The National Financial Reporting Authority (NFRA) – A Case Of New Audit Governance In India

The implementation of the NFRA has impacted the powers of the ICAI drastically, especially with respect to the disciplinary powers of the ICAI.
The National Financial Reporting Authority NFRA: A case Of New Audit Governance In India -Suhail Nathani, Manendra Singh

Jurisdiction of the NFRA: Private companies ousted, extra-territorial applicability

The network liability is definitely an important element to strengthen audit governance, especially in light of various entities (including their affiliates) operating in India; and (iv) total turnover achieved by network members (including their affiliates)

The NFRA is given the power:

1. to impose a penalty of not less than INR 1,00,000 (Indian Rupees One Lakh), but which may extend to 5 (Five) times of the fees received, in case of individuals; and
2. to impose a penalty of not less than INR 5,00,000 (Indian Rupees Five Lakh), but which may extend to 10 (Ten) times of the fees received, in case of firms.

The NFRA is also empowered to impose heavy monetary penalties. In case professional or other misconduct has been proven with respect to a person/entity falling within its ambit, the NFRA is given the power:

Absence of network liability in the Rules

While the Rules have been notified, however, there is one key aspect that the Committee had considered has gone missing in the current form of Rules. In the Report, the Committee has acknowledged the concept of auditor and audit firm operating in India as a member/part of an international network, and in view of the same, it made two noteworthy recommendations, as listed below, however, these recommendations have not found any place in the Rules:

Monetary penalties on international network / entity: The Committee recommended imposition of civil liability in the form of monetary penalties on the international network/entity with whom / which the Indian audit firm has entered into networking/membership, if any audit failure or fraud is found to have been caused due to any faulty methodology being followed by that particular network. The penalty could be up to 5 (Five) times the amount of penalty imposed on the audit firm; and

Annual Transparency Report to the NFRA: Another recommendation from the Committee was that every auditor and audit firm which is operating in India as a member/part of an international network, must submit an annual transparency report to the NFRA. The rationale behind seeking such a report is to gather information which will help the NFRA keep track of the auditors and audit firms operating in India as part of the same network so that in case any legal liability needs to be imposed on that particular network for an audit failure or fraud. Few examples of what should form part of the annual transparency report are: (i) description of the network, its legal and structural arrangement, including payment of any fees, costs, grants, between the Indian audit firm and its network firms and affiliates, directly or indirectly; (ii) details of ownership and management structure of the outside entities constituting the network; (iii) central administration or principal place of business of each network member (including their affiliates) operating in India; and (iv) total turnover achieved by network members (including their affiliates) operating in India.

The network liability is definitely an important element to strengthen audit governance, especially in light of various international networks operating in India, however, failure of consideration of the same in the Rules as on date,

Jurisdiction of the NFRA: Private companies ousted, extra-territorial applicability
In a nutshell, as provided by the Rules, the NFRA will regulate accounting, audit standards and quality of service of auditors of:

<table>
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<tr>
<th>Listed companies</th>
<th>Certain unlisted public companies</th>
<th>Companies governed by other regulators</th>
<th>Entities referred by Central Government</th>
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<tr>
<td>Companies whose securities are listed on any stock exchange in India or outside India</td>
<td>Unlisted public companies having:</td>
<td>Insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special statute for the time being in force or bodies corporate incorporated by other statutes to which the provisions of the Act apply</td>
<td>The Central Government is empowered to refer any body corporate or company or person, or any class of bodies corporate or companies or persons, in public interest</td>
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<td>paid-capital of not less than INR 500,00,00,000 (Indian Rupees Five Hundred Crores); or</td>
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<td>an annual turnover of not less than INR 1000,00,00,000 (Indian Rupees One Thousand Crores); or</td>
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<td>in aggregate, outstanding loans, debentures and deposits of not less than INR 500,00,00,000 (Indian Rupees Five Hundred Crores) as on the March 31st of immediately preceding financial year;</td>
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<td>Offshore associate or subsidiaries of the aforementioned entities</td>
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<td>Any body corporate incorporated or registered outside India, which is a subsidiary or associate company of any of the aforementioned entities if the income or net worth of such subsidiary or associate company exceeds 20% (Twenty percent) of the consolidated income or consolidated net worth of the relevant aforementioned entities</td>
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**Publication of findings of non-compliances with accounting and auditing standards in public domain**

The "name shame" approach has found its way in the Rules. This is one of the key powers given to the NFRA to publish its findings on its website which are available in public domain regarding the non-compliances with accounting and auditing standards where it has conducted investigations or initiated actions under the Rules. This power is in line with the powers of independent audit regulators in other jurisdictions to publish the results of an audit inspection. For instance, the Sarbanes Oxley Act, 2002 authorizes the Public Company Accounting Oversight Board to inspect registered firms and publish the results of the same. This move will ensure transparency in actions taken by the NFRA. However, the Rules also give the discretion to the NFRA to not publish its findings if it has reasons not to do so in public interest and it records the reasons in writing. In such cases, it may not be ruled out, where a member of an international network, it finds itself looped into this, will not proceed for defamation.

**Disciplinary proceedings against auditors and audit firms: Responsibilities of partners/employees**

One of the differentiating powers given to the NFRA is its power to initiate disciplinary proceedings not just against individual auditors but also against audit firms. This was one of the critical limitations under the Chartered Accountants Act, 1949, where the ICAI had the inability to penalize the audit firms for professional or other misconducts, and it could only penalize the members with a monetary penalty up to INR 5,00,000 (Indian Rupees Five Lakhs).

The Rules have empowered the NFRA to initiate disciplinary proceedings against individual auditors and audit firms based on the reference received from the Central Government or findings of its monitoring or enforcement or oversight activities, or on the basis of material otherwise available on record.

Interestingly, in case the action is initiated against an audit firm, the relevant audit firm is required to disclose the names of the partners concerned who shall be responsible for answering the allegations. If no partner, whether erstwhile or present, own responsibility for the allegations made against the audit firm, then the audit firm as a whole, will be responsible for responding to the allegations, and all the partners and even employees of that audit firm as on the date of occurrence of alleged misconduct, will be responsible for answering the allegations.
Investigative powers: ICAI and NFRA’s powers to take disciplinary actions

The NFRA is given the power to investigate if it has received any reference from the Central Government for investigation into any matter of professional or other misconduct, or if it has decided to undertake investigation into any matter on the basis of its compliance or oversight activities, or if it has decided to undertake suo motu investigation into any matter of professional or other misconduct. These powers appear very wide and will require clear parameters for their exercise. The NFRA has the power to investigate all cases of professional or other misconduct against auditors of all companies who fall within the purview of the NFRA and no other institute or body can initiate or continue any proceedings in such matters of misconduct where the NFRA has initiated an investigation. Whereas, all cases of professional or other misconduct against auditors of companies or body corporates who do not fall within the ambit of the NFRA shall be dealt with ICAI unless a specific reference is made to the NFRA by the Central Government.

In a recent ruling by the Supreme Court of India, in the matter of the Council of the Institute of Chartered Accountants of India v/s Shri Gurvinder Singh & Anr. Vide, dated November 16, 2018, the Apex Court held that the disciplinary committee of the ICAI as per the Chartered Accountants Act, 1949 has the powers to conduct disciplinary proceedings and met out punishments against a member of the ICAI if it is of the opinion that the act done by such a person brings disrepute to the profession whether or not related to his personal work. The ruling seems to have strengthened the ICAI’s powers to conduct the disciplinary proceedings, however, after the commencement of the Rules and in light of the NFRA’s powers under the Act, it will be interesting to see as to how powers such as these which have been given to the NFRA as well as the ICAI, fall in place.

Suo moto review of financial statements

The NFRA is empowered to review the financial statements of the companies or body corporate falling within its jurisdiction for the purpose of monitoring and enforcing compliance with accounting standards. It can also direct such companies or body corporates or even their auditors to provide further information or explanation or any relevant documents relating to such company or body corporate. The NFRA is empowered to direct auditors to take measures for improvement of audit quality including changes in their audit processes, quality control, and audit reports and specify a detailed plan with time-limits.

Database of information vis-à-vis auditors

The Rules have also asked the companies and the body corporate to file a return with the NFRA providing details of auditors. Additionally, it has imposed obligations on an auditor of every company/corporate which falls within the purview of the NFRA, to file an annual return in the prescribed form. The format of this form is not provided in the Rules, however, it may contain details about the remuneration (audit as well as non-audit fees), conflict of interest, the international network to which the auditor belongs to, number of entities for which the auditor is acting as auditor, etc.

CONCLUDING REMARKS

Whilst the aforementioned efforts look commendable, they are delayed in their introduction. As an independent audit regulator, it will be expected that the NFRA enhances an investor's confidence and bring more transparency and accountability in the auditing profession. With the roles and responsibilities extending to even employees of the audit firms, they need to be wary of their accountability in the audit firms. The publication of the name of audit firms, especially those which belong to international network will clearly cause reputational damage. Although the NFRA is mandated to not publish proprietary or confidential information, however, at the same time, it is given the power to do so in the public interest if it has reasons for the same. It is a power that will need to be exercised with great caution.

As we see more complex and multi-layered structures and increased corporate governance, it will be interesting to see the implementation and effectiveness of the NFRA vis-à-vis the increased roles and responsibilities of auditors, and whether the NFRA will be able to act as the watchdog to protect the public interest and the interests of investors, creditors and others associated with the companies or bodies corporate falling within its purview.
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Nifty, Sensex End Weaker; All Eyes On Indo-Pak Spat

The broader NSE Nifty closed 0.13 percent lower at 10,792.50, while the benchmark BSE Sensex was down 0.11 percent at 35,867.44.

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Seven content reviewers at Genpact said in interviews late last year and early in 2019 that their work was underpaid, stressful and sometimes traumatic.

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The prime minister also said 2014 was a mandate for fulfilling people's necessities while the 2019 election will be about fulfilling people's aspirations.
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Silver followed suit and dropped by Rs 425 to Rs 41,050 per kg owing to poor offtake by industrial units and coin makers