

Role of Statutory Auditors during Insolvency Proceedings



The introduction of Insolvency and Bankruptcy Code by the Government is a landmark step to tackle the issues pertaining to insolvency and bankruptcy plaguing the Indian economy. With the coming into force of this regulation, it is hoped that the entire insolvency and bankruptcy law will be streamlined and consolidated and matters will be resolved in a time bound manner. The statutory auditors of companies undergoing the insolvency process also have a huge role to play in making this procedure a success. In the present article, the author has discussed and deliberated this in detail. Read on to know more....



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Background

The Indian economy is witnessing significant regulatory reforms over the past few years in order to address multiple complexities and issues to achieve and sustain potential growth level. One such reform requiring attention was to formulate and

implement a key regulation to resolve insolvency issues concerning Corporates/Individuals/LLP's. Looming Non-Performing Assets ("NPA") in the banking industry posed significant threat to the economy. Elevated stress levels in banking sector compelled the Government to enact the Insolvency and Bankruptcy Code, 2016 ("the Code") pursuant to recommendations of the Bankruptcy Law Reform Committee headed by Mr. T. K. Vishwanathan.

Within a year of its enactment, the Code has gained considerable momentum. Consequent to tremendous pressure from Reserve Bank of India ("RBI") to solve the NPA menace, 12 major defaulters totalling about 25% of the Gross NPAs as at 31st March, 2016 have already been referred to various benches of Hon'ble National Company Law Tribunal ("NCLT") to initiate Corporate Insolvency Resolution Process ("CIRP") and another larger list, involving around 35 companies have also been circulated. As per the Economic Survey Report 2017-18, more than 630 cases pertaining to CIRP have been admitted by NCLT till January, 2018, and a sizeable proportion of them are listed companies or other prescribed companies which are required to be mandatorily audited or reviewed as per the Companies Act, 2013 and SEBI Guidelines. Further, this number is expected to increase substantially pursuant to Circular No. RBI/2017-18/131 DBR. No.BP.BC.101/21.04.048/2017-18 issued by RBI dated 12th February, 2018, wherein direction has been issued to effect withdrawal of all the debt restructuring schemes such as Corporate Debt Restructuring, Strategic Debt Restructuring, Joint Lender Forum Mechanism, Scheme for Sustainable Structuring of Stressed Assets available to lenders, thereby indicating CIRP as the sole recourse available to the lenders.

The Code being 'first of its kind' reform in India, is subject to various interpretational and implementational issues, and one among them is the ambiguity concerning roles & responsibilities of the Statutory Auditor during the pendency of CIRP. This article is an attempt to deliberate upon various such ambiguous issues and the possible way out to tackle such issues.

Performance of Audit/Limited Review by Statutory Auditor

With the appointment of an Interim Resolution Professional/Resolution Professional ("IRP/RP"), the powers of the Board of Directors vested by virtue

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of the Companies Act, 2013 are suspended and the IRP/RP is mandated to manage the affairs of the Company. Nevertheless, the Auditor, appointed by the members of the Company should continue to perform duties required as per the Companies Act, 2013 and SEBI regulations. However, following pertinent questions crop up, which require extensive deliberation:

- Can the IRP/RP limit the scope of audit or engagement?
- Whether the Audit Report/Limited Review Report is to be addressed to the members of the Company or the IRP/RP or the suspended Board of Directors?
- Whether the Management Representations required by the auditor, have to be obtained from the IRP/RP (as management vests with the IRP/RP under the Code) or any other person as authorised by IRP/RP?
- Since the powers of Board of Directors are suspended, there may be circumstances where there is disagreement between the Board and the IRP/RP regarding adoption and approval of financials. The Board may take a stand that it has no power to adopt the financials and the IRP/RP may not be willing to take up responsibility regarding financials which are for a period preceding his/her tenure. In such scenario, whether the Financial Statements will be approved by the Board of Directors (though suspended but performing their duties) or the IRP/RP or any other person authorised by the IRP/RP?
- As per the extant provisions of the Code, the Insolvency Resolution Process Cost has priority over other payments. Statutory Audits and Quarterly Limited Reviews are the compliance requirements under various mandatory statutes, which are required to be ensured even by IRP/RP as per Circular No. IP/002/2018 issued by IBBI on 3rd January, 2018. Non-payment of fees is also

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a big challenge for auditors. Whether the audit fee payable to Statutory Auditor can be ratified as Insolvency Resolution Process Cost under Section 5(13)(c) of the Code read with Regulation 31(e) of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (“the Regulations”)?

Comments

Though the Code has an over-riding effect over all other laws which are in force for the time being, Section 28 of the Code clearly states that the IRP/RP cannot make changes in the appointment or terms of contract of Statutory Auditors without prior approval (minimum 75% vote) of Committee of Creditors. Since, the Board gets suspended and its powers are required to be exercised by IRP/RP from the date of his appointment, the onus is on IRP/RP to either adopt and approve or authorise the Key Managerial Persons to adopt and approve the Financial Statements/Results and give appropriate representations, responses to qualification and responsibility statement in the capacity of Board of Directors. The Statutory Auditor shall endeavour to perform the rights and duties and as far as reporting is concerned, the Audit/Limited Review Report which was erstwhile addressed to the Board of Directors, now shall be addressed to IRP/RP and the Audit Report which was conventionally addressed to the Members of the Company shall continue to be addressed to the Members of the Company. Further, the extant provisions of the code grants authority to the IRP/RP to have access to the books of accounts, records and other relevant documents available with Statutory Auditors, which in turn builds added responsibility on the auditors to maintain appropriate documentation and produce relevant documents which are required to be disclosed under the Code without violating professional ethics as mandated under The Chartered Accountants Act, 1949.

Going Concern Assumption

Several ‘events and conditions’ may cast significant doubt over the entity’s ability to continue as a going concern. Typically, an entity having referred to NCLT under the Code would have encountered such ‘events and conditions’.

SA 570(R) provides guidance on Reporting, however, the auditor’s conclusion on Going Concern Assumption is merely based on the adequacy of disclosures provided by the management. Further,

SA 570(R) also provides the mode of reporting in the illustrative formats.

This is creating an edge of the cliff scenario for auditors, who have been providing an Emphasis of Matter concerning the going concern assumption as mandated under erstwhile SA 570. Ideally, when the Company is under the Insolvency Proceedings, an IRP/RP is appointed to run the affairs of the Company as a ‘going concern’ for a specific period of time (180 days + 90 days of extendable period) within which, a resolution has to be arrived at. However, in case the resolution does not crystallise, then the Company will be pushed into liquidation under the framework of the Code.

With conformity to SA-570 “Going Concern”, a statutory auditor shall:

- i. Obtain sufficient audit evidence to evaluate the management’s assessment of Going Concern, which can be based on following parameters:
 - Degree of uncertainty associated with the outcome of Insolvency Proceedings since auditors do not have access to the minutes of the meetings of Committee of Creditors and decisions taken in such meetings.
 - Extent to which business would be impacted by the outcome of CIRP considering the size and complexity of business.



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- Extent to which comfort can be placed on the requirement to run the company as going concern by the Resolution Professional as envisaged under the code, can be considered as reliable to comment upon going concern assumption.
 - Veracity of the proposed/approved Resolution Plan *i.e.* whether the Resolution Plan validates the Going Concern Assumption for the foreseeable future period.
- ii. Conclude on the basis of evidences obtained, whether a material uncertainty exists related to events and conditions that may cast significant doubt on entity's ability to continue as a going concern has been adequately disclosed in the Financial Statements.

The auditor's opinion depending upon the conclusion drawn from evaluation of going concern assessment might be:

- A) Unmodified, if the going concern assumption is appropriate.
- B) Unmodified with an Emphasis Of Matter Paragraph, in case:
- Material uncertainty exists casting doubt over entity's ability to continue as going concern & that matter has been adequately disclosed in the Financial Statements; or
 - Management opts to prepare Financial Statements on liquidation basis and auditor determines that other basis of accounting is acceptable in such circumstances and adequate disclosures have been made in such regard.
- C) Qualified, if:
- Going Concern Assumption is appropriate but material uncertainty casting doubt over entity's ability to continue as going concern has not been adequately disclosed and effect of such inadequate disclosure on Financial Statements is material but not so pervasive.
 - It is not possible for the auditor to obtain sufficient appropriate audit evidences regarding management's assumption of going concern.
- D) Adverse, if:
- Management's going concern assumption is inappropriate and the Financial Statements are prepared on going concern basis, whether disclosure for such inappropriateness has been made or not in the Financial Statements: or

Auditor shall evaluate the management's assessment of going concern thoroughly by obtaining sufficient audit evidences and critically examining the past and present situation of the company, the progress during the Insolvency Proceedings, and the planned course of action in foreseeable future.



- Going Concern Assumption is appropriate but material uncertainty casting doubt over entity's ability to continue as going concern has not been adequately disclosed and effect of such inadequate disclosure on Financial Statements are material and pervasive.
- E) Disclaimer, if there is limitation of scope of audit due to insufficiency of audit evidences to form an opinion.

Comments

Section 20 of the Code requires the IRP / RP to make all possible efforts to preserve the value of the company and manage its operations as a going concern during the period of CIRP, which is 180 days from the insolvency commencement date, and can be further extended by 90 days. However, the management's estimate for going concern assumption shall be for a foreseeable future, which is not less than 12 months from the reporting date. In case the management's assessment covers less than 12 months, the auditor shall request the management to extend its assessment period to at least 12 months failing which auditor may opt for qualification or disclaimer of opinion as may be appropriate. Moreover, auditor shall inquire the management of any events or conditions beyond management's assessment that may cast significant doubt over going concern assumption as a part of additional audit procedures. Auditor shall evaluate the management's assessment

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of going concern thoroughly by obtaining sufficient audit evidences and critically examining the past and present situation of the company, the progress during the Insolvency Proceedings, and the planned course of action in foreseeable future. There may be serious challenges for the auditors considering the fact that the IRP/RP manages the operations of the Company and whether the IRP/RP would facilitate the required information to the Auditor.

Audit Procedures

Some specific additional audit procedures that may be performed during the phase of CIRP are to:

- Analyse the Minutes of Meeting of COC (if available) or obtain understanding of key issues deliberated or significant decisions taken in such meetings.
- Conduct the impact assessment of key decisions undertaken by the IRP/RP or significant events occurred during the resolution process.
- Request the IRP/RP to provide basis of their assumptions/judgements in assessment of going concern beyond the period of 270 days of CIRP.
- Enquire about the IRP's/RP's future course of action to generate required cash flows during the resolution process to maintain consistency in operations and continuing the entity as going concern.
- Analyse the employee turnover rate during the period of CIRP in order to extract relevant information with the available employees to prevent substantial delays in CIRP due to large scale retrenchment being evidenced during the CIRP.
- Obtain and analyse the viability of Management's/Resolution Applicant's Resolution Plan, Cash-Flow Predictions and other Relevant Budget Forecast in case Resolution Plan is approved by Committee of Creditors ("CoC") and NCLT.

Comments

These procedures specified herein are not exhaustive and may vary depending upon the auditor's judgement, situation of the company, stage of development in the CIRP, outcomes of the COC meetings etc. But, the auditors are required to critically examine the complexity involved in the whole process and modify the procedures/audit methodology in such a manner that they can arrive at a conclusion subject to availability of sufficient and appropriate audit evidence to support their conclusion.



Conclusion

During the CIRP, a critical examination of Going Concern Assumption needs to be conducted by the auditors by exercising appropriate due-diligence before reaching any consensus. Since the assessment of revival plans & meetings are time bound, unless some significant meetings are convened and conducted before the date of adoption of Financial Statements, one might not be able to arrive at a conclusion regarding whether the company's revival plans are viable or not or whether the company will continue as a going concern entity or pushed into liquidation. In such a complex and complicated scenario, reporting is required to be done in very diligent manner and such reporting may vary from company to company depending upon the stage of completion of CIRP, various facts and circumstances encountered during CIRP and most importantly availability of sufficient and appropriate audit evidences. It is worth clarifying that though all the businesses are not subject to audit, Statutory Audit (whether mandatory or voluntary) ensures better Corporate Governance and Management and can play an instrumental role in reducing the risk of insolvency if Management takes the right action subsequent to the auditor's warnings in their Audit Report.

It is inevitable for the audit fraternity to pull up their sleeves and gear up for a very patchy road ahead. As a general operational creditor, with no assurance of payment for the audit services rendered or in the process of being rendered, the auditor's independence might be threatened. However, a Chartered Accountant, as "A Partner in Nation Building", would continue to serve in the best interest of the stake holders and the economy in general. ■