

SEBI'S ORDER AGAINST PRICEWATERHOUSE ENTITIES: AN APPRAISAL

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ABSTRACT

Earlier this year, when SEBI passed its Order against the entire network of Pricewaterhouse in India in connection with their involvement in the fudging of accounts of Satyam Computer Services Limited, the auditing profession in India was feeling the ripples. This became evident with several auditors terminating their engagements with certain listed companies for a vast multitude of reasons including but not limited to hostile management, information asymmetry, etc. An appraisal of the Order reveals that the observations made therein have the potential to change the way the audit process works in India. Accordingly, the author has sought to delve into the same and in the process, understand how gatekeepers of a company are held accountable, what are the standards applicable to them, their responsibilities and thereafter, the scope of the study has been broadened to statutory auditors with a focus on listed entities particularly in the Indian context. Towards the end, certain recommendations have been made keeping in mind the Indian context while also focusing on the recommendations of various committees including the Kotak Committee. It is important to mention that there should be a regulatory framework to deal with the discretion available to an auditor while making them accountable for their words and to prevent this crucial process from further deterioration.

INTRODUCTION

The vast multitude of corporate frauds which have occurred in the past decade or so (Enron, Satyam, etc.) have highlighted the need for good and transparent corporate governance. Corporate Governance has been defined as “comprising of applying policies, proper implementation and continuous monitoring with accountability of the governing body being one of the mechanisms of governing”.¹ A perusal of these acts reveal that no matter how ‘greedy’ corporate officers may have been, these actions would not have been possible without the acquiescence of auditors who act as ‘gatekeepers’. This inference is inescapable when one looks at the responsibility of these gatekeepers to act as the custodian of stakeholder interests. This aspect will be further delved into over the course of this Article. Another cause for concern is the

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¹ Henry Campbell Black, *Black's Law Dictionary* (2nd edn, The Law Exchange 1995).

inherent inconsistency in the processes adopted by statutory auditors in a few cases. Take for example the case of Vijay Mallya's United Spirits Limited where PricewaterhouseCoopers (*hereinafter* PwC) was engaged both as a statutory as well as a forensic auditor in different financial years. The forensic audit detected irregularities in its financial matters even in respect of those years wherein PwC as the statutory auditor had categorically ruled out any irregularities.² This makes one wonder about the value of 'unqualified opinions' of statutory auditors of a company on which the investors rely.

To begin with, the question that arises is 'who are these 'gatekeepers' and what is expected of them'? On one hand, they have been defined as intermediaries who provide verification and certification services to investors, on the other; they have been considered institutions or agencies that are imposed between investors and managers/owners in order to play a watchdog role.³ This includes a variety of private actors namely attorneys, accountants, and other industry professionals who play a critical role in the functioning of the securities industry.⁴ In practice, they work with an enterprise to correct misreporting before it occurs,⁵ by acting as gatekeepers of behavioral standards, which entrusts them with the responsibility of pre-emptive action, done primarily by being alert to the risks that exist.⁶ It has been observed in the context of Enron, that outsider accountants/auditors acted in concert with management in perpetrating the fraud by taking advantage of laws which permit them to behave in an apparently fraudulent manner. Resultantly, these were the professionals who helped in carrying out the corporate ruse when they should ideally have raised red-flags.⁷ It has been argued that these gatekeepers in general, and auditors in particular, act based on the confidence reposed on them by the various stakeholders involved. Moreover, it has been seen that a major lapse on the part of the auditors can have a trickle-down effect on the market,

² Khushboo Narayan, 'Advisory Firms call into question Auditors' Role in USL fallout' *The Indian Express* (Mumbai, 28 April 2015) <<https://indianexpress.com/article/business/business-others/advisory-firms-call-into-question-auditors-role-in-usl-fallout/>> accessed 15 September 2018.

³ Kshama Kaushik and Rewa Kamboj, 'Study on the State of Corporate Governance in India' (*Indian Institute of Corporate Affairs*) <<http://iica.in/images/Auditors.pdf>> accessed 26 August 2018.

⁴ Todd Fishman, 'The SEC's Renewed Focus on Gatekeepers' (*Allen & Overy*, 1 November 2016) <www.aoinvestigationsinsight.com/the-secs-renewed-focus-on-gatekeepers/> accessed 15 September 2018.

⁵ Lawrence A Cunningham, 'Beyond Liability: Rewarding Effective Gatekeepers' (2007) 92 *Minnesota Law Review* 323.

⁶ *SEC v WorldCom* 2003 WL 22004827 (SDNY).

⁷ *Lawson v FMR LLC* 571 US 429.

which begins with the investors and extends to the management of the company, placing reliance on the reports of the external experts owing to their specialization.⁸ It is in this backdrop that the recent order by SEBI against PwC and its network entities in India (*hereinafter* PwC Order) has been analysed to arrive at conclusions and identify the implications of this on the auditing landscape in India.

SEBI'S ORDER AGAINST PWC AND ITS NETWORK ENTITIES

FACTS

INVESTIGATION

SEBI upon receiving an e-mail from B. Ramalinga Raju admitting to large-scale manipulations in the books of accounts of Satyam Computer Services Ltd. (*hereinafter* SCSL), carried out investigations into the affairs of SCSL to ascertain whether the provisions of the SEBI Act or regulations thereunder had been violated.⁹

At the relevant time, PwC was the statutory auditor of SCSL and upon investigation, it was found that SCSL's books of accounts contained inflated and manipulated bank balances, etc. which had been prepared by the directors of SCSL in connivance with PwC.¹⁰

ISSUE OF SHOW CAUSE NOTICES (HEREINAFTER SCNs)

The SCNs were issued to the eleven partnership firms in India owing to the fact that they belonged to the same network and the core engagement team on SCSL consisted of persons who were on the payroll of multiple entities in the network. Subsequently, they were accused of acting in gross violation of the duties and responsibilities cast upon them as auditors and were complicit in or acquiesced in the fraud perpetuated by Ramalinga Raju and others at SCSL.¹¹

⁸ Elisse B Walter, 'Gatekeepers Are the Key to Good Governance' (*Forbes*, 21 June 2010) <<https://forbes.com/2010/06/21/shareholders-risk-gatekeepers-elisse-walter-leadership-governanceethisphere.html#23ff90b810da>> accessed 15 September 2018.

⁹ *Re Price Waterhouse* WTM/GM/DRA 1/83/2017-18 paras 1, 2.

¹⁰ *Waterhouse* (n 9) para 3.

¹¹ *ibid* paras 4 and 12.

REPLIES TO SCNs

Notices had contended, *inter alia*, that SEBI lacked jurisdiction to take action and jurisdiction, if any, was only with the ICAI because at no point in time had they 'dealt in securities' or were 'persons associated with the securities market'.¹²

ISSUES

There were two issues, which arose for consideration:

1. Whether SEBI had jurisdiction to pass orders against audit firms?
2. What was the standard of proof for proving 'fraud' under the FUTP Regulations, 2003, as alleged in the SCNs?

CONSIDERATION OF ISSUES ON MERIT

JURISDICTION

SEBI, as the securities market regulator, had jurisdiction if the evidence sufficiently indicated the possibility of there being a role of the auditors in the alleged fraud, whereupon it could pass appropriate directions in order to protect the interests of the investors.¹³

It was found that there existed significant deviations from the Accounting Standards and other guidelines during the audit of SCSL. In addition, there was no 'professional skepticism' exercised by PwC in the course of the audit.¹⁴

This was further supplemented by deviations committed by the engagement team in the audit of the bank balances where they completely lost control of the confirmations received from the banks, particularly the Bank of Baroda, New York branch.¹⁵

When PwC received a whistleblower's letter flagging the inflation of balances in the books of account, there was no response elicited, and multiple transactions were called off and audits deferred. These events went on to highlight the complicity on the part of the auditors.¹⁶

¹² *ibid* para 14.

¹³ *ibid* para 18.

¹⁴ *Waterhouse* (n 9) paras 167-168.

¹⁵ *ibid* para 167.

¹⁶ *ibid* para 171.

BURDEN OF PROOF

SEBI relied on precedents laying down the law that while issuing directions and imposing penalties for offences under the SEBI Act and the FUTP Regulations, the burden of proof was of 'preponderance of probabilities' and not of 'proof beyond reasonable doubt' as argued by the Noticees.¹⁷

LIABILITY OF PWC NETWORK IN INDIA

They were held liable due to the fact that though only PwC (branch office being at Hyderabad) was appointed by SCSL, the assignment was taken up by PwC Bangalore and the core engagement team drew upon personnel and resources from various network entities. In addition, there was an omnibus reference to 'Price Waterhouse' in the Annual Reports of SCSL and therefore it could be concluded that the shareholders had acted under the impression that PwC, an internationally recognized brand of auditors, conducted the audit.¹⁸

DIRECTIONS

Directions were passed by SEBI prohibiting firms practicing as chartered accountants in India under the brand and banner of PwC from issuing any certificate of audit of listed companies or certificates related to SEBI obligations. Similarly listed companies were prohibited from engaging them for a period of two years.¹⁹ The lead audit partners also passed directions for disgorgement of profits.

Prima facie the PwC Order extends to - (i) statutory audit of listed companies, for a period of two years, by (ii) entities/firms practicing as chartered accountants as part of the PwC network in India,²⁰ in addition to the following:

1. PwC network firms cannot issue certificates of compliance with any law or obligation administered by SEBI.

¹⁷ *ibid* para 184.

¹⁸ *ibid* paras 197 and 199.

¹⁹ *Waterhouse* (n 9) para 205.

²⁰ *ibid*.

2. The Order is limited primarily to the statutory auditing by PwC and not the other services like consulting, tax advisory etc. However, a domino effect cannot be ruled out owing to a lack of trust that might be developed in clients.²¹
3. The insolvency practice, which actually forms a part of PwC's regulatory practice, should not be affected since SEBI does not regulate proceedings under the Insolvency Code.²²
4. PwC network can still undertake forensic audits of companies. In the aftermath of the Nirav Modi scam surfacing, PNB had invited bids to conduct a forensic audit and PwC had been the lowest bidder. Its bid was rejected, even though they were not prohibited by the order, which could also be seen by looking at how a forensic audit is conducted.²³
5. While the order was to come into force immediately, it would not impact audit assignments for FY 2017-18.²⁴ This was extended by SAT to allow PwC to complete audit assignments already undertaken for clients who follow the financial year beginning January 1, 2018.²⁵ The SAT, vide its order dated February 15, provided PwC with further extension up to March 31, 2019, or till the time of the constitution of a new Division bench, whichever is earlier.²⁶

Additionally, earlier this year, the Hon'ble Supreme Court passed an order against Multinational Audit Firms (*hereinafter* MAFs) wherein it was held *inter alia* that auditing is a function of great *public importance* because financial statements audited by qualified auditors are acted upon and failures of the auditors have resulted into scandals in the

²¹ 'SEBI ban on PwC: Revenues to take a hit and clientele to shrink, but tax, accounting won't be impacted, says audit firm' (*Firstpost*, 12 January 2018) <<https://firstpost.com/business/sebi-ban-on-PwC-revenues-to-take-a-hit-and-clientele-to-shrink-but-tax-accounting-wont-be-impacted-says-audit-firm-4299233.html>> accessed 15 September 2018.

²² 'Regulatory services' (*Pricewaterhouse Coopers*) <<https://PwC.in/india-services.html>> accessed 15 September 2018.

²³ Somesh Jha and Sudipto Dey, 'Rs 114-bn scam: PNB says will not appoint PwC India as forensic auditor' (*Business Standard*, 24 February 2018) <<https://business-standard.com/article/finance/rs-114-bn-scam-pnb-says-will-not-appoint-PwC-india-as-forensic-auditor-1180224000271.html>> accessed 15 September 2018.

²⁴ *Waterhouse* (n 9) para 206.

²⁵ 'PwC to complete audits taken on this calendar year, but ban to continue' (*Business Today*, 19 January 2018) <<https://businesstoday.in/current/corporate/PwC-to-complete-audits-taken-on-this-calendar-year-but-ban-to-continue/story/268454.html>> accessed 15 September 2018.

²⁶ Shivani Saxena, 'Price Waterhouse Gets Partial Relief at The Securities Appellate Tribunal' (*Bloomberg Quint*, 16 February 2018) <<https://bloombergquint.com/law-and-policy/2018/02/16/satyam-scam-price-waterhouse-gets-partial-relief-at-sat-from-sebi-ban>> accessed 15 September 2018.

past,²⁷ a role that has been acknowledged by the firms also.²⁸ Understanding the implications of the PwC Order on the auditing profession in general and statutory auditors of listed companies needs to be undertaken after noting the above observations of the Court.

TAKEAWAYS FROM THE ORDER

ROLE OF AUDITORS

This was captured by Lord Oliver who looked at it in light of shareholding of companies being widely dispersed and hence independent of management. According to him, the managers operate in a fiduciary capacity and hence are answerable to the shareholders, which is where the auditor steps in and ensures, as far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order.²⁹ This is done, firstly, to protect the company itself from the consequences of undetected errors or, possibly, wrongdoings (for instance, declaring dividends out of capital); secondly, to provide shareholders with reliable intelligence for the purpose of enabling them to scrutinize the conduct of the company's affairs and to exercise their collective powers to reward, control or remove those to whom that conduct has been confided.³⁰

Bridging the 'expectation gap' which basically consists of differences between the perceptions of the duties and responsibilities of auditors held by the investors, and the public generally, as against the views and official pronouncements of auditors and the auditing profession is another important step in clarifying the end goal of an audit.³¹ The way the market functions nowadays, it puts a lot of pressure on companies to meet the expectations of the investor community. Therefore, there is an increased tendency to engage 'smoke and mirrors' to enhance their earnings, which is actually more detrimental to third parties than the managers.³² The statutory auditors are important

²⁷ *S Sukumar v ICAI* (2015) SCC Online Kar 7764 para 49.

²⁸ 'Competition and choice in the Audit Market' (*Pricewaterhouse Coopers*) <<https://PwC.com/gx/en/auditservices/publications/regulatory-debate/assets/PwC-point-of-view-competition-and-choice.pdf>> accessed 15 September 2018.

²⁹ *Leeds Estate Building & Investment Co v Shepherd* (1887) 36 Ch D 787.

³⁰ *Caparo Industries Plc v Dickman* [1990] 2 AC 605 630C-G.

³¹ JSA Fourie, 'Auditors and Corporate Illegality and Fraud' (1994) 6 South African Mercantile Law Journal 178.

³² Reinier H Kraakman, 'Corporate Liability Strategies and the Costs of Legal Controls' (1984) 93 Yale Law Journal 857.

because they have a responsibility to ensure that the financial statements of the company present the true financial position of the company and attest them in accordance with professional standards.³³ This is because investors commit their personal funds to companies, relying, at least in part, upon the auditor's opinion that a company's financial statements fairly reflect its financial position.³⁴ The corollary of the problem mentioned is the management's desire to take 'short-cuts' and this has a possibility of involving the auditors too.³⁵ This is commonly classified as the 'Agency Issue', which arises primarily due to the large size of organizations and the dispersed decision-making power, which renders direct supervision over all decision making unfeasible and almost impossible.³⁶ In addition, there usually exists a commitment/self-serving bias among the auditors towards a big-ticket client, which has the possibility of making them averse to differing, or taking positions contrary to those of the client and addressing these issues need to be at the base of policy making in this regard.³⁷

It has been said that auditors should not be made liable for not tracking out ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion. Yet, it does not follow because defalcations escaped the attention of one set of competent auditors, which is a defence for other auditors who have failed to make the inquiries and investigations that they were required to do in the course of their duty.³⁸ The greater the number of undiscovered peculations, the more difficult it will be for auditors to resist a finding of negligence in failing to discover them.³⁹ This is the position that has been adopted by SEBI against PwC in its recent order.

PROFESSIONAL SKEPTICISM REQUIREMENT

Another question that arises is that what is the extent of an audit by a statutory auditor? Broadly, the purpose is to put a stamp on the financial information giving a 'true and

³³ Securities and Exchange Act 1934 (USA).

³⁴ Isaac C Hunt Jr, 'Accountants as Gatekeepers - Adding Security and Value to the Financial Reporting System' (SEC, 26 October 2001) <<https://sec.gov/news/speech/spch518.htm>> accessed 15 September 2018.

³⁵ Donald C Langevoort, 'Managing the Expectations Gap in Investor Protection: The SEC and the Post-Enron Reform Agenda' (2002) 48 Villanova Law Review 1139.

³⁶ Richard W Painter, 'Convergence and Competition in Rules Governing Lawyers and Auditors' (2004) 29 Journal of Corporation Law 397.

³⁷ Fourie (n 31).

³⁸ Joseph A Guillory, 'The Audit Committee Financial Expert Requirement and the Internal Control Attestation: Effective Contributions to Corporate Governance' (2005) 94 Kentucky Law Journal 600.

³⁹ Rupert M Jackson and John L Powell, *Professional Negligence* (3rd edn, Sweet & Maxwell 1992) ch 8.

fair view' of the state of affairs of the company. It has been argued that an audit conducted in accordance with the auditing standards can rarely uncover management frauds and the same can only be achieved after forensic audits and it is not feasible to conduct every audit with a forensic bent of mind.⁴⁰ This seems to be a very simplistic position. While it cannot be argued that auditing by itself is incapable of separating errors from deceptions and the variety of deceptions resorted to by managers is constantly increasing, this makes a case for auditors to seal the potential gaps by probing, asking questions of managers, obtaining information from a variety of sources.⁴¹ This is what professional skepticism involves, that is, reliance wherever possible but not wholly on company's own internal system, while not having to plan the program with suspicion of fraud in his mind, but still planning procedures that take account of the possibility that the affairs examined may not be true through errors, innocent or fraudulent, appearing in the records.⁴² *Pacific Acceptance* has been a landmark precedent in as much as it has settled the position that an auditor's duty includes a duty to pay due regard to the possibility of fraud, and when fraud is suspected or detected, to give the necessary warnings. The liability is under the law of negligence and courts shall holistically analyse the standards of professional skill and care displayed throughout the audit.⁴³

EXTENSIVE AUDIT

This is a corollary to professional skepticism. SEBI has emphasized at different junctures the following:

1. In light of the importance of their statements and signatures, auditors are supposed to carry out an in-depth examination and not just a superficial one, in compliance with all the accounting standards.⁴⁴
2. Since statutory auditor and internal auditor perform audit, it is essential to maintain synergies between the two. Internal auditor has the task of ensuring that internal control mechanisms are sufficient and this has to be checked by the statutory auditor before the commencement of the audit by a 'walk-through' test.⁴⁵

⁴⁰ Kshama Kaushik and Rewa Kamboj, 'Study on the State of Corporate Governance in India' (*Indian Institute of Corporate Affairs*) <<https://iica.in/images/Auditors.pdf>> accessed 26 August 2018.

⁴¹ Lawrence A Cunningham, 'The Appeal and Limits of Internal Controls to Fight Fraud, Terrorism, Other Ills' (2004) 29 *Journal of Corporation Law* 298.

⁴² *Pacific Acceptance Corporation Ltd v Forsyth* (1970) 92 W.N. (NSW) 29, 76-77.

⁴³ *ibid* 70.

⁴⁴ *SEBI v Kailash Chand Agarwal* MANU/SB/0003/2007.

⁴⁵ *Waterhouse* (n 9) para 105.

3. In addition, the information sought by auditors has to be obtained primarily from external sources and from the auditee only when the external confirmations are not available after reasonable follow-up efforts have been made.⁴⁶
4. Information received through the auditee should not be taken at face value, notwithstanding the size of the company, its reputation and other connected matters.⁴⁷ Thus, the auditor must go beyond what meets the naked eye and verify all the information.⁴⁸
5. Importantly, it is now evident that continuous omission to check figures of the company can lead to an inference of complicity of the auditors.⁴⁹

ADHERENCE TO THE AAS AND OTHER GUIDANCE/INSTRUCTIONS

Principles laid down in the AAS, GAAP, Guidance Notes of the ICAI, etc. have to be adhered to by the auditor. Further, where the standards prescribe an item as having a material risk, the auditor must adhere to the more stringent requirements in relation thereto. Also, avoid bypassing it with any other comparatively lenient approach, so much so that they can adopt procedures beyond the initial plan to subject it to the required level of scrutiny.⁵⁰ An example of this would be PwC's departure from subjecting the current account balances and the FD's with Bank of Baroda, New York branch and relying upon the SCSL's internal balance confirmations without even making requests to the concerned bank branch. If the above exercise fails and the auditor has to make a material deviation from the AAS, there should be an explanation provided for reasons thereto.⁵¹

DESIRE TO RETAIN THE CLIENT AND FOR GREATER PROFITABILITY

The first premise of the gatekeeper theory is that reputation is the auditors' most valuable asset and every attempt shall be made to preserve it. There exists an altogether different scenario in practice wherein reputation is not a good incentive, which might be true owing to multiple factors such as concentrated markets (where all firms might be

⁴⁶ *ibid* para 63.

⁴⁷ *Waterhouse* (n 240) para 102.

⁴⁸ *ibid* paras 112 and 158.

⁴⁹ *ibid* para 180.

⁵⁰ *ibid* paras 29, 146 and 148.

⁵¹ *ibid* para 24.

involved in some scandal or the other but companies have no choice), agency problems, inducements offered to the firm which far outweigh the risks of reputational losses.⁵² As the Enron fiasco unfolded, it was observed that the aspect of self-serving bias could not be removed from the audit process which arose due to a multiplicity of factors at the sub-conscious level like discretionary power in interpreting financial statements, attachment of the engagement partner (if not the whole firm) to a certain client.⁵³ Accordingly, it was found that this bias resulted in auditors being more than willing to certify results and state them to be in line with the GAAP.⁵⁴ Along with the angle of commercial gains, this was also highlighted by SEBI in the PwC Order. It was opined that the auditors of a company should not be carried away by the fame, reputation, good standing of the company in the course of the audit and thereby betray the shareholders.⁵⁵

RECOMMENDATIONS

A PERUSAL OF THE KOTAK COMMITTEE RECOMMENDATIONS

In its Report, the Committee on Corporate Governance (*hereinafter* Kotak Committee) had recommended that the existing Quality Review Board (*hereinafter* QRB) be strengthened further and be made more independent with the objective of attaining IFIAR membership.⁵⁶ The way it is constituted right now has been criticized with further calls to make it more independent of the profession. Therefore, till such time as the NFRA is constituted, the QRB should be strengthened such that it can perform oversight functions akin to those of the PCAOB in the USA.⁵⁷ It is imperative that QRB is made functional going forward to ensure quality in the audit process by a critical review of the intensity and integrity of auditors by peer auditors on an annual basis.⁵⁸ This could

⁵² Jose Joao Montes Ferreira-Gomes, 'Auditors as Gatekeepers: The European Reform of Auditors' Legal Regime and the American Influence' (2005) 11 Columbia Journal of European Law 689.

⁵³ Max H Bazerman et al, 'Why Good Accountants Do Bad Audits' (*Harvard Business Review*, November 2002) <<https://hbr.org/2002/11/why-good-accountants-do-bad-audits>> accessed 15 September 2018.

⁵⁴ *ibid.*

⁵⁵ *Waterhouse* (n 9) paras 179, 187, and 203.

⁵⁶ Report of the Committee on Corporate Governance (5 October 2017), para 13, ch VII 89 <https://sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate-governance_36177.html> accessed 15 September 2018.

⁵⁷ 'Report of the CII Task Force on Corporate Governance' (*Ministry of Corporate Affairs*, November 2009) Recommendation 19 <https://mca.gov.in/Ministry/latestnews/Draft_Report_NareshChandra_CII.pdf> accessed 15 September 2018.

⁵⁸ *ibid.*

be done in terms of both budgetary allocations and personnel, to maintain the faith of the ordinary investor in the auditing profession.⁵⁹

Furthermore, it has been observed in some corners that the way MAFs are organized, the interests of the securities market would be better served if there was a limitation on the category of services that could be provided or at least further disclosed. Currently, in addition to auditing services, firms can only offer those services, which are approved by the Audit Committee and are not prohibited otherwise.⁶⁰ However, the Kotak Committee noted that there was no concurrent obligation on the company to further report this to the stock exchanges. This proposal, therefore, needs consideration and amendments could be made so as to make it necessary for listed companies to disclose the total fee paid to auditors and all entities in the network of which auditor is part in the annual report.⁶¹ This proposal has found traction in the USA also, where it is a clear position that separation of the audit and non-audit services is essential to avoid the role of an auditor being reduced to advocacy and to assure the investors of the independence of the auditor.⁶²

In the immediate aftermath of the PwC order, amid reports that the promoters had diverted funds from Fortis Healthcare, its statutory auditor Deloitte refused to sign their accounts for Q2.⁶³ Other auditors have begun taking similar measures including quitting the audit mandate, admitting to lack of information, etc. The case in point being PwC quitting the mandate of Vakrangee and Atlanta with Deloitte resigning as statutory auditor of Manpasand Beverages citing lack of information sought by them from the management.⁶⁴ These instances of auditors being more careful with what they

⁵⁹ Krishnamurthy Subramanian, 'How to tackle bank fraud: PNB scam should pave the way to reforming the audit profession in India' (*The Times of India*, 23 February 2018) <<https://blogs.timesofindia.indiatimes.com/et-commentary/how-to-tackle-bank-fraud-pnb-scam-should-pave-the-way-to-reforming-the-audit-profession-in-india/>> accessed 15 September 2018.

⁶⁰ Companies Act 2013, s 144.

⁶¹ 'Report of the Committee on Corporate Governance' (5 October 2017) <https://sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate-governance_36177.html> accessed 15 September 2018.

⁶² Arthur Laby, 'Differentiating Gatekeepers' (2006) 1 Brooklyn Journal of Corporate, Financial & Commercial Law 154.

⁶³ 'Fortis Healthcare, Religare tumble on reports of serious fraud probe by SEBI' (*Business Standard*, 20 February 2018) <https://business-standard.com/article/news-cm/fortis-healthcare-religare-tumble-on-reports-of-serious-fraud-probe-by-sebi-118022000292_1.html> accessed 15 September 2018.

⁶⁴ 'Under regulatory glare, Auditors raise decibels on gaps at listed firms' (*Business Standard*, 3 June 2018) <https://business-standard.com/article/companies/under-regulatory-glare-auditors-raise-decibels-on-gaps-at-listed-firms-118060300191_1.html> accessed 15 September 2018.

certify is a good sign for investors but they also bring to the surface another issue i.e. about the impact of negative observations by auditors or their abrupt resignation which might be due to other issues. Under the current legal framework, the auditor who resigns from a company has to complete the appropriate filings with the Registrar and the company itself.⁶⁵ Also under the LODR Regulations, change in auditors is treated as a material event and therefore, must be disclosed to the stock exchanges forthwith.⁶⁶ These regulatory gaps, when seen in the light of the new developments post Satyam and the PwC Order necessitate discussion on the possibility of amending the disclosure requirements in such a manner that the detailed reasons for the resignation of the auditor be disclosed to the stock exchanges and public for greater transparency.⁶⁷

CERTIFYING THE CERTIFICATES BETTER

It is well recognised that reliable financial statements are at the core of corporate governance and therefore, the fiduciary role of auditors is crucial. Therefore, SEBI has recently proposed to amend various regulations laying down obligations relating to fiduciaries and accordingly, it has been proposed that a fiduciary who submits or issues any certificate or report as required thereunder shall -

1. ensure that such a certificate or report is true in all material aspects;
2. exercise due care, skill and diligence and ensure proper care with respect to all processes involved in the issuance of such certificate or report;
3. report in writing to the Audit Committee of the listed company or to the compliance officer in case of an intermediary, trustee in case of pooled investment vehicle, as the case may be, any material violation of securities laws, noticed while undertaking such an assignment.⁶⁸

This seems to be a very crucial development and it could have the effect of allowing the stakeholders to have reasonable foresight while taking investment decisions. The preparation of financial statements is something that requires constant communication between the statutory auditors and the management/audit committee and hence one

⁶⁵ Companies Act 2013, s 140.

⁶⁶ SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, pt A sch III.

⁶⁷ 'Report of the Committee on Corporate Governance' (SEBI, 5 October 2017) <www.sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate-governance_36177.html> accessed 15 September 2018.

⁶⁸ 'Consultation Paper on Proposed SEBI (Fiduciaries in the Securities Market) (Amendment) Regulations' (SEBI, 13 July 2018) <http://sebi.gov.in/reports/reports/jul-2018/consultation-paper-on-proposed-sebi-fiduciaries-in-the-securities-market-amendment-regulations-_39541.html> accessed 15 September 2018.

of the purposes of an audit is to analyze the internal controls of the company. To safeguard the process here, it is also proposed that in this regard, a requirement should be introduced wherein the auditor shall publicize the assumptions made in the audit process and these could be offered protection as forward-looking statements unless of course they are made with knowledge of their falsity.⁶⁹ In addition, for those relying on financial information, the length of the relationship of the auditor with the entity is an important factor and hence, a requirement for a brief statement of the history of the auditor's relationship with the firm would provide useful information to third parties and entail no significant additional costs to the issuer.⁷⁰

ENGAGEMENT PARTNER SIGNATURES

One of the glaring defects in the Satyam matter was that the engagement partners used to perform certifications in the name of PwC and the partners signed in the name of PwC and did not mention the individual audit firm. One of the fixes that the author would like to suggest to prevent these instances is to introduce the requirement of signature of the engagement partner in an audit, mentioning clearly the name of the firm (particularly with respect to MAFs which have a network of entities sharing synergies).⁷¹ Benefits of this practice are manifold in as much as it increases the liability and therefore necessitates greater caution on the part of the engagement team.⁷² However, this could be offset by an increase in audit fees and billables, something that has been corroborated by empirical evidence abroad and hence, is a question that requires lots of stakeholder analysis as to whether it survives a cost-benefit analysis or not.⁷³

⁶⁹ James D Cox, 'Strengthening Financial Reporting: An Essay on Expanding the Auditor's Opinion Letter' (2013) 81 *George Washington Law Review* 1036.

⁷⁰ *ibid* 1055.

⁷¹ *ibid* 1061.

⁷² Cathy Cole, 'Audit Partner Accountability and Audit Transparency: Partner Signature or Disclosure Requirement' (2014) 14(2) *Journal of Accounting and Finance*.

⁷³ Joseph V Carcello and Chan Li, 'Costs and Benefits of Requiring an Engagement Partner Signature: Recent Experience in the United Kingdom' (2013) *The Accounting Review* <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2225427> accessed 15 September 2018.