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EDITORIAL

REGULATORY SCEPTICISM

The Reserve Bank of India (RBI) issued a Circular on 27th April, 2021. Its aim was to improve **audit quality, strengthen independence and accountability**. Considering the short timeline for implementation and the rigour of the guidelines, it appears that the RBI regarded these matters as critical. Therefore, the degree of urgency is justified by the necessity.

These guidelines seem to carry the scars of the IL&FS, Yes Bank, DHFL and other failures. Failures in the banking and financial services sector (BFS) need to be distinguished from other business failures. BFS functions like the veins and arteries in the human body and many institutions are the edifice on which other sectors stand. A few pillars crumbling or blockages in arteries could have an overarching spiral effect.

Audit Quality is 'sterilised' by Independence and gets 'infected' by conflicts of interest. Just as a doctor or a hospital cannot have 'interest' in a pharmaceutical company and a judge cannot be a partner at a law firm that litigates in the court, by the same token impaired independence weakens the objectivity of a professional. The central bank seems to have become mindful of this root cause.

Considering the above, a more **stringent test for BFS** in terms of **number of years of appointment, number of entities that can be audited, the cooling-off period, mandatory joint audits, inclusion of NBFCs and the bar on services to group entities** is only an expected response by the regulator.

The RBI has raised the bar through these guidelines by not allowing non-audit services one year prior to and after the appointment and even imposed a bar on conducting any audit/non-audit engagements with 'group' entities. Covering NBFCs of a certain size within the ambit of the above guidance is also a noteworthy step.

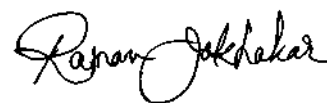
Some reports in the public domain have equated auditor eligibility norms with prescriptions of the Companies

Act, 2013 and the Code of Ethics. A trade body wrote that the principles stated by the RBI are sector-agnostic and therefore must be aligned. One would think that regulations (which are practices, unlike principles) have to be dependent on context. In this case, it is hard to disregard the nature and function of BFS and the scale, spread and shock of recent failures. A concerned regulator will therefore raise the bar in display of its **'regulatory scepticism'** about auditors. Mandatory joint audits also seem to arise from the same thought process.

Taking NBFCs into the fold is a step worth examining. The NBFCs are part of the nervous system of BFS. The IL&FS collapse and AQR findings by NFRA must have been ringing in the regulator's mind till today. I would infer that this move is to firm up a more comprehensive monitoring of the entire BFS by the central bank.

The uproar from some circles routed through trade bodies is understandable. A ban on services to group entities and 'take over' of NBFCs' auditor appointments by the RBI will have adverse commercial consequences for current incumbents. A sudden disqualification of auditors and the additional burden of fresh appointments at a short notice will be tough, but surely not impossible. Some clarifications are also wanting from RBI.

For systemically important entities, a heightened level of regulation seems necessary. The concern about this entire matter must have caused the insistent exigency in the central banker's action. RBI is one of the finest regulators – tough, erudite and not infiltrated by vested interests. One can be reasonably sure about RBI having done its homework before rolling out these changes.



Raman Jokhakar
Editor

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