial parameters to pick up any red flags that require further investigation. The software scrutinises quarterly results, public announcements, filings with stock exchanges, tax returns, etc. over parameters such as if sales with related parties are more than 5%, any discrepancy in EPS ratio of more than 25%, resignation of more than half the board of directors, changing auditors more than once in three years, several companies having the same address and common directors, etc.

The software is expected to pick up companies that raise such concerns and are then referred to Comptroller & Auditor General of India in case of public sector companies and to Registrar of Companies in case of others for further investigations. Since its inception in 2009 in the aftermath of the Satyam accounting fraud, the EWS has referred around 160 companies to CAG & ROC in 2010; however, the outcome of such investigation is not available in public domain and we were unable to verify its efficacy.

b) Auditors

Peer Review Mechanism

Peer Review is a quality control procedure designed to ensure that overall quality of audit is maintained throughout the auditing profession. Under this system, audit working papers of a firm are reviewed either by a panel of experts set up by the professional institute or by another independent audit firm.

The main objective of Peer Review is to ensure that members of the Institute (a) comply with the Technical Standards laid down by the Institute and (b) have in place proper systems (including documentation systems) for maintaining the quality of the attestation services work they perform.

The review begins with the assumption that professionals discharge their responsibilities properly and the aim of review is to enhance attributes of professionalism in the audit process.

It is mandatory for all listed companies to be audited by only peer review certified firms from April 1, 2009; additionally financial statements of companies coming out with initial public offerings (IPOs) need to be certified by firms which have been peer reviewed.
However, the findings of peer review board and action taken on such audit reports are not available in the public domain. Therefore, we are unable to analyse data to comment on the efficacy and efficiency of the system.

A few overall suggestions that may help to improve the system are:

a) Publishing the findings of the Peer Audit, at least for use by other members of ICAI, which may act as a deterrent for professional misconduct

b) At present, costs of the Peer Review Audit are borne by the auditee. Costs notified by ICAI are minimal and the audit is expected to be completed in approximately two days; however, the time and costs may not be adequate in all cases of peer reviews and the system must make provisions for this

c) ICAI may consider setting up a fund to pay for costs of peer reviews so that independence and objectivity is maintained

d) ICAI may mandate a certain number of peer reviews to be conducted by all practicing members as part of their professional duties.

Disciplinary Proceedings (section 21B of the Chartered Accountants Act)

The Disciplinary Directorate, the Board of Discipline, and the Disciplinary Committee form the foundation of the disciplinary process of ICAI. These entities are quasi-judicial and have substantial powers akin to that of a Civil Court to summon and enforce attendance or require discovery or production of documents on affidavit or otherwise. If the Board of Discipline finds a member guilty of professional or other misconduct, it may reprimand the member, remove the name of the member from the register of members for up to three months or impose a fine up to 1,00,000/- (in some cases up to Rs.5,00,000).

ICAI, under its current regulations has the power to proceed only against individual members and not the firm under which practising chartered accountants may be operating. To that extent, its role and power as a regulator is diminished. If punitive action is not taken against a firm, there is little incentive for the firm to improve its processes and ensure institutional remedies since it may be easier to simply remove the affected partners from the partnership. This possibility has been seen in recent years in the case of Price Waterhouse in case of Global Trust Bank, again Price Waterhouse in Satyam Computer Services Limited and Ernst and Young in Maytas. Compounding the dilemma for ICAI is that several recent financial frauds and scams relate to organizations that had multinational accounting firms as their auditors. These multinational firms cannot legally set up a practice in India and therefore practise in the country by different means usually operating through tie-ups with local firms.

ICAI has, to strengthen its regulatory powers, asked the Ministry of Corporate Affairs, Government of India to grant additional powers so that it may proceed against firms whose partners or employees are found guilty of professional misconduct. ICAI also has sent a proposal to the Government of India to amend the Chartered Accountants Act, 1949 in order to enable it to impose a fine up to Rupees Ten Million on audit firms if they are found guilty of colluding with companies to commit a fraud.
Quality Review Board (QRB)

Quality Review Board was constituted by Ministry of Corporate Affairs in 2007 under the Chartered Accountants Act, 1949. The Board performs the following functions:-

a) To review the quality of work and services provided by the members of the ICAI
b) To lay down the evaluation criteria and select the reviewer.
c) To ask for information from ICAI, the Council or its Committees, Members, Clients of members or other persons or organizations
d) To invite experts to provide expert/technical advice or opinion for the purpose of assessing the quality of work
e) To make recommendations to the Council to guide members of the Institute to improve their professional competence and qualifications, quality of work and services offered and adherence to various statutory and other regulatory requirements.

The Quality Review Board can also enter into consultations with the regulators like Comptroller and Auditor General of India, Reserve Bank of India, Ministry of Corporate Affairs, Insurance Regulatory and Development Authority, Securities and Exchange Board of India apart from the Institute of Chartered Accountants of India for improving the quality of audit services.

The Quality Review involves inspection and assessment of the work of auditors while carrying out the audit function (excluding internal audit) so that the QRB is able to assess:

a) The quality of audit and reporting by the auditors; and
b) The quality control framework adopted by the auditors/ audit firms in conducting audit.

Such a review may be done on a reference made to the QRB or it may suo moto select audit firms for review. ICAI has issued detailed guidelines on the declarations to be obtained from the audit firm, content of report, testing parameters, instances of qualification, treatment of recommendations etc. The QRB may take any action (as recommended by the reviewer/ otherwise) on the audit firm basing its opinion on the report.

The Review Team generally comprises of chairman (mandatorily a chartered accountant with at least 15 years of experience) and members (mainly experts or persons with industry specific experience, academicians and other experts as required by the respective case). No firm of Chartered Accountants can be included as a member of the review team.

Financial Reporting Review Board (FRRB)

Under ICAI, Financial Reporting Review Board (FRRB) was formed in July 2002 to review the financial statements and auditors reports to determine compliance with accounting principles, disclosure requirements and reporting obligations of the auditor. Such review may
be done suo motto or on a reference made by regulatory body or in case of reported accounting irregularities.

In case of any non-compliance a reference may be made by FRRB to the disciplinary committee. FRRBs can review the accounts of all listed entities, banks, financial institutions, businesses with turnover greater than Rs 50 crores etc. Investigations are, however, restricted to financial statements that are filed with ROC or stock exchanges; ICAI does not have access to books of accounts of such companies.

As per the data available at www.icai.org.in, during 2010-2011, FRRB has undertaken review of 100 cases on suo motto basis, 18 as special cases and 60 cases pertaining to 2009-2010. Considering that there are 5092 listed companies at Bombay Stock Exchange as on September 2011, total number of listed companies may be more since there are 22 stock exchanges in India, a review of 118 accounts seems too small to have an impact.

3. Recommendations

Based on the above study on status of auditors in India, we propose following recommendations to enhance audit quality and their independence for playing a valuable role as principal gatekeepers of corporate governance.

a) Independent regulator
   The current system of self-regulation (even if it is through the apex body, ICAI) appears to leave room for laxity. Although the regulator is entrusted with several powers, there is a gap in using such powers for maintaining high professional standards. This may be because members of the disciplinary committee, peer review board, etc. are elected by members of ICAI and there may be a conflict of interest in disciplining what may be considered as 'voting constituency'. Perhaps disciplinary bodies should have greater independence akin to a separate audit regulator and act as a watchdog on the functioning of the auditors. The regulator should work on time-bound targets to achieve effectiveness and must be able to issue penal action against erring auditors. Such an organisation can be made on the lines of America’s Public Company Accounting Oversight Board established under Sarbanes Oxley Act.

b) There should be a stronger division between audit and non-audit services rendered by audit firms, thereby eliminating a clear conflict of interest. Audit firms often cross-sell their consulting services. The cross selling may provide auditor with an incentive to please their audit clients and it allowed clients to put pressure on their auditors by threatening to dismiss their consulting services. The regulator may provide a specific list of prohibited services so that there is no ambiguity. Where the firm undertakes any service other than audit, or and the prohibited services listed above, it should be done only with the approval of the audit committee.

c) Audit firms often keep the price of their audit services low to attract certain clients to whom they could then sell more profitable non-audit services. There should be a logical and mathematical formula to calculate the fees to be charged on the basis of
time to be spent on assignment and level of complexity. Such calculations should form part of the annual reports or can be open to inspection by ICAI or other independent regulator.

d) Audit committees of PSUs must have greater power over appointment of statutory auditor. The CAG's role should be to recommend firms empanelled on the basis of agreed criteria. The audit committee of PSUs should also have greater powers and accountability in monitoring audit quality and ensuring that audit fees are commensurate with the level of audit risk and effort levels involved in undertaking the PSU audits.

e) There should be a minimum threshold of size and experience that an audit firm must have to qualify them for auditing any company that is a public-interest entity. These may be listed companies, banks and financial institutions, government owned companies, utilities etc., where any member of public has an interest. These firms also need to be reviewed for quality and enforcement by the regulator at least once in three years. f) In case of auditors appointed for PSUs and Banks, the auditors’ declarations in the empanelment application must be verified before the audit is awarded to them by either the concerned regulator or ICAI.

g) The regulator i.e. CAG and RBI should have access to the client files and auditors working paper to keep a tab on the quality of audit reports. They should also have the right to censure erring auditors.

h) There is multiplicity of regulators in India creating both overlaps and significant gaps. Detailed analysis of this overlap/gap is done in another section of this report.

i) The Institute of Chartered Accountants of India should publish names of banned CAs from time to time to act as a deterrent to professional misconduct.

k) Improving the quality of audit report:

- To standardise the language of disclaimers or qualifications in the report.
- Uniform treatment for non-compliances with accounting standards
- Provision for losses in subsidiaries
- Related party disclosure format.

l) There should be a cooling off period where any partner or member of the engagement team of an audit firm would be allowed to employment at an audit client after a period of two years from the year they were involved in audit of that client.

m) As per current rules, an audit firm’s revenue from a single client cannot be more than 10% of the total revenue and revenue from consultancy charges cannot be more than 100% of the audit fees. However these rules may be circumvented by operating through various affiliate firms. This limit may be increased to a more reasonable level, say 25% of audit to non-audit revenue.
Firms with common partners must be asked to disclose aggregate earnings and names of clients to have greater transparency of independence. This requirement may be extended to both companies and firms with common members/partners so that absolute transparency is ensured.
4. Conclusion

The Indian regulatory and legal system is well-designed to provide robust auditing services to investors, capital markets and other stakeholders. However, implementation of checks and balances often becomes lax, defeating the strength of the structure.

The attestation of a company's financial information by an auditor is only as good as his/her reputation backed by training and knowledge for doing a thorough audit unhampered by conflicts of interest. Reputational risk is found to be the strongest insurance against auditor complicity and therefore assurance of audit quality. Whenever there is a financial crisis, there are strident cries of greater accountability and increased liability for auditors. However, litigation or threat of litigation as a means of promoting audit quality has several limitations.

It also raises the cost of auditing across board since the law does not distinguish between one set of auditors and another. Costs may include costs of extra checking, payment of insurance premium, costs of defending litigation, etc. There are facts and there are perceptions. When faced with the prospect of a lawsuit, an audit firm may choose to settle rather than go through the long drawn process of a trial even if it has strong defences and put its business fate to hang in balance till the conclusion of the trial. This may, therefore, cause considerable reputational damage to the firm if the investing public considers the settlement as an admission of guilt.

Business reversals often are just that—business reversals and nothing more insidious like collusion of auditors is usually proven. (Enron would probably have failed anyway, regardless of who the auditor was, because its business model was faulty). The overall rate of fraud conviction globally is low—and frauds in which auditors participate are lower still (Arthur Anderson was exonerated by the US Supreme Court but too late in the day). Populist sentiments often force regulators to be seen taking action but that may really not help improve the overall system in the long term.

What is needed is constant attention to the regulatory mechanism and ensuring that it works efficiently rather than more laws and regulations. (Annexure I lists out regulations concerning auditors that are followed in various countries.)
ANNEXURES
## Annexure I – Global Rules/ Laws Governing Auditors

### Global rules/laws governing auditors —US, UK and India

<table>
<thead>
<tr>
<th>S.no.</th>
<th>Particulars</th>
<th>United States of America</th>
<th>United Kingdom</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.</td>
<td>Qualification for being Auditor</td>
<td>Certified Public Accountant</td>
<td>Member of Recognised Supervised Board i.e. ICAEW, ICAS, ICAI and ACCA</td>
<td>Member of Institute of Chartered Accountants of India holding certificate of practice.</td>
</tr>
<tr>
<td>3.</td>
<td>Appointed by</td>
<td>Shareholders in Annual General Meeting</td>
<td>Shareholders in Annual General Meeting</td>
<td>Shareholders in Annual General Meeting.</td>
</tr>
<tr>
<td>5.</td>
<td>Governing Body</td>
<td>Public Company Accounting Oversight Board</td>
<td>Financial Reporting Council</td>
<td>ICAI through various committees.</td>
</tr>
<tr>
<td>6.</td>
<td>Auditors Liability in case of fraud</td>
<td>Substantial if involvement/negligence proved</td>
<td>Liability can be limited by entering into liability limitation agreement as per Companies Act, 2006</td>
<td>Unlimited Liability in case of negligence or fraud.</td>
</tr>
<tr>
<td>7.</td>
<td>Rotation of Auditors</td>
<td>Audit Partner Rotation every 5 years</td>
<td>Audit Partner Rotation every 5 years</td>
<td>Rotation of Auditors in case of PSUs- 4 years and in case of Banks- 3 years and in other cases no such provision.</td>
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</tbody>
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