

SEBI Circular - Resignation of statutory auditors to be regulated

Key Highlights

INTRODUCTION

Appointment of a statutory auditor (“Auditor”) is mandated under Section 139 of the Companies Act, 2013 (“Act”). Auditor is expected to inspect and present an opinion about the true and fair presentation of a company’s accounts. However, lately, there has been a spate of sudden resignations of Auditors of listed companies, without completing the audit for the financial year or the quarter, as the case may be.

Reliance Capital Limited, Reliance Home Finance Limited, Manpasand Beverages Limited, Fortis Healthcare Limited, Vakrangee Limited and Eveready Industries India Limited are some of the companies where the Auditors have resigned abruptly. The reasons for the same were often vague, generally citing ‘pre-occupation’ or ‘lack of adequate information or cooperation in sharing of data by the company’.

Though there are legal principles under the Companies Act, 2013, which provide for the manner of resignation of Auditors, however, such abrupt resignations hamper the investor confidence. Investors in listed companies rely amongst other aspects, on the audited financial results for taking their investment decisions. Resignation of Auditors before completion of audits of the financial results raises serious doubts about governance and financial health of a

company and leaves investors with lack of reliable information.

SEBI’S CIRCULAR

The Securities and Exchange Board of India (“SEBI”), after taking note of such resignations issued a ‘Consultative Paper on Policy Proposals with respect to Resignation of Statutory Auditors from Listed Companies’ dated July 18, 2019, wherein tightening of the disclosure norms with respect to Auditor’s resignations was proposed.

Basis the public comments on the same, SEBI issued a circular dated October 18, 2019 on resignation of statutory auditors from listed entities and their material subsidiaries (“Circular”), setting out the procedure and compliances to be followed by the listed entity and its material subsidiaries.

KEY AMENDMENTS

The Circular focuses primarily on achieving two objectives with respect to resignation of Auditors: (i) additional disclosures and providing clarity as to the course of action in situations of resignation by Auditors; and (ii) mandating completion of the audit process of the listed entity or its material subsidiaries.



➤ **Applicability:**

The Circular is applicable to all listed entities and its material subsidiaries (whether listed or unlisted). The Circular had come into force with immediate effect from the date of its publication.

➤ **Compliance for limited review / audit review prior to appointment or re-appointment of Auditors:**

SEBI, in its Circular, provides that if the Auditors of a listed company or its material unlisted subsidiary resign,

- within 45 (forty-five) days from the end of a quarter of a financial year, the Auditor shall, before such resignation, issue the limited review / audit report for such quarter.
- after 45 (forty-five) days from the end of a quarter of a financial year, the Auditor shall, before such resignation, issue the limited review / audit report for such quarter as well as the next quarter.

Notwithstanding the above, if the Auditor has signed the audit report for the first 3 (three) quarters (limited review/ audit) of a financial year, then the Auditor shall, before resignation, issue the limited review / audit report for the last quarter of such financial year as well as the audit report for the said financial year.

➤ **Reporting of concerns to the Audit Committee**

Part C of Schedule II under Regulation 18(3) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

(“SEBI LODR”), provides that the audit committee of a listed entity (“Audit Committee”) is responsible for the appointment, performance evaluation, ensuring independence of the Auditors and reviewing and monitoring effectiveness of the audit process. SEBI vide its Circular imposes additional responsibilities on the Audit Committee by providing for reporting of the concerns of the Auditors to the Audit Committee.

➤ **Disclaimer in case of non-receipt of information:**

The Circular provides that the Auditor may provide an appropriate disclaimer in its audit report, in accordance with the accounting standards in instances wherein the reason for resignation of Auditor might be because of the listed entity and / or its material subsidiaries not cooperating or not providing information.

➤ **Format for Resignation:**

Upon resignation by an Auditor before the completion of its assignments for the year, the listed entity and / or its material subsidiaries shall obtain details in a prescribed format, as provided for in the Circular, which includes detailed reasons for resignation, a declaration by the Auditor that there are no other material reasons other than those provided and also provide for efforts made by the Auditor (including approaching the audit committee), prior to resignation.

➤ **Co-operation by listed entity and / or its material subsidiaries:**



NEED FOR THE CIRCULAR

The listed entity is required to provide all relevant documents or information as required by the Auditor during the period from its proposal to resign till the Auditor submits the report for such quarter / financial year.

➤ Disclosure of views of the Audit Committee's to the stock exchanges:

As per the Circular, upon the resignation of the Auditor and the subsequent deliberations of the Audit Committee, the Audit Committee is required to communicate its views to the management and the listed entity shall ensure disclosure of the Audit Committee's views to the stock exchanges as soon as possible and in any case, not later than 24 (twenty four) hours after the date of such Audit Committee meeting.

This disclosure requirement is separate from the disclosure requirement under sub-clause 7(A) of Clause A in Part A of Schedule III under Regulation 30(2) of the SEBI LODR wherein a listed entity is required to disclose to the stock exchanges about the resignation of the Auditor along with detailed reasons of the same within 24 (twenty four) hours of such resignation.

➤ Exception

The Circular carves out an exception for Auditors that have been rendered disqualified due to operation of any condition mentioned in Section 141 of the Act. In such situations, the provisions of the Circular will not be applicable.

The sudden resignation of Auditors has increased due to the recent turmoil in the corporate sector. Due to the same, Auditors now feel a discomfort when they suspect transactions which might potentially involve unauthorized transfer of assets of the company or siphoning of monies. The reason for the same are the number of regulatory actions being undertaken against Auditors wherein the Auditors are being held liable for misstatement of the financials of listed entities.

Although, there are regulatory provisions to govern the resignation of Auditors, there was a need felt to review the listing and disclosure obligations, as the present provisions have been tested to be inadequate. From a standpoint of the investor and other public shareholders, auditors play a critical role in listed entities. The financials of listed entities provide adequate information, which helps them make informed decisions. It is therefore imperative that the process of audit of such financials is not stalled due to unsatisfactory responses from the management of the listed entity which leaves the Auditor with no option but to choose to put in their papers.

In view of the same and with an aim to address the issues faced by Auditors of a listed companies and / or its material subsidiaries, SEBI has come up with this Circular.

Further, SEBI is also considering setting up a whistle blower mechanism for Auditors to report such cases of financial irregularities and other fraudulent transactions. This proposed whistle blower mechanism would be of significance in situations where the financial irregularities have already been flagged out by the Auditors and the management of the company has not



taken any remedial actions to rectify or provide explanations for the same. This mechanism is also aimed towards maintaining confidentiality to ensure that the Auditors who face such difficulties in conducting their task, avail the said mechanism.

safeguarding investor and other public shareholders confidence is a welcome move.

CONCLUSION

SEBI's safeguard considering the recent developments in the corporate sector aims to maintain investor confidence which is crucial for listed companies. The Circular also aims to promote higher accountability of Auditors so that there is a free flow of accurate information across outsiders who do not have insight into the functioning and accounting of the company.

The Circular lays down safeguards for the Auditors to voice their concerns in situations when the company is not cooperating in the detailed reasons for their resignation as per the format provided for in the Circular. It also goes a step forward by clarifying the role of the audit committee for an overall approach towards addressing concerns of the Auditors. However, one practical problem which the Circular is silent on is, in the instance, the listed entity proceeds with an application to the Central Government for removal of the Auditor and simultaneously, the Auditor resigns from its office and the treatment of disqualification of Auditors vis-à-vis the Circular. Such gaps will only be addressed as and when situations arise, however, SEBI's efforts to tackle issues with respect to corporate governance and

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