To,
Ministry of Corporate Affairs

Via email to: audit.policy@mca.gov.in

Sub: Consultation Paper to examine the existing provisions of law and make suitable amendments therein to enhance audit independence and accountability

At the outset, we, at the Indian Association of Investment Professionals (IAIP), a member society of the CFA Institute, in collaboration with the CFA Institute, appreciate the opportunity to submit our response to the CONSULTATION PAPER TO EXAMINE THE EXISTING PROVISIONS OF LAW AND MAKE SUITABLE AMENDMENTS THEREIN TO ENHANCE AUDIT INDEPENDENCE AND ACCOUNTABILITY.

IAIP is an association of over 2000 local investment professionals who are CFA charterholders and about 4000+ professionals who have cleared exams, eligible and awaiting charter. The Association consists of valuation professionals, portfolio managers, security analysts, investment advisors, and other financial professionals, that; promote ethical and professional standards within the investment industry, facilitate the exchange of information and opinions among people within the local investment community and beyond, and work to further the public's understanding of the CFA designation and investment industry.

CFA Institute is a global non-profit association of investment professionals with over 166,000 members in over 165 countries. In India, the community of CFA charterholders is represented by the Indian Association of Investment Professionals (CFA Society India).

OUR AUDIT ADVOCACY EFFORTS ON BEHALF OF INVESTORS
CFA Society India, in partnership with the CFA Institute, is providing comments on the consultation paper consistent with our objective of promoting fair and transparent global capital markets and advocating for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures – and the related audits – provided to investors and other end users are of high quality. Our advocacy position is informed by our global members who invest both locally and globally.

CFA Institute has a long history of advocating for audit reforms globally including, most recently, the Independent Review into the Quality and Effectiveness of Audit (“Bryden Review”). We have also advocated for audits of internal controls and auditor oversight reforms brought about by legislation such as the U.S. Sarbanes-Oxley Act of 2002 (SOX Act) and similar regulation globally. Appendix A provides a sample of our commentary in recent years.

We believe it is important to comment on the consultation paper as reforms in India related to its audit market may have an impact on other audit markets given the interconnected nature of the audited companies under audit and the nature of the largest accounting firms.

We would be happy to hear and discuss the merits / demerits of suggestions proposed by other practitioners and request to be included in the deliberation process.

Our responses to the proposed initiatives by the Ministry of Corporate Affairs are mentioned below:

A. Details of our Organisation:
   1. Name: Indian Association of Investment Professionals (CFA Society India)
   2. Contact number: +91 98196 30042
   3. Email address: advocacy@iaipirc.org
   4. Postal address: 702, 7th Floor, A Wing, One BKC Tower, Bandra Kurla Complex, Bandra (E), Mumbai - 400 051
### B. Key Contributors:
Sivananth Ramachandran, CFA  
Mohini Singh, ACA  
Om Jha, CFA  
Ashwini Damani, CFA

### C. Suggestions / Comments:

<table>
<thead>
<tr>
<th>Name of Organisation: Indian Association of Investment Professionals (CFA Society India)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SL. No.</td>
</tr>
<tr>
<td>1.</td>
</tr>
</tbody>
</table>

\(^1\) The Market for Lemons: Quality Uncertainty and the Market Mechanism\(^\text{a}\) is a well-known 1970 paper by economist George Akerlof which examines how the quality of goods traded in a market can degrade in the presence of information asymmetry between buyers and sellers, leaving only "lemons" behind.
<table>
<thead>
<tr>
<th>SL. No.</th>
<th>Para No.</th>
<th>Suggestion</th>
<th>Justification</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>1.3 (b)</td>
<td>We don’t support numerical limits on audits under one audit firm.</td>
<td>A cap on number of audits per firm, with a mandatory rotation, would result in extensive complexity in both the tendering for and rotation of companies between audit firms. Without extensive scenario analysis, it is challenging to see how this would work practically. The limits might vary dynamically based on staff movement and require constant monitoring. Also, we’re unconvinced that merely increasing the number of audit firms would have a beneficial impact on audit quality.</td>
</tr>
<tr>
<td>3</td>
<td>1.3 (c)</td>
<td>We don’t support the proposal to reduce number of partners under one audit firm, and by extension firm size.</td>
<td>Limiting the size of firms, by itself will not improve audit quality. Businesses have become complex over time, and technology makes it possible to audit the full population of historical transactions. We also see the use of data and technology as needing to change the skills of the accounting and auditing profession. We would expect larger firms to be able to make the necessary investments in technology and people, and build domain expertise, compared to smaller firms, and the impact of limiting the firm size on innovation needs to be considered.</td>
</tr>
<tr>
<td>4</td>
<td>1.3 (e)</td>
<td>We believe the responsibility for the appointment, compensation and oversight of the work of the auditor should rest with the Audit Committee separate from the management of the companies.</td>
<td>Auditors must report directly to the audit committee. Audit committees must have authority over their own budgets and over external auditors. It is through these protections that investors will come to trust the financial reports released by companies. Regulators will be better placed to focus their time on supervision of auditor appointments, rather than on creation and maintenance of panel of auditors. The document doesn’t suggest the auditor would be appointed by the regulator, which means the management would still control the appointments (now from a curated panel) and their compensation, leaving the conflict of interest issue intact. On the other hand, if NFRA or other agencies also control appointments across thousands of companies, it would take away their limited bandwidth away from more important areas.</td>
</tr>
<tr>
<td>5</td>
<td>1.4</td>
<td>We recommend a full ban on all non-audit services</td>
<td>A full ban on all non-audit services to audit clients seems to be a simple, but is an effective means of...</td>
</tr>
<tr>
<td>SL. No.</td>
<td>Para No.</td>
<td>Suggestion</td>
<td>Justification</td>
</tr>
<tr>
<td>---------</td>
<td>----------</td>
<td>------------</td>
<td>---------------</td>
</tr>
<tr>
<td></td>
<td>3.4</td>
<td>“Accordingly, the suggestions are invited as to whether the Joint Audit should be made mandatory for bigger companies? What should be threshold for the bigger companies?”</td>
<td>We don’t support Joint Audits. Joint audits, with an audit report with multiple audit firm’s names affixed at the bottom without a distinction or discussion of the division of work or responsibilities between the firms, will only add another layer of complexity without transparency for investors. The paper doesn’t mention how joint auditors would explain their division of responsibilities or their individual findings. If the firms are performing work separately and reviewing each other’s work, this should be clearly communicated to investors.</td>
</tr>
<tr>
<td>SL. No.</td>
<td>Para No.</td>
<td>Suggestion</td>
<td>Justification</td>
</tr>
<tr>
<td>--------</td>
<td>----------</td>
<td>------------</td>
<td>---------------</td>
</tr>
<tr>
<td>7</td>
<td>4.3</td>
<td>“on the issue as to whether the holding company’s auditor must also review the working papers of auditor of subsidiary and make mandatory comment on the account of subsidiary companies”</td>
<td>In lieu of mandatory comment on subsidiaries, we would suggest auditor’s ability to review and comment on the account of the subsidiary companies. Making it mandatory to comment only would result in another checkbox exercise in most instances. Giving the ability to not only review the work, but also to make a comment on the account of subsidiary companies places the onus on the principal auditor to exercise judgment.</td>
</tr>
<tr>
<td>8</td>
<td>5.2</td>
<td>“on the feasibility of creation and maintenance of panel of auditors for Non-Government Companies (Both Listed, Unlisted and Private Companies)”</td>
<td>Similar to our suggestions on 1.3 (e) mentioned above, we suggest that regulators will be better placed to focus their time on supervision of auditor appointments, rather than on creation and maintenance of panel of auditors.</td>
</tr>
<tr>
<td>9</td>
<td>6.2</td>
<td>“to see the possibility of taking audit engagement letter on record along with ADT-1 to see if the same is not in violation of section 144 of the Act”</td>
<td>We support the use of engagement letter to ensure its not in violation of section 144 of the Act. We also support the use of the letter to enhance independence of the auditor.</td>
</tr>
<tr>
<td>10</td>
<td>7.4</td>
<td>“whether the concurrent audit is to be made mandatory in big listed companies and what points should be included in the checklist to be”</td>
<td>CFA Society India completely supports the introduction of concurrent audits as an early warning system.</td>
</tr>
</tbody>
</table>

With regards to checklist, recently CFA Institute was part of a SEBI working group on related party transactions (RPTs), and one of the terms of reference was the process followed by the Audit Committee for approval of RPTs. One of the proposals was that the management should compulsorily provide the following information to the audit committee for approval of a proposed RPT; this checklist may be relevant for concurrent
<table>
<thead>
<tr>
<th>SL. No.</th>
<th>Para No.</th>
<th>Suggestion</th>
<th>Justification</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>developed in company audit in this regard”</td>
<td>audit also (reproduced from the report, page 31):</td>
</tr>
<tr>
<td></td>
<td></td>
<td>i. Type, material terms and particulars of the related party transaction;</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>ii. Name of the related party and its relationship with the listed entity or its subsidiary, including nature of its concern or interest (financial or otherwise);</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>iii. Tenure of the transaction;</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>iv. Value of the transaction;</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>v. The percentage of the listed entity’s annual total revenues, total assets and net worth, on a consolidated basis, that is represented by the value of the proposed RPT (and for a related party transaction involving a subsidiary, such percentage calculated on the basis of the subsidiary’s annual total revenues on a standalone basis);</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>vi. Where the transaction relates to any loans, inter-corporate deposits, advances or investments made or given by the listed entity or its subsidiary:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>a. details of the source of funds in connection with the proposed RPT;</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>b. where any financial indebtedness is incurred to make or give loans, inter-corporate deposits, advances or investments, (i) nature of indebtedness; (ii) cost of funds; and (iii) tenure;</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>c. applicable terms, including covenants, tenure, interest rate and repayment schedule, whether secured or unsecured and if secured, the nature of security; and</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>d. the purpose for which the funds will be utilised by the ultimate beneficiary of such funds pursuant to the RPT</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>vii. Justification as to why the RPT is in the interest of the listed entity;</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>viii. A copy of the valuation or other external party report, if any such report has been relied upon; and</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Any other information that may be relevant.</td>
<td></td>
</tr>
</tbody>
</table>

We agree with the requirement of disclosures similar to ones

There is significant guidance for auditors, and companies, on the topic of going concern, yet the job of evaluating going concern seems most
<table>
<thead>
<tr>
<th>SL. No.</th>
<th>Para No.</th>
<th>Suggestion</th>
<th>Justification</th>
</tr>
</thead>
<tbody>
<tr>
<td>the NPAs and defaulters of loan payments, the suggestions are invited as to whether such kind of disclosures are required to be made by the Auditor in his Audit Report?&quot;</td>
<td>made by credit rating agencies. The most pertinent evaluation is that of going concern.</td>
<td>accurately made by investors rather than management, directors or auditors. CFA Society supports requirement for auditors to “show their work” in how they assessed liquidity and business risk and incorporated them into their assessment of going concern. Investors understand these types of risk assessments and disclosures are subject to a high degree of uncertainty. They will be interested in assessment and prioritization of risks. From this, sophisticated investors (i.e. price makers) can make their own assessments and take appropriate market positions to reflect their assessments.</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>10.2</td>
<td>“whether unlisted company whose parent company is a listed company should also require submitting quarterly returns to SEBI”</td>
<td>CFA Society India supports the measure</td>
</tr>
<tr>
<td>13</td>
<td>12.4</td>
<td>“feasibility and mechanism of this inspection of audit engagements, manner and basis of selection of companies for such an inspection, agency which must undertake the same, whether audit firm level inspections also may be incorporated in this etc”</td>
<td>CFA Society India agrees with inspection of audit engagements as a means of supervision and enforcement. We believe the audit regulator NFRA must be tasked with inspections. We look to international experience to inform our opinions on the scope of inspections, as described below. Public Company Accounting Oversight Board (PCAOB) is a nonprofit corporation established in US to oversee the audits of public companies. PCAOB undertakes inspection at the audit firm level, either annually or triennially depending on the number of issuers (&gt;100 means annual; other firms gets inspected once in 3 years). In 2018, PCAOB conducted reviews of over 160 audit firms and portions of approximately 700 audits of public companies. PCAOB also inspected audit firms’ quality control systems. PCAOB used both risk-based and random selection methods. It made selections based on its evaluation of firms and engagements using various characteristics of the firms. It also selected several firms and engagements randomly. PCAOB did not review every aspect of the selected engagements. Rather, it typically focused our attention on the more complex, challenging, or subjective areas, or other areas that presented greater risk based on its evaluation. Canadian Public Accountability Board inspects annually all firms with more than 100 issuers, and</td>
</tr>
</tbody>
</table>
### Name of Organisation: Indian Association of Investment Professionals (CFA Society India)

<table>
<thead>
<tr>
<th>SL. No.</th>
<th>Para No.</th>
<th>Suggestion</th>
<th>Justification</th>
</tr>
</thead>
<tbody>
<tr>
<td>14</td>
<td>13.5</td>
<td>“whether the aforesaid conditions as laid down by ICAI and SEBI should also be made mandatory for the auditors of other companies/bigger companies”</td>
<td>CFA Society India supports the extension of these measures for other companies</td>
</tr>
</tbody>
</table>

The biennial review of firms with 50-99 issuers. The inspection covers file and quality management systems. CPAB identifies and rates issuers and audit firms that may represent the most significant risks to the investing public. By assessing the reporting issuer’s (RI) risk on a standalone basis with risk factors associated with the audit firm, CPAB develops a comprehensive view of risk for RIs. These are used to identify audits that have the highest risk of a material error or misstatement. This model considers the general economy, the RI’s industry, financial stability, size and foreign exposure, management’s track record, the audit firm’s risk profile, and the engagement partner’s experience, including past inspection results.

Financial Reporting Council (FRC) in UK reviews the audit engagements of FTSE 350 companies on average every 5 years, and individual firms’ engagement at least once every 7 years. It looks at firms’ compliance with auditing, ethical, and quality control standards issued by the FRC.

Appendix A provides a sample of CFA Institute’s commentary related to audit in recent years.

Thank you again for the opportunity to comment on this important regulatory framework. If you or your staff have questions or seek further clarification, please do not hesitate to contact Mr. Rajendra Kalur, CFA at +91 98196 30042 or at advocacy@iaipirc.org

Sincerely yours,

Rajendra Kalur, CFA
Director - Research and Advocacy Committee
Indian Association of Investment Professionals, Member Society of CFA Institute
Appendix A

AUDIT RELATED CONTENT

**AUDIT BLOGS**

**a. Audit Reports**

i. Let’s Make the Auditor Report More Informative

ii. Investor Preferences Being Considered for Auditor’s Reporting Model
https://blogs.cfainstitute.org/marketintegrity/2011/03/28/investor-preferences-being-considered-for-auditor%E2%80%99s-reporting-model/

iii. Company Audits — Are Shareholders Getting Enough?

iv. Audit Transparency and Accountability: The Engagement Partner Should be Disclosed
https://blogs.cfainstitute.org/marketintegrity/2014/01/14/audit-transparency-and-accountability-the-engagement-partner-should-be-disclosed/

v. Navigating a Maze: Audit Profession’s Solution for Disclosing Engagement Partner
https://blogs.cfainstitute.org/marketintegrity/2014/03/11/navigating-a-maze-audit-profession%E2%80%99s-solution-for-disclosing-engagement-partner/

vi. PCAOB Plan on Naming Audit Partner Is a ‘Small Ball’ Advance for Investors

vii. Investors to Benefit from Much-Improved Auditor’s Report

viii. Balance in Public Company Audit Priorities Important to Investors

ix. With PCAOB Form, Finally Maybe Some Transparency into Identity of US Audit Partner

x. Seven’s a Charm for Investors: PCAOB Disclosure of Engagement Partner Finally Reality
https://blogs.cfainstitute.org/marketintegrity/2016/05/12/sevens-a-charm-for-investors-pcaob-disclosure-of-engagement-partner-finally-reality/

xi. Investor Expectations Are High That the New Auditor’s Report Won’t Be Al Capone’s Vault

**b. Audit Reforms**

i. Audit Reform—What Is the Optimal Way Forward?

**c. Audit Quality**

i. Enhancing Audit Quality: Lessons from Auditor Deficiencies and Accounting Restatements

ii. Let’s Make the Auditor Report More Informative

**d. Evolving Audit Services**

i. Heads Up Investors! The Implications of Evolving Audit Services
https://blogs.cfainstitute.org/marketintegrity/2017/05/01/heads-up-investors-the-implications-of-evolving-audit-services/

**e. Going Concern**
i. Continued Concern for “Going Concern” Reporting
https://blogs.cfainstitute.org/marketintegrity/2012/05/22/continued-concern-for-going-concern-reporting/

ii. “Going Concern” Warnings: Fewer Firms Improved in 2012 and Its Impact on Investors

iii. Investor Win: FASB Proposes Enhanced “Going Concern” Warnings for U.S. Firms

f. Alternative Performance Measures –
Blog – Investors Require Improvements in Reporting of Alternative Performance Measures
Survey –

Blog – Time to Focus on the Forgotten Middle across Financial vs. Non-Financial Information Spectrum

Survey –

Blog – Implications of the Widening Spectrum of Useful Corporate Information

AUDIT COMMENT LETTERS


c. SOX (Congress) (2011)

d. Audit Partner Signature (PCAOB) (2012)

e. Auditor Report PCAOB and IAASB (2013)

f. SAG Agenda (PCAOB) (2013)

g. Engagement Partner (PCAOB) (2015)
h. Quality & Skepticism (IAASB) (2016)

i. Technology (IAASB) (2017)


k. Strategic Plan (PCAOB) (2018)

l. Audit Quality & Audit Committee (2018)

m. Monitoring Group (IAASB)(2018)

n. UK Audit Market (CMA) (2019)

o. Independent Review into the Quality and Effectiveness of Audit ("Bryden Review")