Appointment of Auditors in Regulated Financial Institutions of India

RBI Guidelines RBI/2021-22/25 dated April 27,2021 introduced joint statutory auditors from the financial year 2021-22 for banks, UCBs and NBFCs having asset size of Rs. 15,000 cr. or above at the end of previous financial year with upper ceiling of joint auditors. Earlier engagement of joint auditors was restricted to public sector banks only. Joint audit isperceived to be a tool for enhancement of audit quality and improvement of auditors' independence. The RBI Guidelines prescribed baseline audit resource as eligibility norms for audit engagement, fixed maximum ceiling for bank audit and set out norms for work allocation among joint auditors. In view of the introduction of mandatory joint audit in the financial sector, this paper analyzes a contrary view that joint audit in India is simply a kind of shared audit and intended to mobilize better audit resource which may indirectly improve audit quality and help enhancing auditors' independence. While the RBI focuses on baseline audit resource, it did not set out mechanism for taking stock of actual deployment of such audit resource in conducting audit. This paper also analyzes the state of audit market competition in the RBI regulated financial sector in India and disparity in audit fees.

1. The New RBI Guidelines

The RBI Guidelines RBI/2021-22 /25 dated April 27,2021 apply to:

- Commercial banks excluding RRBs;
- Urban Co-operative banks (UCBs); and
- Non-banking Financial Companies (NBFCs) including Housing Finance Companies (HFCs); with effect from the financial year 2021-22 with flexibility granted to UCBs and NBFCs to apply from the second half of 2021-22. These regulated entities are termed as regulated financial institutions (regulated FIs) for brevity. Non-deposit taking NBFCs having total assets below Rs. 1000 cr. may continue with the old guidelines.

The RBI Guidelines RBI/2021-22 /25 dated April 27,2021 set out *inter alia*the followingfive major rules:

i. **Upper limit of SCAs/SAs**: The maximum number of SCAs /SAs to be appointed are linked to asset size of the regulated FIs. See Paragraph 2 for upper limit of SCAs/SAs.

ii. **Engagement Join auditors**: The regulated FIs having asset size of Rs. 15,000 cr. or above at the end of previous financial year(in contrast to only public sector banks) shall engage joint auditors effective from the current financial year i.e. FY 2021-22. See Paragraph 2.3for a detailed discussion on efficacy of joint audit.

iii. **Baseline audit resource**: The baseline audit resource has been set out as minimum eligibility norm of an audit firm for being engaged as auditor of regulated FIs. See Paragraph 3 for critical analysis of eligibility norms and discussion on audit transparency.

iv. **Audit fees and expenses** should be reasonable and commensurate with the scope and coverage of audit, size and spread of assets, accounting and administrative units, level of computerization, identified risk of financial reporting, etc. For empirical analysis of audit fees and audit fee disparity see Paragraph 4.

v. **Audit rotation**of three years has been prescribed which too short as compared to the audit tenure specified in the Companies Act, 2013. See Paragraph 5 for a detailed analysis that threeyear audit tenure is too short to affect audit stability.

This paper attempts to critically examine various rules set out in the aforesaid RBI Guidelines including the state of audit market competition in the context of use of joint audit in Europe as a tool for enhancing audit market competition (see Paragraph 2.4).

2. Upper limit of joint auditors

RBI Guidelines required that statutory audit of regulated FIs having asset size of Rs. 15000 cr. or above in the previous financial year be conducted under joint audit of **minimum two audit firms**. Joint auditors should not have any common partners andalso, they should not be under the same audit network. Efficacy of joint audit has been discussed separately in Paragraph 2.3. These Guidelines set out maximum number of SCAs/SAs as per asset size to restrict engagement of too many auditors (see Table 1).

Table 1 Maximum Number of SCAs/SAs in regulated entities

Asset Size of the entity	Maximum No. of SCAs/SAs
Up to Rs. 5,00,000 cr.	4
Rs. 5,00,000 cr. - Rs. 10,00,000 cr.	6
Rs. 10,00,000 cr. - Rs. 20,00,000 cr.	8
Above Rs. 20,00,000 cr.	12

Earlier the RBI mandated joint audit in public sector banks (PSBs) only and the relevant Guidelines applicable from the financial 2018-19 onwards were based on categorization of PSBs:

(*i*) Category "A" Banks (Large Banks viz. Bank of Baroda, Bank of India, Canara Bank, Punjab National Bank, Central Bank of India, IDBI Bank and Union Bank of India) shall not have more than 6 SCAs. However, in case of SBI the number of SCAs shall not be more than 14.

(*ii*) Category "B" Banks (Medium Banks viz. Allahabad Bank, Corporation Bank, Indian Bank, Indian Overseas Bank, Oriental Bank of Commerce, Syndicate Bank and UCO Bank) shall not have more than 5 SCAs, and;

(*iii*) Category "C" Banks (Small Banks viz. Andhra Bank, Bank of Maharashtra, Dena Bank, Punjab & Sind Bank, United Bank of India and Vijaya Bank) shall not have more than 4 SCAs.

Impact of the new Guidelines on joint audit with upper limit of SCAs/SAs are reviewed based on sample of 13 PSBs (Table 2), 22 private banks (Table 3) and 20 NBFCs including HFCs (Table 4).

2.1 De-categorization of PSBs in engaging SCAs/SAs - As per the new Guidelines, all PSBs can rationalize the number of joint auditors to be engaged since the earlier Guidelines (applicable from FY 2018-19 onwards) regarding engagement joint auditors by PSB Categories have been superseded. This will help to rebalance joint audit in PSBs while retaining effectiveness of joint audit and weeding out complex shared responsibility among too many auditors. Also, the norms for statutory branch audit in PSBs (effective 2020-21) [RBI, 2020] require that statutory branch audit should be carried out so as to cover 90% of all funded and 90% of all non-funded credit exposures of a bank.Given the coverage of statutory branch auditor(s),number of SCAs may be balanced to allow them to have enlarged scope of work. The Guidelines require that a minimum level of statutory branch audit shall be carried out by SCAs. Banks will allot the top 20 branches (to be selected strictly in order of the level of outstanding advances) in such a manner as to cover a minimum of 15% of total gross advances of the bank by SCAs. This may, of course, require more than two SCAs for proper distribution of audit load. Thus the RBI has offered minimum and maximum range of joint auditors which the bank management should effectively utilize for improving audit quality.

Table 2: Maximum and Minimum SCAs/SAs in PSBs as new RBI Guidelines

Sl no.	PSU Banks	Asset Size In Rs. Cr.[1]	Exiting no. of auditors[2]	Maximum no of auditors as per New RBI Guidelines	Minimum No. of auditors
1	SBI	4197412	14	12	2
2	Bank of Baroda	1157915	5	8	2

3	PNB	830665	5	6	2
4	Canara Bank	723874	4	6	2
5	Bank of India	656995	4	6	2
6	Union Bank of India	550683	5	6	2
7	Central Bank of India	356435	4	4	2
8	Indian Bank	309468	5	4	2
9	UCO Bank	235908	5	4	2
10	Bank of Maharashtra	168867	4	4	2
11	Punjab & Sind Bank	100503	4	4	2
12	Indian Overseas Bank	260726	4	4	2
13	JK Bank	108872	4	4	2

Notes: 1. Asset size as per standalone financial statements for the FY 2019-20.

2. Existing no. of auditors as per standalone financial statements

3. Excess auditors in terms of new norms of maximum no of auditors are found SBI, Indian Bank and UCO Bank.

The new Guidelines intends to bring uniformity in engagement of statutory auditor across the regulated FIs sector but overlooked the weakness of the joint audit (which is effectively a shared audit) framework. The RBI appears to have three reasonings: (a) existing bank auditors do not have adequate audit resource to carry out large audit singularly, (b) audit work to be allocated engaging more than one auditor such that risk of audit failure is minimized and (iii) increased involvement of many audit firms would increase audit market competition. In this process, the regulator accepts the risk of shared audit which in which none of auditors could form complete view about the financial statements of the entity - each auditor has to rely on the work of others. However, the required minimum two SCAs subject to upper limits of joint auditors seems to be a logical proposition by which number of SCAs can be restricted by the management.

It appears from Table 2, that SBI will need to reduce at least 2 SCAs and Indian Bank and UCO Bank will have to reduce at least one SCAs each to meet the new upper limit of SCAs. It is to be seen whether management of PSBs engage SCAs less than the maximum permissible limit to allow SCAs to have higher level of audit work or engage maximum permissible SCAs based on traditional audit framework.

2.2 Introducing joint audit in Private Banks and NBFCs–In the private banking space so far the statutory audit has been conducted by single auditor except in IDBI Bank and Federal Bank out of 22 sampled banks (see Table 3). Similarly, out of 20 sampled NBFCs including HFCs only two companies (LIC Housing Finance and L&T Finance) are subjected to joint audit. Four sample companies (Table 4 Sl Nos 17-20), fall below Rs. 10,000 cr. asset size level and therefore can continue with the existing audit mechanism.

While introducing joint audit in private banks and NBFCs, the RBI might have been influenced by its experience in PSBs audit and wants to replicate the same on other regulated entities. Regarding joint audit, ICAEW (2019) observed that "*two professional opinions are often considered better than one and seeking a second opinion is seen as a good thing. This is at the heart of joint audit debate for some, to whom it seems obvious that two audit firms issuing a joint audit opinion must be better than one. For others, joint or shared audits are simply on way of increasing competition and choice in the audit market which, of itself, should improve audit quality*". However, the "audit market competition" seems to be not the issue in India as the big four has very limited engagement in the regulated FIs (see Paragraph 2.4).

As per the IFAC (2020) estimates, joint audit is used across fifty-five jurisdictions. France requires joint audit for all listed companies since 1984. Seventeen African nations require joint audit and twenty -two jurisdictions voluntarilyelect joint audit. Denmark required joint audit for all listed companies during 1930-2005; the requirement was withdrawn thereafter considering it as an 'unnecessary financial burden on companies.Apart from Denmark, many countries such as Canada, Sweden, and South Africa abolished mandatory requirements of joint audit. However, many countries including Bulgaria, Dominican Republic, Egypt, India, Liberia and Saudi Arabia require sector-specific joint audit. Within Europe, 90% of all joint audits are carried out in France. The European Commission (2010) in its Green Paper looked into joint audit as a tool to 'dynamise' the audit market to allow mid-tier non-systemic firms to become active players in audit market segment for large corporations. The European Commission proposed to encourage small and medium size audit firms to form consortium for the purpose conducting audit of large corporations as a non-systematic audit firm. If the RBI wished to broad based audit of regulated FIs by introducing joint audit, it should then liberalize theprescribed baseline audit resource

(see Paragraph 3) and permits consortium of small firms to jointly meet the requirement.

However, shared or joint audit requires proper planning atthe audit committee requires level to effectively engage two or more auditors. In India, work allocation among joint auditors often turns into a bitter debate with a referral to the Institute of Chartered Accountants of India (ICAI) for issuance of advisory. In shared audit, various components are shared among the auditors rather than each auditor checks work of the other such that checks and balances are established. For example, distribution of various division or branches to different SCAs is kind of shared audit. Audit committee of the private banks and NBFCs has to adapt to the joint audit framework and make it effective.

Table 3: Maximum and Minimum SCAs/SAs in Private Banks s as new RBI Guidelines

Sl Nos.	Private Banks	Asset Size In Rs. Cr.[1]	Exiting no. of auditors[2]	Maximum no of auditors as per New RBI Guidelines	Minimum No. of auditors
1	HDFC Bank	1530511	1	8	2
2	ICICI	1098365	1	8	2
3	Axis Bank	915165	1	6	2
4	Kotak Mahindra Bank	360252	1	4	2
5	Indusind Bank	307057	1	4	2
6	IDBI Bank	299942	2	4	2
7	Yes Bank	257827	1	4	2
8	Federal Bank	180638	2	4	2
9	IDFC First Bank	149200	1	4	2
10	South Indian Bank	97033	1	4	2
11	Bandhan Bank	91717	1	4	2
12	RBL Bank	88978	1	4	2
13	Karnataka Bank	83314	2	4	2

14	Karur Vysya Bank	68278	1	4	2
15	City Union Bank	49733	1	4	2
16	AU Small Finance	42143	1	4	2
17	DCB Bank	38505	1	4	2
18	Equitas Small Finance Bank	19315	1	4	2
19	CSB Bank	18864	1	4	2
20	Ujjivan Small Finance Bank	18411	1	4	2
21	Dhanlaxmi Bank	12265	1	4	1
22	Suryoday Small Finance Bank	5365	1	4	1

Notes: 1. Asset size as per standalone financial statements for the FY 2019-20.

2. Existing no. of auditors as per standalone financial statements

In joint audit,two or more audit firms conduct audit jointly and take full responsibility of the entire audit. Joint auditors shall have to form their own audit opinion based on their own testing and they would not assume that work done by other auditor(s) is satisfactory. However, SA 299 (Revised) Joint Audit of Financial Statements (issued by thee ICAI) suggests that joint audit to a great extent is a shared audit. SA 299 *inter alia* requires that –

- prior to the commencement of work the joint auditors shall arrive at "division of audit areas and common audit areas amongst the joint auditors that defines the scope of the work of each joint auditor" (Paragraph 8a, SA 299);
- after identification and allocation of work among the joint auditors, the work allocation document shall be signed by all joint auditors and the same shall communicated to those charged with governance(Paragraph 12, SA 299);
- each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures (Paragraph 13, SA 299);

- in case of audit of large entity with several branches including unaudited branches and those required to be audited by branch auditors, the branch audit reports/ returns may require to be reviewed by different joint auditors in accordance with allocation of work and it is specific and separate responsibility of each joint auditor to review the reports/ returns of the division/branches allocated to thee said joint auditors (Paragraph A6, SA 299);
- each joint auditor is entitled to assume that other joint auditors have carried out their part of work as per established audit standards (Paragraph 14, SA 299).

Thus, joint audit report is just culmination of partial view of many auditors. No one auditor possesses complete view of the financial statements.

Table 3: Maximum and Minimum SCAs/SAs in NBFCs as new RBI Guidelines

Sl Nos	*NBFCs*	*Asset Size In Rs. Cr.*[1]	*Exiting no. of auditors*[2]	*Maximum no of auditors as per New RBI Guidelines*	*Minimum No. of auditors*
1	HDFC	524094	1	6	2
2	IRFC	275934	1	4	2
3	LIC Hsg Finance	216806	2	4	2
4	Bajaj Finance	138004	1	4	2
5	Shriram Transport Finance	114129	2	4	2
6	India Bull Housing Finance	102872	1	4	2
7	Dewan Housing Finance	85837	1	4	2
8	PNB Housing Finance	78874	1	4	2
9	M& M Financial	74071	1	4	2
10	Sundaram Finance	33420	1	4	2
11	Mannapuram Finance	23803	1	4	2

12	Can Fin Homes	21044	1	4	2
13	Muthoot Finance	17699	1	4	2
14	GIC Housing Finance	13099	1	4	2
15	PTC India Financial	11642	1	4	2
16	L&T Finance	11338	2	4	2
17	IDFC	8569	1	4	1
18	Tata Investment Corpn.	8095	1	4	1
19	Aavas Financiers	7658	1	4	1
20	Home First	3480	1	4	1

Notes: 1. Asset size as per standalone financial statements for the FY 2019-20.

2. Existing no. of auditors as per standalone financial statements

The above-cited Paragraphs clearly indicate joint audit as per SA 299 is a kind of shared audit. There is no inherent principle that work of one auditor is checked by another. Rather a joint auditor just carries out his/her allocated work and remained responsible for that. Joint auditors are joint and severally liable only for unallocated work. Therefore, the popular saying regarding joint audit that **"four*eyes better than two*"** seems to have very limited merit. One joint auditor believes on the audit work done by another – this just a way of employing many audit firms and by that process possibility of audit error is expected to be minimized. There is a need to review SA 299 in the light of NEP 100 in France wherein joint audit is mandatory.

On the other hand, IFAC (2020) defined joint audit little differently –

"In *joint audits, two (or more) audit firms are appointed to share responsibility for a single audit engagement and to produce single audit report. Joint audits typically involve joint planning, fieldwork allocated between the firms, and a cross-review by each firm of the other's work. The firm jointly report to the audit committee and are both party to the audit report*." This does not match with the definition and principles of joint audit enshrined in SA 299 of the ICAI. Joint audit is distinctly different from shared audit and joint audit – what RBI introduces is simply a shared audit.

2.3 Joint audit and audit quality – academic research and professional views

A survey of academic research papers reveals lack of consensus on using joint audit as tool for improving audit quality. A stream of research papers [Lesage et al (2012), Khatab (2013), Velte and Azibi (2015), Holm and Thinggaard (2018)] found that joint audit has no significant impact on audit quality while Deng *et al* (2014) observed that joint audit may result in a lower level of audit quality. However, another stream of research [Benali (2013), Ittonen and Tronnes (2015) and Revas and Pais (2015) found that joint audit may result in higher level of audit quality.

Summary offive selected research papers that concluded joint audit does not improve audit quality

i. Holm and Thinggaard (2018) studied audit quality differences between audits by a single big audit firm and joint audits with either one or two big audit firms based on data of Danish companies before and after abolishing joint audit with effect from 2005. In Denmark mandatory joint audit was made voluntary beginning 1 January 2005. Authors found no evidence of audit quality differences between audits made by a single big four firm and those conducted by either of the two combinations of joint audits.
ii. Ratzinger-Sakel*et al*(2013) concluded that while joint audits can potentially enhance the audit market competition by allowing smaller audit firms to maintain larger market shares, the related impact on audit quality has not yet been clearly demonstrated.
iii. Lesage et al (2012) studied claimed costs and benefits of joint audit in the backdrop of the Green Paper issued by the European Commission (2010).They investigated whether the claimed drawback (higher costs of joint audit) or advantage (higher audit quality) actually exists. Their result strongly suggests that these claims are not supported. Neither did they find any evidence of additional cost incidence of joint audit nor they could observe any higher quality associated with joint audit.
iv. Using 34 companies in 14 sectors, Khatab (2013) found statistical evidence that the audit rotation has a significance effect on increasing the value of a firm and positive effect on the auditor independence; while the joint audit has a non-significance effect on the value of a firm and the auditor independence.
v. Deng (2014) observed that conventional wisdom holds that joint audits would improve audit quality by enhancing audit evidence precision because "two heads are better than one." They challenged this wisdom and showed that joint audits by one big firm and one small firm may impair audit quality, because, in that situation, joint audits induce a free-riding problem between audit firms and reduce audit evidence precision. Of course, in Indian shared

audit framework there is no problem of 'free riding' although there can be difference on work allocation.

In the light of the mixed result of academic research in other jurisdictions, the RBI should adopt cautious approach in respect of joint audit. SA 299 (revised) is remarkably different from NEP 100 'Audit des comptes réalisés par plusieurs commissaires aux comptes' (Audit of accounts carried out by several statutory auditors) in France. There is no international equivalent of the French auditing standard on joint audits. NEP100(in contrast to SA 299 in India) requires –

- balance in the allocation of work,
- each auditor to make an assessment of audit risks and the control environment, and
- each auditor to perform critical reviews of the work performed by the other firm

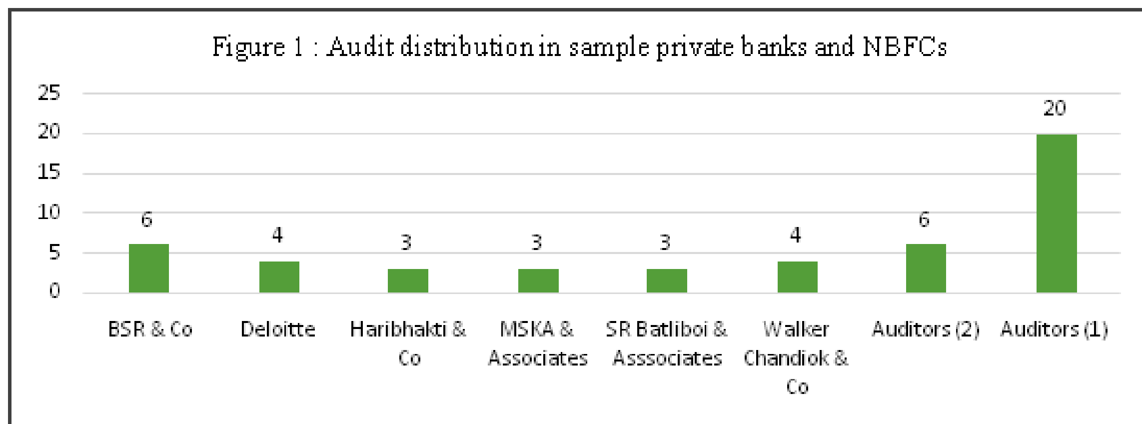
NEP 100 also sets out a joint approach to communication with the audited entity. [SA 299 makes a joint auditor responsible for the work performed by him and thus there is no inherent principle of joint audit which can bring meaningful change to audit quality]. The RBI (in association of the ICAI) should develop a standard similar to NEP 100 in France which makes joint audit more meaningful.

Guide to Joint Audit by Mazars (**www. mazars.com**) provided the following features of joint audit:

i. audit of a company by two or more auditors to produce a single audit report;
ii. audit planning performed jointly and fieldwork is allocated between auditors to avoid duplication;
iii. The work performed by each auditor is subject to cross review by the other auditor;
iv. The auditors jointly review the critical issues affecting the entity;
v. The auditors jointly report to the company's management, audit committee and shareholders;
vi. Each joint auditor is jointly and severally responsible for the audit opinion provided which implies each joint auditor performs a review of the work performed by others; and
vii. The reciprocal per review which leads to issuance of joint audit opinion must be documented.

2.4 Audit market competition

Unlike in the US, there is no audit market concentration in the banking and financial sector in India. While in the PSU Banks 'one auditor one bank audit assignment' principle is adhered to, in the private banks and NBFCs presence of big four auditors is minimaland there is no abnormal concentration of audit assignments within few audit firms. Among big four,Deloitte hadjust four audit assignments and PWC had just one during 2019-20 (based on sample of 20 NBFCs and 22 private banks). It is at the interest of the banking and financial industry, big four auditor should be involvedboth in PSU bank audit as well as in the private financial sector space. Out of 49 audit assignments including joint audits (in forty-two sample private banks and NBFCs) distribution of audit is shown in Figure 1.

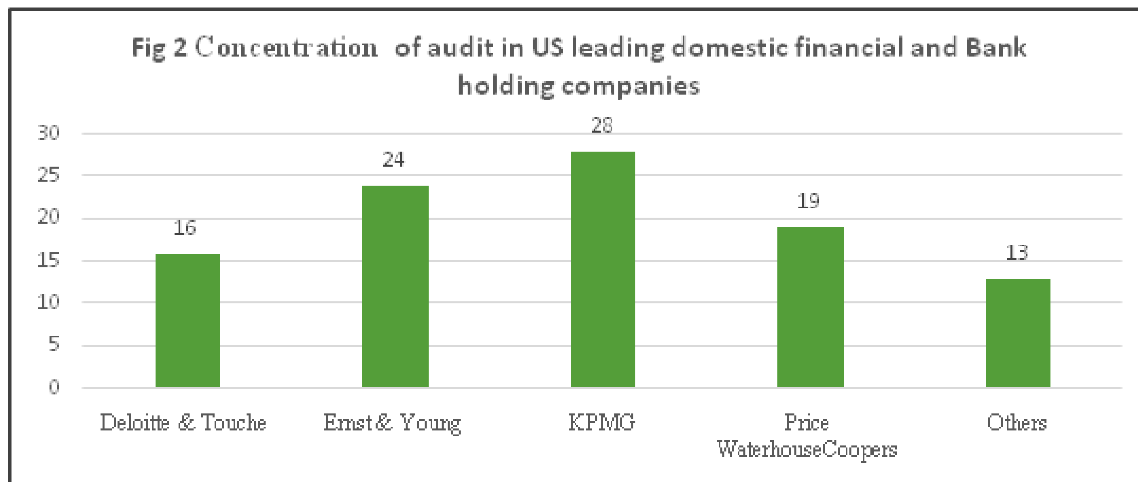


Note to Figure 1: Auditors (2) means auditors who had conducted two audits each.

Auditors (1) means auditors who had conducted only one audit.

It is found that only six auditors had three or more audit assignments and only one auditor had maximum six audit assignments which is well within the audit limits stated in Paragraph 8.3 of the RBI Guidelines. One audit firm is allowed to take up audit of four of commercial banks including not more than one PSB and not more than one All India Financial Institution, 8 UCBs and 8 NBFCs.

A contrasting view is observed in the audit of US leading domestic banking and financial holding companies. As per data available at iBanknet.com, all ninety-eight banks and financial holding companies were subjected to single audit and 87% of those audits are conducted by big four auditors. See Figure 2 for audit concentration in domestic banking and financial sector.



Introduction of mandatory joint audit is expected to share the existing audit assignments among more mid-sized audit firms (that meet baseline audit resource) with reduced audit fee per auditor given that joint audit will have marginal impact on total audit fees. Perhaps the RBI simply intends to create opportunity for more audit firms. But it gives preference to seniority than audit talents (see Paragraph 3).

3. Baseline audit resource

RBI Guidelines has set out a baseline audit resource (Annex I to the Guidelines) as given in Table 5. While defining baseline audit resource, the RBI unduly focused on graded experience to asset size of the audit client. Increased asset size of Banks/ FIs does not require more experienced auditor than that of relatively lower asset size. Rather a smaller banks/ FIs may have complex transactions to be audited. Thus, an audit firm having 15 years of experience can only audit regulated FIs having asset size above Rs. 15000 cr. and that an audit firm having 8 years of experience cannot do that is simply an arbitrary opinion. An auditor who can audit Bank of Baroda, s(he) can audit SBI as well. A smaller asset sized bank audit would require similar audit knowledge and skill what is expected for the larger asset sized banks. No different skill is required for auditing loan book of different size.

Also, the RBI should encourage new entrants to audit market. Baseline audit resource is seriously restrictive to newer audit firms. It simply counts age of an audit firm for the purpose of eligibility. It does not even permit to count a new member because of restrictive "one-year continuous association" clause. Evenit restricts hiring of CISA/ISA qualified chartered accountants insisting in-house expertise. What is important for the regulator is to develop a new generation auditor with capability of auditing FIs in Fintech environment. The RBI, C&AG and ICAI should run an

advanced / specialized audit program and create new generation auditors with capability in handling banking transactions including fraud risk. It is equally important to develop competency of detecting fraud offering compulsory training to bank auditors in forensic audit.

Table 5 Baseline audit resource

Asset size of entity as on 31 March of the previous year	Minimum no. of FTPs(1)	Out of FTPs minimum no of FCAs (2)	CISA/ISA qualified members (3)	Minimum no. of audit experience of the firm (4)	Minimum no. of professional staff (5)
Above Rs. 15000 cr.	5	4	2	15	18
Above Rs. 1000 cr. up to Rs. 15000 cr.	3	2	1	8	12
Up to Rs. 1000 cr.	2	1	1	6	8

Notes to Table 5: (1) Minimum no. of Full Time partners (FTPs) associated with the firm for a period of at least three years. There should be at least one-year of continuous association of partners with the firm as on the date of appointment for PSBs or shortlisting for other entitles.

Further, for appointment as SCAs/SAs of all commercial banks (excluding RRBs) and other entities with asset size of above Rs. 1000 cr., at least two partners of the firm shall have continuous association with the firm for at least 10 years.Also, association of FTPs should be exclusive.

(2) Out of total FTPs, minimum no of Fellow chartered accountants (FCA) partners associated with the firm for at least three years.

(3) Minimum no of FTPs / paid CAs with CISA/ISA qualification. Such members should have association with the audit firm for continuous period of at least one year. No requirement for CISA/ISA qualified for UCBs/ NBFCs up to asset size Rs. 1000 cr.

(4) Minimum experience in respect of commercial banks (excluding RRBs) means experience of audit firms as statutory central or branch auditor of commercial banks or All India Financial Institutions.

RBI Guidelines ensures availability of audit resource rather than quantum of audit hours put into the specific audit. The qualified audit firm (an audit firm which is eligible to be empaneled for audit of regulated financial entity as per Paragraph 5 of the RBI Guidelines and Annexure 1) should have to put into prescribed minimum audit hours with breakup of audit hours of eligible auditors and other audit staff. In this context, the Brydon Report in the UK suggested audit transparency. Paragraph 25.2.3 of the Brydon Report recommends that the concerned audit firm to publish remuneration policy including annual remuneration of each relevant senior statutory auditor – see author's article "**Carillion Failure, Improving Audit Quality and Brydon Review", [2021] 127 taxmann.com 207(article), 6 May 2021.**

The RBI Guidelines regarding baseline audit resource should be reviewed taking into the following points:

- It should prescribe minimum audit experience of chartered accounts as well as audit firms irrespective of asset size of the auditee;
- It should facilitate induction of new entrants to the audit market by allowing an eligible audit firm to have reduced number FCAs among FTPs (such that more ACAs can be accommodated);
- There should be an appropriate mechanism for pooling resources among eligible audit firms without merger.
- CISA/ISA qualified chartered accountants may be hired to the audit team from outside the eligible audit firms.
- Lead auditor of FIsshould have specialized training in forensic audit.

4. Audit Fees and expenses

The RBI Guidelines state that –

- The audit fees for SCAs/SAs of all the entities shall be reasonable and commensurate with the scope and coverage of audit, size and spread of asset, accounting and administrative units, complexity of transactions, level of computerization, identified risks in financial reporting, etc.
- Thee Board/ ACB/ LMC of entities shall make recommendations to the competent authority as per the relevant statutory / regulatory instructions for fixing audit fees of SCAs/SAs.

The RBI did not carry out any comparative study of audit fee in India and other jurisdictions. A Recent IFAC study [IFAC, 2019] presents average audit fees as percentage of revenue in three jurisdictions for a specified level of revenue:

(*i*) Toronto stock exchange companies (Canada) having revenue > CAD 10 million: Average audit fee during 2013-18 0.29% of revenue
(*ii*) Russel 3000 companies (US) having revenue > US$ 10 million: 0.37% of revenue
(*iii*) Europe all major stock exchange companies having revenue >€ 10 million: 0.12%.

Comparative to the average audit fees of broadbased index companies of US, Canada and Europe during 2013-18, audit fees to revenue % of sample regulated FIs inIndia for the financial year 2019-20 are presented in Table 6. It appears that Indian PSU banks have comparatively higher audit fees to revenue% than large European companies (having revenue >€ 10 million) while audit fees to revenue % of Indian private banks and NBFCs are relatively much lower.(See also Figure 3).PSU banks in India have relatively better audit fee structure although there exists disparity in relative audit fee between larger and smaller PSU banks.

Table 6 Audit Fees to Revenue %: Indian PSU Banks, Private Banks & NBFCs

Private Banks	Audit Fee as % of Revenue	NBFCs	Audit Fee as % of Revenue	PSU Banks	Audit Fee as % of Revenue
HDFC Bank	0.0027%	HDFC	0.0090%	SBI	0.0846%
ICICI	0.0096%	IRFC	0.0032%	Bank of Baroda	0.1160%
Axis Bank	0.0025%	LIC Hsg Finance	0.0034%	PNB	0.1122%
Kotak Mahindra Bank	0.0073%	Bajaj Finance	0.0038%	Canara Bank	0.0985%
Indusind Bank	0.0067%	Shriram Transport Finance	0.0055%	Bank of India	0.1595%
IDBI Bank	0.0092%	India Bull Housing Finance	0.0234%	Union Bank of India	0.0938%
Yes Bank	0.0112%	Dewan Housing Finance	0.0027%	Central Bank of India	0.1036%
Federal Bank	0.0612%	PNB Housing Finance	0.0064%	Indian Bank	0.1383%

IDFC First Bank	0.0225%	M& M Financial	0.0117%	UCO Bank	0.2372%
South Indian Bank	0.0449%	Sundaram Finance	0.0288%	Bank of Maharashtra	0.1337%
Bandhan Bank	0.0177%	Mannapuram Finance	0.0117%	Punjab & Sind Bank	0.1274%
RBL Bank	0.0207%	Can Fin Homes	0.0350%	Indian Overseas Bank	0.1632%
Karnataka Bank	0.0540%	Muthoot Finance	0.0114%	JK Bank	0.1970%
Karur Vysya Bank	0.0389%	GIC Housing Finance	0.0096%		
City Union Bank	0.0417%	PTC India Financial	0.0190%		
AU Small Finance	0.0345%	L&T Finance	0.2854%		
DCB Bank	0.0244%	IDFC	0.4424%		
Equitas Small Finance Bank	0.0328%	Tata Investment Corpn.	0.0800%		
CSB Bank	0.1300%	Aavas Financiers	0.0565%		
Ujjivan Small Finance Bank	0.0288%	Home First	0.0905%		
Dhanlaxmi Bank	0.1073%				
Suryoday Small Finance Bank	0.0667%				
Average	**0.0352%**		**0.0570%**		**0.1358%**
Grand average	**0.0681%**				

US average	**0.37%**
Canada average	**0.29%**
Europe	**0.12%**

In view of the lower audit fees to revenue % of private banks and NBFCs, the RBI needs to facilitate improving audit fees. Interestingly, smaller PSU Banks have comparatively higher proportion of audit fees to revenue. It is a general phenomenon that proportionate audit fees of smaller FIs are higher than larger FIs. So, larger FIs appear to be paying less to the auditor while they get more experienced auditors as compared to the smaller FIs. If the RBI considers experienced audit firms are better resource to be engaged for relative larger sized FIs, then there should exist audit fee premium. It appears that experienced audit firms have to work for relatively lower audit fee /revenue % while less experienced firm would get better audit fee/ revenue%. Of course, in absolute terms asset size and audit fee has strong positive correlation although asset size and % audit fees are negatively correlated.

5. Rotation of Auditors

Paragraphs 8.1 & 8.2 of the RBI Guidelines states –

- In order to protect the independence of the auditors/ audit firms, entities will have to appoint SCAs/SAs for a continuous period of three years.
- An audit firm would not be eligible for reappointment in the same entity for six years (two tenures) after completion of full or part of one term of the audit tenure. However, audit firms cam continue to undertake statutory audit of other entities.

The audit rotation rule in the European Union requires public interest entities (which include listed companies, banks, and insurance companies)to change auditors after 10 years. This period can be extended to 20 years if the audit is put out for bid, or 24 years in instances of joint audits, in which more than one firm conducts the audit. While the Companies Act 2013, 5 years tenure to the audit partner and 10 years tenure to the audit firm.

Section 203 of the Sarbanes-Oxley Act specified that the lead and concurring partner must be subject to rotation requirements after five years. [Of course, the PCAOB in the US has been prohibited to implement audit rotation by virtue of subsequent amendment to the Sarbanes Oxley Act]. It was stated that relevant rules will specify

that the lead and concurring partner must rotate after five years and be subject to a five-year "time out" period after rotation. Additionally, certain other significant audit partners were proposed to be subjected to a seven-year rotation requirement with a two-year time out period.

In any case, no jurisdiction so far has conceptualized a short 3 years of audit tenure for ensuring auditors' independence. Rather too short an audit tenure is most likely to impact audit quality as the auditor retires before s(he) gets a grip over the clients' accounts. If independence of auditors is not in jeopardy by 5 years of audit tenure in non- RBI regulated entities in India, how could the RBI draw conclusion that three years are enough to allow before bankers develop cozy relationship with their auditors. Either RBI should follow the company law or the company law should get changed – there cannot be two different standards of auditors' independence vis-à-vis audit tenure.

6. Conclusions

The following are conclusions from the detailed discussion carried out on the RBI norms regarding engagement of SCAs/SAs in regulated FIs:

1. PSBs have opportunity to rationalize number SCAs and may engage reduced number of SCAs to widen the scope of audit work of each joint auditor. This would help to achieve better understanding of the state of affairs of the PSBs.
2. Academic research papers do not have any consensus findings on achieving higher level of audit quality by virtue of adopting joint audit. Joint audit as per Standard on Auditing (SA) 299 is simply a shared audit framework. France audit standard NEP 100 should be looked into for improvement.
3. Except Deloitte, big four has no significance presence in the audit of private banks and NBFCs. Unlike in the United States, there is no significant audit concentration in the hands of Big Four in this industry segment. So, introduction of mandated joint audit will have marginal impact in developing audit market competition. Rather shared audit framework may deteriorate audit quality as joint audit in India is effectively just a mechanism of audit work distribution among different auditors with truncated responsibility.
4. The RBI should liberalize the prescribed baseline audit resource and support newer audit firms for truly enhancing audit market competition. It should also ensure deployment of necessary audit resource rather than simply looking into availability of minimum audit resource merely as an entry norm.
5. Indian private banks and NBFCs including HFCs pay relatively lower audit fees as compared their PSU banking peers. The differentiation in audit fees should be reduced. Also, smaller FIs by asset size pay relatively higher audit fees which imply experienced auditors enjoy no fee premium. If the RBI

insists for better experienced auditors to audit larger FIs, then there is a need for reducing fee disparity.

6. The RBI allows too short an audit tenure of three years with six years of cooling period which is incompatible with global norms and even to the Companies Act, 2013. For establishing audit stability, the RBI should accept a minimum of 5-year audit tenure as has been adopted in the companies law.

References

Doherty, T. (2019), Understanding the role of joint audit, Accountancy Ireland, Oct 1.

European Commission (2010), Green Paper: Audit Policy – Lessons from the crisis, Bruseels, Oct 13.

ICAEW (2019),Shared and Joint Audits: Are Two Auditors better than One? Future of Audit.

ICAI, Standard on Auditing (SA) 299(Revised), Joint Audit of Financial Statements.

International Federation of Accountants (IFAC) (2020), Joint Audit: The Bottom Line- The Evidence in Unclear.

International Federation of Accountants (IFAC) (2019), Audit Fee Survey: An analysis of audit fees as percentage of corporate revenue, Dec. 20.

Mazars, Regulations of Auditing in Australia, Submission 50, A Guide to Joint Audit.

Reserve Bank of India (RBI) (2021), Guidelines for Appointment of Statutory Central Auditors (SCAs) / Statutory Auditors (SAs) of Commercial Banks (excluding RRBs), UCBs and NBFCs (including HFCs), RBI/2021-22/25, Ref. No. DoS.CO.ARG/SEC.01/08.91.001/2021-22, 22 April.

Reserve Bank of India (RBI) (2020), Norms on eligibility, empanelment and appointment of Statutory Branch Auditors in Public Sector Banks from the year 2020-21 and onwards

Academic Research Papers

Benali, A (2013), The shareholders confidence and effectiveness of the Joint Auditors: Empirical validation in the French context, International Journal of Business & Management, 8(11),76-84.

Deng, M. Danna, T. and Ye M. (2014) Do joint audits improve audit quality? Journal of Accounting Research, 52(5), 1029 -1060.

Holm and Thinggaard (2018), From joint to single audit – audit quality differences and auditor pairings, Accounting and Business Research, 48:3, 321-344.

Ittonen, K. and Tronnes, P. (2015), Benefits and costs of appointing joint audit engagement partners, Auditing: A Journal of Practice and Theory, 34(3), 23-46.

Khatab, G.S. (2013) The effect of joint audit and audit rotation on the firm's value, International Business Research Conference,www.semanticscholar.org

Lesage, C., Ratzinger-Sakel, N. & Kettunen, J. (2012), Struggle over joint audit: on behalf of public interest? Working paper available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2176729

Ratzinger-Sakel, Nicole V S, Audousset-Coulier, Sophie, Kettunen, Jaana (2013), Joint Audit: Issues and Challenges for Researchers and Policy-Makers, Accounting in Europe, P.175-199.https://doi.org/10.1080/17449480.2013.834725

Relvas , G and Pais , C. (2015) , The cost of debt , dimension of the auditor and joint auditors: The case of largest European Companies, Working Paper, available at http://www.aeca1.org/pub/on_line/comunicaciones_xviencuentroaeca/cd/69a.pdf

Siddiqui, J (2019), Are four eyes better than two? An examination of recent empirical evidence on the impact of joint audits, University of Manchester, Jan 30.

Velte, P. and Azibi, J. (2015), Are Joint Audits a proper instrument for increased audit quality? British Journal of Applied Science and Technology, 7(6), 529-551.

Source: Taxmann.com