



Committee of Experts

FINDINGS AND RECOMMENDATIONS

ON

REGULATING AUDIT FIRMS AND THE NETWORKS

REPORT

October 25, 2018

Constituted by

MINISTRY OF CORPORATE AFFAIRS, GOVERNMENT OF INDIA

**COMMITTEE OF EXPERTS ON REGULATING AUDIT
FIRMS AND THE NETWORKS**

New Delhi
October 25, 2018

The Secretary
Ministry of Corporate Affairs
Government of India
New Delhi 110001

Dear Sir,

The Committee of Experts to look into the regulating audit firms and the networks presents its report to the government. The findings and recommendations aim to address the issues raised by the Hon'ble Supreme Court in its judgement in *S. Sukumar versus The Secretary, Institute of Chartered Accountants of India* (February 23, 2018) with a focus to strengthen the legal regime of auditors and promote development of the audit profession in the country.

Yours sincerely,



Anurag Agarwal
(Chairman)



Sudhanshu Pandey
(Member)



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(Member)

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Anurag Agarwal

Acronyms

AAPA	American Association of Public Accountants.
ABS	Alternative Business Structures.
ADR	American Depository Receipt.
AICPA	American Institute of Certified Public Accountant.
APESB	Accounting Professional and Ethical Standards Board.
ASSOCHAM	Associated Chambers of Commerce and Industry of India.
BOD	Board of Discipline.
CA	Chartered Accountant.
CICPA	Chinese Institute of Certified Public Accountants.
CII	Confederation of Indian Industry.
CMA	Competition and Markets Authority.
COE	Committee of Experts.
CPA	Certified Public Accountant.
CSRC	Chinese Securities Regulatory Commission.
DC	Disciplinary Committee.
DD	Director of Discipline.
FASB	Financial Accounting Standards Board.
FDI	Foreign Direct Investment.
FICCI	Federation of Indian chambers of Commerce and Industry.
FRC	Financial Reporting Council.
FTC	Federal Trade Commission.
IBBI	Insolvency and Bankruptcy Board of India.
ICA	Italian Competition Authority.
ICAI	Institute of Chartered Accountants of India.
ICOAI	Institute of Cost Accountants of India.
ICSI	Institute of Company Secretaries of India.

IESBA	International Ethics Standards Board for Accountants.
IFAC	International Federation of Accountants.
IFIAR	International Forum of Independent Audit Regulators.
IFRS	International Financial Reporting Standards.
IPA	Insolvency Professional Agency.
IPO	Initial Public Offering.
LLP	Limited Liability Partnership.
LSB	Legal Services Board.
MAF	Multi-national Accounting Firm.
MCA	Ministry of Corporate Affairs.
MDP	Multi Disciplinary Practice.
MHA	Ministry of Home Affairs.
MoU	Memorandum of Understanding.
MRA	Mutual Recognition Agreement.
NACAAS	National Advisory Committee on Accounting and Auditing Standards.
NACAS	National Advisory Committee on Accounting Standards.
NFRA	National Financial Reporting Authority.
NIPFP	National Institute of Public Finance and Policy.
PCAOB	Public Company Accounting Oversight Board.
PIE	Public Interest Entity.
PW	Price Waterhouse.
QRB	Quality Review Board.
RBI	Reserve Bank of India.
RQB	Recognised Qualification Body.
RSB	Recognised Supervisory Body.
SEBI	Securities and Exchange Board of India.
SEC	Securities Exchange Commission.
SILF	Society of Indian Law Firms.
SRO	Self-Regulatory Organisation.

Executive Summary

Auditors are to resolve agency problems. Moreover, independent audits are fundamental to taking informed and correct investment decisions. Availability of trustworthy financial information on the performance of companies is important to proper functioning of market economy. Serious concerns arise if auditors' *independence* is compromised or the *trust* reposed on them is betrayed.

Determining whether an auditor is *independent* in fact as well as in appearance is complex. This is especially so because audit firms across jurisdictions often provide services as part of one common 'network'. Consequently, separate firms belonging to the same network could provide audit as well as non-audit services to the same audit client or its holding company or subsidiaries across the same or different countries. This can give rise to the problem of *conflict of interest* where independence of the auditor may be compromised. Therefore, measures like sufficient disclosure on total fees, imposing cap on non-audit fees from the audit client, revisiting the scope of prohibited non-audit services are needed to address the issue of conflict of interest, especially at the network level.

These networking arrangements also create an impression that the Indian audit firms which are affiliated with these international networks constitute Multi-national Accounting Firms (MAFs). However, on closer scrutiny it turns out that these Indian audit firms are set up as partnerships or Limited Liability Partnerships (LLPs) under Indian laws and all their partners are members of the ICAI. Therefore, there is neither any violation of section 29 (reciprocity) nor any violation of section 25 (companies not to engage in accountancy) of the *Chartered Accountants Act, 1949*. Neither can such Indian audit firms be simply be equated to multi-national corporations. Consequently, the term 'MAF' is a misnomer.

However, such Indian audit firms admittedly follow various internal processes, policies and methodology adopted by their respective networks internationally. This is aimed at maintaining consistent standards in audit quality globally within a network. While such networks bring better business opportunities in a global economy, they should be subject to necessary checks and balances.

Legal measures need to be supplemented with adequate institutional reforms.

Time and again corporate scandals and accounting frauds have nudged institutional reforms across jurisdictions. One such fundamental reform that has happened globally in the last two decades is a shift away from the Self-Regulatory Organisation (SRO) model towards an independent regulatory structure for the audit profession.

In the aftermath of *Enron*, the U.S. enacted the *Sarbanes Oxley Act*, 2002. The Supreme Court in its judgment dated February 23, 2018 has referred to this statute to examine the need of an oversight mechanism for the audit profession. This law *inter alia* provided for the setting up of the Public Company Accounting Oversight Board (PCAOB) as an independent audit regulator to oversee the audits of public companies. Similarly, U.K., also has a two-tier structure, where the Financial Reporting Council (FRC) is the independent regulator for the audit profession.

In the Indian context, the *Satyam* incident has been a wake-up call for policy-makers. Pursuant to the global trend of shift from SRO model to an independent regulatory model for audit profession, the *Companies Act*, 2013 provided for the setting up of the National Financial Reporting Authority (NFRA).

However, the continued opposition to the establishment of NFRA has delayed the implementation of this critical reform. Consequently, although *Companies Act*, 2013 was enacted in August 2013, the section establishing NFRA was notified only on March 21, 2018 along with the *NFRA Chairperson and Members Appointment Rules*, 2018. Once NFRA becomes fully operational, it will be adequately equipped to handle the contemporary challenges in relation to auditors, audit firms and networks operating in India.

Finally, it is important to facilitate a business-friendly environment for corporates as well as professionals in India. It is therefore vital that Indian laws and regulations on professional services keep pace with changing market dynamics. Opening up professional services to competition is necessary and therefore, audit firms should be allowed to advertise with some restrictions. Further, in a global economy use of international brand names for audit firms must be allowed. Laws must be rationalised to promote Multi Disciplinary Practices (MDPs) to allow firms to offer a bouquet of high quality professional services at par with international standards. The *Advocates Act*, 1961 needs to be rationalised to facilitate development of Indian law firms as well as Indian audit firms into MDPs. Adopting these three measures i.e., advertising, branding and MDPs will not only enhance the standards of services offered to corporates, but also

facilitate the audit firms to expand in size/operation enabling them to compete internationally.

1. Background

The Hon'ble Supreme Court of India vide its judgment dated February 23, 2018 in the matter of *S. Sukumar v. The Secretary, Institute of Chartered Accountants of India & Ors.* (Civil Appeal No. 2422 of 2018) issued the following direction to the Union of India:

The Union of India may constitute a three member Committee of experts to look into the question whether and to what extent the statutory framework to enforce the letter and spirit of Sections 25 and 29 of the CA Act and the statutory Code of Conduct for the CAs requires revisit so as to appropriately discipline and regulate MAFs. The Committee may also consider the need for an appropriate legislation on the pattern of Sarbanes Oxley Act, 2002 and Dodd Frank Wall Street Reform and Consumer Protection Act, 2010 in US or any other appropriate mechanism for oversight of profession of the auditors. Question whether on account of conflict of interest of auditors with consultants, the auditors profession may need an exclusive oversight body may be examined. The Committee may examine the Study Group and the Expert Group Reports referred to above, apart from any other material. It may also consider steps for effective enforcement of the provisions of the FDI policy and the FEMA Regulations referred to above. It may identify the remedial measures which may then be considered by appropriate authorities. The Committee may call for suggestions from all concerned. Such Committee may be constituted within two months. Report of the Committee may be submitted within three months thereafter. The UOI may take further action after due consideration of such report.

The judgment is available at *Annexure A*. Pursuant to the aforesaid directions, the Ministry of Corporate Affairs, Government of India, set up this Committee of Experts ('the COE') vide Office Memorandum dated April 20, 2018 comprising Mr. Anurag Agarwal, Joint Secretary, Ministry of Corporate Affairs (Chairperson); Mr. Sudhanshu Pandey, Additional Secretary, Ministry of Commerce and Industry (Member); and Mr. Ravinder, Joint Secretary, Department of Industrial Policy and Promotion, Ministry of Commerce and Industry (Member). A copy of the aforesaid Office Memorandum is annexed as

Annexure B.

1.1. Methodology followed

The COE adopted a holistic methodology including internal meetings, engagement with stakeholders, examining past reports discussed in the Supreme Court's judgment, global literature and best practices in the auditing landscape.

The COE met nine times including three stakeholder consultation meetings. The dates of these meetings are available at *Annexure C*. During these meetings, the COE delineated policy issues arising out of the concerns raised by the Hon'ble Supreme Court and deliberated on the same. The deliberations of the COE were informed by inputs from the stakeholders. The Committee provided a detailed questionnaire (Questionnaire) to stakeholders prior to each consultation meeting. The Questionnaire is available at *Annexure D*.

The COE adopted the following strategy for stakeholder consultation:

- *Meetings with stakeholders:* Stakeholders were given an opportunity to give oral submission on the issues mentioned in the Questionnaire through formal presentation which was followed by detailed question and answer session for addressing any further clarification.
- *Written submission:* In addition to consultation meetings, stakeholders were also given an opportunity to provide detailed written submission to the Questionnaire within the stipulated time-line.

The COE consulted relevant stakeholders which included sectoral regulators, audit firms, professional institutes, industry associations and representatives from the industry. The list of stakeholders who engaged with the COE is available at *Annexure E*.

The COE gave sufficient time to all relevant stakeholders in providing their inputs to ensure a meaningful consultation process. Since this was a time consuming exercise, the COE had to seek an extension of another three months from the Supreme Court for submission of the report. The Supreme Court

granted the said extension vide order dated July 27, 2018. The extension order is available at *Annexure F*.

The COE greatly benefited from the thinking of prior committee reports including the following:

- *Report on Corporate Audit and Governance, 2002* (committee headed by Mr. Naresh Chandra)
- ICAI, *Study Group Report, 2003*
- *Standing Committee on Finance 21st Report on The Companies Bill, 2009, 2010*
- ICAI, *Expert Group Report, 2011*
- *Report of MCA's Expert Group on Issues Related to Audit Firms, 2017* (committee headed by Mr. Ashok Chawla)

In addition to these reports, the COE also examined global literature and identified the best practices in the auditing landscape in several jurisdictions like United States, United Kingdom and China.

The deliberations of the COE were also informed by the research conducted by its research secretariat, NIPFP.

1.2. Structure of report

The report is structured as follows: Chapter 2 provides a theoretical framework used by the COE to understand the role of auditors and the rationale for their regulation. It explains the role of auditors in resolving *agency problems* that are inherent in a corporate structure. The appointment of auditors raises new *agency problems*, creating various conflicts of interests. Moreover, concentration of *market power* is also another contemporary issue in the market for audit services. Accordingly, this Chapter argues that regulation of auditors is motivated by these two potential market failures - *agency problems* and *market power* - in the market for audit services. It concludes by identifying the broad categories

of legal tools that could be used to regulate auditors. Based on this theoretical framework, Chapter 3 analyses the development of the audit profession and corresponding regulations across US, UK and China. In the backdrop of these global developments, this Chapter contextualises the development of Indian auditing market and chronologically explains the evolution of the current Indian legal framework governing auditors. Finally, Chapter 4 delineates the relevant policy issues arising out of the concerns raised by the Hon'ble Supreme Court, provides the opinion of the COE on each of these issues, and gives a rationale that persuaded the COE to come to that particular opinion on each of the issues.

2.Role of auditors and their regulation

2.1. The basic problem

The efficiency of securities market depends on the availability of trustworthy financial information on the performance of companies. The more quickly new information is gathered, processed, verified and distributed among informed traders, the more efficient is the securities market.¹

A fundamental hurdle in creating an efficient market for corporate securities stems from the *agency problems* inherent in the corporate structure itself. Such *agency problems* emanate from three types of *information asymmetry*. *First*, due to the separation of ownership and control in the corporate structure, the corporate managers may have more information about the company than its shareholder-owners. *Second*, the owners of the company who possess majority or controlling interest may have more information than the minority or non-controlling owners. *Third*, the company may have more information about itself than outside stakeholders with whom it contracts, such as creditors, employees and customers.²

In all the three instances, the agent enjoys informational advantage and may act opportunistically. This is the source of the *agency problems*. For instance, companies may be tempted to misinform investors in order to inflate the market price at Initial Public Offering (IPO) stage because those in control are selling the securities. This is problematic for investors seeking to rely on the corporate disclosures. Investor's mistrust may prompt them to discount the value of the company's shares or even to decline from investing.³ Such *agency problems* inherent in the corporate structure hamper development of an efficient market in corporate securities.

¹ Armour, Awrey, et al., *Principles of Financial Regulation*.

² Kraakman et al., *The Anatomy of Corporate Law*, pp. 29-30.

³ Armour, Awrey, et al., *Principles of Financial Regulation*, p. 121.

2.2. Auditors resolve agency problems

Corporate law provides various tools to mitigate these *agency problems*. One such tool is the *trusteeship strategy*. This requires a neutral decision-maker to exercise good faith best judgment in making a corporate decision.⁴ Auditors play this role of a neutral decision-maker. They provide an independent check on the work of the agent and information provided by the agent. This helps the principal maintain confidence and trust on the agent.⁵ This reliance placed on auditors to approve financial statements and certain corporate transactions is an example of the *trusteeship strategy*.⁶

Auditors are also referred to as ‘reputation intermediaries’. The principal trusts the auditor over her own agent as long as the auditor has a clean track record. And the auditor in turn pledges her hard earned reputation, built up over time, to vouch for the agent (the company or its managers). The assumption here is that an auditor being a repeat player in the capital markets has lesser incentive to deceive the principal than the agent. Theoretically, when an auditor has reputational capital whose value exceeds the expected profit from individual client relationship, she should be faithful to the principal.⁷

Auditors often play the critical role of ‘gatekeepers’. The term ‘gatekeeper’ literally means someone that controls access to an activity, in this case the capital markets. For example, a company seeking to access the public capital markets in most countries has to make use of the services of an auditor.⁸ This makes the integrity of auditors all the more important.

Even the legal liability regime on auditors has implications on capital markets. Auditors’ legal liability for an audit failure is an implicit insurance to outside investors. This insurance provided by the auditors enables entrepreneurs to raise capital from investors at lower costs.⁹

⁴ Armour, Hansmann, and Kraakman, “Agency Problems, Legal Strategies and Enforcement”, p. 6.

⁵ The Institute of Chartered Accountants in England and Wales, *Agency theory and the role of audit*, pp. 6-7.

⁶ Armour, Hansmann, and Kraakman, “Agency Problems, Legal Strategies and Enforcement”, p. 9.

⁷ Armour, Awrey, et al., *Principles of Financial Regulation*, p. 122.

⁸ Armour, Awrey, et al., *Principles of Financial Regulation*, p. 122.

⁹ Laux and Newman, “Auditor Liability and Client Acceptance Decisions”, p. 262.

Although the concept of auditors originated to resolve the *agency problem* within the corporate structure, in a modern economy their role extends beyond this scope. Various primary and subordinate legislation require accounts to be audited for use by stakeholders outside the company itself, like, tax authorities, regulators etc. For instance, under the *Income Tax Act, 1961* certain persons carrying out business or profession are required to get their accounts audited.¹⁰ Therefore, the integrity of auditors is critical for the functioning of various other institutions over and above the securities market.

2.3. Concerns about auditors

Although the primary role of auditors is to resolve *agency problems*, their appointment leads to a new set of *agency problems*. These new problems arise because although the auditors are appointed by the shareholders, in practice the management plays a critical role in recommending who should be appointed as auditors.¹¹ The auditors therefore look to the CEOs and CFOs of the auditee company to facilitate continued engagement.¹² Moreover, the auditee company may engage the audit firm for additional non-audit consulting services. The risk of losing fees from a long-term audit engagement and additional non-audit services could align the incentives of the auditors with those of the company's management, creating new *agency problems* (commonly referred to as *conflict of interest problems*).¹³ These *conflicts of interest* could compromise the independence of auditors, rendering them incapable of resolving the original *agency problems* discussed earlier.

The provision of both audit and non-audit services raises further complications. Audit firms across jurisdictions often provide services as part of one common 'network'. A 'network' is a larger structure which is aimed at cooperation and is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality-control policies and procedures, a common business strategy, the use of a common brand-name or a significant part of professional resources.¹⁴ Consequently, separate firms belonging to the same

¹⁰Section 44AB Government of India, *Income Tax Act*.

¹¹Gavious, "Alternative perspectives to deal with auditors' agency problem", p. 458.

¹²Dontoh, Ronen, and Sarath, "Financial Statements Insurance", p. 3.

¹³Dontoh, Ronen, and Sarath, "Financial Statements Insurance", p. 3.

¹⁴This is based on the definition used by EU. See Article 2(7), European Parliament, *DIRECTIVE 2006/43/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of*

network could provide audit as well as non-audit services to the same audit client or its holding company or subsidiaries across different countries. It is possible that such non-audit services provided by one network firm to a company compromise the independence of another network firm which is providing audit services to the same company or its holding or subsidiary companies.

Once auditors' independence is compromised, allowing auditors to act as gatekeepers could give rise to a potential *moral hazard* problem. The existence of a legal mandate to use auditors as gatekeepers may lull other market participants into a false sense of security, causing them to rely on the auditors and seek out less information on their own. Consequently, there may be an expectation gap between what the auditors can actually achieve and what stakeholders think they can achieve.¹⁵

Another serious concern is the lack of competition in the audit profession.¹⁶ In a concentrated market dominated by a handful of market players, there are risks of implicit collusions. Moreover, in such a market, consumers of audit services may not have the ability to exercise choice effectively. Consequently, reputation risk itself may not be enough to check the behaviour of the dominant audit firms. This concern is further corroborated by instances of reputation-depleting behaviour by some audit firms.¹⁷

2.4. Rationale for regulation

Regulation of a market is not an end in itself. It addresses *market failures*.¹⁸ Similarly, regulation on the market for audit services should also be targeted to address potential *market failures*. As is evident from the discussion above, the market for audit services needs to be regulated to address two potential market failures: first, the *agency problems* emanating due to the inherent nature of the auditors' role and the resulting *moral hazard* problems; second, *market power*

17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, a similar definition has been adopted in India.

¹⁵ Armour, Awrey, et al., *Principles of Financial Regulation*, p. 122.

¹⁶ Armour, Awrey, et al., *Principles of Financial Regulation*, p. 132.

¹⁷ Armour, Awrey, et al., *Principles of Financial Regulation*, pp. 132-133.

¹⁸ Government of India, *Report of the Financial Sector Legislative Reforms Commission, Volume I: Analysis and Recommendations*, p. xiv.

in the hands of few players which raises the possibility of abuse of dominance. These two potential market failures form the primary rationale for regulation of the market for audit services.

Legal regimes across jurisdictions have developed a range of tools to address such *market failures*. These legal tools could be broadly classified under six categories:¹⁹

1. **Qualification and disqualification requirements:** The law could lay down specific qualification requirements for acting as a statutory auditor. It could also disqualify persons from acting as auditor of a particular company on grounds of conflict of interest. Such a policy may extend to preventing auditors from providing certain non-audit services to audit clients or requiring mandatory rotation of auditors.
2. **Disclosure obligations:** The law could impose various disclosure obligations on auditors. Such norms could help reveal the conflict of interest that the auditors may face, the sources of funds they receive, and the methodology behind their recommendations.
3. **Management of conflict:** The law could incorporate rules to mitigate the conflict of interest faced by auditors. For instance, since the board within the company has greatest interest in a lax audit, the law could increase the role of shareholders in relation to audit decisions. Even within the board, it is the executive directors who have the greatest interest in lax audit. Given that shareholders face collective action problems, the law could increase the role of non-executive directors in relation to audit decisions. One example of this is the use of audit committees comprising independent non-executive directors.
4. **Regulatory oversight:** The law could also enhance the regulatory oversight on auditors, making them more accountable to the principal - the shareholders - and other stakeholders of financial statements of the auditee company.
5. **Auditors' power:** The law could increase the power that auditors wield against the audited company, thereby making audit decisions more

¹⁹ Armour, Awrey, et al., *Principles of Financial Regulation*; Davies and Worthington, *Principles of Modern Company Law*, p. 808.

independent. For instance, the law could restrict the maximum fees earned by an auditor from an audit client to ensure that no one audit client is of such substantial material importance to the auditor so as to bias its independence.

6. **Liability risk:** The law could increase the liability risk of auditors, over and above their reputation risk. This could be achieved by allowing parties who rely on the audited accounts and reports to impose civil liability (damages) on negligent auditors. For instance, the law could increase the litigation risk that auditors could face for negligence. Similarly, criminal liability could be imposed on auditors for false statements in audit reports.

The next chapter applies this theoretical framework to analyse the evolution of the laws and regulations on the market for audit services across some major jurisdictions as well as in India.

3. Global developments and best practices

The early origins of the audit profession can be traced back to medieval Europe.¹ Since then the profession evolved organically out of the competitive dynamics of free markets. But it was the development of limited liability companies in nineteenth century England and America that created a demand for professional accountants and auditors. Prompted by insolvencies and scandals arising out of such limited liability companies,² especially railway companies, the English Companies Act, 1845 for the first time required semi-annual audits of accounts of certain companies by an audit committee composed of shareholders. Although this audit requirement was removed subsequently, the English Companies Act, 1900 reintroduced compulsory audit for limited liability companies.³

The first English professional societies for accountants were set up in 1870. These professional societies established their brand-names by restricting entry of accountants through examinations, establishing standards of conduct, and by adopting the title of ‘chartered accountants’ for their members. The 1880 Charter of Institute of Chartered Accountants in England and Wales listed the accountants’ functions as liquidators, receivers, trustees and auditors, in that order. By 1900, virtually all traded UK companies were audited by professional chartered accountants.⁴

The growth of bankruptcy and liquidation work for accountants that occurred

¹Auditors were used by guilds, monasteries, priories, manors, joint stock companies from the thirteenth to the seventeenth century. See Watts and Zimmerman, “The market for independence and independent auditors”; also see, Boockholdt, “A historical perspective on the auditor’s role: The early experience of the American railroads”.

²The first bankruptcy statute was passed in England in 1825. The role of professional accountants in bankruptcy increased under the subsequent bankruptcy statutes of 1848, 1861 and 1869. These statutes required appointment of assignees by courts or allowed creditors to appoint trustees. Watts and Zimmerman, “The market for independence and independent auditors”.

³Boockholdt, “A historical perspective on the auditor’s role: The early experience of the American railroads”; subsequently, sectoral statutes mandated audits for various industries like Railway Companies Act, 1867-1879; Banking Companies Act, 1879; and Water Companies Act, 1871. Watts and Zimmerman, “The market for independence and independent auditors”.

⁴Watts and Zimmerman, “The market for independence and independent auditors”.

in England during the nineteenth century did not occur in U.S.⁵ As a result, professional societies were established in U.S. later and were influenced by British accounting firms.⁶ For instance, the American Association of Public Accountants (AAPA) - the predecessor of the present American Institute of Certified Public Accountant (AICPA) - was set up in 1887, and the accreditation system began in 1896. By 1920s, most companies listed on New York Stock Exchange were being audited by professional auditors.⁷

It is evident from the above vignettes that the modern audit profession originally evolved organically out of the competitive dynamics of free markets. The early professionals self-regulated themselves to differentiate themselves from lay accountants and to signal their quality and credibility to potential clients.⁸ However, subsequent events prompted increased levels of state interventions, which have largely shaped the current regulatory architecture as well as regulations on the modern audit profession across major economies.

3.1. United States of America

Following the stock market crash of 1929, the *Securities and Exchange Act*, 1933 for the first time made it mandatory for U.S. publicly listed companies to have independent outside auditors certify the fairness of their financial reports.⁹ Many of the audits that immediately followed were not conducted independently and simply relied on information supplied by the management.¹⁰ This prompted

⁵Accountants were initially hired to assist shareholder audit committees constituted by certain American companies, usually railroad companies. Although initially these auditors were used for investigation of frauds and verification of account balances, some companies chose to publish statements from their auditors in their annual reports. Thus developed the role of auditors in reporting the companies' financial status to its shareholders. Boockholdt, "A historical perspective on the auditor's role: The early experience of the American railroads".

⁶During 1880-1900, the huge expansion of American manufacturing firms was heavily financed through the London capital markets. As a consequence, English auditors with established brand-names entered the American market during 1880s. Watts and Zimmerman, "The market for independence and independent auditors".

⁷Watts and Zimmerman, "The market for independence and independent auditors".

⁸Watts and Zimmerman, "The market for independence and independent auditors".

⁹Sunder, "Rethinking the Structure of Accounting And Auditing", p. 13.

¹⁰For instance, physical inspection of inventories and confirmation of receivables were optional until fraudulent activities in McKesson & Robbins emerged in 1939. Byrnes et al., "Evolution of Auditing: From the Traditional Approach to the Future Audit".

the AICPA to require auditors to inspect inventories and confirm receivables themselves rather than depend on information from their audit clients.¹¹ Even the Federal Trade Commission (FTC), which initially administered the *Securities and Exchange Act*, specifically required ‘independent auditors’ not to have any direct or indirect interest in the client.¹² Thus, from early on auditor independence became a critical issue in U.S.

In 1939, the SEC set up a private standard setting body - the Commission on Accounting Procedures, which subsequently became the Financial Accounting Standards Board (FASB) - to establish accounting standards. However, SEC retained the authority to supercede any accounting standard adopted by FASB, if necessary. The accounting profession was left to regulate itself through its professional body, the AICPA. However, state authorities like SEC retained authority to set and enforce standards and discipline those practicing before it.¹³ As per Rule 102(e), the SEC can censure an auditor as well as audit firm or deny it, temporarily or permanently, the privilege of appearing or practicing before it for lack of qualification or unethical conduct.¹⁴

The SEC has always been concerned about the impact of non-audit services on auditor independence. In 1978, it promulgated the Accounting Series Release No. 250 requiring disclosure of non-audit services performed by independent auditors in terms of their percentage relationship to audit fees. It also issued Accounting Series Release No. 264 regarding the scope of non-audit services to enable companies and their auditors to determine whether any proposed management advisory service engagement should be offered or accepted. At that time, the SEC was not keen to prohibit any particular management advisory service. Instead, it expected the accountants to serve as front line guardians of their professional independence.¹⁵

This self-regulation model had to be reviewed after the *WorldCom* and *Enron* scandals in early 2000s. To rebuild investor confidence in the public markets, the Congress enacted the *Sarbanes Oxley Act*, 2002. It marked the transition from a self-regulatory model to an independent oversight model of auditor supervision. It established PCAOB, a full-time, independent board to conduct

¹¹Statement on Auditing Procedure (SAP) No. 1 issued in October 1939, Byrnes et al., “Evolution of Auditing: From the Traditional Approach to the Future Audit”.

¹²Watts and Zimmerman, “The market for independence and independent auditors”.

¹³Evans, *The regulatory framework for public accounting*.

¹⁴Rule 102(e), U.S. Securities and Exchange Commission, *Rules of Practice*.

¹⁵H. Williams, *The 1980s: The future of the accounting profession*.

inspections of audits. The PCAOB has five members, who are appointed to staggered five-year terms by the SEC, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, and the Secretary of the Treasury. The PCAOB establishes or adopts standards for auditing, quality control, ethics and independence, taking into account public comments, and subsequently conducts economic analysis of such changes. The PCAOB is further vested with investigation and disciplinary powers. It can also revoke registration and impose monetary penalties on auditors.¹⁶

The *Sarbanes Oxley Act*, 2002 makes it unlawful for any audit firm, that is not registered with PCAOB, to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer, broker, or dealer.¹⁷ The law imposes a legal obligation on PCAOB to conduct a continuing program of inspections to assess the degree of compliance of each registered audit firm with all applicable laws and professional standards in connection with its performance of audits, issuance of audit reports, and related matters involving issuers.¹⁸ Annual inspections are conducted for firms which provide audit reports for more than 100 clients and once every three years for firms providing audit reports for 100 or fewer issuers.¹⁹ The inspection results are published in the public domain if the audit deficiencies are not addressed by auditors within twelve months.²⁰ This acts as a deterrent for audit firms because of the potential reputational damage for them.

The PCAOB also inspects those registered public accounting firms located in foreign jurisdictions that prepares or furnishes an audit report with respect to any issuer. Such inspection is carried out to assess those firms compliance with the *Sarbanes Oxley Act*, 2002, the rules of the PCAOB, and the SEC.²¹

The *Sarbanes Oxley Act*, 2002 also strengthened auditor independence by prohibiting auditors from providing certain non-audit services to their publicly traded audit clients.²² It also strengthened the role of the audit committee in public companies by requiring them to pre-approve all audit and non-audit

¹⁶Section 105(c)(4), United States of America, *Sarbanes Oxley Act*.

¹⁷Section 102(a), United States of America, *Sarbanes Oxley Act*.

¹⁸Section 104(a), United States of America, *Sarbanes Oxley Act*.

¹⁹Section 104, United States of America, *Sarbanes Oxley Act*.

²⁰Center for Audit Quality, *Guide to PCAOB Inspection*, p. 12.

²¹Section 106, United States of America, *Sarbanes Oxley Act*.

²²An alternative proposal to impose a complete ban on auditors from providing non-audit services to their clients was considered but subsequently rejected. Barrett, “Tax services” as a trojan horse in the auditor independence provisions of Sarbanes-Oxley”.

services entrusted by the company to the auditor.²³

The *Dodd-Frank Wall Street Reform and Consumer Protection Act*, 2010 further empowered the PCAOB with expanded oversight of brokers and dealers registered with SEC. PCAOB now has registration, inspection, standard-setting, and disciplinary authority over the auditors of broker-dealers. When broker-dealers file their annual reports with the SEC, they are required to include their financial statements and supporting schedules, along with audit reports thereon prepared by PCAOB-registered public accounting firms. Broker-dealers also are required to file compliance or exemption reports, along with examination or review reports that are prepared by the same firms that prepared the audit reports. The audits, examinations, and reviews are required to be performed in accordance with PCAOB standards.²⁴

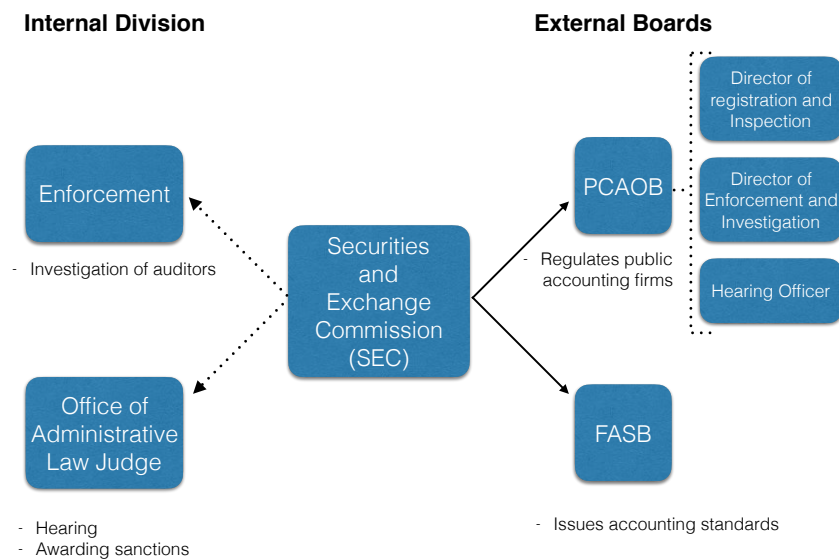


Figure 3.1.: *SEC and PCAOB*

The regulation of public accounting firms i.e., auditors of listed entities is

²³Section 202, United States of America, *Sarbanes Oxley Act*.

²⁴PCAOB, *Information for Auditors of Broker-Dealers*.

done both by SEC and PCAOB. However, SEC is the oversight authority of PCAOB.²⁵ SEC has the authority to take action against an auditor for professional misconduct or violating securities laws.²⁶ As explained in Figure 3.1, the investigation is carried out by the Enforcement Division of SEC *independent* from the Office of Administrative Law Judge which is responsible for disciplinary proceedings and issuing sanctions. Since investigations can be carried out by both SEC and PCAOB, such investigations are duly co-ordinated. Further, PCAOB can refer an ongoing investigation to SEC.²⁷ The regulatory structure provides a clear separation of functions like inspection, investigation and adjudication, which are conducted by different divisions of PCAOB.²⁸

3.2. United Kingdom

In 2002, immediately after the *Enron* debacle, the UK government undertook a review of the regulatory regime for auditors and accountants and the challenges associated with the SRO regime. The principle recommendation of the review exercise was to enhance the monitoring of the listed entities through an independent audit regulator.²⁹ While FRC existed at that time, but this review exercise led to its integration. In April 2004, FRC became the UK's unified independent regulator for corporate reporting and governance.³⁰ Currently, FRC is the *competent authority* responsible for the public oversight of statutory auditors.³¹ It also assumed the responsibility for issuing accounting standards and dealing with their enforcement.

UK follows a *two-tier* structure which consists of an independent audit regulator and multiple front-line SROs. The critical regulatory activities concerning the auditors of public interest entities are vested with FRC, whereas some tasks have been delegated to the multiple SROs - Recognised Supervisory Bodies (RSBs) and Recognised Qualification Bodies (RQBs).³² RSBs supervise certain aspects

²⁵Section 107, United States of America, *Sarbanes Oxley Act*.

²⁶Section 4C, United States of America, *Securities Exchange Act*.

²⁷Section 105(b)(4), United States of America, *Sarbanes Oxley Act*.

²⁸Rules 4000(c), 5100, 5200(b) and 5200(c), Public Company Accounting Oversight Board, *Bylaws and Rules of The Public Company Accounting Oversight Board*.

²⁹Financial Reporting Council, *Professional Oversight Board for Accountancy, Report to the Secretary of State*, p. 10.

³⁰Financial Reporting Council, *Annual Report*, p. 1.

³¹United Kingdom, *Companies Auditors Regulations*.

³²Financial Reporting Council, *Guidelines on Enforcement Measures against Recognised*

of auditors, whereas RQBs award appropriate audit qualification. These SROs are recognised under the *Companies Act*, 2006 subject to certain eligibility conditions.³³ These are not statutory bodies and can be de-recognised for breaching obligations.

The FRC has currently appointed four RSBs and five RQBs. Some of these are - Association of Chartered Certified Accountants, Chartered Accountants Ireland, Institute of Chartered Accountants in England and Wales, Institute of Chartered Accountants of Scotland. Each individual RSB is responsible for maintaining its own standards that are overlooked by the FRC. The FRC can also impose financial penalty on RSBs for breaching its obligations and such enforcement measure is published in the public domain.³⁴

The FRC functions through the help of various committees. For instance, it sets the accounting standards through the Code and Standards Committee which takes into account views of stakeholders. Since setting of accounting standards requires expertise, this committee consists of majority of practitioners. On the other hand, the Conduct Committee of FRC, which conducts inspection of audits and regulation of SROs, has a majority of lay members. Further, to ensure objectivity in its function, the Conduct Committee *excludes* current practising auditors and has no officers of the SROs it regulates.³⁵

As Figure 3.2 shows, if the auditors dispute the findings of the investigation, then an independent disciplinary Tribunal is appointed.³⁶ The Tribunal consists of majority of non-accountants and never has any employee from other division involved in investigation or prosecution. Therefore, the current structure of FRC separates the function of investigation from adjudication to ensure fairness and objectivity. In sum, all the committees in FRC have been composed in a manner to ensure optimum balance between independence and expertise.

The *Companies Act*, 2006 prohibits a person from acting as an auditor unless such person satisfies the independence requirements in the statute.³⁷ Violation of

Supervisory Bodies and Recognised Qualifying Bodies, p. 2; See, Appendix 1-5, Financial Reporting Council, *Delegation Agreement*, pp. 20-25.

³³Schedule 10, United Kingdom, *Companies Act*.

³⁴Financial Reporting Council, *Guidelines on Enforcement Measures against Recognised Supervisory Bodies and Recognised Qualifying Bodies*, pp. 5-6.

³⁵Financial Reporting Council, *Financial Reporting Council Governance Bible*, p. 20.

³⁶Rule 26 and 27, Financial Reporting Council, *Audit Enforcement Procedure*, p. 10.

³⁷Section 1214, United Kingdom, *Companies Act*.

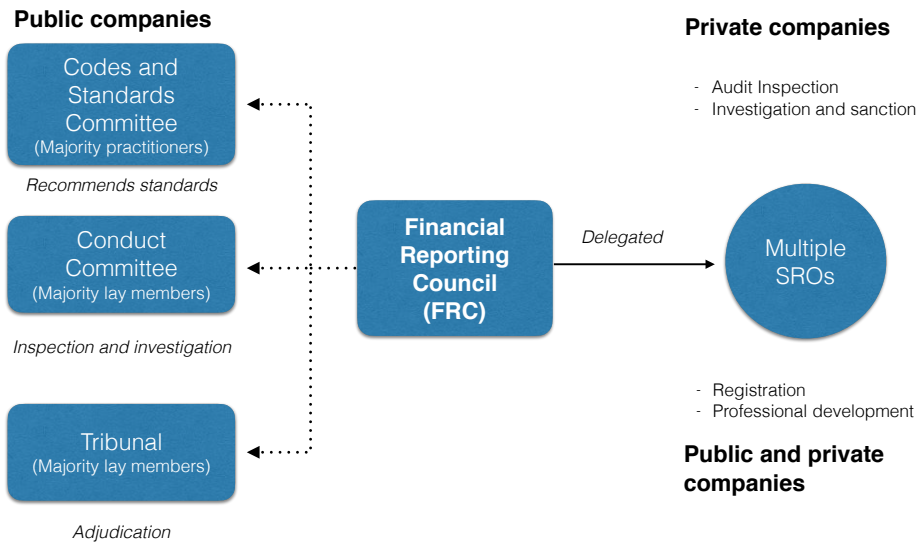


Figure 3.2.: *United Kingdom: Financial Reporting Council*

the independence requirements by an auditor could invite criminal sanctions.³⁸ The *APB Ethical Standard 5* places the task of identifying and managing threats to independence arising out of non-audit work primarily on auditors, but certain types of non-audit services are identified as particularly dangerous and should not be undertaken. These include non-audit services like internal audit, IT design of accounting systems, valuation, actuarial services, certain tax services.³⁹

The *Companies Act*, 2006 also empowers the Secretary of State to issue disclosure regulations to address potential conflict of interest arising out of non-audit services. The Secretary of State has issued regulations for disclosure of terms on which a company's auditor is appointed, remunerated or performs his duties; the nature of any services provided for a company by the company's auditor or by his associates; the amount of any remuneration received or receivable by a

³⁸Section 1215, United Kingdom, *Companies Act*.

³⁹Auditing Practices Board, *APB Ethical Standard 5*.

company's auditor, or his associates, in respect of any such services.⁴⁰

Box 1: Sanction on Big Four

In 2017, an independent review was undertaken by a panel chaired by former Justice Sir Christopher Clarke.^a The review while discussing sanctions, stated that smaller fines allowed the Big 4 to continue to conduct business by looking at sanctions as the 'cost of doing business'. While larger fines would discourage smaller firms from conducting larger scale audits and can cause further segregation of the market. The report concluded by suggesting the Big 4 be treated as a separate category when dealing with sanctions. Justice Clarke further recommended an increase in fines to GBP 10 million or more for poor audit work from a Big 4 accounting firm. The FRC accepted the recommendations from the review. It also agreed to make greater use of non-financial penalties like excluding dishonest auditors from the accounting profession for at least 10 years.

^aClarke, Chambers, and Long, *Independent Review of the Financial Reporting Council's Enforcement Procedures Sanctions*.

The civil liability of an auditor towards the audited entity for a negligent audit is well-established under English law. However, civil liability towards non-client claimants is limited. While in other jurisdictions there has been a move from joint and several liability for auditors to a proportionate liability regime, the *Companies Act*, 2006 provides for an alternative solution by recognising liability limitation agreements between a client company and its auditor.⁴¹

Additionally, the FRC has introduced its Audit Enforcement Procedure ('AEP'), which has only been in operation since June 2016. The Sanctions Policy (Audit Enforcement Procedure) supports the AEP. The AEP is concerned with relevant breaches by Statutory Auditors and Statutory Audit Firms. For instance, it would cover a failure to comply with the standards of professional competence, due care and professional scepticism.⁴² As shown in Box 1, the effectiveness of this sanctioning regime on the Big 4 audit firms is questionable.

Concentration in the market for audit services has emerged as a serious concern for contemporary British policymakers. Following the collapse of the construction company Carillion earlier in 2018, the Work and Pensions Committee reviewed the regulations on the audit profession in UK and expressed serious

⁴⁰Sections 493, 494, United Kingdom, *Companies Act*.

⁴¹Sections 534-538 United Kingdom, *Companies Act*; Davies and Worthington, *Principles of Modern Company Law*.

⁴²Clarke, Chambers, and Long, *Independent Review of the Financial Reporting Council's Enforcement Procedures Sanctions*.

concerns. The Committee noted that in 2016, the Big Four audited 99% of the FTSE 100 and 97% of the FTSE 250 companies.⁴³ In this oligopolistic market, Carillion through its employment of Deloitte (internal auditor), KPMG (external auditor), EY (financial advisor) and PwC (advisor on government contracts) created a situation wherein FRC was forced to appoint the least conflicted out of those firms to review the company's audits. This allowed PwC to dictate its price thereby turning the oligopoly into a monopoly.

Accordingly, the Committee concluded that waiting for a more competitive market that promotes quality and trust in audits has failed. Instead, it recommended referring the statutory audit market to the UK anti-trust regulator, which should consider both breaking up the Big Four into more audit firms, and detaching audit arms from those providing other professional services.⁴⁴ In October, 2018, the Competition and Markets Authority (CMA) issued a consultation document on the market study it plans to carry out to consider whether the market for the provision of statutory audit is working properly. This study aims to focus on three main issues i.e., improvement of incentives, separation of audit and non-audit services and reducing barrier to entry and expansion of non-big four audit firms.⁴⁵

3.3. China

In 1949, the People Republic of China was founded, which led the accountancy profession towards a development course based on the model of socialism. It was only in 1979, when economic reforms started, the existing structure of accountancy profession was revisited. In 1979, the Government promulgated laws on Chinese-foreign equity joint venture which required foreign entities both wholly owned and joint-venture to have their annual financial statements audited by Certified Public Accountants (CPAs). This led to the growth of new accounting firms which provided services to foreign owned enterprises, because state owned enterprises were not required to be audited.⁴⁶

⁴³UK Parliament, *Business, Energy and Industrial Strategy and Work and Pensions Committees of Session 2017-19*, p. 80.

⁴⁴UK Parliament, *Business, Energy and Industrial Strategy and Work and Pensions Committees of Session 2017-19*, p. 85.

⁴⁵Competition & Markets Authority, *Statutory Audit Market*, p. 4.

⁴⁶Turley, "The Accounting Profession in China: Review and outlook", p. 547.

In 1981, the Government allowed the entry of accounting firms which were part of the global network. The Big six firms opened their representatives offices in mainland China for liaison and consulting purposes because rules did not permit audit functions.⁴⁷ In 1985, the Government approved the new accounting regulations for the Chinese and foreign joint ventures which took the accounting profession closer towards the global norms.

In 1988, the Chinese Institute of Certified Public Accountants (CICPA) was established under the supervision of the Ministry of Finance as a SRO.⁴⁸ In 1992, the Ministry of Finance granted *special approval* to the Big six firms to form joint venture with the state controlled local accounting firms. This allowed these firms to enter into the domain of auditing, advisory, tax and other professional services in China.⁴⁹

However, the joint venture structure did not turn out to be much successful for the Big six firms due to interference of the local partner. Therefore, they pushed for allowing the *network membership* route. In 1996, the Ministry of Finance allowed the international firms to identify members firms in China subject to certain conditions.⁵⁰

The securities market had a significant impact on the accounting profession in China. The Chinese enterprises raised funds outside mainland China for which they were required to get financial statements prepared in accordance with the international accounting standards.⁵¹ In 2001, the Chinese Securities Regulatory Commission (CSRC) issued a regulation which mandated companies seeking listing of shares to get their financial statements audited by international accounting firms.⁵² The foreign invested enterprises also fuelled growth in the non-audit services which were rendered mostly by the member firms.⁵³

The companies listed on different stock exchanges (Shanghai Stock Exchange,

⁴⁷Gillis, "The Big Four in China: Hegemony and Counter-hegemony in the Development of the Accounting Profession in China", pp. 94-95.

⁴⁸Turley, "The Accounting Profession in China: Review and outlook", p. 548.

⁴⁹Gillis, "The Big Four in China: Hegemony and Counter-hegemony in the Development of the Accounting Profession in China", p. 108.

⁵⁰Gillis, "The Big Four in China: Hegemony and Counter-hegemony in the Development of the Accounting Profession in China", pp. 159-160.

⁵¹Turley, "The Accounting Profession in China: Review and outlook", p. 550.

⁵²Gillis, "The Big Four in China: Hegemony and Counter-hegemony in the Development of the Accounting Profession in China", p. 125.

⁵³Turley, "The Accounting Profession in China: Review and outlook", p. 553.

Shenzhen Stock Exchange, Hong Kong Stock Exchange) were required to follow different accounting standards and hence, there was no uniformity. Several developments took place in bringing the Chinese accounting standards at par with the international norms. In 2009, the Ministry of Finance converged the standards with the International Financial Reporting Standards (IFRS).⁵⁴

Presently, the accounting profession in China is regulated by three authorities i.e., Ministry of Finance, CSRC and CICPA. Firms are licensed by the Ministry of Finance. The firms providing securities related services are jointly licensed by the Ministry of Finance and CSRC. The Ministry of Finance and CSRC also have powers to investigate and take disciplinary actions against auditors of listed entities. CICPA as a professional body, has oversight authority over the firms and the individual CPAs. The accounting standards are set by the Ministry of Finance; whereas CICPA sets the auditing standards but issued by the Ministry of Finance.⁵⁵

The *Law of the People Republic of China on Certified Public Accountants*, 1993 states that while CICPA is the national organisation of CPAs, there are local CPA institutes which represent CPAs operating in different provinces.⁵⁶ Under this law, every CPA is required to join a local CPA institute in respective provinces. These local institutes are responsible for conducting annual examination on professional qualification and annual practice inspection of CPAs.⁵⁷ The local CPA institutes can revoke the registration of CPAs on grounds of professional misconduct.⁵⁸ The CICPA can take the following disciplinary measures i.e., reprimand, criticism by circulating notice and public condemnation for non-compliance by its members.⁵⁹ The finance department of the government at the provincial level or above can issue disciplinary warnings to individual CPA or firm of CPAs for violations and award punishments like, suspending their operations or impose fines.⁶⁰

⁵⁴Gillis, "The Big Four in China: Hegemony and Counter-hegemony in the Development of the Accounting Profession in China", p. 200.

⁵⁵Turley, "The Accounting Profession in China: Review and outlook", p. 553.

⁵⁶International Federation of Accountants, *IFAC: China, Legal and Regulatory Environment*.

⁵⁷Article 33 and 37, People Republic of China, *Law of the People Republic of China on Certified Public Accountants*.

⁵⁸Article 13, People Republic of China, *Law of the People Republic of China on Certified Public Accountants*.

⁵⁹Article 5, Chinese Institute of Certified Public Accountants, *Disciplinary Measures for Non-compliance Activities Conducted by Members of Chinese Institute of Certified Public Accountants*.

⁶⁰Article 39 and 40 People Republic of China, *Law of the People Republic of China on Certified*

Year	Developments
2002	High Level Committee on Corporate Audit and Governance
2003	ICAI Study Group Report
2007	Constitution of Quality Review Board (QRB), changes in disciplinary proceedings
2009	<i>Satyam</i> financial fraud
	CII Task Force on Corporate Governance
2010	Parliamentary Standing Committee on Finance on <i>Companies Bill</i> , 2009
2011	ICAI Study Group Report on operations of MAF
2013	Notification of <i>Companies Act</i> , 2013
2016	Company Law Committee recommends constitution of NFRA
2017	Report of MCA's Expert Group on Audit Firms
2018	Securities and Exchange Board of India (SEBI) passes order against Price Waterhouse (PW)
	Supreme Court judgment in <i>S.Sukumar v The Secretary, ICAI</i>
	Cabinet approval on setting up NFRA

Table 3.1.: *Important milestones in Indian auditing landscape*

3.4. Indian developments

Although the collapse of Enron in 2001 and the demise of Arthur Andersen in 2002 were watershed moments for corporate governance globally, the initial stimulus of corporate governance reforms in India was generated by the Asian financial crisis in 1997-98. Two subsequent events - the *Satyam* scam and the enactment of the *Companies Act*, 2013 - further shaped the Indian corporate governance regime. Accordingly, this section will review the development of the Indian regulations on auditors and audit firms across three phases - from the *Enron* fallout in 2002 to the *Satyam* scam in 2009, from *Satyam* scam to the enactment of the *Companies Act*, 2013 and post the enactment of *Companies Act*, 2013 till now. Table 3.1 highlights the most critical developments over this period.

3.4.1. Enron fallout: 2002-2009

In the midst of the global churn in corporate governance reforms, the Indian government in 2002 appointed a High Level Committee on Corporate Audit and Governance chaired by Mr. Naresh Chandra to examine various corporate governance issues. This committee undertook a comprehensive examination of various aspects of corporate governance that arose in the context of the *Enron* failure. Closely on the footsteps of the *Report on Corporate Audit and Governance*, the ICAI in 2003 issued a *Study Group Report* which discussed the competition issues in the context of Indian audit firms and firms being members of the international network. In parallel, the *Report of the Expert Committee on Company Law* headed by Mr. J.J.Irani while suggesting reforms to the company law in 2005, made relevant recommendations pertaining to conflict of interest and liabilities on auditors.

Three major themes of policy reforms emerged from these developments: *first*, the need to move from the self-regulation model to an independent oversight model for the audit profession like the PCAOB; *second*, reducing conflict of interest arising out of non-audit services provided by statutory auditors; and *third*, the competition faced by Indian audit firms from their international counterparts.

First, on the issue of setting up a public oversight body, the *Report on Corporate Audit and Governance* examined the PCAOB structure. However, it accepted the arguments of ICAI that there was no need for a new regulator and, instead, the existing mechanism needs to be strengthened.⁶¹ As a middle path, it recommended setting up an independent QRB under the *Chartered Accountants Act, 1949* to refine the quality of attestation of audits.⁶²

Second, regarding conflict of interest arising out of non-audit services, both *Report on Corporate Audit and Governance* and *Report of the Expert Committee on Company Law* stated that there should not be a blanket ban on rendering non-audit services because it could make auditors more dependent on their audit clients for revenue. Instead, prohibition on certain types of non-audit services was recommended, as was the position under section 201 of *Sarbanes Oxley Act*,

⁶¹High Level Committee on Corporate Audit and Governance, *Report on Corporate Audit and Governance*, pp. 51-52.

⁶²High Level Committee on Corporate Audit and Governance, *Report on Corporate Audit and Governance*, pp. 53-57.

2002. The *Report on Corporate Audit and Governance* was of the view that audit firms having affiliated and associated entities engaged in non-audit services like consultancy were necessary for better growth and knowledge development. To mitigate the potential conflict of interest issues arising out of such non-audit engagements, it recommended that no more than 25% of the revenues of the consolidated entity should come from a single corporate client with whom there is also an audit engagement.⁶³ On the other hand, the *Report of the Expert Committee on Company Law* highlighted the importance of the liabilities and duties of auditors in mitigating conflict of interest concerns and recommended that these should be put in the law itself instead of rules.⁶⁴

Third, the competition faced by Indian audit firms from their international counterparts was a critical concern for policymakers in this phase. The *Report on Corporate Audit and Governance* noted that out of approximately 43,000 Indian audit firms, only 0.5% of the firms had more than 10 partners and more than three-fourth of the firms were self-proprietorship concerns. Given such chronically small size, the report was apprehensive that the Indian firms will not be able to compete with international firms in the lucrative consultancy and non-statutory work market. Therefore it was of the view that policymakers should facilitate consolidation of smaller Indian audit firms. It also recommended introduction of limited liability partnership firms to attract more talent to join the profession.⁶⁵ The *Study Group Report* by ICAI also discussed the competition issues between Indian audit firms and firms part of the international network. It concluded that networking between Indian firms and international firms should be promoted.

The policy deliberations in this phase led to four critical legal reforms from 2005 to 2008. *First*, the ICAI acted upon the recommendations of its *Study Group Report* and issued the rules of networking in 2005 allowing Indian firms registered with ICAI to network with MAFs subject to prescribed disclosures given in the rules.⁶⁶

Second, the *Chartered Accountants Act, 1949* was amended based on the recom-

⁶³High Level Committee on Corporate Audit and Governance, *Report on Corporate Audit and Governance*, pp. 40-41.

⁶⁴Expert Committee on Company Law, *Report of the Expert Committee on Company Law*, pp. 105-108.

⁶⁵High Level Committee on Corporate Audit and Governance, *Report on Corporate Audit and Governance*, pp. 92-93.

⁶⁶Institute of Chartered Accountants of India, *Rules of Network*, p. 21.

recommendations of the High Level Committee on Corporate Audit and Governance (Naresh Chandra committee). The newly inserted section 28A of the *Chartered Accountants Act, 1949* provided for the setting up of a QRB. Broadly inspired by the PCAOB, the QRB is supposed to review the quality of services provided by the members of ICAI.⁶⁷ The QRB consists of 11 members. The chairperson and five members are nominated by the Central Government and the rest five are nominated by the council of ICAI.

Third, the 2006 amendment to the *Chartered Accountants Act, 1949* also streamlined the disciplinary mechanism within ICAI. Once a complaint is filed before the Director of Discipline (DD), it is required to formulate a *prima facie* opinion and then place it before the Board of Discipline (BOD) or Disciplinary Committee (DC) depending on the nature of violation. Earlier, the final decision on punishment was taken by the council of ICAI, which is the highest decision making authority. Since the council consists of many members, the meetings were not frequently held which delayed the decision making process. After the amendment, the power to revoke the membership or impose monetary penalty has been vested with the BOD and DC.⁶⁸

Fourth, the *Limited Liability Partnership, 2008* was enacted. However, it was only in 2012 that the *Chartered Accountants Act, 1949* was amended to allow chartered accountants to incorporate as LLPs, as was originally suggested by the *Report on Corporate Audit and Governance*.

Evidently, the transformation of the regulatory architecture of the Indian audit profession from a self-regulation model to an independent oversight model began in this phase with the establishment of the QRB. In parallel, reforms were also initiated to facilitate the development of Indian audit firms by formally providing a framework for international networking as well as enabling them to structure as LLPs.

3.4.2. Post Satyam: 2009-2013

The unravelling of the *Satyam* scandal from December 16, 2008 started exposing shortcomings in the extant Indian corporate governance regime. These

⁶⁷Section 28B(b) Government of India, *Chartered Accountants Act*.

⁶⁸Sections 21, 21A and 21B, Government of India, *Chartered Accountants Act*.

developments prompted multiple studies of the corporate governance regime in India, that shaped the second phase of policy reforms in this space.

In February 2009, the CII constituted a task force on corporate governance under the chairmanship of Mr. Naresh Chandra. This task force made various recommendations to address the conflict of interests faced by auditors and audit firms. These recommendations fed into the *Corporate Governance Voluntary Guidelines, 2009* issued by the MCA. Since the guidelines were voluntary in nature, they lacked enforcement capacity. Consequently, the Standing Committee on Finance reviewing the *Companies Bill, 2009* recommended incorporating the substantive contents of the *Corporate Governance Voluntary Guidelines, 2009* into the bill. The Standing Committee on Finance also considered suggestions given by various stakeholders for setting up an independent oversight body for auditors and to bring auditing standards within the jurisdiction of company law. In January 2009, the ICAI also set up an expert group to study the functioning of audit firms in India and the different kinds of networks between Indian firms and international audit entities. However, in the absence of sufficient information, no conclusive position was arrived at. The *Expert Group Report* issued in 2011 recommended the council of ICAI to further examine the matter.⁶⁹

Evidently, two major themes of policy reforms emerged during this phase, which ultimately influenced the *Companies Act, 2013* : *first*, the need for an independent oversight body for auditors; *second*, the various legal strategies for addressing auditors' conflict of interest.

First, section 210A of the *Companies Act, 1956* provided for the National Advisory Committee on Accounting Standards (NACAS) which had the mandate to formulate accounting standards for adoption by companies. However, the power of setting auditing standards remained vested with ICAI. The Standing Committee proposed to change this by enhancing the role of NACAS to making recommendations on accounting and auditing standards.⁷⁰ It was also proposed that the name of NACAS be changed to National Advisory Committee on Accounting and Auditing Standards (NACAAS). The standing committee further recommended that NACAAS should also act as a *quasi regulator* to monitor the quality of audit undertaken across the corporate sector.⁷¹

⁶⁹Institute of Chartered Accountants of India, *Expert Group Report*, pp. 143-154.

⁷⁰Standing Committee on Finance, *Standing Committee on Finance 21st Report on The Companies Bill, 2009*, pp. 34-37.

⁷¹Standing Committee on Finance, *Standing Committee on Finance 21st Report on The Companies Bill, 2009*, para 9.23.

Second, on the issue of conflict of interest, *Corporate Governance Voluntary Guidelines* 2009 recommended mandatory disclosure of network agreements and pecuniary interests between audit firms and their respective non-audit network entities. It also recommended a cap on fees earned by an audit firm and all its associated entities from a single audit client. It further suggested that auditors' liability should not be limited to the signing partner but must be extended to the audit firm.⁷² The *Corporate Governance Voluntary Guidelines*, 2009 further recommended the presence of a majority of independent directors in the audit committee and need for certificate of independence by auditors to ensure an arms' length relationship with the client. It also required the auditor to specifically state the impact of non-receipt of certain information from the management. On its part, the Standing Committee not only endorsed the negative list of non-audit services incorporated in the draft bill but also recommended expanding its scope to subsidiary companies of the audit client.⁷³

Evidently, in this phase, the Satyam debacle prompted rethinking of the regulatory architecture beyond the QRB under the aegis of ICAI, towards a PCAOB like regulatory body which will monitor the quality of audit undertaken by auditors and audit firms in India. Even the strategies that were proposed for addressing conflict of interest concerns during this phase were more sophisticated. For instance, a general consensus seemed to have emerged that conflict of interest could arise at the network level and not merely at the firm level. Further, if non-audit services are provided by the statutory auditors to the parent, subsidiary or any associate entity of the audited company, that could also create conflict of interest. These considerations that emerged during the policy deliberations at this stage, went on to inform the reforms in the next phase.

3.4.3. New Companies Act: 2013 - 2018

Three relevant developments stand out in this phase. The *first* was the enactment of the *Companies Act*, 2013. *Second*, the manifestation of the *Satyam* episode in this phase revealed critical limitations and ambiguities in the *Chartered Accountants Act*, 1949. Although some of them have been addressed in the *Companies Act*, 2013, certain other issues are still contested. *Third*, this phase

⁷²Confederation of Indian Industry, *Second Naresh Chandra Committee*, pp. 15-17.

⁷³Standing Committee on Finance, *Standing Committee on Finance 21st Report on The Companies Bill, 2009*, para 10.50.

has also seen an active initiative being undertaken by sectoral regulators like Reserve Bank of India (RBI) and SEBI in improving professional accountability of auditors undertaking activities in their respective sectors. These three issues are not necessarily mutually exclusive and therefore, it is relevant to analyse them in detail to appreciate their implications.

First, the *Companies Act*, 2013 finally provided for establishment of an independent statutory regulator - the NFRA - for matters relating to accounting and auditing standards.⁷⁴ In line with the powers vested with PCAOB under section 101 of *Sarbanes Oxley Act*, 2002, the *Companies Act*, 2013 empowered NFRA to:⁷⁵

1. give recommendations to the Central Government on laying down accounting and auditing standards;
2. monitor and enforce compliance of standards and oversee the quality of service of the profession and give recommendations;
3. investigate professional misconduct committed by the members of ICAI for prescribed class of body corporate or persons; and
4. issue order imposing monetary penalty as well as debarring an individual member or firm registered with ICAI for 6 months to 10 years, for professional or any other misconduct.

Even after being accorded statutory status, the debate on the need for NFRA continued. In 2016, this issue was considered by the Companies Law Committee, which was constituted to suggest amendments to the *Companies Act*, 2013. At that time, ICAI had raised objections on the constitution of NFRA. The Companies Law Committee concluded that auditors play a critical role and due to serious lapses in the past, an independent body to oversee the profession was required. It also observed that major economies in the world have already established such regulatory bodies. The Companies Law Committee accordingly recommended that NFRA should be established at the earliest.⁷⁶ Evidently, there is now wide consensus among experts and policymakers about the merit of an independent statutory regulator like NFRA for the Indian audit profession.

⁷⁴Section 132, Government of India, *Companies Act*.

⁷⁵Section 132, Government of India, *Companies Act*.

⁷⁶Para 9.9, Companies Law Committee, *Report of the Company Law Committee*, p. 41.

Moreover, adoption of NFRA will be in tune with the internationally accepted global best practices in this regard.

The continued debate about the need for NFRA has delayed the implementation of this critical reform. Consequently, although the *Companies Act, 2013* was notified in August 2013, the section establishing NFRA was notified only on March 21, 2018 along with the *NFRA Chairperson and Members Appointment Rules, 2018*.⁷⁷ Currently, the rules on the functioning of NFRA are in draft stage. Once these rules come into effect, NFRA will become fully operational.

The *Companies Act, 2013* also addressed the issue of conflict of interest. Inspired by section 201 of the *Sarbanes Oxley Act, 2002*, section 144 of the *Companies Act, 2013* explicitly prohibits provision of eight types of non-audit services by the statutory auditor. Based on the suggestions of previous committees, the prohibition has been extended to the subsidiary or holding company of the audit client. Further, the restriction is also applicable to associate entities of such auditor.⁷⁸ The law has also introduced audit firm liability for violations under the *Companies Act, 2013*.⁷⁹ Evidently, India has now adopted the current global best practice in this regard too.

In spite of such major strides in legislative reforms through *Companies Act, 2013*, subsequent events in this phase following the unravelling of the *Satyam* scandal have led to the *second* development revealing some limitations and ambiguities in the *Chartered Accountants Act, 1949*. As is evident from Box 2, the most critical limitation under *Chartered Accountants Act, 1949* has been the liability regime on auditors. While monetary liability on an individual auditor is capped at Rs. 5 lakhs, there is no monetary liability on audit firms at all.⁸⁰

However, this loophole will soon be plugged once NFRA becomes fully operational. In case of any professional or other misconduct, NFRA has statutory powers under *Companies Act, 2013* to impose monetary penalty up to five times the fees received by an individual auditor or up to ten times of the fees received by an auditor firm. In addition, such individual auditor or the firm could also be debarred from practising for up to ten years by NFRA.⁸¹ Consequently, the limitations in the liability regime under the *Chartered Accountants Act, 1949*

⁷⁷Rajya Sabha, *Delay in Constitution of NFRA*.

⁷⁸Section 144, Explanation ii, Government of India, *Companies Act*.

⁷⁹Section 140, Explanation II, Government of India, *Companies Act*.

⁸⁰Sections 21A and 21B, Government of India, *Chartered Accountants Act*.

⁸¹Section 132(4)(c), Government of India, *Companies Act*.

Box 2: The Satyam case

After the fraud at Satyam Computers Services Ltd. ('Satyam') came to light, the PwC partners involved in the incident were stripped of their ICAI membership and were even imprisoned. Even SEBI has passed a disgorgement order of Rs. 3,09,01,664/- against one of the member firms of PwC network as well as the individual audit partners involved under section 11B of the *Securities and Exchange Board of India Act*.^a However, disgorgement can only take away illegal gains made by the auditor but cannot indemnify investors for a fraudulent or failed audit. Consequently, investors in Satyam's shares in India were never indemnified for the fraud played on them.

In contrast, since Satyam was listed on New York Stock Exchange, a civil money penalty of \$7.5 million was imposed on PwC by the SEC and PCAOB in 2011.^b Additionally, the investors in Satyam's American Depository Receipts (ADRs) filed a Consolidated Class Action Complaint under Sections 10(b) and 20(a) of the Securities Exchange Act, 1934 against Satyam as well as the auditor PwC firms. The matter finally reached a settlement with Satyam and PwC agreeing to pay the ADR investors \$25.5 million.^c

^aSecurities and Exchange Board of India, *In respect of Price WaterHouse Co and Others*, p. 107.

^bSecurities and Exchange Commission, *In the Matter of Lovelock & Lewes*.

^cUnited States District Court, *In re: Satyam Computer Services Ltd*.

could be adequately addressed by NFRA under the *Companies Act, 2013*.

The *Satyam* episode also highlighted the role played by international networks, over and above audit firms. Questions were raised about the legality of operations of such networks under the *Chartered Accountants Act, 1949*. There were concerns that restrictive conditions imposed by foreign investors tilt in favour of larger audit firms affiliated with these international networks. In this backdrop, the MCA constituted an expert group chaired by Mr. Ashok Chawla in 2016 to look into the regulatory aspects of audit firms. In 2017, the expert group submitted its report which explicitly clarified that the so called MAFs are Indian audit firms with international affiliation but they are controlled and managed by Indian nationals. Further, the report stated that these Indian nationals are members of ICAI and all such network firms have firm registration number issued by ICAI.⁸²

The *Report of MCA's Expert Group on Issues Related to Audit Firms* observed that 'merely being part of a network and sharing global costs does not make them MAFs as they are neither owned or controlled by the global parent'. Therefore,

⁸²Expert Group, *Report of MCA's Expert Group on Issues Related to Audit Firms*, p. 7.

it came to the conclusion that ‘it would not be appropriate to consider the so called MAFs as multinational entities’ since there is no foreign control either through ownership or management and the network partners are run, controlled and managed by Indian nationals.⁸³ In spite of the clarifications in the *Report of MCA’s Expert Group on Issues Related to Audit Firms*, questions about the legality of various operations of these networks still exist. This COE seeks to clarify these issues in detail in the next chapter.

The *third* major development in this phase has been the initiatives taken by sectoral regulators like RBI and SEBI in improving professional accountability of auditors undertaking activities in their respective sectors. Towards the end of 2017, SEBI issued the *Report of the Committee on Corporate Governance* where it recommended that there should be adequate disclosure of total fee (audit and non-audit services) earned by the auditor and all entities on the network firms/network entity of which the auditor is a part of.⁸⁴

In early 2018, SEBI penalised PW for its involvement in the *Satyam* case by prohibiting PW and all its network firms to undertake statutory audit of any listed entity for a period of two years.⁸⁵ Thereafter, in the matter of operation of audit firms who are members of the international network, the Supreme Court delivered its judgment and instructed the Government to constitute a COE to look into regulatory aspects of such audit firms.⁸⁶

In July 2018, SEBI issued a consultation paper seeking comments on its proposal to amend several regulations related to the role of *fiduciary* under the securities laws. The proposed definition of *fiduciary* includes *Chartered Accountant (CA)* as well as *statutory auditor*.⁸⁷ In parallel with SEBI, RBI has also ratcheted up

⁸³Expert Group, *Report of MCA’s Expert Group on Issues Related to Audit Firms*, p. 7.

⁸⁴Securities and Exchange Board of India, *Report of the Committee on Corporate Governance*, pp. 83-84. Pursuant to a recent amendment in 2018, a listed company needs to disclose total fees for all services paid by the listed entity and its subsidiaries, on a consolidated basis, to the statutory auditor and all entities in the network firm/network entity of which the statutory auditor is a part. The amendment shall be applicable in respect of the annual report to be filed for the year 2018- 19 onwards. Securities and Exchange Board of India, *Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements)(Amendment) Regulations, 2018*, Clause (10) of Part C of Schedule V.

⁸⁵Securities and Exchange Board of India, *In respect of Price WaterHouse Co and Others*.

⁸⁶Supreme Court of India, *S. Sukumar v. The Secretary, ICAI and Others*.

⁸⁷The proposed regulation further provides that action shall be taken by SEBI against the fiduciary in case of any violation of the obligations under the regulations. Securities and Exchange Board of India, *Consultative Paper on Proposed SEBI (Fiduciaries in the Securities Market) (Amendment) Regulations*; Recently, in August 2018, SEBI issued

its supervision on auditors in the banking sector.⁸⁸ In June 2018, RBI issued a graded enforcement action framework to enable appropriate action by the RBI in respect of the banks's statutory auditors for any lapses observed in conducting a bank's statutory audit.⁸⁹

In 2018, MCA issued rules on appointment of members of NFRA.⁹⁰ The year 2018 also witnessed the resignation of several statutory auditors of listed entities over a short period of time. MCA has already ordered investigation to ascertain the reasons behind these resignations.⁹¹

Evidently, in this third phase, India has experienced legislative reforms which have upgraded the regulatory structure on auditors and audit firms in tune with the current international best practice. The limitation on the auditor liability regime under the *Chartered Accountants Act, 1949* has now been resolved by establishing and empowering NFRA under the new *Companies Act, 2013*. In parallel, this phase has also seen positive regulatory initiatives across sectors to provide an additional layer of transparency and accountability in the Indian audit profession over and above the statutory scheme under the *Companies Act, 2013* and the *Chartered Accountants Act, 1949*. However, as noted by this COE, doubts persist as to the application of *Chartered Accountants Act, 1949* on networks of audit firms, which will be analysed in the next chapter.

Report of Committee on Fair Market Conduct. The committee has recommended a separate code of conduct to be maintained by designated intermediaries, which includes auditors, dealing with price sensitive information of listed entities. Securities and Exchange Board of India, *Report of Committee on Fair Market Conduct*, 78 and 89.

⁸⁸In March 2018, RBI made joint audit compulsory in an Indian investee company, if the foreign investor specifies a particular firm having international affiliation to be appointed as auditor Reserve Bank of India, *Transfer or Issue of Security by a Person Resident outside India)(Amendment) Regulations, 2018*.

⁸⁹Reserve Bank of India, *Enforcement framework for statutory auditors of commercial banks*.

⁹⁰Ministry of Corporate Affairs, *NFRA Chairperson and Members Appointment Rules*.

⁹¹Times of India, *MCA writes to auditors on exits, 15 cases under lens*.

4. Issues, findings and recommendations

4.1. Whether India has an appropriate mechanism for oversight of the audit profession?

1. The COE is of the view that establishment of NFRA creates no inconsistency between the provisions of the *Companies Act, 2013* and the *Chartered Accountants Act, 1949*.
2. The COE observes that with the recent move towards establishment of NFRA, India has adopted the current global best practice in this regard which can address the problems experienced with self-regulation of the audit profession.
3. The COE observes that NFRA has been structured on the lines of international best practices followed by other independent audit regulators in advanced jurisdictions.
4. The COE recommends that NFRA could be further strengthened and therefore, the rules which are presently being formulated, must provide powers to NFRA to publish audit inspection results, subject to necessary checks and balances. This will strengthen NFRA further and will provide an effective tool of deterrence for better compliance by the auditors of public companies with the applicable laws and professional standards.
5. The COE observed that there are benefits of having multiple competing SROs under one independent regulator like in UK as well as in the new insolvency profession in India. The COE is of the view that a similar model may be considered for the Indian audit profession.

The COE observed that traditionally, professions have been self-regulated. In a self-regulatory model, members of the profession undertake to be a guarantor

for competence and conduct of its members.¹ For instance, professions like auditing have been self-regulated where its members established and monitored professional standards, set entry and ongoing education standards and conducted disciplinary actions. Under the self-regulatory model, rules are drafted by the market practitioners/participants using their expert knowledge.² Further, the administrative costs of regulation are borne by the professional members which reduces the regulatory overheads like inspection and enforcement of the government.³

However, the global trend indicates decline in self-regulatory model and shift towards independent regulatory oversight model in the auditing profession. For instance, independent audit oversight regulation exists in countries representing approximately 80% of global stock market capitalisation.⁴ As discussed in Chapter 3, both U.S. and U.K. have moved towards independent regulatory model. For instance, in U.K., FRC is an independent body that regulates auditors of public companies, and has delegated certain tasks related to auditors of private entities to SROs. These powers can be revoked by FRC. FRC can also impose penalty on SROs, if they fail to meet their duties.⁵ U.S. follows a model where SEC along with PCAOB regulates auditor of public companies, whereas professional bodies continue to regulate auditors of the private entities. Under this model, a regulatory body comprising of appointed members (*independent of the practitioners*) regulate the profession. In other words, unlike in SROs, members are not appointed from the profession through an electoral process. As shown in box 3, this feature of independent regulatory oversight of audit regulators has been internationally recognised.

There are numerous reasons behind this shift towards independent oversight like, financial frauds, trust deficit arising out of auditor's failure to act as gatekeepers and lack of accountability. For instance, after the *Enron* and *WorldCom* frauds in U.S., several jurisdictions gradually shifted towards an independent regulator for auditors. Further, the globalisation of economy fuelled demand for standardisation of financial reporting to protect the interest of global investors.⁶

¹Healy, "2015 Norma Parker Address: Being a Selfregulating Profession in the 21st Century: Problems and Prospects", p. 2.

²Securities Commissions, *Model for Effective Regulation*, p. 3.

³Vass and Bartle, *Self Regulation and the Regulatory State - A Survey of Policy and Practice*, p. 37.

⁴International Federation of Accountants, *Regulation of the Accountancy Profession*, p. 6.

⁵Financial Reporting Council, *Guidelines on Enforcement Measures against Recognised Supervisory Bodies and Recognised Qualifying Bodies*, pp. 5-6.

⁶Humphrey, Loft, and Margaret, "The global audit profession and the international financial

Box 3: Features of independent regulatory oversight

- IFIAR, which is a forum of 52 independent audit regulators, has developed certain *core principles* based on the experience drawn from independent audit regulators in different jurisdictions. It requires that the legal framework should provide the regulator with adequate powers and authority that enable the regulator to perform its audit oversight duties. For instance, it should have powers of inspection and investigation to enforce compliance with professional standards and powers to impose sanctions. Further, it requires that the audit regulator should be operationally independent from the audit practitioners.^a
- Further, the *European Parliament* has laid down certain principles for constituting a public oversight body to regulate the auditing profession. It states that such body should have the *ultimate responsibility* of approval and registration of standards, licensing and registration of statutory auditors as well as for standard setting on ethics and auditing, quality assurance and disciplinary systems.^b

^aSee, Principle 1 and 2, International Forum of Independent Audit Regulators, *Core Principles for Independent Audit Regulators*, p. 3.

^bArticle 32, European Parliament and the Council, *Directive on Statutory audits of annual accounts*.

This trend pushed countries towards a similar regulatory approach in the form of independent regulatory structure.⁷

Further, over the years, several drawbacks with the SRO model have emerged. SROs may claim that their interests are in line with public interest but in practice, it may be otherwise.⁸ It has been observed that when professional bodies are required to self-regulate auditing professions, they are placed in a seemingly contradictory situation. On one hand, they have to regulate and discipline members of the same profession to safeguard the public interest, and at the same time promote their profession to compete with other professions.⁹ Further, if any action is taken against the members, it may not be commensurate with the wrongdoing.¹⁰

architecture: Understanding regulatory relationships at a time of financial crisis”.

⁷Lohlein, “Guarding the Guardians Essays on Audit Regulation”, p. 4.

⁸Adams, “Professional Self-Regulation and the Public Interest in Canada”.

⁹Cooper and Robson, “Accounting, Professions and Regulation: Locating the Sites of Professionalization”, p. 420.

¹⁰DeMarzo, Fishman, and Hagerty, “Self-Regulation and Government Oversight”, p. 688.

Box 4: Prime Minister's speech on ICAI's foundation day

In 2017, the *Prime Minister*, speaking to the chartered accountants on the foundation day of the ICAI, expressed concern over the efficacy of ICAI's disciplinary mechanism. He had said:^a

.....CA is an arrangement in which Human Resource Development (HR) is done only by you. Curriculum is made by you only; you conduct the exam; Rules and Regulations are also made by you, and your institute only punishes the culprits. Now the question arises that the temple of democracy i.e. the Parliament of India, which is the voice of 125 crore countrymen, has given you so much authority, then why is it that in the last 11 years, only 25 Chartered Accountants have been prosecuted. Did only 25 people make a mess? And I have heard that more than 1400 cases are still pending for many years now. A single case takes years to settle.....

^aSee, Modi, *PM's speech at Chartered Accountants' Day at IGI Stadium, Delhi.*

Indian development: National Financial Reporting Authority (NFRA)

The COE noted from Chapter 3 that the rethinking of corporate governance in India began in the aftermath of the Asian financial crisis in 1997-98. Subsequently, the *Enron* scandal triggered the debate on the need for an independent audit regulator. In 2002, the *Naresh Chandra Committee* had reviewed the necessity of having India's own public accounting oversight board similar to PCAOB in U.S., but it did not recommend its establishment keeping in view that setting up such body would have required consolidation of powers vested with different regulators.¹¹ In 2010, the *Standing Committee on Finance* recommended that NACAS should be given mandate to regulate auditing standards, which was then under the jurisdiction of ICAI. The committee also recommended that NACAS should be vested with powers to regulate the quality of audit undertaken in India.¹² Again in 2016, the *Company Law Committee* strongly recommended creation of an independent oversight mechanism in the auditing profession.¹³

Keeping in view the past recommendations of various government committees

¹¹High Level Committee on Corporate Audit and Governance, *Report on Corporate Audit and Governance*, pp. 48-52.

¹²Standing Committee on Finance, *Standing Committee on Finance 21st Report on The Companies Bill, 2009*, paras 34-37.

¹³Companies Law Committee, *Report of the Company Law Committee*, para 9.9.

and the global developments, the *Companies Act 2013* brought in NFRA, an independent regulatory body to regulate the profession of auditors. As noted in Chapter 3, Section 132 of the *Companies Act 2013* vests NFRA with several powers. The present legal framework also empowers NFRA to take action not only against an individual CA, but also against a firm of CAs. The COE is of the view that this power is essential to create sufficient deterrence at the audit firm level and is expected to address one of the most critical limitation under the *Chartered Accountants Act, 1949*. Further, Section 132 provides for an appellate tribunal to address grievances arising out any order passed by NFRA. Therefore, the COE notes that the current legal framework provides for an effective independent regulatory mechanism for auditors which was needed considering the serious lapses in the past and their repercussions.

Although the *Companies Act, 2013* was notified in August 2013, the section establishing NFRA was notified only on March 21, 2018 along with the *NFRA Chairperson and Members Appointment Rules*.¹⁴ The continued debate about the need for NFRA delayed the implementation of this critical reform. Presently, the rules regarding the functioning of NFRA are in draft stage. Once these rules come into effect, NFRA will become fully operational.

Consistency between legislations

The COE has noted that creation of independent regulatory oversight through NFRA is in addition to the existing tier of SRO and does not contradict the *Chartered Accountants Act, 1949*. From the information available in the public domain, the COE noted that under the framework of *Companies Act, 2013*, NFRA would regulate auditors of only listed companies, and public companies beyond a certain threshold. On the other hand, ICAI as SRO under the *Chartered Accountants Act, 1949* would continue to regulate the auditors of public companies below a certain threshold and private companies.¹⁵ Further, the *Companies Act, 2013* regulates the auditors of a company appointed for the limited purpose of statutory audit, on the other hand, the *Chartered Accountants Act, 1949* is a legislation which governs the overall chartered accountancy profession. Also, the powers vested with NFRA under the *Companies Act, 2013* would not exclude the jurisdiction of ICAI under the *Chartered Accountants*

¹⁴Rajya Sabha, *Delay in Constitution of NFRA*.

¹⁵The stated thresholds are yet to be notified by the government. Government of India, *Cabinet approves Establishment of National Financial Reporting Authority*.

Act, 1949, unless when NFRA initiates an investigation into matters of professional misconduct of auditors of only listed companies and public companies beyond a certain threshold.¹⁶ The COE also considered the findings of *Standing Committee on Finance 21st Report on The Companies Bill, 2009* which strongly recommended the need for an independent body to monitor the quality of audit undertaken across the corporate sector.¹⁷

The COE also noted other sectoral developments in the domain of regulating auditors which have been discussed in Chapter 3. For instance, the RBI has issued an enforcement action framework for actions to be taken by RBI against the statutory auditors of banks for lapses observed in conducting a banks statutory audit.¹⁸ Similarly, SEBI is considering amendments to several regulations to include *CAs* as well as *statutory auditor* within the scope of fiduciary to initiate necessary actions against them for breaching the securities laws.¹⁹ This growing inclination of other regulators to initiate action against auditors in the event of lapses, could be an indication of challenges in the current SRO structure of ICAI.

Further, the COE studied the international experience which suggests that, regulators like PCAOB and FRC already follow the *two-tier* structure which consists of both independent audit regulator and SRO. For instance, in U.S., the SEC and PCAOB regulates auditors of public companies registered with SEC, whereas AICPAs is a SRO for the accounting profession. Similarly, in U.K., the FRC is the independent regulator for the audit profession and there are four RSBs under it, which function as SROs. Further, the global literature also states that in this model, the threat of enforcement by the independent audit regulator may lead to more enforcement by the SRO and thereby improve its regulatory efforts.²⁰

For the reasons discussed above, the COE is of the view that establishment of NFRA is an insightful regulatory development and it creates no inconsistency between the provisions of the *Companies Act, 2013* and *Chartered Accountants Act, 1949*. The COE believes that creation of NFRA would have dual benefits.

¹⁶Section 132(4), Government of India, *Companies Act*.

¹⁷Standing Committee on Finance, *Standing Committee on Finance 21st Report on The Companies Bill, 2009*, para 9.23.

¹⁸Reserve Bank of India, *Enforcement framework for statutory auditors of commercial banks*.

¹⁹Securities and Exchange Board of India, *Consultative Paper on Proposed SEBI (Fiduciaries in the Securities Market) (Amendment) Regulations*.

²⁰DeMarzo, Fishman, and Hagerty, "Self-Regulation and Government Oversight".

First, NFRA would align the Indian regulatory architecture in the auditing landscape with the global trend; and *second*, it is expected to address the problems associated with the current SRO mechanism under ICAI.

Strengthening of NFRA

The COE observed that globally there has been a growing acceptance of independent audit regulators, because they are expected to restore investor's confidence and bring more transparency and accountability in the auditing profession.²¹ In light of this, creation of NFRA is a positive development. While NFRA as an audit regulator has been vested with necessary powers, drawing inferences from global best practices may help in creating a more robust regulator.

The COE noted that independent audit regulators in other jurisdictions have been empowered to publish the results of audit inspection. For instance, the *Sarbanes Oxley Act*, 2002 authorises PCAOB to inspect registered firms and publish the results. Further, if such inspection reveals any deficiency or defect which are not remedied within 12 months by the audit firm to the satisfaction of PCAOB, it can publish that portion of the inspection report which deals with *criticism and defects*.²² The public copy is redacted accordingly to protect the confidential and proprietary information of the inspected firms.²³ Other audit regulators like FRC in UK also publishes individual reports of their audit quality inspections of each major audit firms.²⁴ Such publication is subject to necessary confidentiality obligations.²⁵

Empowering NFRA on similar lines can have dual benefits. *First*, reputation is a critical capital for audit firms to generate business.²⁶ Fear of loss of reputation can be an effective deterrence for firms to build better internal checks and balances. *Second*, investors in the capital market can be expected to make more informed choices if they are supplied better quality of information about the performance of auditors of listed entities. Section 132 of the *Companies*

²¹Simnett and Smith, "Public oversight: an international approach to auditing", p. 47.

²²Section 104(g), United States of America, *Sarbanes Oxley Act*.

²³PCAOB, *Report on 2017 Inspection of V. P. Thacker & Co., Chartered Accountants*.

²⁴Financial Reporting Council, *Deloitte LLP Audit Inspection*.

²⁵Section 1224A, United Kingdom, *Companies Act*.

²⁶Kay et al., "Regulatory Reform in Britain", p. 310.

Act, 2013 already vests NFRA with the powers to monitor/inspect the quality of services provided by auditors to ensure compliance with the standards. Therefore, the NFRA rules which are being drafted must include the power to publish inspection results.

Multiple SRO model

The COE also noted that creating an ecosystem of multiple SROs can generate competition among them which is necessary for the development of any profession. The COE studied the UK jurisdiction which follows a multiple SRO structure in the audit profession in the form of RSBs and RQB. ²⁷ Unlike ICAI in India, RSBs and RQB are multiple competing SROs. Further, these are not statutory bodies and given recognition under the *Companies Act*, 2006 after complying with certain eligibility conditions. ²⁸ They can also be de-recognised, if they fail to continue to meet those conditions. ²⁹ The FRC as an independent regulator delegates certain tasks to these RSBs through delegation agreement. ³⁰ Further, the FRC can impose financial penalty on RSBs for breaching its obligations and such enforcement measure is also published in the public domain. ³¹

In the Indian context, instance of multiple SROs can be found in the insolvency profession. *The Insolvency and Bankruptcy Code*, 2016 provides for multiple Insolvency Professional Agencies (IPAs) which regulates the insolvency professionals under SRO model through its bye-laws. ³² The Insolvency and Bankruptcy Board of India (IBBI), an independent statutory regulator, has the power to give certificate of recognition to these IPAs which can be suspended or cancelled on breaching its obligations. ³³ Presently, there are three IPAs in India and one them is ICAI itself. The *Bankruptcy Law Reforms Committee* noted that there is a need to create a *new model* of self-regulation which is unlike the current structure of professional agencies having a legal monopoly

²⁷RSB supervises certain aspects of audit profession, whereas RQB offers qualification and conducts examination.

²⁸Schedule 10, United Kingdom, *Companies Act*.

²⁹Schedule 11, United Kingdom, *Companies Act*.

³⁰Financial Reporting Council, *Delegation Agreement*.

³¹Financial Reporting Council, *Guidelines on Enforcement Measures against Recognised Supervisory Bodies and Recognised Qualifying Bodies*, pp. 5-6.

³²Chapter III, Government of India, *The Insolvency and Bankruptcy Code*.

³³Section 201, Government of India, *The Insolvency and Bankruptcy Code*.

over their respective domains. The rationale behind creating multiple SROs is to ensure healthy development of the profession of insolvency practitioners through efficient regulatory efforts.³⁴

In light of these developments both in the domestic and international landscape of professions, the COE notes that *first*, it is not necessary to have a single statutory SRO. *Second*, there are benefits of having a multiple competing SRO structure which may result in healthy development of the audit profession.

4.2. What structures are used by networks operating in India?

The COE is of the view that there are three types of structures used by networks operating in India:

1. **Type 1 Network:** This category consists of domestic networks which could be formed by CA firms set up by CAs registered with ICAI.
2. **Type 2 Network:** This category consists of international networks where domestic CA firms set up by CAs registered with ICAI network with entities outside India using the membership route.
3. **Type 3 Network:** This category consists of international networks where domestic CA firms set up by CAs registered with ICAI network with entities outside India using the sub-licensing route.

The COE examined the legal structure of the big four global accounting ‘networks’.³⁵ Each such network includes a global umbrella organisation. Three of

³⁴Sections 4.4.3 and 4.4.4, Government of India, *The report of the Bankruptcy Law Reforms Committee*.

³⁵The term ‘network’ has been defined by ICAI as ‘a larger structure: (a) that is aimed at co-operation; and (b) that is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of

these - Ernst & Young Global Limited, PricewaterhouseCoopers International Limited and Deloitte Touche Tohmatsu Limited - are U.K. companies limited by guarantee.³⁶ The fourth, KPMG International Cooperative, is a cooperative under Swiss law.³⁷ These umbrella entities themselves do not provide any client services. Instead, they serve as coordinating entities for a network of independent firms, each of which provides services in a particular jurisdiction subject to the respective local laws.³⁸ Some networks have interposed additional coordinating organisations between the global entity and the individual affiliates that provide client services.³⁹

In India, under section 141(1) of the *Companies Act*, 2013, a statutory auditor could be a CA or an audit firm, with majority of partners who are CAs, set up as a partnership firm under the *Indian Partnership Act*, 1932 or the *Limited Liability Partnership Act*, 2008. Initially, audit firms operated in India with international brand names like Price Waterhouse, Lovelock and Lewess, A.F.Ferguson and Co., Fraser & Ross and Deloitte Haskins and Sells. Some of these audit firms came into existence in the pre-independence era and were already part of the respective international networks. In 1988, ICAI issued new regulations which required new firms to apply to the ICAI for approval to use a firm name.⁴⁰ While the audit firms with international brand names operating in India prior to 1988 were protected, no new firm name reflecting the brand of the *international network* were allowed.⁴¹ Consequently, the networking route took off in India. Subsequently, the ICAI issued the *Rules of Network*, 2005, which was superseded by the *Revised Guidelines of Network*, 2011, to regulate

professional resources'. See clause 2(g), Institute of Chartered Accountants of India, *Revised Guidelines of Network*; this definition is broadly aligned with the definition of 'network' in EU. See Article 2(7), European Parliament, *DIRECTIVE 2006/43/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC*.

³⁶EY, *Legal Statement*; PWC, *How are we structured?*; Delloite, *About Delloite*.

³⁷KPMG, *Structure*.

³⁸Buxbaum, "The Viability of Enterprise Jurisdiction: A Case Study of the Big Four Accounting Firms", p. 1791.

³⁹Buxbaum, "The Viability of Enterprise Jurisdiction: A Case Study of the Big Four Accounting Firms", p. 1791.

⁴⁰Regulation 190, The Institute of Chartered Accountants of India, *Chartered Accountants Regulations*.

⁴¹Pursuant to global reorganisation in Price Waterhouse and Deloitte, the name of their respective networks changed to PricewaterhouseCoopers and Deloitte Touche Tohmatsu. However, since this re-organisation took place after 1988, the Indian audit firms continue to operate under the old firm names.

networks operating in India.

The COE reviewed relevant contracts submitted by SRBC and Co. LLP, Deloitte Haskins & Sells LLP, Price Waterhouse Chartered Accountants LLP, BSR and Co. LLP and MSKA & Associates. Based on a review of these documents, the COE concluded that there are broadly three types of networks operating in India:

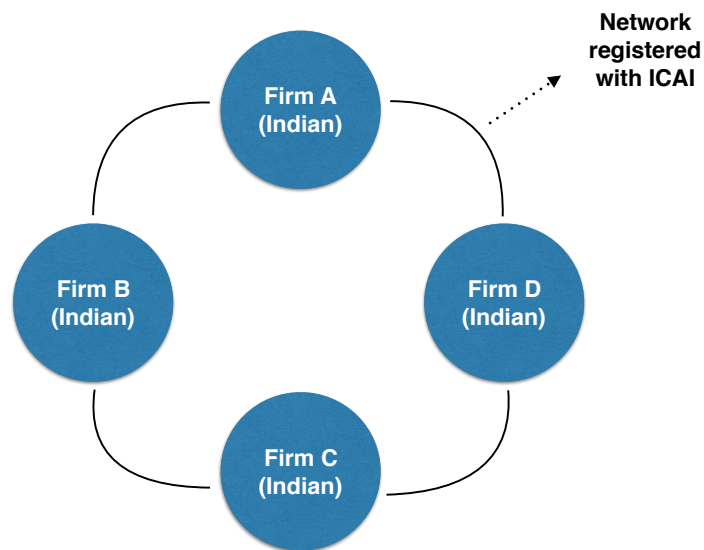


Figure 4.1.: *Type 1 Network*

1. **Type 1 Network:** A domestic network could be formed by CA firms set up by CAs registered with ICAI (see Figure 4.1). The name of such a network must be approved by ICAI. Within 3 months of such approval, the network must be registered with ICAI.⁴²
2. **Type 2 Network:** Domestic CA firms set up by CAs registered with ICAI could also network with entities outside India using the membership

⁴²Guideline 6 Institute of Chartered Accountants of India, *Revised Guidelines of Network*.

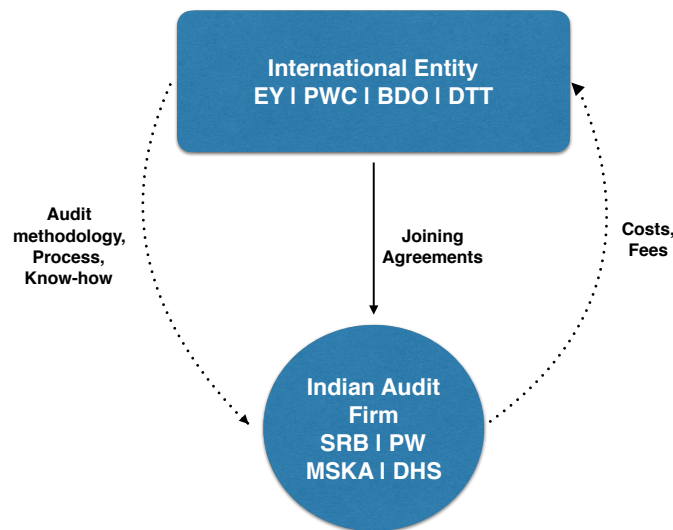


Figure 4.2.: *Type 2 Network*

route.⁴³ In this case, a foreign entity (the international network) enters into a membership arrangement with the domestic CA firm which operates under its local trade name (see Figure 4.2). This is based on contractual agreements (joining/membership agreements) executed between the foreign entity and the domestic CA firm. Unlike Type 1 networks, there is no registration requirement for Type 2 networks in India. A duly authorised representative of the Indian member firm is required to file a declaration with ICAI under Form D within 30 days of entering into the network arrangement.⁴⁴

⁴³Guideline 7 Institute of Chartered Accountants of India, *Revised Guidelines of Network*.

⁴⁴Guideline 7, Institute of Chartered Accountants of India, *Revised Guidelines of Network*.

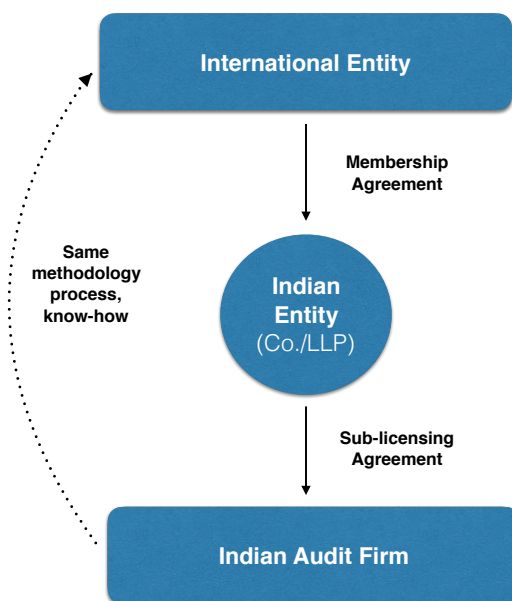


Figure 4.3.: *Type 3 Network*

3. **Type 3 Network:** Domestic CA firms set up by CAs registered with ICAI could also network with entities outside India using the sub-licensing route.⁴⁵ In this case, the domestic CA firm does not enter into direct membership arrangement with the international entity. Instead, it enters into a *sub-licensing agreement* with an Indian entity, which is a member firm of that international network (see Figure 4.3). This *sub-licensing agreement* allows the domestic firm to use the brand name(s) of the international network without entering into any direct contractual relationship with the international entity itself. Moreover, the domestic firm follows the same global procedures and methodologies prescribed by that international network by virtue of the sub-licensing agreement and other contractual arrangements. Therefore, the legal structure used by Type 3 networks is aimed at co-operation and is clearly aimed at common quality control policies and procedures or use of a common brand name, which squarely

⁴⁵Guideline 7, Institute of Chartered Accountants of India, *Revised Guidelines of Network*.

falls within the definition of ‘network’ under the *Revised Guidelines of Network*, 2011. Consequently, there is a legal obligation on the domestic network firm to make appropriate declaration with ICAI.⁴⁶

4.3. Whether Indian network firms are *governed* or *controlled* from outside India?

The COE concludes that the term MAF is a misnomer. The COE agrees with the observation in the *Report of MCA’s Expert Group on Issues Related to Audit Firms*, which had noted that merely being part of a network and sharing of global costs do not make these Indian network firms MAFs as they are neither *owned nor controlled* by the international network/entity. These are Indian firms registered with ICAI with partners who are members of the ICAI.

The COE observed that there is an impression that Indian audit firms which are affiliated with these networks may be *governed* or *controlled* from outside India.⁴⁷ The COE examined if this perception is correct.

The COE noted that ICAI has permitted networking through the *Revised Guidelines of Network* issued in 2011. The term ‘network’ has been defined by ICAI to mean a larger structure clearly aimed at common quality control policies and procedures, common business strategy etc.⁴⁸ Some of the stakeholders have highlighted to the COE that membership of an international network helps them adopt consistent audit methodology globally, common technology, infrastructure, IT tools, quality, risk management and conflict of interest practices.⁴⁹ It is therefore natural that there will be some policies and procedures adopted by the network internationally related to the *supervision and control* of internal processes followed by the member firms globally including those in India. Therefore, such *supervision and control* of internal processes of an Indian chartered accountant firm by the network is a *sine qua non* of networking as defined under the *Revised Guidelines of Network*.

⁴⁶Guideline 7, Institute of Chartered Accountants of India, *Revised Guidelines of Network*.

⁴⁷Institute of Chartered Accountants of India, *Expert Group Report*, paras 4.6, 6.4.

⁴⁸Clause 2(g), Institute of Chartered Accountants of India, *Revised Guidelines of Network*.

⁴⁹Representation to this effect was made before the COE by S R Batliboi.

The COE noted that *supervision and control* of internal processes of network firms is aimed at maintaining consistent standards in audit quality globally within a network. This helps ensure a certain consistency in the level of services offered to clients by the network firms globally. Such *supervision and control* over internal processes for consistent audit quality cannot be equated with *ownership* or *control* for the purposes of corporate law. Instead, such *supervision and control* of internal processes by a network helps improve service quality to consumers.

Therefore, the COE concludes that the term MAF is a misnomer. The COE agrees with the observation in the *Report of MCA's Expert Group on Issues Related to Audit Firms*, which had noted that merely being part of a network and sharing of global costs do not make these Indian network firms MAFs as they are neither *owned nor controlled* by the global parent.⁵⁰ These are Indian firms registered with ICAI with partners who are members of the ICAI.

However, the COE also felt that since international network entities bring better business opportunities in the days of global economy and have ability to invest hugely in technology to improve processes & standards, they may wield influence on the Indian audit firms which are part of the network.

4.4. Whether Indian network firms should be allowed to use the brand name of the network?

- 1. The COE is of the view that branding with international networks would increase competitiveness of the Indian audit firms. Further, Indian companies may benefit from using Indian audit firms which are members of international networks with a brand name.**
- 2. To further facilitate this, the COE recommends that NFRA and ICAI should make appropriate changes to respective laws and regulations, including Regulation 190 of *Chartered Accountants Regulations, 1988* and *Code of Ethics, 2009*.**

⁵⁰Expert Group, *Report of MCA's Expert Group on Issues Related to Audit Firms*, p. 7.

Regulation 190 of *Chartered Accountants Regulations*, 1988 require a CA firm established in India after 1988 to apply to the ICAI for approval to use a firm name.⁵¹ Subsequently, since 2005, ICAI has allowed Indian CA firms to enter into contractual or other arrangements with an international network and become members of the said network.⁵² This *Revised Guidelines of Network*, 2011 allows use of a common brand name.⁵³ Consequently, the Indian network firms providing audit services are often associated with the brand name of the network.

The COE noted here that Regulation 190 does not explicitly prohibit usage of international brand names of networks. It merely restricts the trade/firm name to name of the proprietor or partner(s) of the firm. It also provides several options for using the names, like full surname, full first name, combination of the first name, middle name, initials of full name, etc. The regulation gives power to the council of ICAI to reject a trade/firm name which smack of publicity. Further, the council of ICAI reserves the discretion to refuse registration of a trade/firm name, if that name is *undesirable* in the opinion of the council. However, the regulation does not require the council to provide reason for arriving at such an opinion. In effect, the international audit networks could not obtain registration for their brand names. For instance, an Indian audit firm using the first letter of the surnames of their partners had applied for registration, which resembled with the brand name of an international network.⁵⁴ The application was eventually struck down by ICAI.⁵⁵

The COE observed that the network firms are registered with ICAI and those established post-1988 have also obtained their trade/firm name under Regulation 190. Moreover, pursuant to the *Revised Guidelines of Network*, 2011 issued by ICAI, some of these Indian firms have entered into network arrangements with international networks, which *inter alia* associate those Indian firms with the brand names of their respective networks. In Type 3 networks, the sub-licensing agreement could specifically allow for use of brand name(s) of the international

⁵¹Regulation 190, The Institute of Chartered Accountants of India, *Chartered Accountants Regulations*.

⁵²Paragraph 1.4, Appendix I, Institute of Chartered Accountants of India, *Revised Guidelines of Network*.

⁵³Clause 2(g) read with clause 5, Institute of Chartered Accountants of India, *Revised Guidelines of Network*.

⁵⁴Financial Express Bureau, *Kapadia, Perrera, Makhijani & Girish May Help KPMG Beat ICAI Rules*.

⁵⁵The COE learned about the outcome of this application based on inputs from the stakeholders.

network by the Indian firm.

The COE observed that Part I of the First Schedule to the *Chartered Accountants Act, 1949* provides that:

A chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he:

(7) advertises his professional attainments or services, or uses any designation or expressions other than chartered accountant on professional documents, visiting cards, letter heads or sign boards, unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the Institute of Chartered Accountants of India or of any other institution that has been recognised by the Central Government or may be recognised by the Council

Similarly, the explanatory notes to Clause 7 of the ICAI's *Code of Ethics, 2009* state:

For use of logos by Members on letter heads, visiting cards etc. the Council had decided that the logos unconnected with the first letter of the name of the firm or its partners or proprietors would not be permitted for use by members in practice/firms of Chartered Accountants on their letter heads, visiting cards etc. as the same would have amounted to advertisement or smacking of publicity.

In view of these restrictions on individual CAs, the COE deliberated on whether use of brand name(s) of the international network by an Indian network firm is desirable. It was noted that audit firms with a reputed international brand name enjoy a premium globally as well as in India. Companies are willing to pay a higher price to engage them as auditors. This could potentially be because of three reasons. *First*, they are considered to be a potential indemnifier of losses for the stakeholders of the company. *Second*, they provide a better quality of audit which improves the quality of reported earnings. *Third*, companies may use audit firms with a reputed international brand name to 'signal' a superior quality of reported information. Recent research has shown that in the Indian context the demand for the big four auditors in India is primarily driven by the

third factor - the need to 'signal' a superior quality of reported information.⁵⁶

Evidently, Indian companies benefit from the 'signalling' effect of using auditors with international brand names. The markets perceive information audited by the big four to be of a higher quality. Therefore, 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. Prohibiting Indian audit firms from using international brand names may therefore be counter-productive for Indian companies. Moreover, it was recommended in the *Report of MCA's Expert Group on Issues Related to Audit Firms*, that branding with international affiliation would increase competitiveness of the Indian audit firms. This would also help in capacity building of the Indian audit firms through adoption of advanced audit methodologies, improve infrastructure and attract high calibre aspirants.⁵⁷ This in turn can also help the smaller and mid-sized Indian audit firms in expanding their size and business. The COE further noted that U.S., U.K. as well as China allow such branding by network members. For instance, BDO China Dahua CPA Co. Ltd., Ernst & Young Hua Ming LLP; KPMG Huazhen etc are some examples of co-branding model being used in China.⁵⁸ In view of these reasons, the COE recommends that Indian network members should be allowed to use the brand name of their respective network. To further facilitate this, the COE recommends that NFRA and ICAI should make appropriate changes to respective laws and regulations, including Regulation 190 of *Chartered Accountants Regulations, 1988* and *Code of Ethics, 2009*.

4.5. Should Chartered Accountants and firms be allowed to advertise?

The COE recommends that CAs and CA firms should be permitted to advertise their services and solicit work subject to the following conditions:

- 1. A CA or CA firm shall not solicit work by advertising or other**

⁵⁶Jacob, Desai, and Agarwalla, "Are Big 4 Audit Fee Premiums Always Related to Superior Audit Quality? Evidence from India's Unique Audit Market".

⁵⁷Expert Group, *Report of MCA's Expert Group on Issues Related to Audit Firms*, p. 15.

⁵⁸Securities and Exchange Commission, *In the Matter of BDO China Dahua CPA Co. Ltd.*

forms of solicitation in a manner that is false, misleading, or deceptive.

2. A CA or CA firm shall not promote or market abilities to provide professional services or make any claim which is false, misleading or deceptive.
3. A CA or CA firm shall not make exaggerate claims for services offered.
4. A CA or CA firm shall not indulge in disparaging references or unsubstantiated comparison to the work of others.

Explanation: Promotional efforts or advertisement would be false, misleading, or deceptive if they contain any claim or representation that would likely cause a reasonable person to be misled or deceived.

This would necessitate amendment to Part I of the First Schedule to the *Chartered Accountants Act, 1949*, and *Code of Ethics, 2009*.

Part I of the First Schedule to the *Chartered Accountants Act, 1949* provides for professional misconduct in relation to chartered accountants in practice. With relation to advertising, it states *inter alia*:

A chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he:

...

*(6) solicits clients or professional work either directly or indirectly by circular, **advertisement**, personal communication or interview or by any other means:*

Provided that nothing herein contained shall be construed as preventing or prohibiting -

(i) any chartered accountant from applying or requesting for or inviting or securing professional work from another chartered accountant

in practice; or

(ii) a member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence;

(7) advertises his professional attainments or services, or uses any designation or expressions other than chartered accountant on professional documents, visiting cards, letter heads or sign boards, unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the Institute of Chartered Accountants of India or of any other institution that has been recognised by the Central Government or may be recognised by the Council:

Provided that a member in practice may advertise through a write up setting out the services provided by him or his firm and particulars of his firm subject to such guidelines as may be issued by the Council;

The COE noted that since these restrictions stem from the *Chartered Accountants Act, 1949*, they apply to network members which are Indian CA firms registered with ICAI under the *Chartered Accountants Act, 1949*.⁵⁹ However, network members which are Indian entities but are not practicing as CAs (for example, offering consultancy services), are not bound by these prohibitions under the *Chartered Accountants Act, 1949*. This creates an opportunity for networks to engage in a regulatory arbitrage. As the *Report of MCA's Expert Group on Issues Related to Audit Firms* observed, these networks take advantage of this differential regulatory standards by making surrogate advertisements by virtue of their consultancy services, circumventing the prohibitions on advertisements by ICAI.⁶⁰ Although, such practice may not be illegal, such regulatory arbitrage may raise questions about the efficacy of such restrictions on advertisements in the first place.

The COE is of the view that to create a level playing field between network firms and non-network firms as well as individual CAs, it is essential that advertisements by all CAs are allowed subject to reasonable restrictions. This is

⁵⁹Such firms have to register with ICAI under Regulation 190 read with Form 18, The Institute of Chartered Accountants of India, *Chartered Accountants Regulations*.

⁶⁰Expert Group, *Report of MCA's Expert Group on Issues Related to Audit Firms*, p. 7.

in tune with the decision by ICAI to relax restrictions on advertising, issuance of brochures and hosting of websites by Indian CA firms.⁶¹ Recently, the ICAI has issued the draft *Code of Ethics*, 2017 derived from the International Ethics Standards Board for Accountants (IESBA) code of ethics issued by the IFAC.

The COE has looked at the global best practices on advertisement and marketing in the auditing landscape. For instance, the Accounting Professional and Ethical Standards Board (APESB) in Australia allows solicitation of work by public accountants through advertisement, but requires conformity with two necessary conditions. *First*, there should be no exaggerated claims for services offered. *Second*, such practices should not amount to disparaging references or unsubstantiated comparison to the work of others. Further, it provides that in the event of any doubt, the member is required to consult the professional body.⁶² Similarly in the U.S., there is no restriction on solicitation of work through advertisement and promotion, subject to certain conditions. The code laid down by AICPA states that a member shall not solicit work by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive. Further, it prohibits member from promoting or marketing abilities to provide professional services or make any claim which is false, misleading or deceptive. The code also clarifies that:⁶³

promotional efforts would be false, misleading, or deceptive if they contain any claim or representation that would likely cause a reasonable person to be misled or deceived.

The COE after looking at the international best practices observed that it would be inappropriate to impose blanket restriction on solicitation of work by CAs or CAs firms through advertisement, provided certain conditions are met to avoid self-interest threat. Further, it also noted that the global trend indicates *principle based* restriction on solicitation of work against a prescriptive approach which is currently the position under the *Chartered Accountants Act*, 1949 and *Code of Ethics*, 2009. Therefore, there is a need to move towards a principle based approach and give freedom to the CAs or CAs firms to solicit work through advertisement subject to certain checks and balances.

⁶¹Expert Group, *Report of MCA's Expert Group on Issues Related to Audit Firms*, p. 13.

⁶²Section 250, Accounting Professional & Ethical Standards Board Limited, *APES 110 Code of Ethics for Professional Accountants*.

⁶³Section 1.600, American Institute of Certified Public Accountants, *AICPA Code of Professional Conduct*.

Box 5: IESBA code of ethics on marketing

The IESBA code of ethics has been issued by IFAC, which is an independent standard-setting board. IFAC develops and issues ethical standards and other pronouncements for professional accountants worldwide. It has prescribed the following code for marketing professional services:^a

- When a professional accountant in public practice solicits new work through advertising or other forms of marketing, there may be potential threats to compliance with the fundamental principles. For example, a self-interest threat to compliance with the principle of professional behavior is created if services, achievements or products are marketed in a way that is inconsistent with that principle.
- A professional accountant in public practice should not bring the profession into disrepute when marketing professional services. The professional accountant in public practice should be honest and truthful and should not:
 - Make exaggerated claims for services offered, qualifications possessed or experience gained; or
 - Make disparaging references to unsubstantiated comparisons to the work of another.

^aSection 250, International Federation of Accountants, *IESBA Code of Ethics*.

4.6. Should auditors, firms and networks be prohibited from providing non-audit services to auditee companies?

The COE recommends the following measures to address the problem of conflict of interest in providing non-audit services to an auditee company or its holding company or subsidiary company:

1. If the auditor is a part/member of an international network, the non-audit fees earned by such network from a listed auditee company or its holding company or subsidiary companies in a financial year shall be maximum 50% of the statutory audit fee earned by that network from that auditee company or its holding company or subsidiary companies in a financial year.
2. Such auditor must separately disclose to NFRA the audit as well as non-audit fees earned by its network from each of its listed auditee company or its holding or subsidiary companies.

The auditor shall also file a declaration with NFRA stating that revenue earned from non-audit services is not in excess of 50% of the statutory audit fee earned by its network from that listed auditee company or its holding company or subsidiary companies in a financial year.

3. The prohibited list of non-audit services under section 144 of the *Companies Act, 2013* must include all kinds of taxation, valuation and restructuring services provided to the auditee company or its holding company or subsidiary companies. For this, the appropriate rules should be made.
4. Details of approval given by audit committee or the board of directors to auditors for providing non-audit services should be separately disclosed in the board report of the auditee company or its holding company or subsidiary companies. The board report should also contain a description of the necessary safeguards in place to protect the independence and objectivity of such auditors providing non-audit services to the auditee company or its holding company or subsidiary companies. This will require necessary rules under section 134 of the *Companies Act, 2013*.

Explanation: Entities in the network should include:

- Entities covered in Explanation (i) and (ii) of section 144 of the *Companies Act, 2013* depending on whether the auditor is an individual or firm.
- Entities covered within the meaning of ‘network’ under the *Revised Guidelines of Network, 2011* whether registered with ICAI or not.
- Affiliates which, regardless of its legal form, are connected to a network firm by means of common ownership, control or management.

Explanation: NFRA would regulate auditors of all listed companies, and unlisted public companies beyond a certain threshold, as prescribed by the government.

Since the collapse of *Enron* and the demise of *Aurthur Andersen*, there has been public concern about the extent to which audit firms are providing non-audit services to their audit clients. Such non-audit services could range from system design to compliance related services like taxation and accounting. The concerns regarding such non-audit services are two-fold: *first*, auditors may not stand up to the management of the auditee company because the auditors wish to retain the additional income from non-audit services to the company; *second*, providing a range of services to the management may lead to the auditor identifying too closely with the management's interests and lose their professional skepticism. For instance, in the Enron case, it has been widely reported that Andersen received \$25 million in audit fees and \$27 million for non-audit services.⁶⁴ These developments fuelled concerns that provision of non-audit services compromise auditor independence and nudged the legislative changes.

Policymakers globally have responded by prohibiting auditors from performing some specific non-audit functions. For instance, *Sarbanes Oxley Act*, 2002 in U.S. prohibited auditors from providing eight specific categories of non-audit services to their auditee companies.⁶⁵ A similar list was also introduced in 2016 in the European Union for auditors of public listed companies. This prohibits eleven category of services comprising of further sub-categories.⁶⁶ Auditors were prohibited from providing non-audit services like tax, consultancy, and advisory services to the audited entity; services that involve playing any part in the management or decision-making of the audited entity; services linked to the financing, capital structure and allocation, and investment strategy of the audited entity.⁶⁷ Similar position has been adopted in jurisdictions like U.K. and Australia.⁶⁸

Policymakers globally have also intensely debated the need to impose a cap on the non-audit fees of audit firms. For instance, the SEC has long been concerned about the potential impact of audit and non-audit fees on auditor independence. It has repeatedly asserted that auditors must be independent in fact and in appearance. Independence-in-fact is defined by SEC as the auditor's mental

⁶⁴Chung and Sanjay Kallapur, "Client Importance, Nonaudit Services, and Abnormal Accruals", p. 948.

⁶⁵See, 12 CFR 621.31

⁶⁶Article 5, European Parliament and the Council, *Regulation (EU) No 537/2014 Of the European Parliament and of the Council*.

⁶⁷European Commission, *Reform of the EU Statutory Audit Market - Frequently Asked Questions*.

⁶⁸Auditing Practices Board, *APB Ethical Standard 5*, p. 1; Accounting Professional & Ethical Standards Board Limited, *APES 110 Code of Ethics for Professional Accountants*, p. 41.

state lacking any bias, while independence-in-appearance is a public perception that the auditor is objective and unaffected by a financial interest in the client. However, a recent study has argued that auditors' *independence-in-appearance is related to client importance* (total fees from a client as a percentage of the total revenues of the audit firm) rather than non-audit fee ratio (non-audit to total fees from a client).⁶⁹

Box 6: Cap on non audit services in EU

The European Union has introduced caps on fees from non-auditing services to Public Interest Entities (PIEs) as well as a disclosure obligation on the total fees received from PIEs.^a Some of the salient features of this scheme are:

- When a statutory auditor or an audit firm has been providing non-audit services to the audited PIE for a period of three or more consecutive financial years, the total fees for such services shall be limited to a maximum of 70% of the average of the fees paid in the last three consecutive financial years for the statutory audit(s).
- There is, however, no fixed limit with regard to the amount of fees that a statutory auditor or an audit firm can receive from a given audited PIE. Instead, when the total fees received - both for audit and non-audit services - by a statutory auditor or an audit firm from a single PIE in each of the last three consecutive financial years exceed 15% of the total fee income received by that statutory auditor or audit firm, that fact should be disclosed to the audit committee.
- The audit committee should then consider submitting the audit engagement to a quality control review. If the fees received continue to exceed 15%, the audit committee should also consider whether the audit engagement should be kept; if so, the audit engagement can remain in place, but for a period no longer than 2 years.^b

^aPIEs are defined as listed companies, credit institutions and insurance undertakings. In addition, Member States can designate as PIEs other undertakings that are of significant public relevance, because of the nature of their business, their size or the number of their employees.

^bEuropean Commission, *Reform of the EU Statutory Audit Market - Frequently Asked Questions*.

Indian position

The Indian debate on conflict of interest related to non-audit services was triggered immediately after the *Enron* scandal. In 2002, the committee headed

⁶⁹Ghosh, S. Kallapur, and Moon, "Audit and non-audit fees and capital market perceptions of auditor independence".

by *Naresh Chandra* deliberated over the issue of non-audit services and recommended the position adopted in U.S. under the *Sarbanes Oxley Act, 2002*.⁷⁰ Consequently, India adopted a similar approach by prohibiting auditors from performing specific non-audit services in the new *Companies Act, 2013* (see, table 4.1).⁷¹ If the auditor is a firm, this prohibition is applicable to its associated entity or any entity whatsoever in which the firm has significant influence or control or whose brand name is used by such audit firm or its partners.⁷²

Companies Act, 2013	Sarbanes Oxley Act, 2002
Book-keeping	Book-keeping
Internal Audit	Internal audit
Financial information systems	Financial information systems
Actuarial services	Actuarial services
Investment and banking Advisory	Investment and banking Advisory
Outsourced financial services	Appraisal or valuation services, fairness opinion
Management function	Management or human resource function
Any other services	Legal/expert services unrelated to audit

Table 4.1.: Comparison of prohibited non-audit services

While section 144 of the *Companies Act, 2013* provides an exhaustive list of prohibited non-audit services, it also authorises the government to prescribe any other kind of services in this list. The COE has noted that there could be a case of *self-review risk* if certain services are allowed to be provided by the auditor. Therefore, there is a need to revisit the list keeping in view the various kinds of services rendered by auditors which can possibly result in conflict of interest. The international practice (EU, Australia, U.K.) shows prohibition on non-audit services like taxation, restructuring and valuation since they are likely to influence the objectivity and independence of auditors. Presently, these services are permitted in India. Therefore, the COE is of the view that

⁷⁰High Level Committee on Corporate Audit and Governance, *Report on Corporate Audit and Governance*, pp. 40-41.

⁷¹Section 144, Government of India, *Companies Act*.

⁷²Section 144, Explanation(ii) Government of India, *Companies Act*.

the list prescribed under section 144 of the *Companies Act*, 2013 needs to be expanded.

Presently, there is a cap which requires that non-audit services fee earned by statutory auditor along with its associate concern or corporate bodies must not exceed the aggregate statutory audit fee.⁷³ However, this cap was set in 2002 by ICAI and since then the market of non-audit services has evolved. Therefore, the COE is of the view that this cap on non-audit services needs to be reviewed. Taking into account, the international position, especially in European Union and U.K., the COE recommends a cap on fee earned from non-audit services which shall not be more than 50% of the audit fee paid to the auditor by the listed auditee company or its holding or subsidiary company.

Further, there is no provision in the *Companies Act*, 2013 which mandates disclosure of non-audit fee earned by the auditor in the financial statements of the auditee company. Recently in 2018, SEBI amended regulations which would now require a listed company to disclose total fees for all services paid by the listed entity and its subsidiaries, on a consolidated basis, to the statutory auditor and all entities in the *network firm/network entity* of which the statutory auditor is a part.⁷⁴ However, this disclosure obligation is on the listed entity. The COE recommends that a statutory auditor must separately disclose to NFRA the audit as well as non-audit fees earned from each of its auditee company or its holding or subsidiary companies. From the information available in the public domain, the COE noted that under the current Indian framework, NFRA would regulate auditors of all listed companies, and public companies beyond a certain threshold, as prescribed by the government.⁷⁵

The COE noted that under the *Companies Act*, 2013, an auditor has to obtain prior approval of the audit committee or board of the directors for providing non-audit services.⁷⁶ Similar approvals are required in other jurisdictions also. For instance, in U.S. under the *Sarbanes Oxley Act*, 2002, audit committee approves the types of non-audit services which can be provided to the auditee

⁷³Institute of Chartered Accountants of India, *Notification No. 1-CA (7)/60/2002*, para 3.

⁷⁴The amendment shall be applicable in respect of the annual report to be filed for the year 2018-19 onwards. Securities and Exchange Board of India, *Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements)(Amendment) Regulations, 2018*, Clause (10) of Part C of Schedule V.

⁷⁵The thresholds are yet to be notified by the government. Government of India, *Cabinet approves Establishment of National Financial Reporting Authority*.

⁷⁶Section 144(1), Government of India, *Companies Act*.

company. Further, such approval has to be disclosed by the auditee company to investors in periodic reports.⁷⁷ Similar practice is also followed in U.K. where *The UK Corporate Governance Code, 2016* requires audit committee to develop and implement the policy on engagement of external auditor to supply non-audit services. Further, the annual report must contain a separate section describing how the audit committee has safeguarded the objectivity and independence of auditors providing non-audit services.⁷⁸ Therefore, keeping in view the best international practices, the COE recommends that the approval of audit committee or board of directors given to auditors to provide non-audit services should be separately disclosed in the annual report of the auditee company along with a description of the necessary safeguards in place to protect the independence and objectivity of the auditors.

The *Enron* scandal lead to *Sarbanes Oxley Act, 2002* which reduced the scope of non-audit services to address the issue of conflict of interest. This nudged several international audit firms to sell off their consultancy venture. However, over the years, they have re-established their presence in this domain.⁷⁹ These consulting entities are members of the global *network*.⁸⁰ The COE after examining inputs from various stakeholders observed that there is a likelihood that substantial amount of non-audit services are provided to an auditee company by network entities belonging to the same *network* of which the auditor is also a member/part.⁸¹ The COE is of the view that such a likelihood of serious conflict of interest within a network compromises the independence - in-fact as well as in-appearance - of auditors/audit firms within that network.

Further, the government may consider placing a cap on the maximum number of statutory audit of public companies by an audit firm.

⁷⁷Section 201, United States of America, *Sarbanes Oxley Act*.

⁷⁸Section C.3.2 and 3.8 Audit Committee and Auditors, Financial Reporting Council, *The UK Corporate Governance Code*.

⁷⁹Mahanta, *Big four accounting firms PwC, Deloitte, KPMG, E&Y back in consulting business*.

⁸⁰Ernst & Young, *EY Member Firms and Affiliates*; PricewaterhouseCoopers, *List of active client facing entities within the PwC network*.

⁸¹Ernst & Young, *EY Member Firms and Affiliates*; PricewaterhouseCoopers, *List of active client facing entities within the PwC network*.

4.7. Is the current Indian legal regime of liability of auditors, audit firms and the networks adequate?

1. The COE concludes that the current Indian legal regime on liability of individual auditors and audit firms is adequate.
2. The COE on the issue of network liability recommends that NFRA should be explicitly empowered by law to impose civil liability in the form of monetary penalties on the international network/entity with whom/which the Indian audit firm has entered into networking/membership, if any audit failure or fraud is found to have been caused due to any faulty methodology being followed by that particular network.

Explanation: The amount of penalty to be imposed on such international network/entity shall be upto five (5) times the amount of penalty imposed on the audit firm.

3. To enable NFRA to perform this function, every auditor and audit firm, which is operating in India as a part/member of an international network, must submit an Annual Transparency Report to NFRA, disclosing the following:
 - A description of the network, its legal and structural arrangements, including payment of any fees, costs, grants, etc between the Indian audit firm and its network entities, directly or indirectly;
 - Details of ownership and management structure of the outside entity or entities constituting the network;
 - The name and registered office, central administration or principal place of business, of each network member operating in India as a sole practitioner or audit firm;
 - The name and registered office, central administration or principal place of business, of each affiliate of the network

operating in India;

- The total turnover achieved by network members operating as sole practitioners and audit firms as well as network affiliates operating in India; and
- The internal standard audit methodology followed by all the network firms globally and in India.

For these disclosure requirements, the COE recommends necessary provision in the NFRA rules which are presently under consideration.

Explanation I: NFRA would regulate auditors of all listed companies, and public companies beyond a certain threshold, as notified by the government.

Explanation II: ‘Affiliate’ means any entity, regardless of its legal form, which is connected to a firm by means of common ownership, control or management.

Legal liability on auditors for an audit failure or fraud is necessary mainly for three reasons. *First*, legal liability on auditors is necessary to deter any intentional breach of duties or fraudulent behaviour. *Second*, legal liability is necessary to disgorge any unlawful gains made by an auditor. However, it is not enough to merely restore the auditor back to the position it was before committing a breach or fraud. *Third*, it is important to ensure that direct victims of an audit failure or fraud are also compensated by the auditor. Such compensation by the auditor for audit failure or fraud represents a form of implicit insurance to outside investors. Such an insurance provided by the auditor enables the entrepreneur to raise capital from such investors at lower cost.⁸²

However, excessive imposition of liability on auditors could be counterproductive. *First*, excessive legal liability could drive auditors out of the market, making it more concentrated with fewer auditors. *Second*, a higher risk of legal liability on auditors could drive up their audit fees, making mandatory audit costly for all companies. *Third*, auditors may refuse to audit riskier companies, making

⁸²Laux and Newman, “Auditor Liability and Client Acceptance Decisions”.

it difficult for such companies to raise capital. Recent research shows that the relationship between the strength of the legal liability regime and the client rejection rate is U-shaped. In other words, clients are less likely to be rejected in environments with moderate legal regime, as compared to environments with relatively strong or relatively weak legal regime.⁸³

Taking into account the pros and cons of legal liability on auditors, the COE is of the view that it is important that the Indian legal regime on auditors' liability should take a balanced approach. From this perspective, the COE analysed the current Indian legal regime on auditors' liability to identify the nature of sanctions that could be imposed against individual auditors as well as audit firms in case of a fraud. The COE reviewed the relevant provision under *Chartered Accountants Act, 1949* as shown in Table 4.3 and those under *Companies Act, 2013* as shown in Table 4.4.

Sections	Application	Criminal sanction	Civil sanction
21A	CA found guilty of professional or other misconduct under Schedule I	NA	Board of Discipline can reprimand the CA, remove the name of the CA from the register up to a period of 3 months, and/or impose fine up to Rs. 1 lakh
21B	CA found guilty of professional or other misconduct under Schedule II or both Schedules I and II	NA	Disciplinary Committee can reprimand the CA, remove the name of the CA from the register permanently or temporarily, and/or impose fine up to Rs. 5 lakhs

Table 4.3.: *Chartered Accountants Act 1949*

⁸³Laux and Newman, "Auditor Liability and Client Acceptance Decisions".

Table 4.4.: Companies Act 2013

Sections	Application	Criminal sanction	Civil sanction
132(4)(c)	Professional or other misconduct	NA	For individual auditor, penalty not less than Rs. 1 lakh but extendable to five times the fees; for audit firm, penalty not less than Rs. 5 lakhs but extendable to ten times the fees; debar individual chartered accountant or firm for a period of minimum 6 months and upto 10 years maximum.
140(2) r/w	Failure to file timely statement on resignation as statutory auditor	Fine not less than Rs. 50,000/- or remuneration of auditor, whichever is less.	NA
140(3)	Failure to report fraud discovered	Fine not less than Rs. 1,00,000/- but which may extend to Rs. 25,00,000/- .	NA
143(12) r/w	Failure to report fraud discovered which performing duties as auditor of a company		
143(15)			
147(2) r/w	Contravention of sections 139 (Appointment of auditors), 143 (Powers and duties of auditors and auditing standards), 144 (Auditors not to render certain services) and 145 (Auditor to sign audit report etc)	Fine which shall not be less than Rs. 25,000/- but which may extend to Rs. 5,00,000/- or four times the remuneration of the auditor, whichever is less.	Where an auditor has been convicted u/s. 147(2), such auditor is liable for: (i) disgorgement; (ii) damages for loss caused to the company, its members or creditors, and statutory bodies or authorities.
147(3)			
147(5)	Acting, abetting, colluding in any fraud by or in relation to the company, its directors or officers	The partner(s) and the audit firm will be jointly and severally liable for fine. For criminal sanctions other than fine, only the concerned partner(s) will be liable.	The partner(s) and the audit firm will be jointly and severally liable for civil penalty.
245(1)(g)(ii)	Improper or misleading statement in audit report or any fraudulent, unlawful or wrongful conduct.	NA	A class of members or depositors may claim damages, compensation or suitable action against auditors if the company was conducted in a prejudicial manner.

447 or 448	Guilty of fraud or punishment for false statement	For fraud amount more than Rs. 10,00,000/- or 1% of turnover, imprisonment for a term not less than 6 months but which may extend to 10 years; and fine not less than the amount involved in the fraud but may extend up to 3 times the amount involved in the fraud; Imprisonment not less than 3 years for fraud involving public interest; For fraud amount less than Rs. 10,00,000/- or 1% of turnover or does not involved public interest, imprisonment may extend to 5 years or fine up to Rs. 20,00,000/- or both.	NA
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As is evident from these tables there are various criminal sanctions that could be imposed on individual auditors as well as audit firms involved in any audit failure or fraud. It is important to note that the amount levied in the form of 'fine' goes to the consolidated fund of India and not to the investors of the company.⁸⁴ Therefore, these criminal sanctions can only have a deterrence function and do not serve any indemnification function.

In contrast, there are three provisions on civil sanctions that provide for indemnification to users of the faulty audited financial statements. These are section 132(4)(c), section 147(3)(ii) and section 245(1)(g)(ii) under the *Companies Act, 2013* as shown in Table 4.4. The COE noted that section 132(4)(c) empowers NFRA to impose monetary penalty on auditors as well as audit firms including debarment. Under section 147(3)(ii) an auditor or audit firm which is convicted under section 147(2), is liable to pay damages to the potential users of its audited financial statements. Finally, section 245(1) could be used by NCLT to award damages or compensation against auditor including audit firms for improper or misleading statements made in audit report or for any fraudulent, unlawful or wrongful act or conduct.

On review of the above provisions, the COE is of the view that the current Indian regime on auditor liability provides for all three functions - deterrence, disgorgement as well as indemnification. Accordingly, the COE concludes that the current Indian legal regime on liability of individual auditors and audit firms is adequate.

Network liability

The COE noted that an audit failure or fraud could happen because of two reasons. *First*, it could be due to lapses on the part of the auditor or audit firm because of which proper audit methodology is not followed or observed. As discussed earlier, there are various provisions in the law to hold the auditor or audit firm liable for such a lapse being a fault on the part of the auditor or the audit firm. *Second*, an audit failure or fraud could also happen because the audit method followed by auditor or audit firm as part of a network is itself flawed. Since this is a fault of the method being followed by the network itself, in such cases, it is important that NFRA has the power to extend the

⁸⁴Controller General of Accounts, *List of Major and Minor Heads of Account of Union and States*, p. 102.

liability on the network. Therefore, the COE recommends that NFRA should be explicitly empowered by law to impose civil liability in the form of monetary penalties on the international network/entity with who/which the Indian audit firm has entered into networking/membership agreement, if any audit failure or fraud is found to have been caused due to any faulty methodology being followed by that particular network.⁸⁵

Box 7: Network liability on Big Four

The COE noted that network liability of big four firms has been recognised in other jurisdiction also. In 2017, the Italian Competition Authority (ICA) imposed a fine of 23 million Euro on the big four firms for indulging in cartelisation in a tender contract. The big four had entered into a horizontal and secret agreement aimed at conditioning the dynamics of the tender in order to avoid competition in the award of contracts.^a The ICA observed that in Italy a consulting firm and an audit firm co-exist in every big four network: this division is for regulatory reasons. It was found that despite this formal subdivision, all the companies involved in the proceedings belonging to the same networks had acted in a coordinated manner as a single economic entity.^b To arrive at this conclusion, the ICA observed that each entity in the network is identified by the same brand, shared professional and structural resources, shared common offices, adopted unitary communication strategies and used the same website as a tool to promote the entire range of services offered by the network. Therefore, each network which consisted of (KPMG & KPMG Advisory); (EY & EY Business Advisory); (PWC & PWC Advisory); and (Deloitte & Touche and Deloitte Consulting) was made jointly and severally liable for paying the penalty.^c

^aScavuzzo, “The Italian Competition Authority (AGCM) has fined the ‘Big Four’ consultancy firms following a serious infringement of Article 101 TFEU in a public tender for audit services”, p. 6.

^bDepau, “Bid Rigging Practices Aimed at Manipulating Consip’s Tender in the Market of Cleaning Services For Public Institutions (I785)”.

^cDepau, “Bid Rigging Practices Aimed at Manipulating Consip’s Tender in the Market of Cleaning Services For Public Institutions (I785)”.

The COE observed that European Union has imposed a higher liability on auditors of listed companies. To achieve this, the *Regulation (EU) No 537/2014 Of the European Parliament and of the Council* has imposed legal obligations on auditors and audit firms to disclose financial information at the level of the network to which such auditors belong.⁸⁶ The COE is of the opinion that a similar disclosure obligation has to be placed on all members of a network

⁸⁵The jurisdiction of NFRA covers auditors of listed companies and public companies beyond a certain threshold as prescribed by the government.

⁸⁶European Parliament and the Council, *Regulation (EU) No 537/2014 Of the European Parliament and of the Council*, para 17.

operating in India to enable NFRA to impose monetary penalty on such members in the event of a process failure at the network level leading to an audit failure or fraud.

The COE recommends that every auditor and audit firm, which is operating in India as a member/part of an international network, must submit an *Annual Transparency Report* to NFRA, disclosing the following:⁸⁷

- A description of the network, its legal and structural arrangements, including payment of any fees, costs, grants, etc between the Indian audit firm and its network firms and affiliates, directly or indirectly;
- Details of ownership and management structure of the outside entity or entities constituting the network;
- The name and registered office, central administration or principal place of business, of each network member operating in India as a sole practitioner or audit firm;
- The name and registered office, central administration or principal place of business, of each affiliate of the network operating in India;
- The total turnover achieved by network members operating as sole practitioners and audit firms as well as network affiliates operating in India; and
- The internal standard audit methodology followed by all the network firms globally and in India.

Explanation II: ‘Affiliate’ means any entity, regardless of its legal form, which is connected to a firm by means of common ownership, control or management.

This information available from the *Annual Transparency Report* will help NFRA keep track of the auditors and audit firms operating in India as part of the same network so that in case any legal liability needs to be imposed on that particular network for an audit failure or fraud.

⁸⁷Similar disclosure requirements exist in European Union. See Article 13 European Parliament and the Council, *Regulation (EU) No 537/2014 Of the European Parliament and of the Council*.

4.8. Whether network firms violate section 25 of the Chartered Accountants Act, 1949?

The COE observed that when a CA signs a document as such, claiming to practice on behalf of a company or a limited liability partnership which has a company as its partner, it would amount to a violation of section 25. Although no instance of such malpractice was brought before the COE, the COE recommends that to prevent any such potential malpractice, ICAI should amend the *Chartered Accountants Regulations, 1988* to explicitly prohibit a CA from signing on behalf of any company.

Section 25 of the *Chartered Accountants Act, 1949* states:

(1) No company, whether incorporated in India or elsewhere, shall practise as chartered accountants.

[Explanation - For the removal of doubts, it is hereby declared that the 'company' shall include any limited liability partnership which has company as its partner for the purposes of this section.]

(2) If any company contravenes the provisions of sub-section (1), then, without prejudice to any other proceedings which may be taken against the company, every director, manager, secretary and any other officer thereof who is knowingly a party to such contravention shall be punishable with fine which may extend on first conviction to one thousand rupees, and on any subsequent conviction to five thousand rupees.

Since the application of this section depends on the meaning of the words 'practise as chartered accountants', it is relevant to consider section 2(2) of *Chartered Accountants Act, 1949* which states:

(2) A member of the Institute shall be deemed 'to be in practice', when individually or in partnership with chartered accountants [in practice] [or in partnership with members of such other recognised professions as may be prescribed], he, in consideration of remuneration received or to be received -

(i) engages himself in the practice of accountancy; or

(ii) offers to perform or performs services involving the auditing or verification of financial transactions, books, accounts or records, or the preparation, verification or certification of financial accounting and related statements or holds himself out to the public as an accountant; or

(iii) renders professional services or assistance in or about matters of principle or detail relating to accounting procedure or the recording, presentation or certification of financial facts or data; or]

(iv) renders **such other services** as, in the opinion of the Council, are or may be rendered by a chartered accountant [in practice];

and the words 'to be in practice' with their grammatical variations and cognate expressions shall be construed accordingly.

Explanation: An associate or a fellow of the Institute who is a salaried employee of a chartered accountant [in practice] or [a firm of such chartered accountants or firm consisting of one or more chartered accountants and members of any other professional body having prescribed qualifications] shall, notwithstanding such employment, be deemed to be in practice for the limited purpose of the [training of articled [assistants].

The *Study Group Report*, 2003 had suggested that section 2(2) of the *Chartered Accountants Act*, 1949 could be interpreted such that all functions specified under section 2(2) are reserved for chartered accountants only subject to those exceptions specifically excluded by any statute.⁸⁸ The COE found it difficult to agree with the said interpretation.

The COE noted that section 2(2) does not prohibit persons, who are not members of ICAI (hereinafter referred to as 'lay persons'), from providing the services mentioned in section 2(2)(i)-(iv). It merely *deems* a member of ICAI to be in practice if she is engaged in providing the said services. In contrast, if the same services are provided by a lay person, such lay person is

⁸⁸Institute of Chartered Accountants of India, *Study Group Report*, (ii), 27.

not deemed to be in practice. A contrary interpretation would suggest that ICAI has unfettered discretion under section 2(2)(iv) to expand the exclusive areas of practice for chartered accountants to any other profession or vocation. Such an interpretation would be arbitrary and unworkable. Therefore, the COE is of the view that section 2(2) does not provide any exclusive domain of practice to chartered accountants and any lay person can also provide the services mentioned therein.

This is relevant because certain other statutes bestow chartered accountants with the exclusive privilege of auditing accounts or attesting documents. For example, under *Companies Act, 2013* only a CA is eligible for appointment as an auditor of a company.⁸⁹ Similarly, under *Income Tax Act, 1961* only a chartered accountant can audit accounts of certain persons carrying out business or profession.⁹⁰ Therefore, most of the exclusive privileges enjoyed by chartered accountants stem from various other statutes than from the *Chartered Accountants Act, 1949*.

The COE noted that section 25 is violated if a company or a limited liability partnership which has a company as its partner, practices as CAs. In other words, when a CA signs a document as such claiming to practice on behalf of a company or a limited liability partnership which has a company as its partner, it would amount to a violation of section 25. No instance of such malpractice was brought before the COE. However, in light of this discussion, the COE is of the view that to prevent any such potential malpractice of the nature mentioned above, ICAI should amend the *Chartered Accountants Regulations, 1988* to explicitly prohibit a CA from signing on behalf of any company.

4.9. Whether audit firms by being members of international networks violate the reciprocity requirement under section 29 of the Chartered Accountants Act, 1949?

The COE concluded that the Indian audit firms which are members of international networks are set up as partnerships or LLPs under

⁸⁹Section 141(1) Government of India, *Companies Act*.

⁹⁰section 44 read with section 288 Government of India, *Income Tax Act*.

Indian laws and all their partners are members of the ICAI. Therefore, the COE is of the view that there is no question of violation of the reciprocity requirement under section 29 of the *Chartered Accountants Act, 1949*.

Section 29 of the *Chartered Accountants Act, 1949* states as follows:

(1) Where any country, specified by the Central Government in this behalf by notification in the official Gazette, prevents persons of Indian domicile from becoming members of any institution similar to the Institute of Chartered Accountants of India or from practising the profession of accountancy or subjects them to unfair discrimination in that country, no subject of any such country shall be entitled to become a member of the Institute or practise the profession of accountancy in India.

(2) Subject to the provisions of sub-section (1), the Council may prescribe the conditions, if any, subject to which foreign qualifications relating to accountancy shall be recognised for the purposes of entry in the Register.

Evidently, this provision is aimed at persons who are subjects of any foreign jurisdiction. Such persons shall be entitled to become a member of ICAI or practice as an accountant in India only if that foreign jurisdiction does not prevent such privilege being extended to persons domiciled in India.

The COE noted that ICAI has taken active initiatives by entering into Memorandums of Understanding (MoUs) with its counterpart institutions in several foreign jurisdictions.⁹¹ Several of such MoUs have also been approved as Mutual Recognition Agreements (MRAs) by the Union Cabinet of India. As a result of such MRAs, Indian qualified chartered accountants are recognised as chartered accountants in those foreign jurisdictions subject to certain examination requirements.

As has been mentioned earlier, Indian audit firms which are members of international networks are set up as partnerships or LLPs under Indian laws and all their partners are members of the ICAI. Therefore, the COE is of the view that

⁹¹ICAI, *MoU/MRA/Joint Declarations signed with Foreign Bodies*.

there is no question of violation of the reciprocity requirement under section 29 of the *Chartered Accountants Act, 1949*.

4.10. What measures could be taken to promote multi-disciplinary practice firms?

The COE recommends that development of MDPs should be facilitated in India by rationalising the *Advocates Act, 1961* using the template of UK *Legal Services Act, 2007* as a starting point.

The *Report of MCA's Expert Group on Issues Related to Audit Firms* expressed the vision that India as a global power in services should aspire to have its own audit firms at international level which provides services internationally, particularly in developing countries. Yet, Indian audit firms continue to remain chronically small. The country has as many as 43,000 audit firms, of which as many as three-fourths are single person proprietary firms. Less than 200 firms (0.5%) have more than 10 partners.⁹²

One major hurdle in the growth of Indian audit firms is the lack of development in MDPs in India. Quality auditing requires specialists in many areas like law, valuation, IT systems, actuarial etc. The need for specialisation increases with the complexity of the business model of the client. For instance, audits of clients with complex IT systems like banks and insurance companies require extensive involvement of IT specialists. A narrow approach to audit would have serious implications for attracting talent and developing expertise. Without such expertise and breadth of talent, Indian chartered accountant firms, especially the non-network firms, would be unable to provide depth of industry expertise to their clients. Not only is this detrimental for the growth of Indian audit firms but even for the Indian economy as a whole. A fast growing economy like India is developing highly complex businesses in the financial as well as non-financial sectors. Auditors need to develop adequate capacity to be able to effectively assess the risks in such businesses and must act swiftly to resolve issues as they arise. Recent reforms like the Insolvency and Bankruptcy Code, 2016 highlight the importance of chartered accountants, valuers and lawyers working together efficiently in resolving the huge volumes of stressed assets across sectors. Even

⁹²High Level Committee on Corporate Audit and Governance, *Report on Corporate Audit and Governance*, p. 92.

during the stakeholders' meetings it emerged that most of them including audit firms, professional institutes and industry associations favour development of MDPs in India. Therefore, the COE is strongly of the view that MDPs are the need of the hour for the Indian economy.

The COE noted that in recent times legislative and regulatory reforms have been initiated to recognise MDPs. Section 141(1) of the *Companies Act, 2013* envisages the possibility of MDP. Even the *Chartered Accountants Act, 1949* was amended in 2012 to allow CAs to form partnerships with members of other recognised professions as may be prescribed by ICAI.⁹³ Similarly, Regulations 53A and 53B were added to the *Chartered Accountants Regulations, 1988* to allow partnership, fee and profit sharing as well as sharing of services among chartered accountants, company secretaries, cost and work accountants, advocates, architects and actuaries.⁹⁴

However, the COE noted that the current laws and regulations of the Indian legal profession are not conducive to MDPs. For instance, in 2015 Society of Indian Law Firms (SILF) had reportedly complained to the Delhi Bar Council against PwC, Delloite, KPMG and EY for unauthorised practice of law. The main argument was the these firms had violated section 29 of the *Advocates Act, 1961* and therefore, criminal sanctions under section 45 of *Advocates Act* should be imposed on them.⁹⁵ Even before the Hon'ble Supreme Court of India in *Bar Council of India v. A.K. Balaji and Ors.* it was alleged that many accountancy and management firms are employing law graduates who are rendering legal services in alleged violation of the *Advocates Act, 1961*.⁹⁶ In spite of these legal complications, law firms are diversifying into MDPs like forensic operations and undertaking commercial diligence and investigations for their clients. For instance, AZB & Partners reportedly hired up six forensic experts from EY.⁹⁷ In light of these complications, fundamental legal reforms would be necessary to facilitate development of MDPs in India.

To understand how other jurisdictions have reformed their laws and regulations to promote MDPs, the COE reviewed the developments in UK in view of the common law origins of the Indian legal profession. Prior to 2009, non-lawyer

⁹³Section 2(2), Government of India, *Chartered Accountants Act*.

⁹⁴Regulation 53A(1)(a)-(e), The Institute of Chartered Accountants of India, *Chartered Accountants Regulations*.

⁹⁵Mohan, A., *Big 4 firms face charges of unauthorized practice of law*.

⁹⁶Supreme Court of India, *Bar Council of India v. A.K. Balaji and Ors.* paras 7-8.

⁹⁷Vyas, M., *Turf War: Law firms take on Big 4 - EY, KPMG, PwC & Deloitte expansion*.

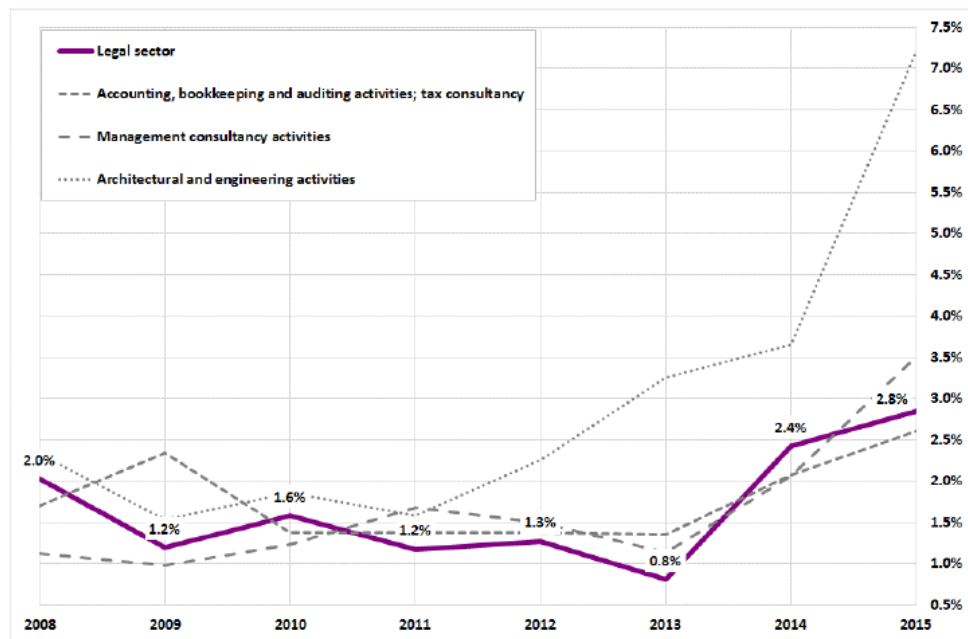


Figure 4.4.: Total net capital expenditure as a percentage of annual turnover (ONS, UK Wide) for selected service industries (Source: Legal Services Board)

partnerships were prohibited in UK. However, this changed when the Legal Services Board (LSB) established under the *Legal Services Act, 2007* issued new regulations in 2011 allowing complete non-lawyer ownership of law firms. Such firms are designated as Alternative Business Structures (ABS).⁹⁸

The COE observed that after UK allowed complete non-lawyer ownership of law firms through the ABS structure, the capital expenditure in the UK legal sector has grown substantially as is evident from Figure 4.4. Prior to gaining their ABS licence, 63% of ABSs offered legal services while the remaining 37% did not offer any form of legal services before being granted an ABS licence. The main motivations for seeking an ABS licence were to promote non-lawyers to management of the business, boosting market profile, accessing external investment and succession planning. Figure 4.5 shows the steady growth in number of ABS licences issued by different licensing bodies till April 2017.⁹⁹

⁹⁸Legal Services Board, *Evaluation: ABS and investment in legal services 2011/12-2016/17 - Main report*, p. 12.

⁹⁹Legal Services Board, *Evaluation: ABS and investment in legal services 2011/12-2016/17 - Main report*, pp. 14-15.

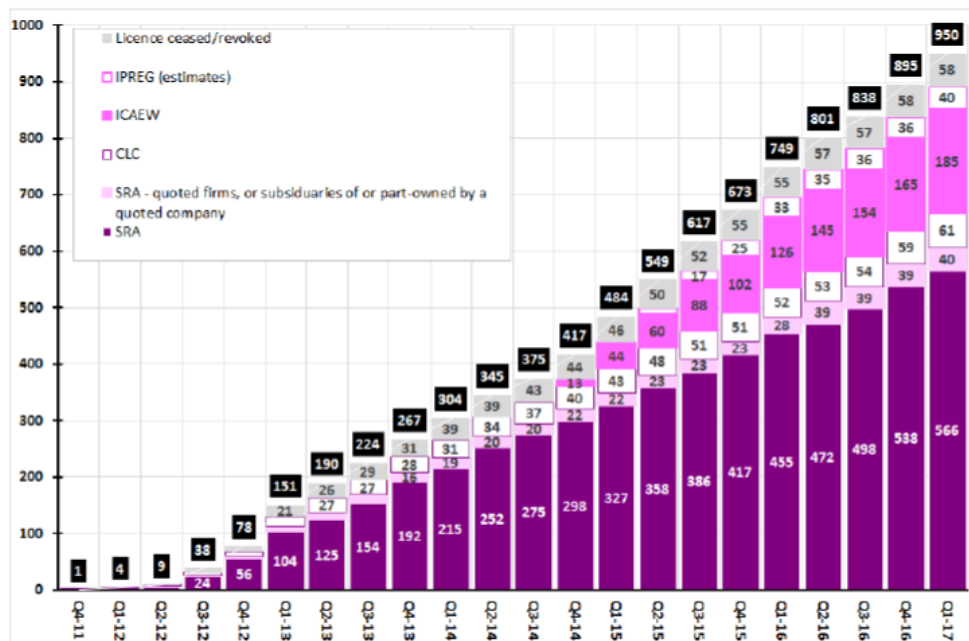


Figure 4.5.: The growth in the number of ABS licences (Source: Legal Services Board)

Taking into account the stakeholders' demands as well as global developments, the COE is of the view that MDPs would be beneficial for Indian corporates. In sync with this demand, law firms as well as audit firms are already expanding the portfolio of services they offer to their clients. However, archaic laws and regulations, especially the ones on the legal profession, impose unnecessary hurdles in the smooth development of MDPs. For Indian firms to evolve into global leaders in auditing, legal, consultancy, and ancilliary services, it is necessary to rationalise the *Advocates Act, 1961* to facilitate development of Indian law firms as well as audit firms into MDPs. The UK *Legal Services Act, 2007* provides a useful template which could serve as a starting point for Indian legal reforms.

4.11. How should FEMA and its regulations be enforced on auditors, firms and networks?

In view of the claim by the audit firm that the foreign funds have been received by it in the form of grants and not as capital, RBI has stated that then it is not a question of violation or enforcement of FEMA per se. However, this has to be seen by the Ministry of Home Affairs (MHA) from the perspective of the *Foreign Contribution (Regulation) Act, 2010*. From the point of view of the COE, only MHA can verify the veracity of this claim of the audit firm to settle it towards finality.

Under the Foreign Direct Investment (FDI) policy, a non-resident entity can invest in India, except in those sectors/activities which are prohibited.¹⁰⁰ This seems to suggest that there is currently no restriction in foreign investment in auditing and consultancy services. However, as per para 5.2 of *Consolidated FDI Policy, 2017*, FDI is further subject to sectoral laws and regulations. The COE also noted that presently an entity incorporated outside India may contribute to the capital of an LLP operating in sectors/activities where foreign investment upto 100% is permitted under the automatic route.¹⁰¹

The Supreme Court in its judgment dated February 23, 2018 raised the issue of remittance from outside India and its alleged application to acquire Indian audit firms. The Supreme Court observed:

It is an undisputed fact that there are remittances from outside India. The same could be termed as investment even though the remittances are claimed to be interest free loans to partners. The amount could also be for taking over an Indian chartered accountancy firm. Relationship of partnership firms, though having Indian partners, operating under a common brand name from same infrastructure, with foreign entity is not ruled out. It is not possible to rule out violation of FDI policies, FEMA Regulations and the CA Act. Thus, appropriate action may have to be taken in pending proceedings or initiated at appropriate forum. (para 45)

¹⁰⁰Government of India, *Consolidated FDI Policy*, para 3.1.1.

¹⁰¹Regulation 5(6), Reserve Bank of India, *Foreign Exchange Management (Transfer or Issue of Security by a person resident outside India) Regulations*.

In the present context, having regard to the statutory framework under the CA Act, current FDI Policy and the RBI Circulars, it may prima facie appear that there is violation of statutory provisions and policy framework effective enforcement of which has to be ensured.
(para 50)

For this purpose, the COE sought clarification from the concerned audit firm (Price Waterhouse) and in its submission it has been stated that funds received by it from outside India are in the nature of grants.¹⁰² The COE is not in a position to comment on the reply of PW about the nature of funds.

The COE also consulted RBI as a relevant stakeholder, for its clarification on the issue of alleged violation of *Foreign Exchange Management Act, 1999*/rules/regulations or FDI policy by the audit firms which are part of the international network. The COE also sought suggestions from RBI for better enforcement of the FDI policy and the FEMA regulations.

The RBI in its response stated that:¹⁰³

As per the submissions made in this matter, the Audit companies have claimed that the foreign funds have been received by them in the form of grants and no capital instruments have been issued. Therefore, it is not a question of violation or enforcement of FEMA Regulations per se. However, this issue may come under the purview of Foreign Contribution Regulation Act (FCRA) administered by MHA and it can be examined from the perspective of donation/grant. As far as outward payments by such Audit companies (in the form of membership fees) is concerned, MCA may consider seeking clarification from these companies as to the manner and amounts which is being sent and under which legal provisions.

In view of the claim by the audit firm that the foreign funds have been received by it in the form of grants and not as capital, RBI has stated that then it is not a question of violation or enforcement of FEMA per se. However, this has to be seen by the MHA from the perspective of the *Foreign Contribution*

¹⁰²Submission by Price Waterhouse Chartered Accountants LLP, dated August 2, 2018.

¹⁰³RBI's email to the COE dated October 15, 2018.

(Regulation) Act, 2010. From the point of view of the COE, only MHA can verify the veracity of this claim of the audit firm to settle it towards finality.

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Appendices

A. Annexure A - Supreme Court Judgment

A.1. Supreme Court Judgement

1

REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE/ORIGINAL JURISDICTION

CIVIL APPEAL NO. 2422 OF 2018
(ARISING OUT OF SPECIAL LEAVE PETITION (CIVIL) NO.1808 OF
2016)

S. SUKUMAR ...APPELLANT

VERSUS

THE SECRETARY, INSTITUTE OF CHARTERED
ACCOUNTANTS OF INDIA & ORS. ...RESPONDENTS

WITH

WRIT PETITION (CIVIL) NO. 991 OF 2013

CENTRE FOR PUBLIC INTEREST LITIGATION ...PETITIONER

VERSUS

UNION OF INDIA & ORS. ...RESPONDENTS

J U D G M E N T

ADARSH KUMAR GOEL, J.

1. Leave granted in SLP (Civil) No.1808 of 2016 filed against the order dated 3rd August, 2015 of the High Court of Karnataka in Writ

Petition No.17959 of 2012. The petition before the High Court sought direction for exercise of power under Section 21 of the Chartered Accountants Act, 1949 ('CA Act') to initiate investigation against Multi-National Accounting Firms (MAFs) and Indian Chartered Accountancy Firms (ICAFs) having arrangement with such MAFs for breach of Code of Professional Conduct under the CA Act and also to take penal action by way of cancellation of permission granted to them by the Institute of Chartered Accountants of India (ICAI). Since the issue raised in Writ Petition (Civil) No.991 of 2013 is identical, both the matters have been heard together. In the Writ Petition, some other connected issues have also been raised to which reference will be made in due course.

The Issue

2. The issue raised in the appeal arising out of Karnataka High Court Judgment and the Writ Petition filed directly in this Court is: Whether the MAFs are operating in India in violation of law in force in a clandestine manner, and no effective steps are being taken to enforce the said law. If so, what orders are required to be passed to enforce the said law.

The Pleadings

3. Briefly, the averments in the High Court writ petition are: The MAFs are illegally operating in India and providing Accounting, Auditing, Book Keeping and Taxation Services. They are operating with the help of ICAFs illegally. Operations of such entities are, *inter alia*, in violation of Section 224 of the Companies Act, 1956, Sections 25 and 29 of the CA Act, the Code of Conduct laid down by the ICAI. Reference has been made to the Report dated 15th September, 2003 of Study Group of the ICAI on the subject (hereinafter referred to as 'Study Group Report'). The Study Group was constituted by the Council of the ICAI in July, 1994 to examine attempts of MAFs to operate in India without formal registration with the ICAI and without being subject to any discipline and control. This was in the wake of liberalization policy and signing of GATT by India. It was noted that the bodies corporate formed for management consultancy services were being used as a vehicle for procuring professional work for sister firms of Chartered Accountants (CAs). Members of ICAI were associating with such bodies as Directors, Managers etc. to provide escape route to MAFs. CA functions must be discharged by animate persons and not in anim bodies.

4. The concerns of various segments of CAs noted by the Study

Group are :

- “(a) Sharing fees with non-members;*
- (b) Networking and consolidation of Indian firms;*
- (c) Need to review the advertisement aspect;*
- (d) Multi disciplinary firms with other professionals;*
- (e) Commercial presence of multi-national accounting firms;*
- (f) Impact of similarity of names between accountancy firms and MAFs/Corporates engaged in MSC-Scope for reform and regulation;*
- (g) Strengthening knowledge base and skills;*
- (h) Facilitating growth of Indian CA firms & Indian CAs internationality;*
- (i) Perspective of the Government, corporate world and regulatory bodies and role of ICAI in shaping the view;*
- (j) Introduction of joint audit system;*
- (k) Recognition of qualifications under Clause (4) of Part I of the First Schedule to the Chartered Accountants Act, 1949 for the purpose of promoting partnership with any persons other than the CA in practice within India or abroad;*
- (l) Review the concept of exclusive areas for the keeping in view the larger public interest involved so as to include internal audit within it;*
- (m) Conditionalities prescribed by certain financial institutions/Governmental agencies insisting appointment of select few firms as auditors/concurrent auditors/consultants for their borrowers.”*

5. The Study Group considered whether goal should be to focus on ethics or growth of the profession with Code of Ethics being guiding points and not barriers. Further issues were what should be the regulatory regime; whether networking could be allowed to benefit Indian CAs; whether MAFs may be required to furnish particulars about their ownership, persons responsible and other financial particulars. It was noted that the Code of Ethics under First Schedule to the CA Act prohibits sharing of fee with persons other than members of the ICAI. Only cost for obtaining assistance/advice to international affiliates could be given. Indian Firms with International Affiliates (IFIA) may be required to adhere to bench mark in regard to audit procedures, quality standards etc. Decision making and real control should be with Indian firms. Number of audits qua each partner should be fixed. Mentioning of affiliation with any person not member of ICAI may amount to advertising which was not permissible. It could be permitted if entities were registered with ICAI. It was also suggested that concept of Multi disciplinary firms was required to be explored for rendering integrated service with suitable safeguards. Steps to upgrade knowledge were also suggested. However, it was suggested that commercial presence of MAFs should not be

allowed *de facto* or *de jure*. Reference was made to Sarbanes Oxley Act, 2002 in USA making a foreign public accounting firm preparing audit report to be accountable to the Public Company Accounting Oversight Board and the Securities and Exchange Commission. Thus, MAFs could not be allowed without registration with ICAI. Non Indian CAs should not authenticate any financial statement of any Indian entity. MAFs' claim to provide audit services through affiliates amounts to indirect entry in India without requisite reciprocity for Indian accountancy firms. It was suggested that even where MAFs affiliate with Indian CA, same brand should not be allowed as in other services. Use of name identical to MAFs was brand building exercise which gave impression that Indian CA firm was not independent. Separation of identity was a must. Use of statutory visiting cards etc. must display separation of identity. Under collective label of management consultancy services, CA services should not be allowed as Code of Ethics for auditors cannot be enforced in this manner. Audit cannot be done in non professional way. Advertisement and publicity was harmful to the cause of the profession so that user relies only on real worth of services. It is further noted that though the CAs are not allowed to share fees or

profits with anyone other than a member of the institute, some of the members were lending their names to the MAFs who are non-members and enabling them to illegally operate in the field of Chartered Accountancy and sharing fees and profits with them. Indian CAs have not been provided reciprocity in the countries to which the MAFs belong as per Section 29 of the CA Act.

6. Reference has also been made to a report on operations of MAFs in India dated 29th July, 2011 submitted by Expert Group of the ICAI (for short Expert Group Report) in the wake of the 'Satyam Scam', and decisions of the ICAI laying down the Code of Conduct. The Expert Group Report noted that the MAFs are rendering services which are rendered by the CAs in terms of Section 2(2) of the CA Act such as accountancy, auditing, professional services about matters of accounting procedure, presentation or certification of financial facts or data. The MAFs are corporates/juridical persons. They solicit professional work in international brand name. They have registered Indian CA firms with ICAI with the same brand names which are their integral part. There is no regulatory regime for their accountability. Thus, the principle of reciprocity under Section 29 of the CA Act, Section 25 prohibiting corporates from chartered accountancy practice and

Code of Ethics prohibiting advertisement and fee sharing are flouted. The MAFs also violate FDI policy in the field of accounting, auditing, book keeping, taxation and legal services. Detailed reference to the said report will be made in the later part of the judgment.

7. The stand of the ICAI in the form of a status report filed before the High Court is that 161 out of 171 firms were examined by the High Powered Committee in pursuance of report of the Expert Group dated 29th July, 2011 with regard to alleged violations and some of the cases were referred to the Director (Discipline) for further action. Remaining 10 firms were in the process of being examined. Thus, the ICAI has already taken action on its part.

8. The High Court observed that in view of the stand of the ICAI, no further action was necessary and disposed of the writ petition.

9. In the writ petition filed directly in this Court, apart from the averments noted above, it has been stated that PricewaterhouseCoopers Private Limited (PwCPL) and their network audit firms operating in India, apart from other violations, have indulged in violation of Foreign Direct Investment (FDI) policy, Reserve Bank of India Act (RBI)/Foreign Exchange Management Act

(FEMA) which requires investigation. Firms operating under the brand name of PwCPL received huge sums from abroad in violation of law and applicable policies but the concerned authorities have failed to take appropriate action. M/s. Pricewater House, Bangalore was the Auditor of the erstwhile Satyam Computer Services Limited (Satyam) for more than eight years but failed to discover the biggest accounting scandal which came to light only on confession of its Chairman in January, 2009. The said scandal attracted penalty of US Dollars 7.5 Million (approx. Rs.38 crores) from the US Regulators apart from other sanctions. Since certification by Auditors is of great importance in the matter of payment of subsidies, export incentives, grants, share of government revenue and taxes, sharing of costs and profits in PPP (Public Private Partnership) contracts etc., oversight of professionals engaged in such certification has to be as per law of the land. Accordingly, even though investigation was sought by the petitioner vide letter dated 1st July, 2013, no satisfactory investigation has been done.

10. PwCPL is the brand under which member firms of PricewaterhouseCoopers International Limited, U.K. (PwCIL), an

English private company provides professional services in respect of audit, tax and advisory services. 'PwC India' firms are network member firms of the PwCIL. There are 10 Audit Firms namely Price Waterhouse (PW), Lovelock and Lewes (LL), Price Waterhouse Bangalore, Price Waterhouse & Co. Bangalore, Price Waterhouse & Co. Kolkata, Price Waterhouse Delhi, Price Waterhouse & Co. Delhi, Price Waterhouse & Co. Chennai, Dalal & Shah Mumbai and Dalal & Shah Ahmedabad, besides a private limited company, namely PwCPL, who are collectively referred to as "PwC India" firms and who operate from various metros including Delhi. Their clients include Government departments, Public Sector organizations, ministries for which huge payments are made to them. They are engaged in auditing/certifying statutory compliances. They have violated Foreign Direct Investment (FDI) Policy, RBI master circulars, FEMA Act and Rules. According to Notification dated May 3, 2000, under Section 47(2)(h) of FEMA Act, no person resident outside India can make investment by way of contribution to the capital of a firm or a proprietary concern or any association of persons in India without permission of the RBI. In violation of the said provision, PwC India entities received Rs.240 crores in Financial Year 2010-2011. The Chairman of PwC India confirmed

the receipt of funds from Global Network. Receipt of Rs.22.90 crores in the Financial Year ended March, 2010 is reflected in the balance sheet and profit and loss account of the PwCPL. Receipt of Rs.7.97 crores is reflected in the balance sheet and profit and loss account of Dalal & Shah, Mumbai. This apart, approximately Rs.210 crores was received by PwCPL, Price Waterhouse (PW) and Lovelock and Lewes (LL). However, no action was taken for receipt of these sums in violation of law. A sum of Rs.41 crores was received by Price Waterhouse & Company, Kolkata to acquire another audit firm, Dalal & Shah, Mumbai through a circuitous route by giving interest free loans to its four partners to enable them to invest the said amount in Dalal & Shah, Mumbai in violations of the RBI Guidelines, FEMA policy and ICAI Regulations.

11. There is also violation of Companies Act. Insurance premium has been paid by three firms of PwC for benefit of other member firms which is illegal. Lovelock and Lewes (LL), a member firm of PwC India failed to point out the high level of NPAs, in its audit report, resulting in Global Trust Bank (GTB) being forced to merge with Oriental Bank of Commerce in 2004. This happened due to accumulated losses of GTB. LL was also found guilty of

manipulating share prices and falsification of accounts by Serious Fraud Investigation Office (SFIO). PwC has been found guilty of accounting scandals outside India.

12. After making the above averments, the petition suggests that falsification of accounts should be made a non-bailable offence to ensure effective governance and to avoid potential loss of revenue to the public exchequer. An independent regulator should be appointed for the auditors. Prayer has been made for investigation into the above allegations against the PwCPL and their network Audit Firms operating in India sharing the brand name of PwC.

13. To sum up, the case of the petitioners is:

- (i) The MAFs violate provisions of Sections 25 and 29 of the CA Act, the Code of Conduct laid down by the ICAI, Companies Act, the FDI Policy as highlighted in report of the Study Group of the ICAI dated 15th September, 2003 and the report of the Expert Group of the ICAI dated 29th July, 2011. Regulatory framework was required

to be re-visited to cover the gap in the existing regulatory framework and challenge on account of operations of MAFs as noted in the said reports. Audit functions were required to be separated with a separate oversight body.

- (ii) PwC Services BV, Netherlands in violation of law, made investment of Rs.41.42 crores through PwC, Kolkata to acquire Dalal & Shah, Mumbai which is an audit firm through a circuitous route by giving interest free loans to its partners allowing them to invest the said amount with Dalal & Shah, Mumbai. This is clear offence under the Benami Transactions (Prohibition) Act. It is also an offence under the FEMA, the Chartered Accountants Act, and RBI Master Circulars.
- (iii) The PwC Services, BV Netherlands remitted Rs.240 crores to various PwC entities in India for 'enhancement of skills'. Payment of Income Tax on the said amounts does not

legalise the remittance. The remittance shows that the foreign company has control over Indian Firms and is thus indirectly running chartered accountancy business in India and also getting its return on the said amount.

- (iv) There is falsification of accounts with regard to insurance premium for a 280 crore policy by PwC firms in India in violation of Companies Act, 1956.
- (v) PwC is responsible for the violations by Satyam scam, failure of the Global Trust Bank (GTB) and UB Group (Kingfisher Airlines) for which action ought to be taken.
- (vi) SFIO and CBI have found PwC guilty. Still, the PwC firms have not been prosecuted and have been awarded Government contracts such as GST Suvidha Provider for GST Network, consultancy contract by the Kerala Government for preparing master

plan to connect Kochi with industrial corridor of south India.

14. The prayers of the petitioners on above basis are:

- (a) *ICAI must take immediate action for deregistration of these firms in terms of their own report of 2011 which they had themselves accepted.*
- (b) *These audit firms ought to be prosecuted for offences under the Chartered Accountants Act, 1949.*
- (c) *PwC firms ought to be prosecuted under FEMA, 1999 regarding the payment of Rs.240 crores and Rs.42 crores by the ED.*
- (d) *PwC Kolkata firm and partners need to be prosecuted under the Benami Transactions (Prohibition) Act.*
- (e) *Investigation and action on part of ICAI and Ministry of Corporate Affairs with regard to the falsification of accounts and wrong accounting of the insurance policy of Rs.280 crores that was utilized by PwC Bangalore without paying any premium.*
- (f) *A CBI investigation into the receipt of Rs.240 crores so that the real purpose of such receipts is known and necessary action may be taken.*

High Powered Committee Expert Group Report dated 29th July, 2011

15. In its report dated 29th July, 2011 on Operation of Multinational Network Accounting Firms (MAFs) in India, the expert group constituted by the ICAI examined the issues concerning operation of MAFs in India. The group was constituted in the context of corporate fraud of high magnitude revealed by the statement of Chairman of Satyam. The ICAI sought curbing of undesirable activities/operations of MAFs. The Ministry held a meeting with the representatives of the ICAI to identify the issues. Thereafter, the following issues were referred to the Expert Group by the High Powered Committee of the ICAI:

- “(a) Manner in which certain Indian CA firms, hold out to public that they are actually MAFs in India, the manner in which assignments are allotted, determination of nexus/linkage. The representatives of certain Indian CA firms carry two visiting cards one of Indian CA firm and another of a multinational entity. They represent the multinational entity and seek work for Indian CA firm.*
- (b) Name used by auditor in/his report - The basic question was whether the auditors of M/s. Satyam had correctly mentioned the name of their firm in the audit report.*
- (c) Terms and conditions and cost payable for use of international brand name - No*

international firm will allow its name to be used by all and sundry. The question is what is the consideration whether it is determined as a percentage of fee or profits and whether it is within the framework of Chartered Accountants Act, 1949, Regulations framed, thereunder Code of Conduct and Ethics.

- (d) *Nature of extra benefits accrued to the Indian CA firms having foreign affiliation.*
- (e) *How the MAFs placed their foot in India - Long back in a meeting with RBI it was informed that the MAFs entered in India to set up representative offices. No documents are available as regards the terms and conditions set out while granting them permission to operate in India. However, the RBI vide its letter No.Ref.DBS.ARS.No.744/08:91:008 (ICAI)/2003-2004 dated 23rd March, 2004 inter alia, mentioned that "RBI has not permitted any foreign audit firm to set up office or to carry out any activity in India under the current exchange control regulations."*
- (f) *Contravention of permission originally granted by Government - What was the original permission given for these firms to enter into India and subsequently whether they are adhering to the terms and conditions of that permission? If contravention was found to take up with Government/FIPB - for approaching Government or FIPB, ICAI must have information as to the nature of permission given. As already mentioned, no documents are available indicating the nature of permission granted. What is the current position of international trade in accounting and related services? The opening up of accounting and related services, can be linked to reciprocal opening up by developed countries.*

- (g) *Additional powers required by ICAI to curb the malpractices - If under the existing legislation, ICAI does not have enough powers to curb this practice, whether they would need more powers. A separate proposal for amendment of Chartered Accountants Act, 1949 has been sent by the Council to the Government seeking additional powers."*

16. It was noted that some of the MAFs are active in India and are rendering services which are provided by CAs without registration with the Institute. Certain MAFs are corporate or juridical persons with significant commercial presence in India and are rendering assurance services. They solicit professional work including audit work by including international brand name in their name. With the same brand names certain Indian CA firms were registered with the ICAI. They hold out to public that they are actually MAFs in India, whereas to the ICAI they hold out that they are purely Indian CA firms having no relationship with foreign entities. The government, regulators and the ICAI must ensure that such wrong impression is not permitted. Entities other than CAs in practice should be prohibited from providing auditing and assurance services in absence of their regulation under a law. Indian CAs are not getting mutual treatment in other countries, while the MAFs continue to operate in India through the Indian CA firms. Entities having similar

name as that of MAFs, which entered through automatic/FIPB route, are rendering Chartered Accountancy services contrary to the policy of not permitting Foreign Direct Investment (FDI) in the field of accounting, auditing and book keeping services, taxation services and legal services. The Institute requested the Department of Company Affairs to take the following action:

- “(i) for reviewing the existing situation for ensuring reciprocal advantage in favour of the Indian accounting profession;*
- (ii) to take appropriate action against MAFs if found to be in violation including cancellation/revoking/ withdrawal the permission already granted to such foreign entities;*
- (iii) to ensure that the non-compliance of the terms & conditions of the permission granted by the Government to such MAFs is dealt with effectively;*
- (iv) to prohibit the MAFs/consultancy firms which have set up commercial presence either as a corporate entity or otherwise from defying the restrictions in terms of the Government policy both in letter & spirit; and*
- (v) to ensure that the names of the companies which are same or similar to the names of MAFs should not be allowed to continue to operate in India.”*

17. The Institute called for information from the Indian CA firms perceived to be having international affiliations to examine whether

they are functioning within the framework of CA profession. The exercise resulted in finding out 171 names of firms but the said firms were reluctant to submit copies of agreements with foreign entities and their tax returns. Certain CA firms submitted the documents by masking certain portions contained in their agreements, partnership deeds and assessment orders/income tax returns claiming confidentiality and commercially sensitive nature of the documents. Some of the firms did not give the details.

18. The group considered network groups as 'A' to 'D'. With regard to 'A', it was observed that the multinational entity had permitted the participating firms in the network to use the brand name. The relationship between members and firms and how these are governed from the same offices under common management and control was not disclosed. The linkage was clear from the data disclosed on the website. Firms received financial grants from non-CA firms contrary to the prohibition for the members of the Institute to receive any part of profits from non-member of the Institute. The networking firms have made remittances to a multinational entity, sharing their revenue purportedly towards subscription fees, technology cost and administration cost etc. However, the break-ups of costs were not furnished. The cost

excluded marketing, publicity and advertising which was not allowed as per the CA Act. The data was not furnished to support the claim that remittances are only in respect of such matters and not related to the volume of business generated through the efforts of the multinational entities. A total and full disclosure was not made in spite of repeated directions. The domain name used by all the firms in the network was identical to the name of the multinational entity which supports the view that they hold out that these firms were part of international network. Some of the firms operate from the same premises from where their international affiliate also operates. They share the same telephone and fax numbers. They share human resources with other firms. Articled Assistants are also shared without following the restrictions imposed by the ICAI.

19. With regard to group 'B', the multinational entity had executed sub-licence agreements with the Indian firms. They stated that they are not sharing their fees or profits with any multinational entity but reimbursement of costs relating to certain central facilities and levies are made annually. The CA firms used name of the international entity in their E-mail IDs. The E-mail ID and the domain name resembled the name of the multinational entity. Thus,

in the same manner, as in respect of network 'A' the CA firms in network 'B' hold out that they are part of the international network. They share same premises, same telephone and fax number. They made remittances annually to the multinational entity sharing their revenue with multinational entity which they have claimed to be towards reimbursement of cost towards central facilities and levies. They do not provide break-up which may show that the cost included marketing, publicity and advertising.

20. The firms in the Network 'C' are also using the MAF's name as part of domain name in their E-mail IDs, which is displayed in the visiting cards of the partners of the firms.

21. Similar was the position with regard to Network 'D'. The firms in Network 'D' also used the name of multinational entity as domain name.

22. The Council has prescribed maximum limit for statutory audit and tax audit which a member in practice can undertake in a year. But, by sub-contracting the work to other firms, the firms are undertaking more than the prescribed work leading to deterioration of quality of performance.

23. The member firms are required to refer the work among themselves. In respect of some firms, referral fee is payable and receivable. Agreements also provided for use of name and logo. Payment/receipt of referral fee is prohibited as per code of conduct applicable to CAs.

24. The group noted that firms have names identical to the names of MAFs operating in India but in absence of complete data, a conclusive finding could not be recorded as to violation of the CA Act with regard to sharing of fees or profits with non-members, securing business through solicitation/publicity. International affiliations with entities which do not follow the same Code of Ethics as applicable to Indian CA firms vitiate the level playing field with other Indian CA firms. Control of the Indian CA firm is effectively placed in the hands of non-members/companies and foreign entities.

25. Some of the observations in the report are:

“4.2 The Council of ICAI has deliberated that some of the MAFs are active in India and are rendering services such as assurance services, taxation services, etc. normally provided by Chartered Accountants, without registration with the Institute and, without being subject to any disciplinary and regulatory control on the ethical and independent issues. Certain MAFs either as corporate and other juridical persons with the Institute brand name were

given permission by the other regulators/Government for doing consultancy business in India. These entities have established significant commercial presence in India and are rendering assurance services. These private limited companies in certain cases solicit professional work including audits by using the international brand name and projecting large experience, infrastructure and international database including turnover, manpower size, technical expertise and experience in other countries. These private limited companies work under the name and style/trade name/brand name of well known MAFs and in certain cases also co-brand multinational name with certain Indian CA including by making presentations and organizing mega public programmes. In fact these firms and individuals employ with them as Directors or partners or in other capacity and hold out to the public that they are MAFs. In view of their well known brand and presence internationally the corporate sector, the Government and the society at large and sometimes even the regulators carry a wrong impression as if these private limited companies are in fact MAFs and the services being provided by these private limited companies are actually services being provided by such MAFs.

4.3 Certain Indian CA firms and private limited companies associated with them hold out to public that they are actually MAFs in India whereas to the ICAI/regulators, they hold out that they are purely Indian CA firms having no relationship with foreign entities.

4.4 It is important for the Government, regulators and the ICAI to ensure that such wrong impression is not permitted and all entities other than Chartered Accountants in practice and CA firms should be actually prohibited directly or indirectly from providing auditing and assurance services, as these are required to be regulated in the public interest. The very objective of having the profession relating to

accountancy under specific Act of Parliament, incorporating therein a strict disciplinary and ethical code was to ensure that there is no dilution of the professional standards and services are provided in a regulated manner.

4.5 In certain cases, joint venture agreements, MOUs, foreign collaboration agreements, shareholders agreements, private equity participations and side letters are exchanged between parties mandating appointment auditors as prescribed by international parent. In certain cases public sector undertakings, Government departments/Central and State Governments advertise for various professional services wherein the basic eligibility requirement tends to favour Multinational Network Accounting firms or other corporate entities. It has also been observed that auditors have been replaced by Indian CA firms networked with Multinational Network Accounting firms apparently for no professional reasons.

4.6 The ICAI has been pursuing with the accounting bodies in different countries for recognition of its qualification and relaxation for its members for entry level requirements like appearance in certain papers such as accounting, auditing as well as training requirements giving due credit to the ICAI's educational and training curriculum. In addition, the Indian Chartered Accountants face various invisible/non-professional barriers like visa, citizenship and residency requirements, procedural impediments to provide services in such countries. While the Institute has been pursuing vigorously for recognition of its qualification-for ensuring level playing field for Indian Chartered Accountants whereas the countries concerned are not showing a sense of seriousness and urgency which these matters deserve. Indian Chartered Accountants are not getting a fair, reasonable and mutual treatment which they deserve. Since MAFs, in corporate or other form, are already commercially present and operating in India on the

basis of holding out as MAFs/the Indian CA Firms and private limited companies may be *de jure* owned and managed to Indian Chartered Accountants, whereas *de facto* these are fully governed MAFs having headquarters in developed countries, who are denying a level playing field to Indian Chartered Accountants in their country by the restrictions as explained herein. As a result the negotiating capacity of India accounting services favouring the Indian accountants has been significantly reduced. In fact, this has also adversely affected the bargaining capacity of the Government of India for Indian accounting profession under the ongoing negotiations under the WTO/General Agreement of Trade in Services (GATS).

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4.8 However, it has been noticed that the entities having similar name as that of MAFs, which entered through automatic/FIPB route for rendering management consultancy services (as defined in CPC 865), are transgressing the permission so granted and are rendering taxation services (CPC 863), auditing, accounting and book keeping services (CPC 862) and legal services (CPC 861). Instances brought to the notice of the Study Team constituted by the Council in April, 1995 and the Study Group constituted by the Council in February, 2002 are placed at Annexure-III. Extracts taken from the website pages of some of the MAFs are given at Annexure-IV.

4.9 It is noted that as per the policy of the Government of India, Foreign Direct Investment (FDI) is not permitted in the field of accounting, auditing and book keeping services, taxation services and legal services and no commitment had been made by India for opening of such services under the WTO/GATS. However, some entities were not only providing services through their own establishment (signifying their commercial presence i.e., Mode-3) in India but also through service providers in India

particularly for those services like auditing which cannot be rendered by them under the relevant laws of the country.

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4.16 The 171 firms from whom documents/details were called for by and large furnished the documents that were called for. However, certain CA firms have submitted the documents by masking certain portions contained in their agreements, partnership deeds and assessment orders/income tax returns claiming confidentiality and commercially sensitive nature of the documents. The financial details were asked with a view to confirm compliance of these firms with the code of ethics in regard to sharing of fees, inward and outward remittances, nature of expenses, financial dealing with non-members, nature of payment, nature of revenue sharing of fees belonging to non-members and to identify activities not permitted within the framework of the Chartered Accountants Act, 1949, other laws including Foreign Exchange Management Act, 1999 and Foreign Contribution (Regulation) Act, 1976, Code of Ethics and Conduct. Masking/omission of certain portions was construed as non-compliance with the directions of the Institute, and such firms which had masked certain portions were asked to additionally submit copies of their financial statements i.e. Income & Expenditure Account and Balance Sheets or Statement of Affairs including tax audit reports for the last 3 years. However, these firms, instead of submitting unmasked and complete information, had been questioning the logic/reasoning behind asking such data, which according to the firms are commercially sensitive/confidential. Despite reminders, some of the firms had not submitted unmasked/complete details.

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5A.8 Observations :

(i) The multinational entity has granted permission to the participating firms in the network to use the brand name. This is notwithstanding the fact whether the firms have signed the License Agreement with the entity or not. The relationship between members and firms how these are governed from same offices under common management and control is not disclosed. The data disclosed on the website, however, clearly brings out the linkage.

(ii) Though some of the participating firms in the Network 'A' have not signed, the Verein document of Name License Agreement yet while making remittances to the multinational entity, the revenue of the entire network is taken into account.

(iii) The Verein document makes a mention of Supplemental Regulation but while submitting documents to the Institute the firms in Network 'A' have not submitted a copy thereof.

(iv) The networking firms in Network 'A' have received financial grants from a non-CA firm. A member of the Institute is prohibited from receiving any part of profits from a non-member of the Institute. Such an act on the part of a member/firm seems to be in violation of Item (3) of Part I of the First Schedule to the Chartered Accountants Act 1949.

(v) The networking firms in Network 'A' have made remittances to the multinational entity, sharing their revenue with multinational entity, which they have claimed to be towards subscription fees, technology cost including cost of licenses - obtained for software, budgeted expenses, cost of administration etc. However, the firms have not provided break-up/computation and whether the cost includes cost towards marketing, publicity and advertising the products and services in India as well as abroad and any other cost which is not allowed as per the Chartered Accountants Act, 1949, Regulations framed thereunder and Code of Ethics. The firms in

Network 'A' have also not furnished any data in support of their claim that the money remitted by them to the multinational entity is in respect of above matters only and that the same in no way relates to the volume of business generated through the efforts of the multinational entity and through use of brand name. A total and full disclosure in this regard has not been made in spite of repeated directions by the High Powered Committee/Group on the basis of directions of the Council.

(vi) The Verein document lay an obligation on the member firms in Network A "to make every reasonable effort to refer clients to other member firms". A member of the Institute is prohibited from securing any professional business by means which are not open to a Chartered Accountant. However, they are required to follow the networking guidelines of the Institute. Such an act on the part of a member/firm seems to be in violation of Item (S) 1 of Part I of the First Schedule to the Chartered Accountants Act, 1949.

(vii) The networking firms in Network A and all their personnel are using the domain name identical to the name of the multinational entity in their email IDs and the same is displayed in their visiting cards. This clearly supports holding out by these firms in Network A that they are part of the international Network A of MAFs. Some of these firms operate from the same premises from where their international affiliate also operates. They share the same telephone and fax nos. thus establishing that they are one and the same. The Indian firms in Network A and MAFs are *de facto* the same entities providing assurance, management and related services and as such their operations seem to circumvent the provisions of the Chartered Accountants Act, 1949 and Regulations framed thereunder. A member of the Institute is prohibited from disclosing the affiliation with any international entity. In this regard, the Council, at its 172nd meeting held in January, 1995,

while agreeing with the recommendation of the then Committee on Ethical Standards and Unjustified Removal of Auditors that the use of expression/words, "In Association with", Associates of", Correspondents of" etc. on the stationery, letter-heads, visiting cards and professional documents of the firm of CAs was not permissible in view of the provisions of Item (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949, decided that it should not be permitted irrespective of whether the name sought to be used is the name of an Indian firm or a foreign firm.

(viii) The networking firms in Network A are sharing their human resources with other firms in the network. However, it has been possible to ascertain whether the articled assistances are also being rotated among the firms. It may be mentioned that articled assistants are assigned to a member, whose obligation is to train them. As such, the articled assistances cannot be allowed to be utilized by any other member. However, to address this issue, there exists a provision under Regulation 54 of the Chartered Accountants, Regulations, 1988 enabling secondment of articled assistances with a view to provide the articled assistants the opportunity of gaining practical experience in areas where the principal may not be in a position to provide the same. Such secondment is allowed under the Regulations with certain restrictions and conditionalities and the same is required to be sent to the Institute for records within thirty days from the date of commencement of training on secondment.

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5B.7 Observations :

(i) The CA firms in Network B and all their personnel are using the domain name identical to the name of the multinational entity in their email IDs, and the same is displayed in the visiting cards. This clearly supports holding out by these firms in Network C that

they are part of the international Network C of MAFs. Some of these firms operate from the same premises from where their international affiliate also operate. They share the same telephone and fax nos. thus establishing that they are one and the same. The Indian firms in Network B and MAFs are *de facto* the same entities providing assurance, management and related services and as such their operations seem to circumvent the provisions of the Chartered Accountants Act, 1949 and Regulations framed thereunder. A member of the Institute is prohibited from disclosing his affiliation with any international entity. In this regard, the Council, at its 172nd meeting held in January, 1995, while agreeing with the recommendation of the then Committee on Ethical Standards and Unjustified Removal of Auditors that the use of expression/words, "In Association with", "Associates of", Correspondents of" etc. on the stationery, letter-heads, visiting cards and professional documents of the firm of CAs., was not permissible in view of the provisions of Item (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949, decided that it should not be permitted irrespective of whether the name ought to be used is the name of an Indian firm or a foreign firm.

(ii) The CA firms in Network B have made remittances annually to the multinational entity sharing their revenue with multinational entity which they have claimed to be towards reimbursement of cost towards central facilities and levies. However, the firms have not provided break-up/computation and whether the cost includes cost towards marketing/publicity and advertising the products and services in India as well as abroad and any other cost which is not allowed as per the Chartered Accountants Act, 1949, Regulations framed thereunder and the Code of Ethics. The firms in Network B have also not furnished any data in support of their claim that the money remitted by them to the multinational is in respect of above

matters only and that the same in no way relates to the vote of business generated through the efforts of the multinational entity and through use of brand name. A total and full disclosure in this regard has not been made in spite of repeated directions by the High Powered Committee/Group on the basis of directions of the Council.

(iii) The networking firms in Network A are sharing their human resources with other firms in the network. However, it has not been possible to ascertain whether the articled assistants are also being rotated among the firms. It may be mentioned that articled assistants are assigned to a member, whose obligation is to train them. As such, the articled assistants cannot be allowed to be utilized by any other member. However, to address this issue, there exists a provision under Regulation, 1988 enabling secondment of articled assistants with a view to provide the articled assistants the opportunity of gaining practical experience in areas where the principal may not be in a position to provide the same. Such secondment is allowed under the Regulations with certain restrictions and conditionalities and the same is required to be sent to the Institute for records within thirty days from the date of commencement of training on secondment.

(iv) The obligations set out in respect of the CA firms in Network B as per the sub-licensee agreement give a clear indication that the CA firms are under the management and supervision of a non-CA firm for matters such as admission of partners, merger, purchase of assets, etc.

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5C.4 Observations :

(i) The CA firms in Network C have amounts to the multinational entity, which they claim to be on account of actual and allocable cost for activities and services provided, however, the firms have not

provided break up/computation and whether the cost includes cost towards marketing, publicity and advertising of the products and services in India as well as abroad and any other cost which is not allowed as per the Chartered Accountants Act, 1949, Regulations framed thereunder and Code of Ethics. The firms in Network C have also not furnished any data in support of their claim that the money remitted by them to the multinational entity is in respect of above matters only and that the same in no way relates to the volume of business generated through the efforts of the multinational entity and through use of brand name. A total and full disclosure in this regard has not been made in spite of repeated directions by the High Powered Committee/Group on the basis of directions of the Council.

(ii) The firms in Network C have admitted that the global network identifies broad market opportunities, develops strategies, strengthens network's internal products and promotes international brand. The member firms in India also gain access to brand and marketing materials developed by their overseas affiliate. This amounts to indirectly soliciting professional work and securing professional business by means which are not open to a Chartered Accountant.

(iii) The firms in Network C have mentioned that they have joined the network and formed different firms in different cities to overcome the limitation on number of partners.

(iv) The network C firms have entered into an agreement for sharing of resources. Sharing of human resources includes articled assistants also, as confirmed by one of their then partners, in a statement given by him to the members of the Committee. It may be mentioned that articled assistants are assigned to a member, whose obligation is to train them. As such the articled assistants cannot be allowed to be utilized by any

other member. However, to address this issue, there exists a provision under Regulation 54 of the Chartered Accountants Regulations, 1988 enabling secondment of articled assistants with a view to provide the articled assistants the opportunity of gaining practical experience in areas where the principal may not be in a position to provide the same. Such secondment is allowed under the Regulations with certain restrictions and conditionalities and the same is required to be sent to the Institute for records within thirty days from the date of commencement of training on secondment.

(v) The firms in the Network C and all its personnel are using the MAFs name as part of domain name in their email IDs, which is displayed in the visiting cards of the partners of these firms as well as the CA employees. This clearly supports holding out by these firms in Network C that they are part of the International Network C of MAFs. Some of these firms operate from the same premises from where their international affiliate also operates. They share the same telephone and fax nos. thus establishing that they are one and the same. The Indian firms and MAFs are *de facto* the same entities providing assurance/management and related services and as such their operations seem to circumvent the provisions of the Chartered Accountant Act, 1949 and Regulations framed thereunder. A member of the Institute is prohibited from disclosing his affiliation with any International entity. In this regard, the Council, at its 172nd meeting held in January, 1995, while agreeing with the recommendation of then Committee on Ethical Standards and Unjustified Removal of Auditors that the use of expression/words, "In Association with", "Associates of", "Correspondents of" etc. on the stationery, letter-heads, visiting cards and professional documents of the firm of CAs, was not permissible in view of the provisions of Item (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949, decided that it should not be

permitted irrespective of whether the name sought to be used is the name of an Indian firm or a foreign firm.

(vi) As per the Name License Agreement, the CA firm in Network C shall be liable for and will indemnify the Business Trust against any and availability, loss, damage, cost, legal cost and other expenses of any nature suffered, or incurred by the Business Trust arising out of any dispute against the Business Trust by a third party.

(vii) The service as defined in the agreement with the Trust granting license for use of name, prescribes the services which will be covered by the said Trust and rendered by the CA firm. This includes audit, assurance as well as tax advisory services.

(viii) The letterheads and the visiting cards furnished by the firm in Network C do not mention anywhere that it is a firm of Chartered Accountants.

5D.6 Observations :

(i) The firms in Network D have a management services agreement, technical services agreements, regulations and name license agreements with other entities, copies of which have not been furnished by the firms.

(ii) The firms in Network D and all their personnel have been using the name of multinational entity as domain name in their email IDs, which is displayed in the visiting cards used by the partners of these firms as well as their CA employees. This clearly supports holding out by these firms that they are part of the international Network D of MAFs. Some of these firms operate from the same premises from where their international affiliate also operates. They share the same telephone and fax nos. thus indicating that they are one and the same. The Indian firms and MAFs are *de facto* the same entities providing assurance, management and related services and as such their

operations seem to circumvent the provisions of the Chartered Accountants Act, 1949 and Regulations framed thereunder. A member of the Institute is prohibited from disclosing his affiliation with any international entity. In this regard, the Council at its 172nd meeting held in January, 1995, while agreeing with the recommendation of the then Committee on Ethical Standards and Unjustified Removal of Auditors that the use of expression/words, "In Association with", "Associates of", Correspondents of" etc. on the stationery, letter-heads, visiting cards and professional documents of the firm of CAs, was not permissible in view of the provisions of Item (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949, decided that it should not be permitted irrespective of whether the name sought to be used is the name of an Indian firm or a foreign firm.

(iii) The firms in the Network D have signed an agreement for sharing of human resources; however, it has not been possible to ascertain whether the articulated assistants are assigned to a member, whose obligation is to train them. As such, the articulated assistants cannot be allowed to be utilized by any other member. However, to address this issue/there exists a provision under Regulation 54 of the Chartered Accountants Regulations, 1988 enabling secondment assistants with a view to provide the articulated assistants the opportunity of gaining practical experience in areas where the principal may not be in a position to provide the same. Such secondment is allowed under the Regulations with certain restrictions and conditionalities and the same is required to be sent to the Institute for records within thirty days from the date of commencement of training on secondment.

(iv) One of the network firms in Network D, though is yet to sign the agreement with the multinational entity, but has already been operating

as part of the multinational entity's network and complies with the obligations.

(v) The amount of remittance made by firms in Network D to the multinational entity (exceeding Rs.XXXX million in a year) has been disclosed. However, the firms in Network D have not provided break up computation and whether the cost includes cost towards marketing, publicity and advertising the products and services in India as well as abroad and any other cost which is not allowed as per the Chartered Accountants Act, 1949, Regulations framed thereunder and Code of Ethics. The firms have also not furnished any data in support of their claim that the money remitted by them to the multinational entity is in respect of above matters only and the same in no way relates to the volume of business generated through the efforts of the multinational entity and through use of brand name. A total and full disclosure in this regard has not been made in spite of repeated directions by the High Powered Committee/Group on the basis of directions of the Council.

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6. Findings

6.1 The Committee/Group with a view to ascertain compliance with the various aspects of Code of Ethics had received documents/details listed in para 4.13 hereinabove, from 171 firms. Based on information received, it was found absence of affiliation etc. to 135. Of these, nearly firms submitted data in entirety. Other firms submitted most of the data, such as financial that for various reasons the number of firms actually 73% of the firms submitted the data masking of withholding most of the important data, such as financial figures, profit sharing, capital contribution etc. primarily on the grounds of commercial sensitiveness/confidentiality of the data.

6.2 In the absence of complete set of documents such as complete copy of agreements between some of the Indian CA firms and their international affiliates/network along with annexures referred thereto, networking agreement, internal regulations, service agreements, statute of international affiliate etc. it was not possible to draw conclusive inference as to violation of the Chartered Accountants Act, 1949 with reference to sharing of fees or profits with non-members, sharing profits of non-members, securing business through means not open to Chartered Accountants, solicitation, direct or indirect publicity etc. This shall require proper examination under the relevant provisions of Sections 21, 22 and Schedules framed thereunder.

6.3 Most of these networks are created/established outside India and are functioning under different set of ethical and regulatory guidelines. The India CA firms having international affiliations are subject to regulatory jurisdiction of ICAI and are required to follow the Code of Ethics applicable to Chartered Accountants in India. However, due to the dichotomy of other entities operating in close association with the Indian CA firms, often permitting common brand name/using of logos, coupled with leveraging on international resources etc., is vitiating the level playing field with other Indian CA firms.

6.4 Most of these firms have a name license agreement to use International brand name. One of the terms of such agreement is that apart from common professional standards etc., the Indian affiliates shall harmonize their policies etc. with the global policies of the network. In this manner, matters such as selection and appointment of partners, acquisition of assets, investment in capital etc. are regulated through the means of such agreements and at time even the representative voting is held by an aligned private limited company rather than the CA firms themselves. As a

consequence of this, the control of the Indian CA firms is effectively placed in the hands of non-members/companies foreign entities. The desirability of such a practice from the point of view of independence needs to be examined in the light of Code of Ethics and Schedules to the Chartered Accountants Act, 1949 and Sections 21 and 22 thereof.

6.5 In respect of some firms with names approved by Institute e.g. "XYZ & Co., Patna", the partnership deeds sent by the said firm revealed that the name of the firm is given as "XYZ & Co." and not as "XYZ & Co. Patna" which is the name registered by the Institute. This means that the firm has submitted to the Institute the partnership deed of a firm by the name "XYZ & Co.", whereas the partnership deed supposed to have been submitted should be that of "XYZ & Co., Patna". Letters were written to such firms requesting them to submit the appropriate partnership deed. The first have replied that it was an inadvertent mistake on their part and on the part of the Institute which had approved a trade/firm name with city name as the suffix.

6.6 The firms, M/s WZ, Patna and M/s XYZ & Co. Patna, vide form No.117 sought approval of the Council of the Institute for the firm name, 'XYZ, Patna' and 'XYZ & Co., Patna' respectively. The subsequent forms 18 filed by the firm, for change in the constitution, also mention the firm name as such. However, the partners of the firm, while affixing their signatures on the audit reports, mention the name of the firm as 'XYZ' and 'XYZ & Co.' respectively. The audit reports of companies, which were audited by them, have been signed on behalf of 'M/s XYZ' and not 'M/s XYZ Patna' and by 'M/s. XYZ & Co.' and not 'M/s. XYZ & Co. Patna'. It is an accepted fact that M/s XYZ, Patna and M/s XYZ & Co. Patna have carried out audits of certain companies whose shareholders have appointed M/s XYZ as the auditors. M/s XYZ and M/s XYZ & Co., by allowing the partners of M/s XYZ, Patna

and M/s XYZ & Co. Patna respectively to audit the accounts of clients have rendered the audited accounts invalid ab-initio.

6.7 It is noted that Item (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, which deals with professional misconduct in relation to Chartered Accountants in practice, mentions that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client or otherwise than as required by any law for the time being in force. The auditors, by allowing the audit to be conducted by an unauthorized firm, without the consent of the client, which was not appointed as the statutory auditors, may have allowed all information relating to the audit being passed on to the said firm, thus breaching the aforesaid Item, for which both the firms which were appointed and the one which carried out the audit, may be in violation of the Code of Ethics.

6.8 In response to Institute's letter, some firms have furnished details/documents after masking or eliminating certain portion such as financial figures, profit sharing ratio, capital contribution etc. The Institute has sent numerous letters to these CA firms for providing the information particularly, copies of agreements/contracts they have with their international affiliates/networks with complete annexures, partnership deed with complete annexures and schedules mentioned therein, assessment orders and/or tax returns, financial statements i.e. income and expenditure statement, balance sheet or statement of affairs including tax audit reports. As stated earlier, most of the firms have submitted copies of agreements/contracts, partnership deeds, assessment orders or income-tax returns but around 27% of firms have not furnished the information and have masked/blackened/not

provided the important information. It may be further stated that some of the firms instead of complying with the directions of the Institute, have questioned the logic/reasoning behind seeking copies of income-tax returns, which according to them are commercially sensitive/confidential. One group of firms belonging to one network has cited two legal opinions that they have obtained in this regard and have declined to submit unmasked details.

However, they have sought personal hearing. As mentioned earlier, the Group considered this matter and noted that documents have been called in pursuance of the directions given by the Council and that detailed reasoning for calling of documents has also been given to the firms. Hence, the Group felt that it would not be within its powers to override directions of the Council and grant any concession to certain firms.

6.9 Section 2(2) of the Chartered Accountants Act, 1949 defines the term 'to be in practice'. Pursuant to Section 2(2) above, the Council of the Institute has passed a resolution permitting Chartered Accountants in practice to render entire range of management consultancy and other services. The members of the Institute are governed by a Code of Ethics which is mandatory for every member of the Institute. The services rendered by the multinational entities in India are also to the nature of management consultancy (including financial services, valuation, audit and assurance services etc.) and other related services which are carried on through the medium of private limited companies which are carried using the internationally known accounting firm's name. Since these entities employ Chartered Accountants as well as non-Chartered Accountants for discharging various responsibilities, a misleading Impression is created that the services rendered by the private limited companies are in fact rendered by a Multinational Accounting Firm. In fact, this is not so as the company rendering such services is neither registered

with ICAI nor is governed by any ethical code or regulatory framework.”

26. Accordingly, the recommendations were made to the effect that the Council should consider action against the firms which had not given the full information; consider action against the firms who are sharing revenue with multinational entity/consulting entity in India which may include cost of marketing, publicity and advertising as against the ethics of CAs; action should be considered against the firms who had received financial grant from the multinational entities in spite of prohibition against the CA firms. A member is not allowed to accept any share, commission or brokerage from a non-member unless such non-member is a member of a professional body with prescribed qualifications. Further recommendation is that action be taken against the audit firms distributing its work to other firms and allowing them access to all confidential information without the consent of the client; require the CA firms to maintain necessary data about the remittances made and received on account of networking arrangement or sharing of fee; consider action against firms being paid or offered referral fee; it should be made mandatory for all firms who enter into any kind of affiliation/arrangement with any foreign entity to disclose their international affiliation/arrangement every year to the Institute;

Council should consider action against the firms using name and logo of international networks; action should also be considered for securing professional business by means which are not open to CAs in India. The Council should also issue public statement that without specific approval of the Council, by a notification under Section 29(2) of the CA Act, no MAF can directly or indirectly operate in India through any agreement or arrangement with any Indian entity/firm of CAs. No international firm or entity should be permitted to hold out to public that they are operating in India as a MAF as part of their network. No Indian CA firm should be permitted to pay any part of their profit or fee or other receipts to any person other than a member of ICAI or a firm owned by them by way of cost or percentage except payment for specific professional fee. The Council may request the Ministry of Corporate Affairs, Reserve Bank of India and other relevant Ministries/Departments to take appropriate action so that the recommendations can be implemented to engage the services of accounting firms registered with ICAI. Only CAs and CA firms registered with ICAI should be permitted to provide audit and assurance services. Wherever MAFs are operating in India, directly or indirectly, they should not engage in any audit and assurance services without 'No Objection' and

permission from ICAI and RBI. Instructions may be issued that any joint venture agreement, MOU, foreign collaboration agreement, stakeholders agreement, private equity fund condition, venture capital fund condition or side letters prescribing for appointment of a specific Chartered Accountant or a CA Firm or any other entity are illegal and against public interest.

Stand of the ICAI

27. ICAI in its response submitted that the function of the institute was to regulate the profession of chartered accountancy and to take action against misconduct of its members under The Chartered Accountants (Procedure of Investigations of Professional and Other Misconduct and Conduct of Cases) Rules, 2007. The accounting professionals had significant role in the economy of the country. The economy of India had witnessed two major securities scams in 1992 and 2001. The CA Act was amended on the recommendation of the Joint Parliamentary Committee which enquired into the stock market scams including the high level committee on the 'Corporate Audit and Governance' under the chairmanship of Shri Naresh Chandra which examined the Auditor-Company relationship and disciplinary mechanism for the

Auditors. Amendment was proposed by the Council of the Institute to establish a Disciplinary Directorate headed by Director (Discipline).

28. In response to the grievance that no action was taken against PwCPL and their network audit firms in India, the ICAI submitted that its Disciplinary Directorate had already taken cognizance of the information in the Article dated 17th January, 2012 in the Times of India "Sundry Income cushions PwC India". Letter dated 9th March, 2012 was written to PwC, New Delhi, Chennai, Bangalore, PwC, Kolkata, LL, Kolkata. A letter was also written to RBI. The stand of the PwC firms, was that news item did not make any reference to their firms and no clarification was necessary. PwC, Kolkata submitted that it was member of PwC network of firms around the world ('PwC Network'). To maintain the quality standards of all members, a grant of Rs.65 crores was given to them by the PricewaterhouseCoopers Services BV during the financial year ended 31st March, 2011 as an outright, non refundable grant. The same was included in the "Sundry Income" in their annual accounts. The stand of LL, Kolkata, was that it was a member of PwC Network of Firms around the world. It received grant of Rs.28.97 crores for maintaining quality standards from

PwC Services BV during the financial year ended 31st March, 2011 as an outright, non-refundable grant. The Disciplinary Directorate sent a reminder to the RBI and sent a letter to the Commissioner of Income Tax, Kolkata and Joint Secretary (Revenue), Ministry of Finance. The Deputy Commissioner of Income Tax, Kolkata stated that scrutiny proceedings on issue of transfer pricing were pending for the assessment year 2010-2011 and 2011-2012 in respect of PwCPL. With regard to the failure of PwC, Bangalore to discover the scandal of 'Satyam', it was stated that the US Regulators, i.e., Securities and Exchange Commission (SEC) and PCAOB had taken action but in India the proceedings were getting prolonged. As regards failure of LL to point out high level of NPAs of GTB, it was submitted that no formal complaint was filed against PwCPL. The same is not registered and the Institute could not take any action against them under the CA Act as amended in 2006 and 2007 Rules. Action was taken against the members of LL, Shri S. Gopalakrishnan, Shri P. Rama Krishna and Shri Manish Agarwal. Action was also taken against Shri Kersi H. Vachha and Shri Amal Ganguli. In 2002-2003 action was taken against Shri Partha Ghosh and Shri D.V.P. Rao of M/s. PwC. PwC Bangalore were the auditors of 'Satyam' for which action was taken against CA S.

Gopalakrishnan (For the period 1.4.2000 to 31.3.2007), CA S. Talluri (For the period 1.4.2007 to 30.9.2008), CA Pulavarthi Siva Prasad (for the period 1.4.2001 to 31.3.2005), CA Chintapatla Ravindernath (for the period 1.4.2005 to 30.9.2008). Action was also taken against V. Srinivasu, the then CFO of the Satyam, V.S. Prabhakara Gupta, the then head of Internal Audit Cell of Satyam. The Joint Director, SFIO filed a complaint dated 3rd March, 2009 in respect of DSQ Softwares Limited against CA Naresh Kumar Tharad of M/s. N.K. Tharad & Co., Chartered Accountants, Kolkata. It was revealed that company had made preferential allotment of shares to various entities in a fraudulent manner.

Stand of the Respondent-Firms

29. In its written submissions, Respondent No.5 M/s. Deloitte Haskins & Sells submitted that there is no allegation against it in the SLP. All the partners of Respondent No.5 were Indians and the firm was also registered with the ICAI. An expert group was constituted by the Ministry of Corporate Affairs which gave its report dated January 31, 2017 to the effect that Big six firms (MAFs) were not operating directly. Their network partners were rendering audit services. Indian network firms pay global network charges to their parent organization towards sharing common global costs of human

resources and other infrastructure, technology cost. This is a standard practice across jurisdictions. It does not make MAFs subject to the control by the global parent. MAFs cannot be considered as multinational entities as there is no foreign control through ownership or management. Network partners are run, controlled and managed by Indian nationals. It was submitted the writ petition was not maintainable.

30. Reference has also been made to letter dated 3rd July, 2017 addressed to the Secretary, Ministry of Corporate Affairs from the PMO, with reference to the said expert group incorporating the conclusions of the expert group as follows:

- a) The accounting and auditing standards and practices followed in India should be aligned to international standards and practices with customization to the extent necessary.*
- b) The small size of majority of India audit firms being a constraint in facing global competition, consolidation through merger and networking of India audit firms should be encouraged through policy measures.*
- c) With audit becoming a multi disciplinary function, formation of multi disciplinary audit firms with participation by professionals from other relevant professions should be promoted.*
- d) It should be ensured that the recommendations of Quality Review Board*

conducting technical evaluations of India audit firms are implemented.

- e) *If and when audit and assurance are opened to global competition, the principle of reciprocity should be followed and the interests of India audit firms should be given due consideration."*

31. The stand of the PwC Network (Respondents 6 to 11) is that PwC or PW is the brand owned by PwCIL registered under the laws of England limited by guarantee. PwCIL acts as a coordinating company within the PwC network and does not provide any business or audit services. Respondent Nos.6 to 11 are member entities of the PwC Network which consists of companies and firms around the world all of which are separate legal entities. PwCIL allows desirous entities to become members of the PwC network if they follow global standards to provide quality services for clients in respect of audit/non audit services. Uniform and consistent delivery is important. PwC network is not a global partnership. The network activities are to develop and implement policies and initiatives for a common and coordinated approach to maintain quality and standards of service. PwC brand name is based on name licence agreement to exercise cooperation amongst member firms. All the members (in 177 countries) have to pay a licence fees. PwC

Services BV (Services BV) is incorporated in Netherlands to operationalize global standards of services. Services BV coordinates efforts of various firms across the globe to develop superior global common standard. Services BV does not do any client related work but develop standards. It pools money by charging the network entities a percentage of their revenue which is used to meet the expenses to develop standards. Firm Service Agreements are signed by network entities. Services BV works on no profit no loss basis. Network charges are paid by all member entities including the Indian member entities. The network felt the need of enhancing the standards and capacity of Indian network entities for which non refundable grants were provided. The grants are not in the nature of investment. These are current account transactions and not capital account transactions. For FY 2009-10, the grants were taxed but network charges paid to Services BV were disallowed as deduction. For FY 2010-11 assessment order has been passed on 29th September, 2016 against which appeal was pending.

32. The Enforcement Directorate (ED) sought information in respect of funds received from outside India. In March and August, 2016, ED issued summons. In July, 2017, ED again issued summons under Section 37 of FEMA seeking details of inward/outward

remittances. In August, 2017, the Chief Financial Officer (CFO) was issued summons by the ED to provide information about the remittances.

33. The Registrar of Companies issued notices to show cause why prosecution should not be launched against the Directors and Company Secretary of the PwCPL in January, 2013. Company Law Board allowed compounding of the offences on payment of composition amount of Rs.8,31,000/-.

34. Auditing services are being carried by firms belonging to PwC Group as follows :

- i) Price Waterhouse [FRN-310002E] - 66 Indian Partners (Respondent No.7)
- ii) Lovelock & Lewes [FRN-301056E] - 66 Indian Partners (Respondent No.8)
- iii) Price Waterhouse & Co. [FRN-050032S] - 19 Indian Partners (Respondent No.9)
- iv) Price Waterhouse, Bangalore [FRN-007568S] - 18 Indian Partners (Respondent No.10)
- v) Dalal & Shah LLP [FRN-102021W/W100110] - 16 Indian Partners (Respondent NO.11)

35. There are other LLPs which are members of PwC Network in India. All the partners are Indian by nationality and registered with

ICAI. Directors are not partners. Indian Chartered Accountant member firms of PwC Network operate as independent entities.

36. Guidelines of the ICAI dated 27th September, 2011 apply to a network if the network has common ownership, control or management, common quality control policies and procedures, common business strategy, use of a common brand name or a significant part of professional resources.

37. The Expert Group Report of the ICAI recommended the following:

“No person or entity and specially Chartered Accountants can hold out to public that they are operating in India as or on behalf or in their trade name and in any other manner so as to represent them being part of or authorized by MAFs to operate on their behalf in India or they are actually representing MAFs or they are MAFs office/representatives in India, except those registered with ICAI in terms of Clause (Hi) as a network, in accordance with network guidelines as notified by the ICAI from time to time.”

[(Clause 7.12 (v) of the Report at pg.152 of SLP No.1808 of 2016).”

38. The guidelines allow registration of a network and the PwC firms have filed their declaration in accordance with the above

guidelines and are registered in India as per Regulations of the ICAI. Merely because the PwC audit firms are part of global PwC Network does not by itself violate any applicable law. As regards the grants received in Financial Years 2008-09, 2009-10 and 2010-11, amounting to Rs.142.9, tax has been paid as per assessment and proceedings are pending. The Network has furnished all the information to the ICAI.

39. Since all the partners are Indians and are registered with ICAI, they are personally accountable to the ICAI for any professional misconduct. Services BV does not have any stake in the partnership or profits of the firms. Thus, there is no violation of Section 25 of the CA Act.

Stand of Central Board of Direct Taxes (CBDT)/ED

40. Stand taken by the CBDT is that on receipt of letter dated 1st July, 2013 from the Advocate for the petitioner, investigation was conducted by the Director General of Income Tax (Investigation) (DGIT) with regard to the income tax implications. It was found that 11 entities belonging to the PwC Group are operating in India. Four entities have received grants of Rs.477.64 crores from PwC Services

BV during the period 2009 to 2013. The grants are of two types – professional capacity building and business expansion. Rs.416.39 crores are offered for tax which were taxed for professional capacity building as “sundry income”. The balance was claimed as capital receipt for expansion of business. The Assessing Officer made assessment of tax and proceedings were pending. According to ED, investigation in the matter is pending, though number of witnesses have been examined.

Stand of the Registrar of Companies (ROC)

41. The stand of the ROC, Kolkata is that prosecution was initiated against the auditors of the Company, who compounded the offences. Certain proceedings are still pending against the auditors of the Company.

Stand of the RBI

42. The stand of the RBI is that it only issues circulars and frames Regulations under the FEMA but does not conduct any investigation for compliance thereof. Regulation 3 of the Foreign Exchange Management (Investment in Firm or Proprietary concern in India) Regulations, 2000 is that a person resident outside India cannot invest in a firm or proprietary concern without permission of the RBI.

As per para 3.3.2 of the FDI Policy, investment without prior approval of the RBI is not permitted.

The statutory provisions

43. Sections 2(2), 25 and 29 of the CA Act are reproduced below :

“2 (2) A member of the Institute shall be deemed “to be in practice”, when individually or in partnership with chartered accountants [in practice], he, in consideration of remuneration received or to be received— (i) engages himself in the practice of accountancy; or (ii) offers to perform or performs services involving the auditing or verification of financial transactions, books, accounts or records, or the preparation, verification or certification of financial accounting and related statements or holds himself out to the public as an accountant; or (iii) renders professional services or assistance in or about matters of principle or detail relating to accounting procedure or the recording, presentation or certification of financial facts or data; or] (iv) renders such other services as, in the opinion of the Council, are or may be rendered by a chartered accountant [in practice]; and the words “to be in practice” with their grammatical variations and cognate expressions shall be construed accordingly. 3 Explanation:— An associate or a fellow of the Institute who is a salaried employee of a chartered accountant [in practice] or [a firm, of such chartered accountants] shall, notwithstanding such employment, be deemed to be in practice for the limited purpose of the [training of articled [assistants]].

25. Companies not to engage in accountancy. (1) No company, whether incorporated in India or elsewhere, shall practise as chartered accountants. (2) If any company contravenes the provisions of sub-section (1), then, without prejudice to any other proceedings which may be taken against the company, every director, manager, secretary and any other officer thereof who is knowingly a party to such contravention shall be punishable with fine which may

extend on first conviction to one thousand rupees, and on any subsequent conviction to five thousand rupees.

29. Reciprocity. (1) Where any country, specified by the Central Government in this behalf by notification in the official Gazette, prevents persons of Indian domicile from becoming members of any institution similar to the Institute of Chartered Accountants of India or from practising the profession of accountancy or subjects them to unfair discrimination in that country, no subject of any such country shall be entitled to become a member of the Institute or practise the profession of accountancy in India. (2) Subject to the provisions of sub-section (1), the Council may prescribe the conditions, if any, subject to which foreign qualifications relating to accountancy shall be recognised for the purposes of entry in the Register. [29A. Power of Central Government to make rules. (1) The Central Government may, by notification, make rules to carry out the provisions of this Act. (2) In particular and without prejudice to the generality of the foregoing powers, such rules may provide for all or any of the following matters, namely:- (a) the manner of election and nomination in respect of members to the Council under sub-section (2) of section 9; (b) the terms and conditions of service of the Presiding Officer and Members of the tribunal, place of meetings and allowances to be paid to them under sub-section (3) of section 10B; (c) the procedure of investigation under sub-section (4) of section 21; (d) the procedure while considering the cases by the Disciplinary Committee under sub-section (2), and the fixation of allowances of the nominated members under sub-section (4) of section 21B; (e) the allowances and terms and conditions of service of the Chairperson and members of the Authority and the manner of meeting expenditure by the Council under section 22C; (f) the procedure to be followed by the Board in its meetings under section 28C; and (g) the terms and conditions of service of the Chairperson and members of the Board under sub-section (1) of section 28D.]”

First and Second Schedule of the CA Act :

[THE FIRST SCHEDULE]
[See Sections 21(3), 21A(3) and 22]

PART I

Professional misconduct in relation to chartered accountants in practice

A chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he —

(1) allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him;

(2) pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualifications as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Explanation. - In this item, "partner" includes a person residing outside India with whom a chartered accountant in practice has entered into partnership which is not in contravention of item (4) of this Part;

(3) accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute:

Provided that nothing herein contained shall be construed as prohibiting a member from entering into profit sharing or other similar arrangements, including receiving any share commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as is referred to in item (2) of this Part;

(4) enters into partnership, in or outside India, with any person other than a chartered accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (v) of sub-section (1) of section 4 or whose qualifications are recognised by the Central Government or the Council for the purpose of permitting such partnerships;

(5) secures, either through the services of a person who is not an employee of such chartered accountant or who is not his partner or by means which are not open to a chartered accountant, any professional business:

Provided that nothing herein contained shall be construed as prohibiting any arrangement permitted in terms of items (2), (3) and (4) of this Part;

(6) solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means:

Provided that nothing herein contained shall be construed as preventing or prohibiting -

(i) any chartered accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice ; or

(ii) a member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence;

(7) advertises his professional attainments or services, or uses any designation or expressions other than chartered accountant on professional documents, visiting cards, letter heads or sign boards, unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the Institute of Chartered Accountants of India or of any other institution that has

been recognised by the Central Government or may be recognised by the Council:

Provided that a member in practice may advertise through a write up setting out the services provided by him or his firm and particulars of his firm subject to such guidelines as may be issued by the Council;

(8) accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing;

(9) accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of section 225 of the Companies Act, 1956 [9 1 of 1956] in respect of such appointment have been duly complied with;

(10) charges or offers to charge, accepts or offers to accept in respect of any professional employment, fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulation made under this Act;

(11) engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage:

Provided that nothing contained herein shall disentitle a chartered accountant from being a director of a company (not being a managing director or a whole time director) unless he or any of his partners is interested in such company as an auditor;

(12) allows a person not being a member of the Institute in practice, or a member not being his partner to sign on his behalf or on behalf of his firm, any balance-sheet, profit and loss account, report or financial statements.

PART II

Professional misconduct in relation to members of the Institute in service

A member of the Institute (other than a member in practice) shall be deemed to be guilty of professional misconduct, if he being an employee of any company, firm or person -

- (1) pays or allows or agrees to pay directly or indirectly to any person any share in the emoluments of the employment undertaken by him;
- (2) accepts or agrees to accept any part of fees, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

PART III

Professional misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he -

- (1) not being a fellow of the Institute, acts as a fellow of the Institute;
- (2) does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;
- (3) while inviting professional work from another chartered accountant or while responding to tenders or enquiries or while advertising through a write up, or anything as provided for in items (6) and (7) of Part I of this Schedule, gives information knowing it to be false.

PART IV

Other misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he —

- (1) is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months;
- (2) in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.]

THE SECOND SCHEDULE

[See sections 21(3), 21B(3) and 22]

PART I

Professional misconduct in relation to chartered accountants in practice

A chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he —

- (1) discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client or otherwise than as required by any law for the time being in force;
- (2) certifies or submits in his name, or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice;
- (3) permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead

to the belief that he vouches for the accuracy of the forecast;

(4) expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest;

(5) fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity;

(6) fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity;

(7) does not exercise due diligence, or is grossly negligent in the conduct of his professional duties;

(8) fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion;

(9) fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances;

(10) fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

PART II

Professional misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

- (1) contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council;
- (2) being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment except as and when required by any law for the time being in force or except as permitted by the employer;
- (3) includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false;
- (4) defalcates or embezzles moneys received in his professional capacity.

PART III

Other misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.

Regulation 3 of the Foreign Exchange Management (Investment in Firm or Proprietary concern in India) Regulations, 2000

“3. Restrictions on investment in a firm or a proprietary concern in India by a person resident outside India

Save as otherwise provided in the Act or rules or regulations made or directions or orders issued thereunder, no person resident outside India shall make any investment by way of contribution to the capital of a firm or a proprietary concern or any association of persons in india;

Provided that the Reserve Bank may, on an application made to it, permit a person resident outside India subject to such terms and conditions as may be considered necessary to make an investment by way of contribution to the capital of a firm or a proprietary concern or any association of persons in India.”

Clause 3.3.2 (III) of the Circular 2 of 2010 of the Consolidated FDI (CFDI) Policy :

“3.3.2 FDI in Partnership Firm / Proprietary Concern:

(iii)Investment by non-residents other than NRIs/PIO: A person resident outside India other than NRIs/PIO may make an application and seek prior approval of Reserve Bank for making investment by way of contribution to the capital of a firm or a proprietorship concern or any association of persons in India. The application will be decided in consultation with the Government of India. “

Consideration of the Issue

44. The above resume of facts and pleadings shows the following:
- i) There is a bar under CA Act to practice as CAs for a company which includes a limited liability common partnership which has company as its partners.
 - ii) Code of Conduct for the CAs prohibits fee sharing, advertisements but the MAFs by using international brands and mixing other services with the services to be

provided as part of practice of chartered accountancy violate the said Code of Conduct for which there is no regulatory regime as the MAFs do not register themselves with ICAI. Indian firms using similar brand names are registered with the ICAI but the real entities being MAFs, ICAI is unable to take requisite action for violation of Code of Ethics by the MAFs. Thus, revisit of existing legal framework may become necessary so as to have an oversight mechanism to regulate MAFs on the touchstone of Code of Ethics.

- iii) Need for amendment of law to separate regulatory regime for auditing services on the pattern of Sarbanes Oxley Act enacted in US making a foreign public accounting firm preparing audit reports to be accountable to the Public Company Accounting. Similar oversight body may need to be considered in India.
- iv) Section 29 of the CA Act provides that if a specified country, prohibits persons of Indian domicile from becoming members of any institution similar to ICAI or practicing the profession of accountancy or subjects them to unfair discrimination in that country, no subject

of any such country shall be entitled to become a member of the Institute or practice the profession of accountancy in India.

- v) FDI Policy and the RBI Guidelines framed under the FEMA prohibit the investment by a person outside India to make investment by way of contribution to the capital of a firm or a proprietary concern without permission of the RBI
- vi) PwC Services BV Netherlands has made investments in Indian firms. According to the petitioners, the investment is also intended to acquire an audit firm through a circuitous route of giving interest free loans and further investments are in the form of grants for enhancement of skills. Profit sharing is in the form of licence fees/network charges. According to the network, the partners are all Indian partners and use of common brand name is only for uniform standard and giving of grants is for maintaining the said standard. There was no investment by an entity outside India. Nor it amounts to profit sharing by the Indian accountancy firms with an entity outside India.

45. It is an undisputed fact that there are remittances from outside India. The same could be termed as investment even though the remittances are claimed to be interest free loans to partners. The amount could also be for taking over an Indian chartered accountancy firm. Relationship of partnership firms, though having Indian partners, operating under a common brand name from same infrastructure, with foreign entity is not ruled out. It is not possible to rule out violation of FDI policies, FEMA Regulations and the CA Act. Thus, appropriate action may have to be taken in pending proceedings or initiated at appropriate forum.

46. The investigation so far carried out cannot be held to be complete in all respects. The investigation by income tax authorities is only for assessment of income tax. Action by the ROC also does not cover the issue raised herein. The investigation by the ED is said to be still pending, though several persons are said to have been examined and documents collected, which are under scrutiny. The said investigation relates to FEMA violations. The ICAI has initiated action with regard to foreign remittances and is said to have written a letter dated 19th March, 2012 to the RBI to enquire whether investigation was conducted by the RBI. However, according to ICAI, its investigation can only be in respect of

members, registered with it, for the misconduct conducted by them. The ICAI does not claim to have conducted complete investigation for want of complete information into the issue whether the chartered accountancy firms by receiving remittances from outside India or remitting licence fee/network charges outside India have allowed participation of a company or a foreign entity in the accountancy business in violation of Section 25 of the CA Act and whether use of common brand name by the network firms is in violation of reciprocity stipulated under Section 29 of the CA Act. The ICAI should have taken the matter to logical end, by drawing adverse inference, if information was withheld by the concerned groups.

47. No doubt, the report of the committee of experts of ICAI dated 29th July, 2011 does not specifically name the MAFs involved, groups A,B,C,D are mentioned. The ICAI ought to constitute an expert panel to update its enquiry. Being an expert body, it should examine the matter further to uphold the law and give a report to concerned authorities for appropriate action. Though the Committee analysed available facts and found that MAFs were involved in violating ethics and law, it took hyper technical view that non availability of complete information and the groups as such were not

amenable to its disciplinary jurisdiction in absence of registration. A premier professionals body cannot limit its oversight functions on technicalities and is expected to play proactive role for upholding ethics and values of the profession by going into all connected and incidental issues.

48. Thus, a case is made out for examination not only by ED and further examination by the ICAI but also by the Central Government having regard to the issues of violation of RBI/FDI policies and the CA Act by secret arrangements.

49. It can hardly be disputed that profession of auditing is of great importance for the economy. Financial statements audited by qualified auditors are acted upon and failures of the auditors have resulted into scandals in the past. The auditing profession requires proper oversight. Such oversight mechanism needs to be revisited from time to time. It has been pointed out that post Enron Anderson Scandal, in the year 2000, Sarbanse Oxley Act was enacted in U.S. requiring corporate leaders to personally certify the accuracy of their company's financials. The Act also lays down rules for functioning of audit companies with a view to prevent the corporate analysts from benefitting at the cost of public interest. The audit companies were also prohibited from providing non audit services to companies

whose audits were conducted by such auditors. Needless to say that absence of adequate oversight mechanism has the potential of infringing public interest and rule of law which are part of fundamental rights under Articles 14 and 21. It appears necessary to realise that auditing business is required to be separated from the consultancy business to ensure independence of auditors. The accounting firms could not be left to self regulate themselves.

50. While we appreciate that it is for the policy makers to take a call on the issue of extent to which globalization could be allowed in a particular field and conditions subject to which the same can be allowed. Safeguards in the society and economy of the country in the process are of paramount importance. This Court may not involve itself with the policy making but the policy framework can certainly be looked at to find out whether safeguards for enforcement of fundamental rights have been duly maintained. In the present context, having regard to the statutory framework under the CA Act, current FDI Policy and the RBI Circulars, it may *prima facie* appear that there is violation of statutory provisions and policy framework effective enforcement of which has to be ensured. Statutory regulatory provisions intended to advance the object of law have to be enforced meaningfully. No vested interest can flout the

same by manifesting compliance only in form. Compliance has to be in substance. The law enforcing agencies are expected to see the real situation. As found by the Expert Committee in its report, there is a compliance by MAFs only in form and not in substance, by having got registered partnership firms with the Indian partners, the real beneficiaries of transacting the business of chartered accountancy remain the companies of the foreign entities. The partnership firms are merely a face to defy the law. The principle of lifting the corporate veil has to apply when the law is sought to be circumvented. In expanding horizons of modern jurisprudence, it is certainly permissible. Its frontiers are unlimited. The horizon of the doctrine is expanding. While the company is a separate entity, the Court has come to recognize several exceptions to this rule. One exception is where corporate personality is used as a cloak for fraud or improper conduct or for violation of law. Protection of public interest being of paramount importance, if the corporate personality is to be used to evade obligations imposed by law, the real state of affairs needs to be seen¹. The same principle applies while overseeing the compliance of applicable ethics of not permitting profit sharing or complying with the ceiling limit for the business

¹ State of Rajasthan vs. Gotan Lime Stone Khanji Udyog Pvt. Ltd. (2016) 4 SCC 469, paras 24 to 28; State of Karnataka vs. Selvi J. Jayalalitha (2017) 6 SCC 263, paras 205 to 211

which is violated by using the technique of sub contracts for outsourcing. If the premises are same, phone number/fax number is same, brand name is same, the controlling entity is same, human resources are same, it will be difficult to expect that there is full compliance on mere separate registration of a firm. The prohibition under Section 25 of the CA Act can be held to be defeated. It is perhaps for this reason that the network firms avoided giving the information sought by the Committee. The issue of separate oversight body for auditing work and updating existing legal framework appear to be necessary.

51. The other aspect is of investment in CA firms, in violation of prohibition of FDI policy, by using a circuitous route of interest free loans to partners. The fact that the income tax authorities have taken the grants received as revenue receipts and taxed the same as such is not conclusive to hold that the receipt is not an investment which is impermissible. If investment is not permitted, the policy of law cannot be defeated by terming such investment as grant for quality control specially when the grant has been used to acquire a chartered accountancy firm.

52. Absence of revisiting and restructuring oversight mechanism as discussed above may have adverse effect on the existing

chartered accountancy profession as a whole on the one hand and unchecked auditing bodies can adversely affect the economy of the country on the other. Moreover, companies doing chartered accountancy business will not have personal or individual accountability which is required. Persons who are the face may be insignificant and real owners or beneficiary of prohibited activity may go scot free. As already noted, the Reports of the Study Group and Expert Group show that enforcement mechanism is not adequate and effective. This aspect needs to be looked into by experts in the Government. It may consider whether on the pattern of the Sarbanse Oxley Act corporate leaders be required to personally certify the accuracy of the financial statements. Further, how to prevent corporate analysts from benefitting from the conflict of interests, how to check audit companies from providing non audit services and how to lay down protocol for auditors. It has also been brought to our notice that another law in US '*Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010*' to ensure more transparency and accountability of financial institutions to decrease the risk of investing needs consideration. It sets up an oversight body called the Financial Stability Oversight Council (FSOC).

53. Accordingly, we issue the following directions:

- (i) The Union of India may constitute a three member Committee of experts to look into the question whether and to what extent the statutory framework to enforce the letter and spirit of Sections 25 and 29 of the CA Act and the statutory Code of Conduct for the CAs requires revisit so as to appropriately discipline and regulate MAFs. The Committee may also consider the need for an appropriate legislation on the pattern of Sarbanes Oxley Act, 2002 and Dodd Frank Wall Street Reform and Consumer Protection Act, 2010 in US or any other appropriate mechanism for oversight of profession of the auditors. Question whether on account of conflict of interest of auditors with consultants, the auditors' profession may need an exclusive oversight body may be examined. The Committee may examine the Study Group and the Expert Group Reports referred to above, apart from any other material. It may also consider steps for effective enforcement of the provisions of the FDI policy and the FEMA Regulations referred to above.

It may identify the remedial measures which may then be considered by appropriate authorities. The Committee may call for suggestions from all concerned. Such Committee may be constituted within two months. Report of the Committee may be submitted within three months thereafter. The UOI may take further action after due consideration of such report.

- (ii) The ED may complete the pending investigation within three months;
- (iii) ICAI may further examine all the related issues at appropriate level as far as possible within three months and take such further steps as may be considered necessary.

The matters stand disposed of accordingly.

.....J.
[ADARSH KUMAR GOEL]

.....J.
[UDAY UMESH LALIT]

NEW DELHI;
23rd FEBRUARY, 2018.

B. Annexure B - Government order establishing the Committee of Experts

B.1. Government order establishing the Committee of Experts

No. 1/4/2018- PI
GOVERNMENT OF INDIA
MINISTRY OF CORPORATE AFFAIRS

5TH Floor, 'A' Wing, Shastri Bhawan
Dr. Rajendra Prasad Road,
New Delhi-110001
Dated: 20-04-2018

OFFICE MEMORANDUM

Sub: Constitution of three (3) member Committee of Experts as per directions of Hon'ble Supreme Court of India vide order dated 23.02.2018 in Civil Appeal No. 2422 of 2018 (Arising out of Special Leave Petition)(Civil) no. 1808 of 2016 to look into the regulatory and other issues related to Multi-National Accounting Firms (MAF)

The Hon'ble Supreme Court in Civil Appeal No. 2422 of 2018 has vide Order dated 23.02.2018 in Civil Appeal No. 2422 of 2018 (Arising out of Special Leave Petition)(Civil) no. 1808 of 2016 has directed Union of India to constitute a three member Committee of Experts to look into the regulatory and other issues related to Multi-National Accounting Firms (MAFs). Accordingly, three member Committee of Experts consisting of the following members is hereby constituted:-

- | | |
|---|-------------|
| (i) Shri Anurag Agarwal,
Joint Secretary,
Ministry of Corporate Affairs | Chairperson |
| (ii) Shri Sudhanshu Pandey,
Joint Secretary,
Department of Commerce | Member |
| (iii) Shri Ravinder,
Joint Secretary,
Department of Industry | Member |

2. The terms of reference of the Committee of Experts are as follows:

(i) The Committee of Experts will look into the question whether and to what extent the statutory framework to enforce the letter and spirit of Sections 25 and 29 of the CA Act and the statutory Code of Conduct for the CAs requires revisit so as to appropriately discipline and regulate MAFs.

(ii) The Committee may also consider the need for an appropriate legislation on the pattern of Sarbanes Oxley Act, 2002 and Dodd Frank Wall Street Reform and Consumer Protection Act, 2010 in US or any other appropriate mechanism for oversight of profession of the auditors.

(iii) The issue regarding conflict of interest of auditors with consultants, the auditors' profession may need an exclusive oversight body may be examined.

(iv) The Committee may examine the Study Group and the Expert Group Reports referred to in the order 23.2.2018 of Hon'ble Supreme Court apart from any other material.

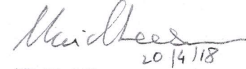
(v) The Committee may also consider the steps for effective enforcement of the provisions of the FDI policy and the FEMA Regulations.

(vi) The Committee of Experts may identify the remedial measures which may then be considered by appropriate authorities. The Committee may call for suggestions from all concerned.

(vii) Any other matter to be considered the Committee of Experts.

3. The Committee of Experts shall complete its work and submit its report within three months of its constitution.

4. This issues with the approval of Competent Authority.


20/14/18

(G. Vaidheeswaran)

Deputy Secretary to the Govt. of India

To

1. Shri Anurag Agarwal, Joint Secretary, Ministry of Corporate Affairs.
2. Shri Sudhanshu Pandey, Joint Secretary, Department of Commerce.
3. Shri Ravinder, Joint Secretary, Department of Industry.

Copy for information to:-

- (i) PS to CAM
- (ii) PS to MOS
- (iii) PPS/PS to Secretary, CA/JS(AA)
- (iv) Guard File

C. Annexure C - Dates of Committee of Experts Meeting

C.1. Dates of Committee of Experts Meeting

Sl. No.	Dates
1.	May 29, 2018
2.	June 27, 2018
3.	July 12, 2018
4.	July 27, 2018
5.	August 03, 2018
6.	August 10, 2018
7.	September 11, 2018
8.	October 04, 2018
9.	October 17, 2018

D. Annexure D - Stakeholders Questionnaire

D.1. Stakeholders Questionnaire

COMMITTEE OF EXPERTS

Inviting comments from stakeholders

- 1 The Supreme Court of India in its recent judgment dated February 23, 2018 in the matter of *S. Sukumar versus The Secretary, Institute of Chartered Accountants of India and Centre for Public Interest Litigation versus Union of India* directed the Government to constitute a three member Committee of Experts to look into the regulatory and other issues related to multi-national accounting firms.
- 2 The Government of India has constituted a three-member Committee of Experts on April 20, 2018 consisting of the following persons:
 - i Chairperson: Shri Anurag Agarwal, Joint Secretary, Ministry of Corporate Affairs.
 - ii Member: Shri Sudhanshu Pandey, Joint Secretary, Department of Commerce, Ministry of Commerce and Industry
 - iii Member: Shri Ravinder, Joint Secretary, Department of Industry, Ministry of Commerce and Industry.
- 3 The Committee invites specific suggestions from all stakeholders like auditors, audit firms, companies, investors and regulators.
- 4 For the convenience of the stakeholders, the questions have been categorised under two broad heads i.e., competition issues and oversight mechanism.

Competition

- a Do you think foreign audit firms are operating in India or whether these are Indian firms affiliated with an international network?
- b Do you know whether these firms while operating in India have violated any provision of the Chartered Accountants Act, 1949 (CA, Act), norms prescribed by the Institute of Chartered Accountants of India (ICAI) or any other laws? If yes, what kind of violations?
- c The Companies Act, 2013 prohibits rendering of certain non-audit services by the statutory auditor/network entities to avoid conflict of interest. However, there are no disclosure requirements in the Act on other (permitted) non-audit services rendered by the network/associated entities. What specific disclosures should be made both by the company and auditor to ensure sufficient transparency in the domain of non-audit services?
- d Do you think audit firms having affiliation with international network:
 - i) face any indirect control issues in their audit functions?
 - ii) have an unfair advantage through network?

If yes, please elaborate.

- e Presently the CA Act and professional code of conduct imposes several restrictions on soliciting work through advertisement and promotion. What are your views on these restrictions?
- f The respective councils of the professional institutes i.e., ICAI, ICSI and ICAI¹ are yet to take a final decision on the modalities of setting up multi-disciplinary partnership (MDP) firms. What are your views on allowing MDP firms ?

Oversight mechanism

- a Do you think the current liability regime for auditors i.e., both firm and individual, is strong enough to ensure sufficient transparency and accountability in audit profession? If no, what are the key measures which can be taken to strengthen/improve the standards of accountability?
 - b In the event of serious lapses, is liability correctly attributed in the cases of large firms (including big four) to the concerned decision making partner?
 - c What should be the appropriate form of oversight mechanism in the Indian context?
 - d The Companies Act, 2013 proposes to set up the National Financial Reporting Authority (NFRA), an exclusive oversight body. Do you agree that there is need for setting up such a body? If yes, what specific powers should be given to NFRA to ensure a strong enforceable oversight mechanism?
 - e How do you see the role of ICAI going forward once NFRA becomes completely operational?
- 5 Your submissions would be very helpful for the Committee, if they are provided with supporting facts, reasons and suggestions. When responding please state whether you are responding as an individual or representing the views of an organisation. Kindly mail your comments with your details (Name, Address, Occupation, etc.) to:

Shri G. Vaidheeswaran at (g.vaidheeswaran@nic.in)
Deputy Secretary, Ministry of Corporate Affairs, Government of India

¹ Formerly known as ICWAI.

E. Annexure E - List of Stakeholders

E.1. Annexure E - List of Stakeholders

Stakeholders who engaged with the Committee of Experts

Sl. No.	Name	Designation	Organisation
1.	Mr. Vinod Jain	President	All India Chartered Accountants Society of India
2.	Mr. Mritunjay Kapur	Chairman	National Council on Corporate Frauds and Internal Audit, ASSOCHAM
3.	Mr. Narinder Wadhwa	Co-chairman	National Council on Capital Market, ASSOCHAM
4.	Mr. Santosh Parashar	Head	Corporate Affairs and Capital Market Division, ASSOCHAM
5.	Mr. Kaushal Kishore	Partner	BSR & Co. LLP
6.	Mr. Sanjiv Chaudhary	Partner	BSR & Co. LLP
7.	Mr. Ashish Bansal	Partner	BSR & Co. LLP
8.	Mr. Marut Sen Gupta	Deputy Director General	CII
9.	Mr. Vikkas Mohan	Senior Director	CII
10.	Mr. J K Jain	Executive Director	DCM Shriram Ltd.
11.	Mr. P. R. Ramesh	Chairman	Deloitte Haskins & Sells LLP
12.	Mr. K Sai Ram	Partner	Deloitte Haskins & Sells LLP
13.	Mr. Manjeet Bijlani	Senior Vice-President, Finance	Edelweiss
14.	Ms. Abha Seth	Senior Director	FICCI
15.	Mr. Chandrapal		FICCI
16.	Mr. Mahesh		FICCI
17.	Mr. V. Sagar	Secretary	ICAI
18.	Mr. Dinesh C. Arora	Secretary	ICSI
19.	Mr. L. Gurumurthy	Secretary(Acting)	ICAOI
20.	Mr. Russell Guthrie	Executive Director, External Affairs	IFAC
21.	Mr. Brian Hunt	Chairman	IFIAR
22.	Mr. Deepak Bhalla	Senior Vice-President	Infosys
23.	Mr. Sanjay Mathur	Vice-President Finance	Maruti Suzuki

Stakeholders who engaged with the Committee

Sl. No.	Name	Designation	Organisation
24.	Mr. Yogesh Sharma	Partner	MSKA & Associates
25.	Mr. Rajan Vaidyan	Senior Consultant	MSKA & Associates
26.	Mr. Anil Khiatan	President	PHD Chambers of Commerce and Industry
27.	Mr. Harinderjit Singh	Partner	Price Waterhouse Chartered Accountants LLP
28.	Ms. Sharmila A. Karve	Partner	Price Waterhouse Chartered Accountants LLP
29.	Mr. Raj Agarwal	Partner	S.R. Batliboi & Co. LLP
30.	Mr. Sudhir Soni	Partner	S.R. Batliboi & Co. LLP
31.	Ms. Pallavi Dinodia Gupta	Partner	S R Dinodia & Co Chartered Accountants
32.	Ms. Madhuri Ravi Srinivasan	Partner	Walker Chandiook & Co LLP
33.	Mr. Khushroo B Panthaky	Partner	Walker Chandiook & Co LLP

F. Annexure F - Supreme Court extension order

F.1. Supreme Court extension order

1

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION
M.A.No.2039 OF 2018
WITH
I.A.NO.102786 of 2018
IN
CIVIL APPEAL NO.2422 OF 2018

S. SUKUMAR

..APPLICANT(S)
/APPELLANT(S)

VERSUS

THE SECRETARY, INSTITUTE OF
CHARTERED ACCOUNTANTS OF INDIA & ORS.

..RESPONDENT(S)

O R D E R

Heard.

The applicant is granted extension of three months further time for submission of report of the Expert Committee in terms of order dated 23rd February, 2018 passed by this court.

M.A.No.2039 of 2018 is accordingly disposed of.

.....J.
[ABHAY MANOHAR SAPRE]

.....J.
[UDAY UMESH LALIT]

NEW DELHI
JULY 27, 2018

Signature Not Verified
Digitally signed by
ANITA MALHOTRA
Date: 2018.07.01
10:44:03IST
Reason: []

ITEM NO.64

COURT NO.11

SECTION IV-A

S U P R E M E C O U R T O F I N D I A
R E C O R D O F P R O C E E D I N G SM.A.No.2039/2018 in C.A.No.2422/2018

S. SUKUMAR

Petitioner(s)

VERSUS

THE SECRETARY, INSTITUTE OF CHARTERED
ACCOUNTANTS OF INDIA & ORS.

Respondent(s)

(FOR ADMISSION and IA No.102786/2018-EXTENSION OF TIME)

Date : 27-07-2018 This application was called on for hearing today.

CORAM :

HON'BLE MR. JUSTICE ABHAY MANOHAR SAPRE
HON'BLE MR. JUSTICE UDAY UMESH LALITFor Applicant(s)
Appellant

(Union of India)

Mr.Vikramjeet Banerjee, ASG
Mr.Anmol Chandan, Adv.
Mr.Amarjeet Singh, Adv.
Ms.Shruti Agarwal, Adv.
Mr.Arvind Kumar Sharma, Adv.Mr.Rohit Kumar, Adv.
Mr.T.Sudhakar, Adv.
Mr.Omanakuttan K.K., Adv.
Mr.Devesh, Adv.
Mr.Prashant Bhushan, Adv.

For Respondent(s)

Mr.Vishal Gehrana, Adv.
Ms.Ruby Singh Ahuja, Adv.
Mr.Utsav Trivedi, Adv.
Mrs.Manik Karanjawala, Adv.
M/s.Karanjawala & Co.Mr.Pramod Dayal, Adv.
Mr.Nikunj Dayal, Adv.
Ms.Payal Dayal, Adv.Mr.Kamal Shankar, Adv.
Mr.Atul N., Adv.
Ms.Arati Singh, Adv.

UPON hearing the counsel the Court made the following
O R D E R

Heard.

The applicant is granted extension of three months further time for submission of report of the Expert Committee in terms of signed order.

M.A.No.2039 of 2018 is accordingly disposed of.

(Ashok Raj Singh)
Court Master

(Chander Bala)
Court Master

(Signed Order is placed in the file)

