SAT's verdict in Satyam case

What is the issue?

- The Securities Appellate Tribunal's (SAT) has given its verdict in the Satyam case.
- It has reversed the large part of the order delivered by Securities and Exchange Board of India's (SEBI) Whole Time Member against the auditors of Satyam Computers.

What is the story behind?

- The Satyam saga that began on January 7, 2009 with the famous email sent by Ramalinga Raju to SEBI, has had a far-reaching impact on the audit profession.
- The mail compared Raju's predicament to 'riding a tiger' and stated that the accounts of the company were not true and fair.
- SEBI's investigations revealed that the published books of accounts (on September 30, 2008) contained false and inflated bank and fixed deposit balances, fictitious interest income, revenue and debtors' figures.
- Based on these findings, **SEBI had issued an order against firms practising under the brand of PwC** (Price Waterhouse Coopers) and the partners involved in the audit of Satyam, restricting them from auditing any listed companies for a period of 2 years.
- SEBI had also ordered disgorgement of the audit fee of ₹13.09 crore along with interest at 12% p.a. from January 2009.
- In a balanced and well-argued ruling, the SAT has **quashed the SEBI order barring the firms** from auditing listed companies, while it **retained the disgorgement ruling**.

What is SEBI's jurisdiction?

- The important contention in the auditors' appeal against the SEBI order was with regard to the SEBI's power to rule against auditors who were governed by the Institute of Chartered Accountants of India (ICAI).
- In 2015, the ICAI had already passed an order against the chartered accountants involved in the case.
- It found them guilty of professional misconduct and awarded the punishment of removal of their names from the Register of Members permanently and

also imposed fine on them.

- In order to address the issue of extent of SEBI's powers, SAT relied on Bombay High Court's order pertaining to the Satyam case.
- The Court held that the SEBI's jurisdiction to rule against the auditors of Satyam Computers would depend on the evidence unearthed during the SEBI investigation.
- It also said that if there was only some omission without any connivance with anyone, SEBI could not issue any further direction.
- Based on the above, the SAT has held that SEBI does not have the power to pass an order restraining the auditors.
- It took this decision saying, while accounts have been falsified, there is no direct evidence that the auditors were involved in the falsification.
- The negligence and recklessness in adhering to the Auditing and Assurance Standards (AAS) during auditing the accounts of Satyam, points towards professional negligence.
- This needs to be addressed by the ICAI and does not fall within the purview of SEBI.
- In instances where the company's management intentionally falsifies accounting statement, auditors needn't worry if they have conducted their work in accordance with auditing standards.
- Only if they have connived in falsifying the financial statements of a listed company, SEBI will get the power to pass a preventive and remedial order (restraining them from audits of listed companies).

Why auditors are only watchdogs and not bloodhounds?

- With rising instances of corporate frauds, it is common to point fingers at internal and statutory auditors for not detecting the falsification of statements.
- SAT has batted for the auditing profession in this order by pointing out that the auditor is required to employ reasonable skill and care.
- But the auditor is not required to begin with suspicion or to proceed in the manner of trying to detect a fraud or a lie, unless some information has reached which creates suspicion.
- The auditor is not required to perform the functions of a detective. "The auditor is a watchdog and not a bloodhound. The duty of an auditor is verification and not detection," says the order.
- The Tribunal has also pointed out that forensic audit is different from a statutory audit wherein verification is done by selective sampling alone.

Who are the governing auditors?

- Since the Satyam episode first came to light, the audit profession has also

seen numerous changes that increase transparency and decrease the possibility of auditor connivance with the management.

- Yet, the recent instance of the role of auditors in IL&FS revealed in the SFIO report shows that the regulatory bodies can't let their guard down in supervising the conduct of the auditors.
- But converting regulatory supervision into a witch-hunt is also not a solution as it can have adverse impact.
- Clearly, audit profession is an old one and the rules are mostly in place.
- If audit committees which have a majority of independent directors do their work diligently, it can ensure that auditors are truly independent and carry out their duties effectively.
- With the National Financial Reporting Authority set up in 2018, taking on the role of a supervisor to ensure compliance with AAS or undertaking investigations, auditing outcomes could get better.
- Providing sufficient resources to this institution will be important for establishing an additional level of check on the auditors.

Source: Business Line

