Grant Thornton

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"The Future of Audit in India"– A series by Grant Thornton

Part I – Mandatory Firm Rotation– Is India Inc. ready? – A survey

Preface

The world is constantly evolving. Multiple financial crisis across the globe emphasise the extent to which financial systems are connected globally. Policymakers continue to respond to both the economic fallout from the crisis and public outcry from various regulatory changes.

The crisis has led to a lack of public trust, hence, audit is expected to be a major part of the solution. In practice, to achieve this, audit and auditors will need to change to be able to respond to the challenges of this more interconnected world and greater public expectations.

Among the several changes, few are noteworthy. Introduction of smart machines, new media and global connectivity are likely to influence global need of accountants. Novel funding and business models may require novel assurance services. This has led to submission of new proposals in the form of audit reports by enhancing auditor reporting to include critical audit matters, key areas of judgment, etc. Introduction of big data and digital conveniences are prompting stakeholders to expect auditors to exploit new ways of working to drive efficiencies so that reporting timetables can be shortened while continuing to improve audit quality. Legislative and regulatory intervention is higher than ever before. Investors want increased dialogue – they want to hear about early warning signals. Auditors are expected to provide more forward-looking, meaningful conclusions rather than be reactive to historical financial information.

Overall, the idea that audits need to become more adaptable has widespread consensus among all stakeholders. The changing dynamics outlined above pose a fundamental challenge for:

Auditors: how to meet the needs of users without compromising the independence that is at the heart of auditors' professional standards?

Providers of finance: how to receive rich and varied range of information, relevant to decision - making, in addition to regular, reliable audit reports?

Standard setters: how to align audit to changing requirements to remain relevant and continue to build user confidence in the auditing profession?

Regulators: how to retain and restore investor confidence given the recent changes and crises?

While the message remains the same, need for users to get 'as much as possible' from audit; policymakers in different jurisdictions have reacted differently to these reforms. Some have removed the requirement of mandatory audit to align regulatory focus to public interest entities only, while the others have allowed the profession to evolve on the basis of jurisdiction specific needs and requirements. Some are reassessing the addresses of the audit report while others are re-engineering timeline to ensure audit information remains relevant. Recent examples include the unprecedented reforms proposed in the European Union audit market, most notable amongst which are mandatory audit firm rotation, restriction on providing non-audit services, prohibit the use of restrictive clauses in contracts which limit a company's choice of auditor thus, promoting competition and reducing market concentration.

India Inc. has reacted to some of these changes, as suited to the current economic environment. The Ministry of Corporate Affairs (MCA) along with the policymakers have engaged in considerable rule making over the past 18 – 24 months. Some of the notable ones include mandatory auditor rotation, internal financial controls over financial reporting, fraud reporting, alignment of Indian Accounting Standards (Ind AS) to globally accepted accounting principles, stricter norms for independence of auditors, limits on number of audits for an auditor, etc. The underlying theme of all such changes is to make financial reporting more robust and reliable, enhance corporate governance and investor confidence.

Through this report, Grant Thornton India LLP presents its first knowledge paper on the series "The Future of Audit in India", focussed on the topic "Mandatory Firm Rotation" (MFR). Grant Thornton International has been leading a series on The Future of Audit across 7 countries including China, Singapore, South Africa, UAE, UK, Ukraine and Brussels, engaging diverse stakeholders to discuss and gain insights into the growing pressures to evolve audit services, both over the short term and further into the future. The inputs from the research and subsequent conversations is designed to help identify future drivers of change and emerging innovations in audit services.

Changing nearly six decades of old regulations, the Indian corporate lawmakers have made it mandatory for certain classes of companies to appoint auditors for restricted incumbency. To reduce the risks of excessive familiarity and bring in much-needed transparency into the process, the Companies Act 2013 ('2013 Act') provides for MFR for all the listed and certain classes of unlisted companies such that audit firms completing a term of 10 years or more need to be rotated beginning 01 April 2017. This is a landmark legislation which may potentially have far-reaching consequences and may significantly impact the audit approach and concentration in the audit market. Grant Thornton India LLP has launched this initiative to understand the impact of the legislation and to ensure that its consequences, both intended and unintended, are taken into account while complying with the new requirements.

India Inc. has been at the forefront of adopting such an unprecedented reform. While MFR is proposed to be or has been adopted in some form in several countries across the globe, India Inc. has clearly taken the lead. Coverage of entities under the regulation is far more substantial and the transition period is much shorter. In contrast, there aren't too many countries across the world that have adopted MFR with the exceptions of European Union and the existing rules prevalent in Italy which require mandatory rotation of the audit firm after a period of nine years. The EU regulations, which have been effective since June 2016, require mandatory rotation of firms after a period of 10 years post appointment; however, it offers a transition measure of one-time extension of 10 years or 14 years from the end of initial 10 years period, subject to compliance with specified criteria. Accordingly, due to lack of complete precedence, the impact of the reform for all of us is yet to be acknowledged. Regardless, India Inc. seems to be readying itself to embrace this change, which though nascent, seems to have the potential to result in a paradigm shift in the process of selection and appointment of auditors and the audit market at large. No statistical evidence seems to be available of whether MFR truly meets the intended objective of 'independence' or whether it just results in an added administrative cost for the companies.

The Survey – Executive summary

Grant Thornton and Prime Database conducted a joint survey to assess India Inc.'s readiness to meet the requirement of Mandatory Firm Rotation (MFR) and the perceived impact of this important legislation. This survey was conducted from April to mid June 2016, which is substantially close to the effective date of the new legislation. Comprising of 10 questions, the survey was designed for companies across industries and sizes which come under the gamut of MFR.

It attracted a total of 303 responses from various sectors of the industry such as manufacturing, media and entertainment, technology, telecom, section 8 companies and aviation services, etc.

A snapshot of survey analysis and its implications is given below:

- MFR is expected to have a significant impact on majority of Indian companies;
- There is an increasing sentiment to embrace the MFR as the new regulatory norm with a view to enhance auditor objectivity and independence;
- 61% of the survey respondents are required to rotate their auditors from FY 2017-18 onwards;
- While there is significant awareness about the changing regulatory landscape and acknowledgement of the effort involved in changing an auditor, the awareness however, is yet to be translated into action. A majority of companies still fall behind the timeline in drafting and implementing a transition plan specific to their organisation.

  It is worth mentioning that out of 1480 companies listed on the National Stock Exchange (NSE), only 131 companies have changed their auditors in the years 2015 and 2016.[1] The survey results also indicate that 82% of respondents are yet to start planning or somewhat have an informal plan agreed with the board of directors. Considering the short time span left, this indicates a huge task for the companies;
- A majority of companies believe that MFR adoption should be aligned with the transition to Ind AS;
- A fairly large proportion of the respondents expect that there will be an increase in audit fee upto 25% on account of auditor rotation.

1. Source: Prime Database

Contents

The Companies Act, 2013

Rotation norms under the Companies Act, 2013

	Individual auditor	Audit firm
Rotation norms		
First appointment	Appointment can be made from the conclusion of first Annual General Meeting (AGM) till the conclusion of sixth AGM	
Next appointment	N.A.	Re-appointment can be made for another term of 5 consecutive years
Cooling off period	Cooling off for a period of at least 5 years (post completion of the term as stated above)	

Transitional provisions

Every company, existing on or before the commencement of the 2013 Act (i.e. 01 April 2014) and which is required to comply with the requirement of rotation of auditors, shall comply with the said provisions within three years from the date of commencement of the 2013 Act. Accordingly any company with auditors for more than 10 years as of 01 April 2017 needs to appoint new auditors.

Applicability

MFR norms apply to:

a. All listed companies;

b. All unlisted public companies with paid up share capital of INR 10 crore or more;

c. All private limited companies with paid up share capital of INR 20 crore or more;

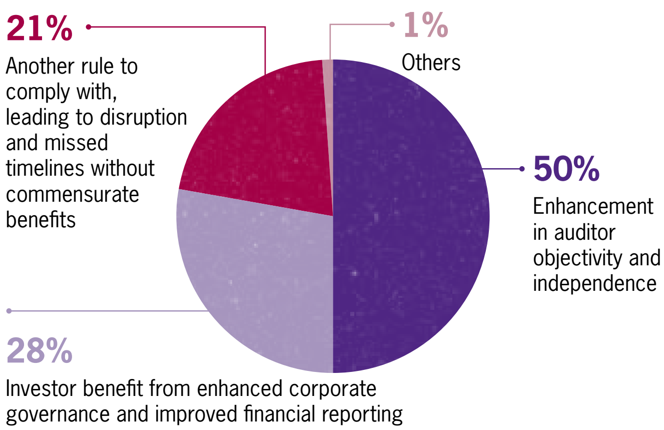
d. All companies with paid up share capital of below threshold limit mentioned in (b) and (c) above, but having public borrowings from financial institutions, banks or public deposits of INR 50 crores or more.

Survey findings and analysis

Our analysis present a deep dive into the corporate sentiments, unfolding a mix of wariness and excitement as they evaluate operational and technical aspects while planning to embrace the MFR reality.

1. The understanding and the acceptance of MFR

In order to judge the perception of the industry on MFR, we asked companies to share their views on what best describes the MFR legislation.



An extraordinary percentage of respondents'. i.e.

78% believe that MFR is a step in the right direction to enhance objectivity leading to improved financial reporting.

Looking at MFR from the lens of human psyche brings in yet another interesting facet of objectivity; the take-turns approach would bring "fresh set of eyes" on the company's financial statements, which may result in improved financial reporting, since the new auditor will be expected to spend more time seeking relevant audit evidence rather than just relying on his prior experience with the client. A long term relationship may also mean that the audit approach becomes 'stale' and susceptible to repetition. Institutional familiarity can dilute the auditor's inclination or ability to challenge management assertions, which acts as a disincentive to professional scepticism. These responses are a strong indicator of India Inc.'s forthrightness to accept this regulatory change.

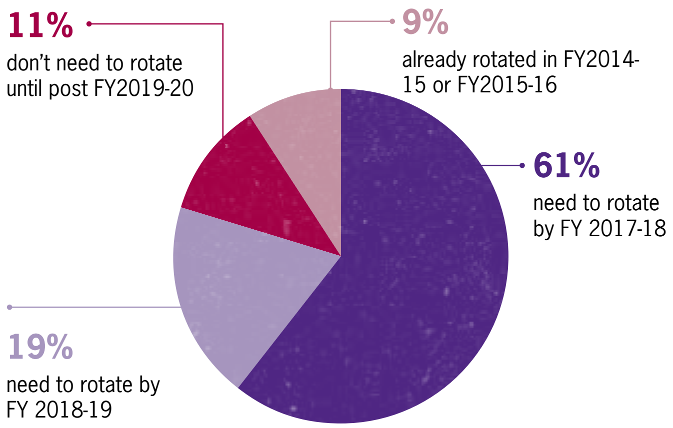
A small proportion of 21% of the respondents perceive auditor rotation to be yet another rule to comply with, (out of which 54% are unlisted/private companies/others while the remaining are listed companies) which may lead to disruption of operations, increased compliance with limited benefits, and perhaps, increased risk of audit failure. While on the other hand, changing an auditor will entail enormous investment of time and effort from the auditee and the new auditor alike which cannot be overlooked. As an auditor's tenure increases, the auditor learns more about the client, its operations and business processes, resulting in a more effective audit. Further, the longer tenure can allow the auditor to develop experience and credibility with the companies, by demonstrating, over time its technical expertise, the quality of audit work and knowledge of the company's business.

Also, the increased costs associated with communication between the new/incoming and the previous audit firms have to be considered, given that under the new regulation, transitions would be more common than they have been in the past.

While the survey results on the effects of MFR on auditor independence and audit quality suggest that rotation might improve auditor independence, especially in appearance, one cannot ignore the negative consequences rotation might have for the client-specific expertise of the auditor and the related cost or risk. The rotation of key audit partners could have balanced the need for a fresh perspective with the need for continuity in knowledge. Further requiring rotation for small unlisted companies is not in consonance with the global trends and therefore, the preferred approach may have been to apply the MFR norms in a phased manner, i.e., initially to only large listed and public interest companies and then to other companies.

2. Preparedness for MFR

To gauge the preparedness of India Inc. to comply with MFR, we first assessed the year in which the transition to the new auditor would begin.



According to the findings, out of the total respondents,

61% of the companies are required to rotate audit firm/auditor from FY 2017-18.

On further analysis of the responses it was observed that 71% of the respondents were listed companies which are required to rotate audit firm/auditor from FY 2017-18. Essentially, these companies are left with less than a year to implement their transition plans.

One of the few concerns identified in this regard is meeting regulatory, interim and year-end deadlines. Also, the appointment of a new auditor shall have to be made keeping in view the new norms on independence and prohibited services. The 2013 Act has laid down very comprehensive and significantly stringent provisions in relation to the eligibility, qualification and disqualification of an individual/ firm for appointment as an auditor. The regulators believe that rendering of certain non-audit services (such as internal audit, design and implementation of any financial information system, investment advisory services, management services, etc.) to the client may impact the objectivity and independence of the auditor. Therefore, if an auditor is rendering any of the prohibited non-audit services on or before the commencement of the 2013 Act, the company needs to terminate such services before the closure of the first financial year after the date of commencement of the 2013 Act. Hence, the management would need to take proactive steps to mitigate these concerns.

Some companies have chosen to rotate earlier

It is interesting to note that 9% respondents rotated in FY 2014-15 or FY 2015-16.

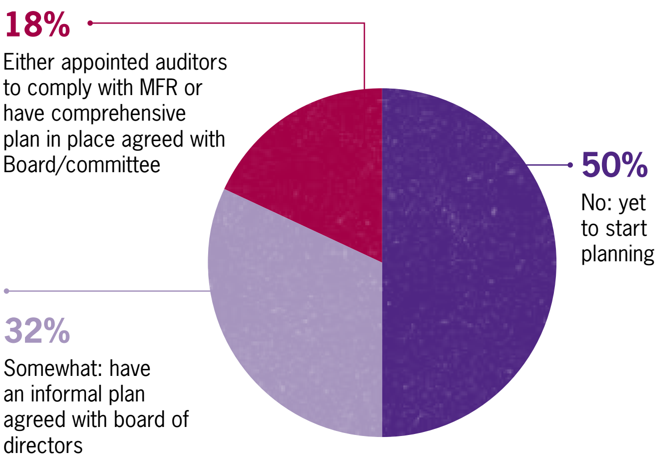
Out of this, majority are listed companies, i.e., 64% have chosen to comply with MFR norms earlier, which reflects a step towards enhanced corporate governance.

Some observations in this regard are:

- The Indian regulatory and reporting framework is undergoing a change. If the timing of the appointment of the new audit firm coincides with the adoption of Ind AS, it can help companies derive synergies from a streamlined process.
- In few cases, there is a possibility that an audit firm or the Engagement Partner of the audit firm appointed by a company is liable for rotation in accordance with its internal or international requirements prior to the completion of the transition period. The appointment of the new audit firm can be made to coincide with this change.
- In case of a merger or acquisition, a common auditor may be appointed across entities, even if this change is required to be made before the completion of the transition period.
- Voluntary adoption of MFR norms may also indicate efforts towards demonstrating adoption of better corporate governance norms by the companies.
- Companies may have acted in a pro-active manner so as to avoid any legal non-compliance or other challenges in appointment of new auditors.

To further assess the level of preparation, we asked companies how prepared they are for rotation at the eleventh hour

Nearly 82% of the respondents are yet to start planning or somewhat have an informal plan agreed with the board of directors. Only 18% have either appointed auditors to comply with MFR or have a comprehensive plan in place agreed with board of directors/audit committee. Considering the transition period left with the companies, majority of companies are now exchanging invites and quotes from the audit firms so as to block their appointments, while a few others have already hit the nail on the head by bringing the second auditor (in few cases, as a joint auditor) on board to avoid the last–minute rush.



It is interesting to note that 78% of the total respondents who believe that MFR is a step in the right direction are yet to start planning or somewhat have an informal plan agreed with the board of directors. This reflects lack of preparedness/delayed planning of the India Inc. to comply with MFR norms.

Prior preparation and meticulous planning at every stage of the process, is a key driver for a successful and seamless transition. Despite representation to the contrary by various stakeholders, the MFR norms remain in the 2013 Act. If the transition is not planned well, it may lead to disruption in the ongoing commitments of the company and missed timelines.

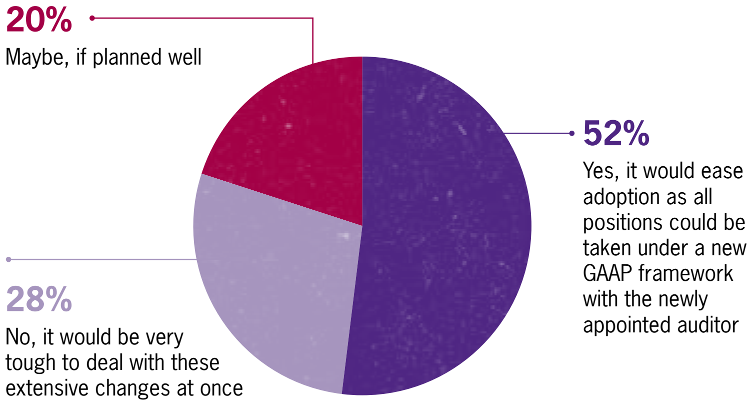
Some of the parameters which a company can consider while appointing a new auditor are given in **Appendix I.**

Ind AS transition – alignment with the timelines of MFR

Another key transformational regulatory change is the implementation of Ind AS i.e. IFRS converged financial reporting. Pursuant to the roadmap issued by MCA, transition to Ind AS from Indian GAAP has been made mandatory effective 01 April 2016 for the prescribed class of companies.

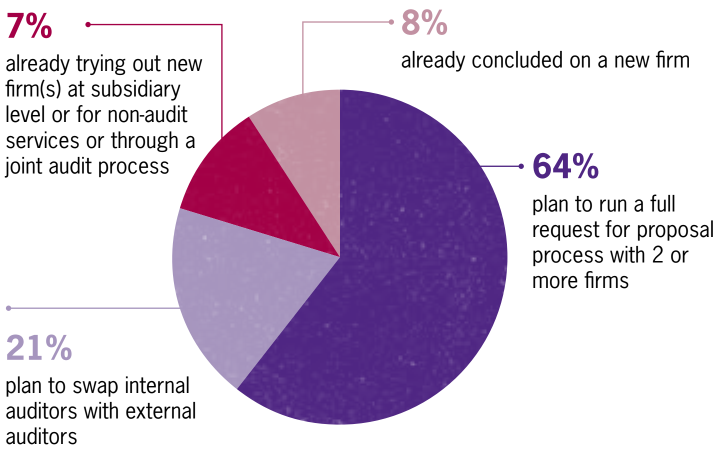
We asked companies their views on adoption of Ind AS alongside auditor transition and received mixed responses, indicating apprehension to transition as a result of the complexities involved.

52% companies are of the view that it would be favourable for the companies to comply with MFR requirements earlier, as it would ease the adoption of Ind AS. While, 28% of the companies believe that dealing with multiple changes at one time would lead to instability.



Successful implementation of Ind AS would need proper planning, alignment of resources, training and effective project management to ensure a seamless transition. It is recommended that auditor appointment coincides with the transition to Ind AS to yield synergistic benefits from the alignment to new accounting policies and their impact assessment on the financial statements. It is important that companies meticulously evaluate the transition of auditors and the new reporting standards.

3. Plans of corporates to comply with MFR requirements



We asked companies about their plans to comply with the MFR requirement and changing the auditor. The responses indicate that 64% plan to run full Request for Proposal (RFP) process and 21% plan to swap internal auditors with existing auditors.

Based on the responses, 70% of the companies which are transitioning in 2017-18, plan to run a full RFP process while 17% are planning to swap internal auditors with external auditors. The analysis further reveals that majority of these companies are listed (76% of the companies planning to run RFP are listed and 70% of companies who are planning to swap internal auditors with external auditors are also listed) and certainly require adequate preparation to comply with the MFR norms, as they might fall short of time due to quarterly reporting requirements.

Swapping internal auditor with external auditor can reduce company's cost and time taken to familiarise the new auditor with company's operations. The internal auditor would have the required knowledge of the business and the internal control systems and therefore, will take comparatively lesser time in understanding the company's financial reporting systems. However, before appointing the internal auditor as the statutory auditor, the company needs to ensure that the internal auditors comply with the independence requirements provided under the 2013 Act.

The companies who wish to run a full RFP process should ensure that they are able to obtain sufficient information from the participating auditors through the RFP. As a mandate, the RFP should include details on the following aspects:

- Information about the participating audit firm including qualifications, industry expertise, global presence;
- Audit approach;
- Policies for independence and confidentiality;
- Audit firm's pricing policy;
- Audit firm's credentials;
- Availability of experts to support audit process.

Grant Thornton in India has issued a set of questions that have a bearing on this important decision in the form of a standard template which could be used by the companies as a 'Request for Proposal'. Please refer to Appendix II for RFP template.

A good RFP coupled with subsequent meetings and discussions offers the opportunity to gain insight into the participating audit firms' experience and credentials and ensure that a correct choice is being made through a well-defined process.

It would be appropriate for the companies to formalise a timeframe before they transition to the MFR norms. The timeline could vary depending on the company's level of preparedness and requirements.

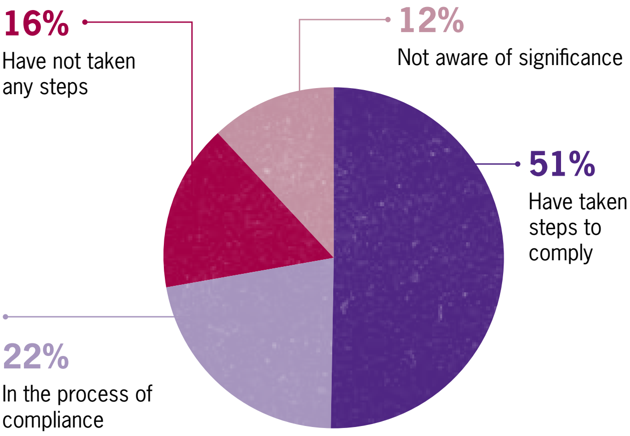
Illustrative timeline that may be followed by a company planning to hold its AGM in August 2017 in order to comply with MFR norms:

Proposed action	Timelines	Proposed action
	September 2017	Meeting between previous auditor and new/incoming auditor
Hold AGM and appoint auditors	August 2017	
	May 2017	Holding board meeting and propose the appointment
Obtain eligibility certificate, terminate any prohibited services relationship and agree on the audit plan	February 2017	
	December 2016/ January 2017	Discussion with the audit committee/ Board and selection of the auditor (including presentation of the proposals by the proposed auditors to audit committee, if necessary and applicable)
Presentation and discussion on RFP by the proposed auditors/ audit firms	November 2016	
	October 2016	Review the proposals and invite selected firms for discussion
Finalise and float the RFP	August-September 2016	
	July 2016	Form a committee for appointment of new auditors. The committee to set the criteria for selection of the auditors

4. Compliance with 'independence norms'

Auditor independence is a fundamental pre-requisite when looking to change the auditor. We asked companies whether steps have been taken to ensure that the incoming auditor complies with the independence norms specified by the 2013 Act, such as obtaining the eligibility certificate from the auditor, compliance with restrictions on rendering of prohibited services, etc.

Our analysis signify that 73% of the companies have taken steps to comply with the independence requirements of the 2013 Act beforehand, or are in the process of doing so.



It is worthwhile to note that the independence norms of the 2013 Act are more stringent than those that are currently applicable. Keeping that in view, it is heartening to witness that 78% of the companies which are looking to transition in 2017-18 are aware of the requirements and either in the process of compliance or have already taken steps to ensure independence of the incoming auditor.

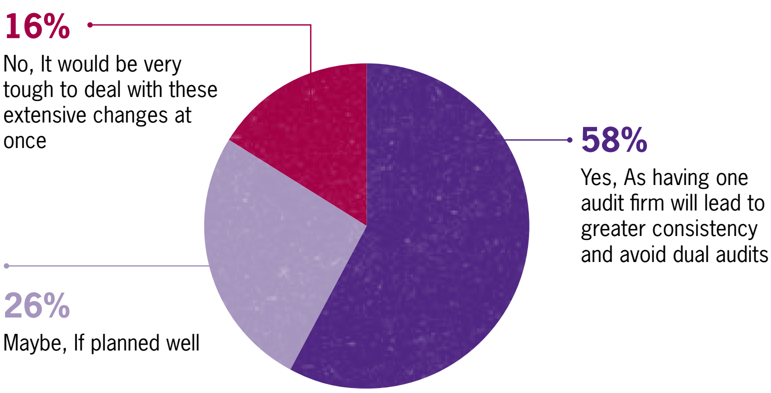
Both the auditors as well as the auditee are responsible for ensuring compliance with independence norms to avoid any non-compliance with the law. The companies should seek confirmation from the participating audit firms at the time of inviting the RFP.

Reference may be made to Appendix II.

5. Compliance with MFR at 'Group' level

We asked the companies about their views on compliance with MFR at the 'Group' level, regardless of the applicability of the MFR norms to individual entities.

Overall 84% of the respondents believe that compliance with MFR at group level will lead to a smoother transition. Of this, 58% of the companies believe that complying with the MFR requirement at group level would lead to smoother transition regardless of the applicability of the MFR rules to individual entities, whereas 26% of the respondents believe that compliance with MFR at group level may lead to a seamless transition only if planned well.



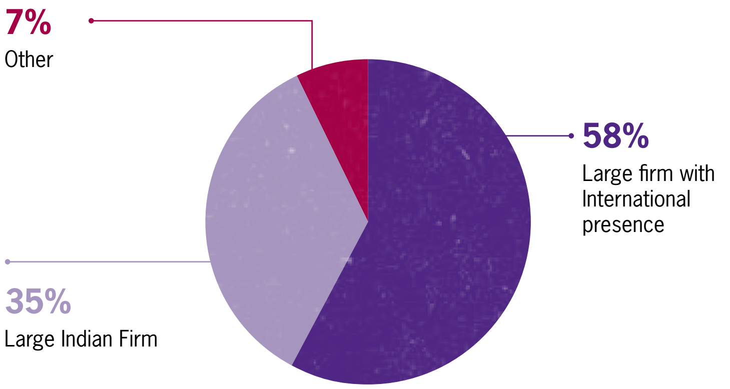
While there is merit in having a single auditor across the group, there are a few companies who are not keen on upsetting the apple cart all at once, unless imperative according to the 2013 Act.

It is advised that the management must carry out a cost-benefit analysis of having one firm v/s multiple audit firms across entities, as this choice may have a perceived impact on audit cost and quality.

6. Commencement of the 'match-making' process

The mandate of auditor rotation has caused an increased activity in the assurance services market, with not only companies required to comply with the new norm but audit firms reaming under the pressure to maintain their market share or emerge as game changers. The market will be filled with choices, however, if driven by laws of economics, the audit fees will see a downward impact. On the flip side, the 2013 Act has increased responsibilities of the management, the board of directors and the auditors, steering to the common adage "higher risks lead to higher rewards". While cost is an important metric, it should always be viewed along with quality of deliverables.

Within our survey, we asked the companies about their preference for the new auditor - whether they want a large firm with international presence or large Indian firms, who do not have international presence. We received a mixed response on our question. Corporates were of a mixed view on assigning an auditor which is large and has international presence.

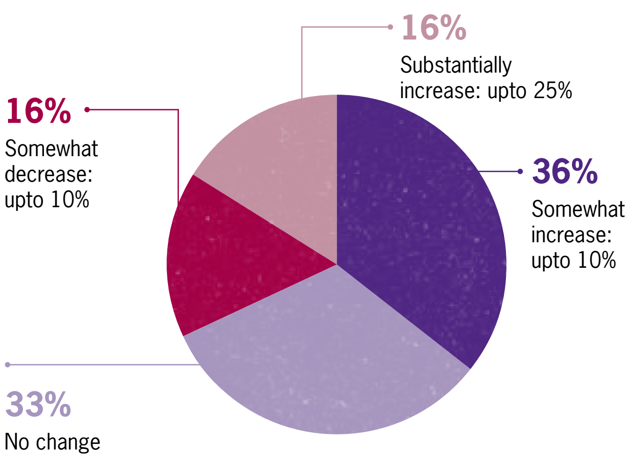


Out of the total respondents, 58% prefer the large firms with international presence, while others were keen to have large Indian firms/others as auditors.

Upon further analysis of the responses, out of the listed companies, the preference to the large firms with international presence is 65%. Another important observation is that only 431 companies out of 1480 companies i.e. only 29% of the companies listed on NSE are audited by large firms with international presence.[2] Considering the preference shown by the listed companies for the large firms with international presence as their auditors, there may be a change in the market structure.

7. Impact of MFR norms on audit fees

The 2013 Act widens auditor responsibilities and makes it more onerous. We sought views of the companies as to their expectations for audit fee pursuant to the MFR. While decisions in India Inc. are driven by cost consciousness, the survey results yield that there is an appreciation of quality and effort.



52% of the respondents believe there will be an increase in fees in the range of up to 25%. Only 16% of the respondents believe there will be a decrease in the audit fees; while 33% of the respondents believe there will be no change in the fee levels. Majority of the respondents believe that due to the learning curve for a new auditor, the costs are bound to increase. This is also coupled with the fact that 2013 Act casts more responsibilities on the auditor and has increased reporting requirements.

While audit firms may manage transitions effectively to comply with MFR with appropriate planning and support from management of the companies, this cannot be done without added cost or risk. The cost of MFR may also be increased due to company's specific circumstances. For example, changing an auditor in the midst of a major business transaction or restructuring could be complicated and costly. Also, scheduling the timing of firm rotation could cause greater disruption under volatile market conditions.

2. Source: Prime Database

Survey conclusion

The survey analysis and findings suggests that though there is awareness amongst Indian companies about the new MFR requirements, still a majority of the companies are yet to start planning to comply with the MFR requirements. The selection and appointment of a new auditor can be tedious, time consuming and costly. Therefore, companies which are transitioning in 2017-18 are advised to expedite the selection process for the appointment of new auditor.

MFR may also result into change in audit market structure and may provide significantly different opportunities to the audit/ accounting firms which were earlier not available/ difficult to get in the form of new audits or non-audit services opportunities.

On the whole, it is certain that well planned decision making and coordinated implementation of the selection process (while keeping in mind the requirement of appointment of new auditor at group level, adoption of Ind AS, etc.) will not only help in selection of the right auditors for the company but also result in seamless transition process.

Industry speak

Amal Ganguli

Amal Ganguli is a Director and a fellow member of the Institute of Chartered Accountants of India and the Institute of Chartered Accountants of England and Wales, and a member of the New Delhi chapter of the Institute of Internal Auditors, Florida, and the US. He was the Chairman and Senior Partner at Pricewaterhouse Coopers (PWC), India till his retirement in March 2003.

During his career spanning over 40 years, his work included international tax advice and planning, cross border investments, corporate mergers and re-organisation, financial evaluation of projects, management, operational and statutory audit and consulting projects funded by various international funding agencies.

Legally enforced rotation of audit firms has been discussed in India and longer in the developed countries at least since the late 1960s and I have personally been part of the debate. There were and still are strong views held on both sides but over the recent past, to a large extent, the debate is now academic since in large parts of the world where business is done in an organised way and largely using the corporate structure for business entities, rotation of firms has been legally mandated. The chief argument in favour, namely, that long association between client and audit firm erodes independence and quality of the audit, has never been proved empirically, though intuitively this appears logical. However, there are many examples of fraud or deliberately misleading accounting practices taking place in the early years of particular auditors being in place. In the nature of the suspicion, lack of independence in a professional person cannot be proved either way, for any of the "learned" professions. However, now legislators and regulators are largely in favour of rotation and the tide is flowing in that direction. It remains to be seen how well it will work and how soon the lack of deep knowledge of the client can be overcome. Analysts and proxy advisors are certainly vociferously in favour. Shareholders as a body seem still to be largely apathetic and indifferent. There is no evidence about another part of the constituency, the lenders. Many audit firms are joyful in the hope of acquiring new work, though this is far from certain- losses of audits are likely to hit them harder than the larger firms. Rotation will certainly present many challenges to those who audit as well as those who are audited. Large audit firms will face uncertainty and difficulties in organising themselves. Clients will face similar problems from the other side of the table. Let us all hope that compulsory rotation of audit firms demonstrably improves the quality of the audit. The genie cannot now be put back in the bottle!

Nawshir Mirza

Nawshir Mirza is a fellow of the Institute of Chartered Accountants of India. He spent most of his career with global consulting firm, EY and its Indian member firm, S. R. Batliboi & Co., Chartered Accountants, and its predecessor firm, Arthur Young. Here, he held the position of a Partner from 1974 to 2003. Since 2003, he has been involved in the movement for improved governance in the corporate sector. He is also involved in propagating knowledge on threats to humankind from climate change and finding an appropriate response to it.

If rotation was the panacea to auditor complicity, the administrative services of the government would have an impeccable record. Unfortunately, that is not the case. Indeed, the greatest risk is at the time of change and the risk of audit failure is greatest when an auditor has insufficient experience of a client because the client is a new one for her or him. I say this based on my 36 years of work experience as an auditor. In the public sector there has been rotation of auditors for over sixty years and whilst I have no empirical evidence to support my view, experience tells me that the first year or two is when auditors of government enterprises have missed several issues. It is also an excellent opportunity for unscrupulous managements to tuck, concealed, into the accounts, problems or manipulations that they have not had earlier the opportunity to do with an experienced auditor continuing.

The risk has been compounded manifold by the mass rotation of auditors that will occur in 2017 - 18 due to the requirements of the Companies Act. Auditors will be faced with the near impossible task of becoming knowledgeable with a very large portfolio of first time clients. Combined with this is the simultaneous introduction of Ind AS, an accounting system significantly different from what has been in use till now. The government has set things up for a perfect storm and its outcome will become apparent three years hence when companies come out with corrections of earlier errors. Worryingly, auditors are petrified of losing large volumes of business and are ripe for being pressured. For example, it is said that one business group is asking prospective auditors to first assure it that they will not question accounting policies agreed to by the group with the previous auditor.

Audit committees should be most worried with this scenario. A few wise ones have decided to change their auditors before the mass whirl-a-gig change in 2017 so that the incoming firm has the luxury of working with the outgoing firm for a couple of years and of settling in before the confusion. Most audit committees have not had the foresight.

M. Damodaran

M. Damodaran has held a number of important positions with the Central and State Governments overseeing India's financial sector. This included Chairman, Securities Exchange Board of India (SEBI), Chairman, Unit Trust of India (UTI), Chairman, Industrial Development Bank of India (IDBI), Chief Secretary, Government of Tripura. After successful stints at UTI, IDBI and SEBI, he has set up Excellence Enablers Private Limited (EEPL), a corporate governance and board advisory consultancy firm.

One of the salutary provisions in the Companies Act, 2013, relates to the rotation of auditors. This long overdue reform has, not unexpectedly, been questioned by persons who have been taken out of their comfort zones in which the same set of auditors continued for decades at a stretch.

The predictable argument that rotation of auditors could be disruptive, since the incoming auditors might not have domain familiarity, does not hold water. On the other hand, a decade-long relationship of the auditor with the auditee company sometimes results in "peaceful co-existence", with punches being pulled, and the less obvious questions remaining unasked. Over the years, auditors also tend to lapse into the belief that the managements that engage them, constitute their clients.

Recent experience in this regard and the induction of a joint auditor as a transitional arrangement, has led to fresh issues, both of process and of content, being raised before the audit committees. All this is necessarily in the interest of the shareholders and other stakeholders on whose behalf and in whose name the company is sought to be managed.

Shailesh Haribhakti

Shailesh Haribhakti is a fellow Chartered Accountant and the Chairman of DH Consultants Private Limited. During a career span of more than three decades, he has successfully led many complex engagements involving business consulting across various geographies and industries. His prior experience includes stints at Arthur Young & Co., Chicago and consulting assignments with Polish Business Advisory Services, an affiliate of International Finance Corporation (Washington).

Auditor rotation emerged as the desire of the large body of shareholders. Objectivity and trust creation are the fundamental fulcrum on which the audit function depends. Rotation creates the basis. India became the first country in the world to mandate by law widespread rotation of Audit firms after a tenure selected by shareholders.

While the Streep learning curve and benefit of experience arguments are strong, we in India have had a good experience with rotation in Bank and PSU Audits. In all situations shareholder empowerment is the call of today.

As an independent director and Chairman of several Audit Committees I wholeheartedly support and welcome the idea. Let's together make it work for our system.

Amarjit Chopra

Amarjit Chopra is a Director at a registered Bank under the Chartered Accountant category. He has been a member of the Central Council of the ICAI since 1998 and has rich experience and expertise of having represented ICAI on various committees of government, SEBI, RBI, etc. Presently, he is the Chairman of the IFRS implementation committee and professional development committee.

To me it is not important whether other countries have implemented the concept of rotation of audit. There is no harm in being leaders in that case. My support to the concept of rotation does not arise out of conviction that it would result in work percolating to smaller and medium sized firms. Rather it is based on improving public perception that longer relationship between the auditor and auditee leads to a cozy relationship. Let the public including the Regulators, Govt. and our Parliamentarians have no reasons to complain on generally perceived "cozy" relationship between auditors and auditee. It is important to build faith of public in profession. However there can be a valid argument against extending the concept of rotation to certain unlisted entities up to a reasonable threshold limit.

Appendix I

Parameters to be considered while appointing a new auditor

The companies may consider the following parameters while appointing a new auditor:

Applicability of MFR to the organisation
Some organisations may currently have multiple audit firms across various companies in their group. For a global company with operations in many countries, there may be varying and inconsistent approaches to firm rotation. In such scenarios, it may be worthwhile to consider a single auditor across all the companies. In other words, in case audit rotation is triggered at the parent level or subsidiary level of the organisation, the selection of the audit firm can be aligned in line with the global selection process to the extent possible.
Criteria for the appointment of the new firm
Proper planning is essential for an effective selection process. Company's plan for the appointment should be clearly defined as to whether the company wants to run a full request proposal seeking responses from two or more firms or whether it is planning to swap internal auditors with external auditors.
Non-audit services
Companies need to evaluate non-audit services that various firms are providing to the company and the corresponding independence conflict that may arise. It is important to evaluate which firm one wants to consider for audit and which firm for non-audit services.
Adoption of Ind AS
The Indian regulatory and reporting framework is undergoing a change. As per the 2013 Act, transition to Ind AS from the currently followed Indian GAAP has been made mandatory for prescribed companies from 01 April 2016. Companies should critically evaluate the timing of appointment of the new audit firm to coincide with the implementation of Ind AS in order to achieve synergies and alignment of various accounting policies and management estimates impacting the financial statements.
Industry specialisation
Auditors obtain in-depth knowledge of specific industries during the course of their engagements, and invest significant resources to obtain and maintain industry expertise. Mandatory requirement of rotation of audit firms could make it difficult for some companies to find auditors with expertise in their industry. Companies should critically evaluate this aspect before appointing the new audit firm.
Appointment of joint auditors
To facilitate smooth transition, you can evaluate opportunities to engage with the new auditor in a year prior to the completion of the mandatory transition period. This can be accomplished through appointment of new audit firm as a joint auditor along with the incumbent auditor.
Availability of experts/specialists
Consider the auditors' capabilities with respect to availability of specialists in the proposed audit firm to support the audit for direct and indirect tax, forensic, information technology, etc. related matters.

Appendix II

Request for proposal – Template

In this section, we present a set of questions that have a bearing on this important decision in the form of a standard template, which could be used by companies as a 'request for proposal'. These questions have been framed keeping in mind the results of our recent MFR survey and we suggest companies tailor these to suit their unique requirements.

We hope you find this useful. Should you require any assistance with customising this document or at any stage of this critical process, please feel free to contact us at **contact@in.gt.com.**

Invitation to tender (ITT) – Statutory audit services

Introduction

This ITT has been issued to enable Company ABC to evaluate the options available in the marketplace for the provision of statutory audit services under Companies Act, 2013, for a period of the next five years and beyond. Company ABC is actively looking at creating a valuable partnership with a solutions oriented service provider and best in class player in the marketplace.

The purpose of this document is to provide participating firms with a set of questions which are important to us as a company, in making this selection and to enable them to send over a service and fee proposal (please mention any out of expenses separately).

Sample letter for proposal

To,

M/S PQR & Co LLP,

Delhi, India

We request you to confirm receipt of this proposal and confirm your intent to participate within five working days. Firms may be asked to sign a confidentiality agreement. We would request your responses to reach us at – firstname.lastname@abc.com. In this email, please provide contact details along with the email ID and telephone number of the person you wish we should contact in connection with this tender.

Our company vision, values and mission statement as well as relevant financial information can be found at our website www.companyabc.com. If you need any further information about our company, please contact me at the details below. All questions must be submitted on email.

We would like to receive your proposals no later than XXX 2016. Any key assumptions should be separately stated. No sub-contracting will be allowed. Shortlisted firms will be contacted to deliver a presentation in early XX X 2016. During this meeting, we will describe the criteria used to evaluate firms – which principally comprise of excellence of service, reputation in the marketplace, tone at the top, qualified and independent teams as well as finality over pricing. All respondents will be intimated of the company's decision at the end of each phase, regardless of the outcome.

We look forward to receiving your response.

Yours sincerely,

Mr. XYZ

Chief Financial Officer

Company ABC

Mumbai, India

Phone numbers:

Email:

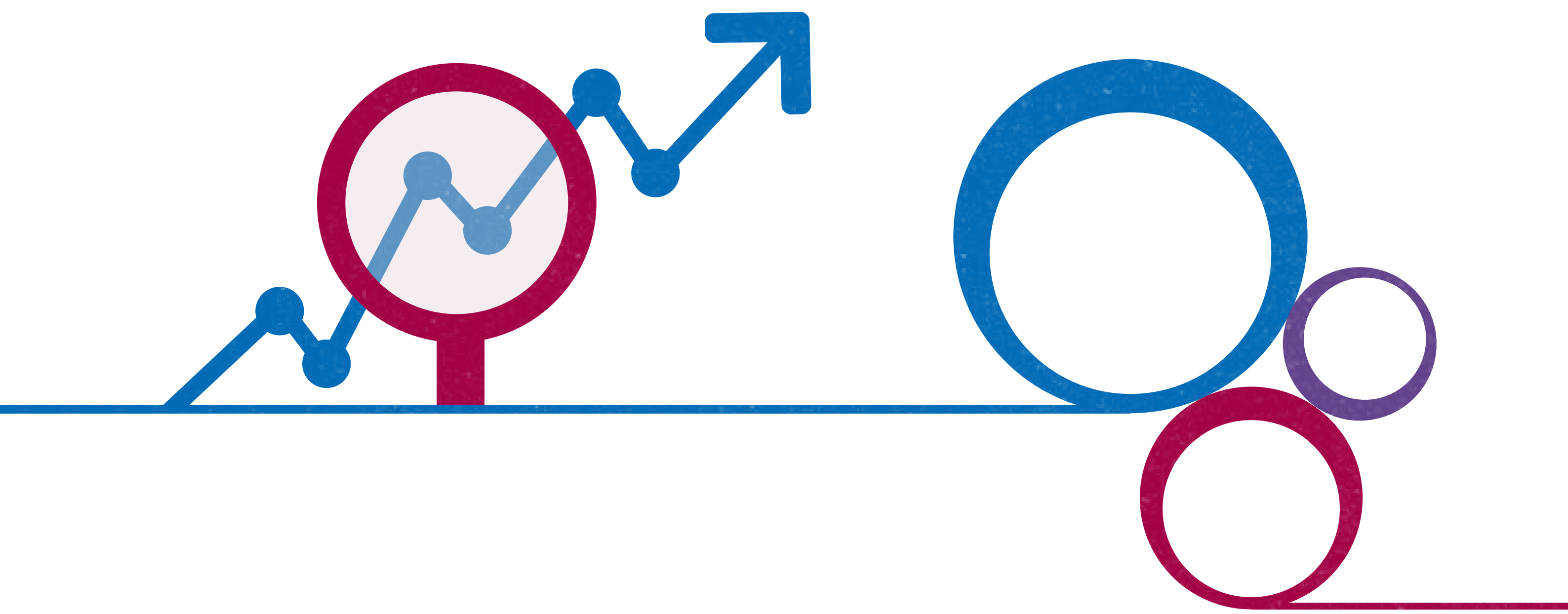
A. Executive summary of the participating audit Firm		
#	**Questions**	**Brief description (required)**
1	What characteristics best distinguish your firm from your competitors?	
2	Summarise the potential benefits to our company by engaging with your firm?	
3	Summarise the organisation and its structure as it is relevant to the engagement.	
4	What is the relative size and strength of your firm in the professional services space?	

B. Firm qualifications		
#	**Questions**	**Brief description (required)**
1	Please provide an overview of the firm's national and/or local resources.	
2	Does the firm have global reach? What is the position of your firm in the global network?	
3	What is the depth of experience the firm has in serving the clients similar to the size and complexity of our company? Do you understand the industry we operate in? Please share industry specific credentials of your firm.	
4	How are the firm's professionals kept informed of emerging legislative, regulatory, auditing and accounting issues?	
5	How will you keep us informed of those issues that directly affect our company? Include/ describe examples of your firm's relevant thought leadership, industry participation, and publications.	
6	Ind-AS and IFC are two key changes to financial reporting. Please provide a brief overview of your firm's strength and knowhow in these areas.	
7	What programmes does the firm have in place to help ensure that clients are satisfied with their services?	
8	Could you share feedback available on record from your marquee clients, across different sectors?	
9	Have you recently been inspected by regulators or examiners? What is the quality standing of your firm and the results of the engagements inspected?	

C. Engagement team		
#	**Questions**	**Brief description (required)**
1	Whether the engagement team members possess the necessary knowledge and experience in their professional field? Whether the team has requisite industry experience?	
2	Describe the engagement team organisation, the way the engagement will be coordinated, and how this engagement management approach will contribute to the effectiveness of the engagement.	
3	Identify other firm resources that will participate in the engagement to ensure expertise in critical businesses of the company/client to support the audit team.	
4	Whether the firm is in a position to allocate resources and people worldwide quickly and effectively wherever the firm needs them?	
5	Please provide CVs for each key partner and manager in an appendix to your response.	
D. Audit approach		
#	**Questions**	**Brief description (required)**
1	Outline the firm's approach in performing the audit (audit scope, deliverables, risk assessment techniques, interim work, year-end close, audit procedures and processes, timetable, and other matters).	
2	Describe the firm's approach in working with the Internal Audit and/or the tax department.	
3	Based on your industry experience, what will be the key areas of focus for the audit? What do you see as the major audit risks for our industry and company?	
4	Does the firm use high quality technology tools in the audit? How will you involve information technology risk management expert in the audit?	
5	Outline the firm's plan to ensure a smooth transition to the firm for the first-year audit period.	
6	Describe the firm's decision-making procedures for reviewing auditing, accounting, and reporting matters affecting the company. Who is the primary decision maker for audit-related issues, and what is the extent of this individual's authority? Please explain the levels of escalation for our Company in context of this hierarchy.	
7	Describe how the firm will ensure effective and timely communication of audit results with management and our Audit Committee. Describe the firm's role in assisting the Audit Committee to fulfill its responsibilities to shareholders.	
8	Describe the firm's quality assurance process and the value it adds to your audit.	
9	Describe how you will work with our team in a proactive manner to assess the impact and changes needed as arising from accounting changes and new pronouncements.	
10	Who would be our single point of contact in your firm, for any audit related matter that arises globally in our audits?	

E. Independence and confidentiality		
#	**Questions**	**Brief description (required)**
1	Does the firm have any relationships that exist between your partners and staff and directors, officers, or key employees of the company that would impair firm's objectivity or independence, in fact or by appearance? If any relationships exist, discuss how the firm proposes to mitigate/eliminate such objectivity or independence issues.	
2	Describe the process the firm uses to monitor and maintain independence from clients.	

F. Fees		
#	**Questions**	**Brief description (required)**
1	What is the firm's pricing policy? Is it in line with the market?	
2	Provide the list of services considered out-of-scope outlining an approximate hourly rate that would be billed for such services.	
3	Can you summarise your value added proposition for the fee your firm plans to charge us?	



About Grant Thornton India LLP and Prime Database Group

Grant Thornton in India

Grant Thornton in India is one of the largest assurance, tax, and advisory firms in India. With over 2,500 professional staff across 13 offices, the firm provides robust compliance services and growth navigation solutions on complex business and financial matters through focused practice groups. The firm has extensive experience across a range of industries, market segments, and geographical corridors. It is on a fast-track to becoming the best growth advisor to dynamic Indian businesses with global ambitions. With shorter decision-making chains, more senior personnel involvement, and empowered client service teams, the firm is able to operate in a coordinated way and respond with agility.

Over the years, Grant Thornton in India has developed a host of specialist services such as Corporate Finance, Governance, risk & operations, and forensic & investigation. The firm's strong subject matter expertise (SME) focus not only enhances the reach but also helps deliver bespoke solutions tailored to the needs of its clients.

Prime Database Group

PRIME Database Group (primedatabasegroup.com) is an 'information management' specialist. While its flagship product is PRIME Database, the Group has also developed several other unique databases/websites. It also provides a variety of other services including database creation and management, content generation, website development and management, information consulting and data cleaning and standardisation.

PRIME has over 25 years of extensive experience in dynamic sourcing, aggregation, standardisation and distribution of information, with a focus on database creation and maintenance. Clients include developmental institutions, banks, corporates, stock exchanges, FIIs, asset management companies, stock brokers, academic institutions, management consultants, HR firms, insurance companies, law firms etc. A large number of services of the Group are also focused towards investor education and protection.

Innovation has always been a key mantra at PRIME. Almost all databases developed by PRIME are path-breaking and are the worlds' first and unreplicated.

Databases/Websites created by PRIME: PRIME Database (primedatabase.com)- India's premier database on the primary capital market; **nseinfobase.com**- Database on listed corporates, in partnership with NSE, including a database dedicated to auditors in companies; **watchoutinvestors.com**-Aggregating information on economic defaulters, now listing over 2,00,000 persons/entities; **primebbdatabase.com**- Database on Bulk and Block deals; **primecrmdatabase.com**- Database tracking credit rating migrations; **primecbdatabase.com**- Database on listed and unlisted corporate bonds; **primemfdatabase.com**- Database and League Tables of AMCs on the basis of Assets under Management; **The IVCA-PRIME Private Equity & Venture Capital Directory (primedatabase.com/ivca)**-A database providing details of Private Equity & Venture Capital Firms investing into India and Service Providers to this industry; **primedirectors.com**-A databank of professionals for listed companies to select independent directors, now hosting profiles of over 24,000 professionals;; **msmementor.in**-A platform for MSMEs to find experts/mentors; **bsepsu.com**-The most authentic & comprehensive website on Disinvestments in India and **Investors Website Services-**Creation, maintenance & hosting of Investors Websites for listed and unlisted companies in India.

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