

**SEBI mulls audit reforms - mandatory rotation of audit partner, and more on the anvil - a natural outcome of the Satyam scam.**

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SEBI has from time to time reviewed and revised the disclosure formats under the Listing Agreement in order to bring transparency in disclosures made by listed companies. SEBI Committee on Disclosures and Accounting Standards (SCODA) has recently reviewed the extant norms relating to disclosure requirements and accounting standards for listed entities. The following are few of the issues that are deliberated by SCODA and public views are solicited on the same:

1. **Professional Qualification/ Financial Literacy of the CFO:** The Committee considered that a mere certification by the CEO/ CFO on the true and fair presentation of the affairs of the Company disclosed in the financial Statements and Cash Flow Statement was not enough. To ensure that the certification really holds value for shareholders, SEBI is of the view that CFO should have adequate financial expertise to review and certify the financial statements. To this effect the Committee recommends that the appointment of the CFO is to be approved by the Audit Committee. The responsibility is cast on the Audit Committee to assess the qualifications, experience & background, etc. of the candidate.  
**Our views:** The recommendation is welcomed, as it not only casts greater responsibilities on the independent directors forming a part of the Audit Committee, it also ensures that the certification provided by the CFO of the company reflects his 'financial sophistication' holding greater value and reliance for the stakeholders.
2. **Rotation of statutory auditors:** The Committee considered that the requirement of the shareholders to appoint the auditors may just be a procedural requirement as they only chose from the few names proposed by the Board of Directors who may along with the promoters on the strength of the voting power appoint the firm of their choice. The Committee further considered that a longer association of an auditor with the listed entity may bring in complacency and hamper the independence of the auditors. In this regard the Committee recommends mandatory rotation of partners of auditors firm every five years. Once again further responsibility is cast on the Audit Committee whereby it is to ensure that statutory auditors are independent of the management of the Company
3. **Role of Internal Auditors of the Company:** SEBI is of the view that the work of the internal auditors should be carried out by external audit firms. The Committee shares a similar view that an external audit firm carrying out the work of the internal auditor would ensure greater independence of the internal audit function it may not be viable for all listed entities to employ an external audit firm as internal auditor

**Our views:** As rightly put by the Committee though the consideration is good but not practical as it would be a great pinch on the financials of the small cap and mid cap companies. However, the recommendations can be materialized for larger cap companies

4. **Modification in formats of limited review report and statutory auditor's report:** After the Satyam fiasco, SEBI was quick in bringing modifications to this Clause 41 of the Listing Agreement, to include disclosures regarding the details of promoters and promoter group shareholding, including the details of pledged/encumbered promoters' shareholding, by including an additional line items (Item Nos. 17 and 18 of the format) alongwith the periodical disclosures of financial results. There were concerns that such a disclosure may create a misleading notion for the investors that the disclosures have been reviewed and certified by the auditors. Thus the Committee recommends that the auditors may at an appropriate place in the limited review report and in the statutory auditor's report an exception clause which would state - "*except for disclosures in item No. 17 and 18 namely, 'Public Shareholding' and 'Promoter and Promoter Group Shareholding' which have been traced from disclosures made by the management.*" This would mean that the verification of details of pledged/encumbered shares of the promoters/ promoter group may not be within the scope of the statutory auditors of listed entities

**Our views:** Why auditors should not review this and the disclosures made by management should be relied upon?

5. **Voluntary adoption of International Financial Reporting Standards (IFRS) by listed entities having subsidiaries:** With the globalization trends picking up in the corporate sector Ministry of Corporate Affairs has recognized this need to harmonize the financial reporting standards for Indian companies with the IFRS and had tentatively announced that the Indian financial reporting standards be converged with IFRS from the accounting periods commencing on or after 1st April, 2011 for all public interest entities. The Committee reviewed whether all listed entities should be permitted to present consolidated accounts in IFRS or only those entities that have foreign subsidiaries should be permitted to do so. Two views have surfaced that either the listed entities with overseas subsidiaries contributing 50% or more to the total revenue of the consolidated entity should be given an option of submitting consolidated financial results in IFRS or all the option should be open to all listed entities as it would help entities to prepare themselves for mandatory convergence with IFRS by 2011.
6. **Interim disclosure of balance sheet by listed entities:** Being in sync with international practices, the Committee recommends that the listed entities should make interim disclosures of Balance Sheet as the shareholders are not only interested in the profitability of the company but are also concerned with the issue of solvency and financial soundness of the company. Thus the Committee recommends that *the audited figures of the major heads of the balance sheet prepared in accordance with Schedule VI to the Companies Act or its equivalent in other statutes may be disclosed by listed entities on a half-yearly basis.*
7. **Timelines for Submission of financial results by listed entities:** As per the requirements of the Listing Agreements, a company has an option of submitting

the unaudited financial results with respect to the last quarter within one month from the end of the quarter or submit the audited financial results for the entire year within three months from the end of the quarter. So if a company opts to exercise the latter option of submitting audited financial results, the financial information of the company is unavailable to the company for a period of five months or more, making the shares prone to insider trading. The Committee's recommendations have reduced the time limit available to companies for submitting the financial results. In case of quarterly and year to date un-audited stand-alone financial results accompanied by limited review report of the auditor (excepting the last quarter), the report is to be submitted within 45 days rather than the 2 months time available to the companies as of now. In case of annual audited financials results are to be submitted within 60 days from end of financial year rather than time limit of three months.

The recommendations are in the wake of the financial crisis and take a first hand approach on the practical issues faced by companies.