

# Report Summary

## Regulating Audit Firms and Networks

- The Committee of Experts (Chair: Mr. Anurag Agarwal) submitted its report to the Ministry of Corporate Affairs on October 25, 2018 presenting its findings and recommendations on regulating audit firms and their networks. Key recommendations of the Committee include:
- **Audit Structures in India:** The Committee observed that there are three types of structures used by audit networks operating in India: (i) domestic networks of firms set up by Chartered Accountants (CA) registered with the Institute of Chartered Accountants of India, (ii) international networks where domestic CA firms tie up with entities outside India through a membership agreement, and (iii) international networks where domestic CA firms tie up with Indian member firms of an international entity, through sub-licensing.
- **Oversight of audit profession:** The Committee noted that the National Financial Reporting Authority (NFRA) must be empowered to publish their audit inspection results. It noted that loss of reputation, from an adverse report, can be an effective deterrent for audit firms to build better internal checks and balances. Further, investors can make more informed choices if they have better information about the performance of auditors of listed entities. The Committee also noted that there are benefits of having multiple Self-Regulatory Organisations in the audit profession. It can generate competition among them which can help the development of the profession.
- **Using brand name:** The Committee observed that branding with international networks would increase competitiveness of Indian audit firms. Further, Indian companies may benefit from using Indian audit firms which are members of international networks with a brand name. It noted that using such international brand names may be commercially advantageous to Indian companies for various reasons ranging from ease of access to foreign investment to better bonding with their clientele abroad. To effect this, it recommended that appropriate amendments should be made to the Chartered Accountants Regulations, 1988 and Code of Ethics, 2009.
- **Legal regime of liability:** The Committee noted that the current regime of liability of individual auditors and audit firms is adequate. On network liability, it recommended that NFRA should be empowered by law to impose monetary penalties on international networks with whom Indian audit firms have entered into membership, if there is an audit failure or fraud. The amount of penalty on such international network/entity should be up to five times the amount of penalty imposed on the audit firm.
- To enable the NFRA to perform this function, every auditor and audit firm, which is operating in India as a part of an international network, should submit an Annual Transparency Report to the NFRA, disclosing certain details. These include: (i) description of the network including details of payment between the Indian audit firms and its network entities, and (ii) details of ownership and management structure of the outside entities constituting the network.
- **Providing non-audit services:** The Committee noted that audit firms across jurisdictions often provide services as part of one common network. It recommended permitting firms to provide non-audit services to an auditee company or its holding or subsidiary company, subject to certain conditions. These include: (i) if the auditor is part of an international network, capping fee from non-audit services to 50% of audit fee earned by the network from that auditee company or its holding or subsidiary companies, in a financial year, and (ii) the auditor must disclose the audit and non-audit fees earned by its network to the NFRA, and (iii) the auditor must file a declaration with the NFRA stating that the revenue earned from non-audit services does not exceed 50% of the audit fee.
- **Advertising:** The Committee recommended that CAs/CA firms should be permitted to advertise their services and solicit work, subject to certain conditions. These are: (i) the advertising/soliciting should not be conducted in a manner which is false, or misleading, (ii) services/claims promoted should not be false, or misleading, and (iii) no disparaging references or unsubstantiated comparison to the work of others should be made. It noted that this would need amendments to the Chartered Accountants Act, 1949 and Code of Ethics, 2009.

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