RBI's new guidelines for appointment of auditors by Commercial banks, NBFCs and Housing Finance Corporation- An Overview

1. Introduction

RBI has issued certain guidelines for Appointment of Statutory Central Auditors (SCAs)/Statutory Auditors (SAs) of Commercial Banks (excluding RRBs), UCBs, and NBFCs (including HFCs) for joint audit as the concept, and this decision is backed by the Institute of Chartered Accountant (ICAI). RBI has decided to harmonize the norms for appointment of auditors of various entities in the financial sector, such as Private Banks, NBFCs, UCBs, HFCs, and ICAI supported this step and stated that it would ensure independence transparency in the selection of auditors that will enhance the audit quality.

2. Background

UK, France, Ireland, and countries in European Union like Belgium, and in Africa joint Audits are mandated for companies in the financial services sector. The Commonwealth countries look to the UK for best practice financial regulation and adopt rules that they consider beneficial for their markets. More countries are therefore likely to seriously consider joint audits as a measure to diversify their audit markets.

It is expected that other countries will follow the same by starting considering joint audits for large corporates as part of a package of solutions to improve audit quality and reduce market concentration. Ireland also preparing a similar report on the Future of Audit was raised at a Joint Committee on Finance, Public Expenditure, and Reform. As an audit firm with a proven track record in joint audit, we believe that this is a solution that can provide tangible benefits to all stakeholders and help the corporates to choose their auditors from a larger pool from a location of their choice.

3. Applicability

Guidelines issued by RBI will apply to the Commercial Banks (excluding RRBs), UCBs, and NBFCs including HFCs for Financial Year 2021-22 and onwards in respect of appointment/reappointment of SCAs in case of the Entities which appoint separate Statutory Branch Auditors and in other entities cases SA to be appointed of the Entities. However, non-deposit-taking NBFCs with asset size2 below ₹1,000 crores have the option to continue with their extant procedure.

As RBI guidelines regarding the appointment of SCAs/SAs shall be implemented for the first time for UCBs and NBFCs from FY 2021-22, they shall have the flexibility to adapt these guidelines from the second half of FY 2021-22 to ensure that there is no disruption.

4. What is a joint audit?

In a joint audit, two separate audit firms are appointed by a company to express a joint opinion on its financial statements. It is fundamentally different from a 'dual' or 'shared' audit, whereby one audit firm (or sometimes more) audits parts of a group and reports to another audit firm, which ultimately signs off on the group audit. Statutory joint auditors must belong to separate audit firms.

5. Benefits of Joint Audit

a) Enables companies to benefit from the technical expertise of more than one firm;
b) Encourages "coopetition" (cooperation and competition) between joint auditors, resulting in improved quality of service;
c) This leads to a real debate on technical issues and offers additional scope for benchmarking;
d) Allows for the smooth and sequenced rotation of audit firms, where appropriate; and
e) Retains knowledge and understanding of group operations, which minimizes the disruption caused when one audit firm is changed.
f) Enhance audit quality, auditor independence, and strengthen corporate governance
g) Ensure due continuity in the audit process as one of the firms is continuing during rotation.
h) Enables each of the joint auditors to focus better on its area of expertise and mitigate systemic risk.

6. Number of SCAs / SAs and Branch Coverage

For Entities with an asset size of ₹15,000 crores and above as at the end of the previous year, the statutory audit should be conducted under joint audit of a minimum of two audit firms [Partnership firms/Limited Liability Partnerships (LLPs)]. All other Entities should appoint a minimum of one audit firm (Partnership firm/LLPs) for conducting the statutory audit. It shall be ensured that joint auditors of the Entity do not have any common partners and they are not under the same network of audit firms. Further, the Entity may finalize the work allocation among SCAs/SAs, before the commencement of the statutory audit, in consultation with their SCAs/SAs.

Requirements of the Entity, the actual number of SCAs/SAs to be appointed shall be decided by the respective Boards/LMC, subject to the following limits

Sl. No.	Asset Size of the Entity	Maximum number of SCAs/SAs

1	Up to ₹5,00,000 crore	4
2	Above ₹ 5,00,000 crore and Up to ₹ 10,00,000 crore	6
3	Above ₹ 10,00,000 crore and Up to ₹ 20,00,000 crore	8
4	Above ₹ 20,00,000 crore	12

The above limits have been prescribed to ensure that the number of SCAs/SAs appointed by the Entities are adequate, commensurate with the asset size and extent of operations of the Entities, with a view to ensure that audits are conducted in a timely and effective manner.
CA Institute has suggested to the RBI that instead of prescribing the maximum number of SCAs in public sector banks, the RBI should set the minimum numbers to be appointed.

7. Tenure and Rotation

Entities will have to appoint the SCAs/SAs for a continuous period of three years.
NBFCs removing the SCAs/SAs before completion of three years tenure shall inform concerned SSM/RO at RBI about it, along with reasons/justification for the same, within a month of such a decision being taken.
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 and that would be treated as a cooling off period. However, audit firms can continue to undertake a statutory audit of other Entities

8. Procedure for Appointment of SCAs/SAs

a) Entities shall shortlist a minimum of 2 audit firms for every vacancy of SCAs/SAs so that even if the firm at first preference is found to be ineligible/refuses appointment, the firm at second preference can be appointed and the process of appointment of SCAs/SAs does not get delayed.
b) The banking companies shall continue to follow the existing procedure followed by them for the selection of SCAs/SAs. Upon verifying their compliance with the eligibility norms prescribed by RBI, the Bank shall seek RBI's prior approval for the appointment of SCAs/SAs.
c) For PSBs, empanelment of audit firms eligible for appointment as SCAs will continue to be done by the Office of C&AG, based on the norms prescribed by RBI,. The list of firms as furnished by C&AG to RBI will be subjected to scrutiny by RBI for identifying the eligible firms and excluding audit firms who have been denied audit by C&AG/RBI. Further, the PSBs shall place the list of shortlisted firms, in order of preference, before the ACB for the selection of SCAs in a transparent

manner. Upon selection of SCAs by the PSBs in consultation with their ACB and verifying their compliance with the eligibility norms prescribed by RBI, the PSBs shall seek RBI's prior approval for the appointment of SCAs

d) The UCBs shall place the name of shortlisted audit firms, in order of preference, before their Board for selection as SCA/SA. Upon selection of SCAs/SAs by the UCBs in consultation with their Board and verifying their compliance with the eligibility norms prescribed by RBI, the UCBs shall seek RBI's prior approval for the appointment of SCAs/SAs.
e) **5.** The Entities shall obtain a certificate, along with relevant information in the prescribed form, from the audit firm(s) proposed to be appointed as SCAs/SAs by the Entity. Such certificate should be signed by the main partner/s of the audit firm proposed for appointment of SCAs/SAs of the Entities, under the seal of the said audit firm.
f) 6. The Commercial Banks (excluding RRBs)/UCBs shall verify the compliance of audit firm(s) to the eligibility norms prescribed by RBI for the purpose and after being satisfied with their eligibility, recommend the names along with a certificate.
g) 7. While approaching the RBI for its prior approval for the appointment of SCAs/SAs, Commercial Banks (excluding RRBs)/UCBs shall indicate their total asset size as of March 31st of the previous year as per audited accounts, forward a copy of Board/ACB Resolution recommending names of audit firms for appointment as SCAs/SAs in the order of preference.

9. Conclusion

The new guidelines are expected to give opportunities to small and mid-sized Indian audit firms by potentially increasing competition, breaking old links, and bringing in more scrutiny. This step will improve transparency and disclosure quality in the audit. Also, confidence-building will be one of the advantages that would be seen as positive by increase participation by global investors. This step will not only curtail growth opportunities for multinational firms and create substantial transitional issues but also help bring more confidence in auditing. Indian firms also get a chance to get more audit business from the financial sector that is currently dominated by the Big Four. The RBI guidelines will be a big boost to Indian firms that lost most of their marquee clients to multinational firms during the Companies Law 2013 mandated audit rotation in 2017-18.