SEBI issued new requirements with regard to an auditor’s resignation

6 November 2019

**Background**

Section 140(2) of the Companies Act, 2013 (2013 Act) specifies the procedure to be followed by an auditor when he/she resigns from a company. The procedure is as follows:

- File a statement in the prescribed form with the company and the Registrar of Companies within 30 days from the date of resignation. For a government or a state government company (companies specified in Section 139(5) of the 2013 Act), file such a statement with Comptroller and Auditor General of India.

- Statement should indicate the reasons and other facts as may be relevant with respect to such resignation.

From 1 April 2019, the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) also cast responsibility on the listed entities in relation to an auditor’s resignation. The listed entities are required to disclose detailed reasons to the stock exchanges when there is a resignation by an auditor as soon as possible but not later than 24 hours of receipt of such reasons from the auditor.

In July 2019, SEBI issued a Consultative Paper (CP) inviting public comments on policy proposals with respect to resignation of statutory auditors from listed entities. The CP focussed primarily on the following two aspects:

- Strengthening disclosures to investors
- Strengthening and clarifying the role of the audit committee.

The last date for sending comments on the above was 8 August 2019.

**New development**

Recently, SEBI has issued a circular clarifying mandatory conditions to be complied with when the statutory auditor of a listed entity or its material subsidiary resigns, in relation to a limited review/audit report. The circular issued by SEBI comes into immediate effect.

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1 On 18 October 2019, SEBI issued its circular number CIR/CFD/CMD1/114/2019.

2 Listing Regulations define material subsidiary as a subsidiary, whose income or net worth exceeds 10 per cent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.
In case an entity is not required to form an audit committee, then the board of directors of the entity is required to ensure compliance with this circular.

The circular covers the following aspects to be complied with by listed entity/material subsidiary:

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Aspects covered in the circular to be complied with by listed entity/ its material subsidiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Conditions to be complied with while appointing/re-appointing an auditor</td>
</tr>
<tr>
<td>2</td>
<td>Procedure to be followed in relation to resignation by auditors</td>
</tr>
<tr>
<td>3</td>
<td>Obligations of a listed entity and its material subsidiary</td>
</tr>
</tbody>
</table>

SEBI has also clarified that in case the auditor is rendered disqualified due to operation of any condition mentioned in Section 141 of the 2013 Act, then the provisions of this circular would not apply.

This edition of First Notes summarises the key aspects of this circular as follows:

1) **Conditions to be complied with while appointing/re-appointing an auditor**

   The conditions to be complied by a listed entity/material subsidiary while appointing/re-appointing an auditor are as following:

   a) If the auditor resigns within 45 days from the end of a quarter of a financial year, then the auditor should, before such resignation, issue the limited review/audit report for such quarter.

   b) If the auditor resigns after 45 days from the end of a quarter of a financial year, then the auditor should, before such resignation, issue the limited review/audit report for such quarter as well as the next quarter.

   c) Notwithstanding the above, if the auditor has signed the limited review/audit report for the first three quarters of a financial year, then the auditor should, before such resignation, issue the limited review/audit report for the last quarter of such financial year as well as the audit report for such financial year.

2) **Procedure to be followed in relation to resignation by auditors**

   The Listing Regulations require an audit committee, *inter alia*, to make recommendations for the appointment, remuneration and terms of appointment of auditors of a listed entity. Additionally, the audit committee is also responsible for reviewing and monitoring the independence and performance of auditors and the effectiveness of the audit process. The circular lays down certain procedures to be followed in case of resignation by the statutory auditor. These procedures are as follows:

   a) **Reporting of concerns with respect to the listed entity/its material subsidiary to the audit committee**

      (i) In case of any concern with the management of the listed entity/its material subsidiary such as non-availability of information/non-cooperation by the management which may hamper the audit process, the auditor should approach the chairman of the audit committee of the listed entity. The audit committee should receive such concerns directly and immediately without specifically waiting for the quarterly audit committee meetings.

      (ii) In case the auditor proposes to resign, all concerns with respect to the proposed resignation, along with relevant documents should be brought to the notice of the audit committee. In cases where the proposed resignation is due to non-receipt of information/explanation from the company, the auditor should inform the audit committee of the details of information/explanation sought and not provided by the management, as applicable.

      (iii) On receipt of such information from the auditor relating to the proposal to resign as mentioned above, the audit committee/board of directors, as the case may be, should deliberate on the matter and communicate their views to the management and the auditor.
b) Disclaimer in case of non-receipt of information

In case the listed entity/its material subsidiary does not provide information required by the auditor, then to that extent, the auditor should provide an appropriate disclaimer in the audit report. The disclaimer should be in accordance with the Standards of Auditing as specified by the Institute of Chartered Accountants of India (ICAI)/National Financial Reporting Authority (NFRA).

c) Other procedures

- **On appointment/re-appointment of auditor:** A listed entity/its material subsidiary is required to ensure that all the above conditions (as mentioned for appointing/re-appointing an auditor and procedure to be followed in relation to resignation of auditors) are included in the terms of appointment of the statutory auditor at the time of appointment/re-appointment of the auditor. In case the auditor has already been appointed, then the terms of appointment should be suitably modified.

- **Certificate of compliance:** A practicing company secretary is required to certify compliance of the provisions of the circular by a listed entity as mentioned above in their annual secretarial compliance report.

3) Obligations of a listed entity and its material subsidiary

The circular prescribes the following formats and disclosures to be filed by a listed entity and its material subsidiaries to the stock exchange:

a) **Format of information to be obtained from the statutory auditor upon resignation:** Annexure A of the circular specifies the format in which the listed entity/its material subsidiary should obtain information from the auditor on resignation. The format includes information to be filed by the statutory auditor such as:

- Detailed reasons for resignation
- Details of association with the listed entity/its material subsidiary
- Whether the inability to obtain sufficient appropriate audit evidence was due to a management-imposed limitation or circumstances beyond the control of the management
- Whether the lack of information would have a significant impact on the financial statements/results
- Whether the auditor has performed alternative procedures to obtain appropriate evidence for the purposes of audit/limited review as laid down in SA 705 (Revised), *Modifications to the Opinion in the Independent Auditors’ Report*
- Whether the lack of information was prevalent in the previous reported financial statements/results. If yes, on what basis the previous audit/limited review reports were issued
- Any other facts relevant to the resignation.

Further, a declaration of the above information needs to be given by the statutory auditor that the information so provided is correct and complete and there are no other material reasons for resignation other than those provided above by the statutory auditor.

b) **Co-operation by listed entity and its material subsidiary:** During the period from when the auditor proposes to resign till the auditor submits the report for such quarter/financial year as specified above, the listed entity and its material subsidiaries are required to continue to provide all such documents/information as may be necessary for the audit/limited review.

c) **Disclosure of views of the audit committee to the stock exchanges:** Upon resignation by an auditor, the audit committee should deliberate upon all the concerns raised by the auditor with respect to resignation but not later than the date of the next audit committee meeting. The views of the audit committee should be communicated to the management. The listed entity should ensure disclosure of the views of the audit committee to the stock exchanges as soon as possible but not later than 24 hours after the date of such audit committee meeting.

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3 SEBI Circular no CIR/CFD/CMD1/27/2019 dated 8 February 2019 has prescribed the format for annual secretarial compliance report to be issued by a practicing company secretary for listed entities and their material subsidiaries.
Our comments

The 2013 Act requires only the auditor/s to communicate reasons for resignation to both the company and the Registrar of Companies. Recently, SEBI has amended the Listing Regulations and made it mandatory for the listed entities to disclose to stock exchanges the reasons for resignation of auditors within 24 hours of receipt of such reasons.

The ICAI has issued an Implementation Guide on Resignation/Withdrawal from an Engagement to Perform Audit of Financial Statements. This guide elaborates on the following three aspects:

- **Circumstances leading to withdrawal/resignation:** The guide explains that it is expected that if an engagement to audit the financial statements has once been accepted, the auditor should discharge the professional obligations associated with the role and responsibility of an auditor. Unless there are circumstances that are covered by Standards of Auditing, SQC-14 and the Code of Ethics issued by ICAI where resignation is the only available alternative, the auditor should complete the engagement.

- **Guidance for auditors at the time of resignation/withdrawal from an existing engagement:** The guide explains that the practicability of withdrawing from the audit may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. If the auditor has substantially completed the audit, then the auditor may decide to complete the audit to the extent possible, disclaim an opinion and explain the scope limitation with the Basis of Disclaimer of Opinion section prior to withdrawing.

In certain circumstances, withdrawal from the audit may not be possible if the auditor is required by law or regulation to continue the audit engagement. It is, therefore advised that the auditor should discharge his/her professional obligations.

The auditor is advised, particularly in case of listed entities, to comply as below:

- In case an auditor has signed all the quarters (either limited review or audit) of a financial year, except the last quarter, then the auditor has to finalise the audit report for the said financial year before resignation.

- In other cases, the auditor should resign after issuing limited review/audit report for the previous quarter with respect to the date of resignation.

- To the extent information is not provided to the auditor or the management imposes a scope limitation, the auditor should provide an appropriate disclaimer in the audit report.

- **Applicability of the guide:** The implementation guide is applicable in case of audits of all listed entities. Further, in case of audits of banks, insurance companies and other corporate entities, the guidance given in the guide would be followed, as applicable.

Following are the points to be evaluated after considering guidance given by SEBI, 2013 Act and ICAI:

1) **Applicability:** The recent SEBI’s circular brings material subsidiaries of the listed entities into its fold and requires them to disclose reasons for an auditor’s resignation to stock exchanges. While ICAI’s implementation guide is applicable to auditors and it requires disclosure of reasons for resignation to Registrar of Companies with regard to all corporate entities.

2) **Reasons for resignation:** The ICAI’s implementation guide explains that the auditor should specify the reasons for resignation and other facts relevant to the resignation. It requires auditors to describe the circumstances while giving the reasons for resignation suitably, instead of mentioning ambiguous reasons such as other pre-occupation, personal reasons, administrative reasons, health reasons, mutual consent, or unavoidable reasons. Now SEBI’s circular also provides guidance similar to ICAI’s implementation guide.

3) **Conditions to be complied while appointing/re-appointing an auditor:** The ICAI’s implementation guide provides principles to be followed by an auditor while resigning/withdrawing from an audit engagement. It emphasizes that the practicability of withdrawing from the audit may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. It further mentions that for a listed company in case an auditor has signed all the quarters (either limited review or audit) of a financial

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4 Standard on Quality Control (SQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Service Engagements*
year, except the last quarter, then the auditor has to finalise the audit report for the said financial year before resignation. In other cases, the auditor should resign after issuing limited review/audit report for the previous quarter with respect to the date of resignation.

Now SEBI’s circular provides prescriptive guidance and defines the conditions when a company appoints/re-appoints a statutory auditor. These conditions may have large implication in certain situations, for example, if an auditor decides to resign in October 2019, then he/she would be expected to complete limited review of the September quarter. Also depending upon the date of resignation, the quarterly review/audit of December quarter may also be required to be completed along with the review/audit report of the March quarter. Therefore, in this example, it appears that if an auditor has not resigned/withdrawn from an audit engagement by 15 November of any year then the auditor will have to complete the audit of the financial statements for the year ending on 31 March in that financial year.

4) **Procedure to be followed in relation to resignation of auditors:** SEBI has emphasised the role of the audit committees with regard to an auditor’s resignation. It requires statutory auditors to approach an audit committee to report their concerns during the audit, and not wait for the meeting for quarterly review. Additionally, the audit committees are required to deliberate upon all concerns raised by auditors in their resignation letter by its next meeting and communicate their views to management. Such views are to be disclosed to the stock exchanges within 24 hours of the audit committee meeting by the listed entities.

The ICAI’s Implementation guide also requires the auditor to communicate with the appropriate level of management and, where appropriate, those charged with governance regarding the circumstances and conclusions reached.

5) **SEBI’s format of information to be obtained from the statutory auditor upon resignation vis-à-vis Form ADT-3 and ICAI guide:** The information required by ICAI’s implementation guide along with Form ADT-3 is generally similar to the SEBI’s format. SEBI’s format requires certain additional information and one of the important point added is the requirement for auditors to mention ‘whether the lack of information was prevalent in the previous reported financial statements/results. If yes, on what basis the previous audit/limited review reports were issued’.

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**The bottom line**

The listed entities may take note of the circular as additional onus is cast on them for disclosure of information in case of resignation of statutory auditors. The steps undertaken by SEBI are aimed at strengthening the corporate governance framework. In the past whenever there has been an auditor resignation its impact has been quite adverse for the investors and hence, in the interest of protecting the interests of the investors the rules for resignation by auditors have been strengthened. However, the circular does not prohibit resignation of auditors but aims at an orderly resignation after the relevant period end review/audit is completed and discourages resignations without communicating appropriate reasons.
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Missed an issue of Accounting and Auditing Update or First Notes

Issue no. 39 – October 2019

The topics covered in this issue are:

- Ind AS 116, Leases: Emerging implementation challenges-Part 2
- Ind AS 115 disclosures- An analysis of Nifty50 annual reports
- Accounting for guarantee fee paid to a party other than a lender
- Regulatory updates.

Amendments to IFRS pursuant to benchmark interest rate reform

22 October 2019

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- **Pre-replacement issues**: Issues affecting financial reporting in the period before replacement of IBOR with an alternate interest rate, and
- **Replacement issues**: Financial reporting issues arising once the IBOR had been replaced.

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