

# VIEW AND COUNTERVIEW



## NFRA: AN UNWARRANTED REGULATOR?

*There are at least two views, if not more, on almost everything. Call it perspectives or facets. VIEW and COUNTERVIEW seeks to bring before a reader, two opposite sides of a current issue and everything in between. Our world is increasingly becoming linear and bipolar. VIEW and COUNTERVIEW aims to inform the reader of multi dimensional totality of an issue, to enable him to see a matter from a broad horizon.*

*This second 'VIEW and COUNTERVIEW' is on National Financial Reporting Authority (NFRA). NFRA, a creation of the Companies Act, 2013, was not notified for more than 3 years. The recent PNB scam resulted in sudden activation of NFRA. NFRA is mandated with formulation of accounting and auditing standards, to monitor and enforce their compliance on members and firms, and oversee the quality of services of professions associated with compliance with such standards. The body will have the same powers as a civil court. With NFRA, the international practice of an 'independent' audit regulator has finally arrived in India. In the USA, PCAOB has about 1,935 firms registered with it, has a staff of about 700 people and has a budget of \$259 million. Unlike in the US, ICAI is a body formed by the parliament to regulate the audit profession. Is it intentionally sidelined by the government? While NFRA is a reality now, the question remains whether the audit fraternity requires another regulator without better regulations and regulating machinery?*

### VIEW: WITHOUT REGULATIONS ANOTHER REGULATOR MAY NOT WORK

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#### THE ISSUE:

It is said that the government should govern the country and not run business. Regulating business is a difficult

business and requires competence, budget, credibility and rigour. These are generally not what our administrators are known for.

Not so long ago, the government thought it fit to step in to the domain of the Chartered Accountants of India to pronounce accounting and auditing standards to be followed by a section of the corporate world. In fact, Section 209 and 211 of the Companies Act, 1956 were amended to make the accounting and auditing standards mandatory. This created a form of 'advisory' function by the government within the domain of accounting and auditing. However, it was announced that till NACAS pronounced the standards, the ICAI standards will remain in force.

After the Satyam and Global Trust Bank scams, the effectiveness of accounting standards to avoid fraudulent transactions were put to test again by the government and Amendments were brought about in Sections 211, which added new Subsections- 3A, 3B, 3C in 1999 in the 1956 Act. In addition, Section 210A was also inserted. The government was probably not satisfied with its 'advisory' role but thought it fit to assume 'regulatory' powers by creation of National Financial Reporting Authority (NFRA). In the Companies Act, 2013, Section 132 was inserted for implementation of NFRA compliance to be effective from the date of notification to be published in this respect. Till February 2018, such notification was not issued but on the news of PNB Scam, very hurriedly the notification was issued by the government.

**NFRA:** In the wake of recent scams, post Satyam and more immediately relating to Winsome Diamonds, Nirav Modi, Mehul Choksi, has created a belief within the government that one of the causes could be non application of proper auditing methodology. Presumptions are rebuttable. NFRA was notified in the wake of recent scams and rules have been prescribed for its operations.

## THE KEY POWERS AND FUNCTIONS OF NFRA ARE:

- a. To investigate either Suo moto or on the reference made by the Central Government in matters of **Professional Misconduct** committed by any member or a CA firm.
- b. To make recommendations to the central government on formulation or laying down of accounting standards and auditing policies by companies or their auditors.
- c. To monitor and implement compliances relating to accounting standards and auditing policies as prescribed.
- d. To oversee the quality of service of professions associated with compliance of accounting standards and auditing policies as suggested measures for improvement.
- e. To exercise powers as of a civil court under the Code of Civil Procedure, 1908.
- f. Impose penalties:
  - i. Not less than 1 lakh rupees which may extend up to 5 times of the fees received in case of individuals
  - ii. Not less than 10 lakh rupees which may extend up to 10 times of the fees received in case of firms.
- g. To consider an investigation based on monitoring and compliance review of auditor upon audit firms upon recommendations by member – accounting and member – auditing.
- h. To receive a final report from the committee on enforcement on matters referred to them and issue a notice in writing to the investigated company or the professional on whom the action is proposed to be taken.
- i. To conduct quality review for the following class of companies:
  - ◆ Listed companies
  - ◆ Unlisted companies having net worth or paid up capitals of not less than 500 crores or annual turnover of not less than 100 crores as on 31<sup>st</sup> March of immediately preceding financial year.
  - ◆ Companies having securities listed outside India.

j. To debar any member or firm from engaging himself or itself from practice as a member of institute of chartered accountants of India for a minimum period of six months which may extend up to 10 years on account of proved misconduct.

k. To accept or overrule clarifications received or objections raised in writing.

l. To investigate against the auditor or audit firms which conducts

i. 200 or more companies in a year or,

ii. Audit of 20 or more listed companies.

**ICAI:** Section 21A of the Chartered Accountants (Amendment) Act, 2006 provides for constitution of board of discipline and prescribes its powers which are as follows:

i. To consider the *prima facie* opinion of the director (discipline) in respect of all information and complaints where opinion of the director is that the member is *prima facie* guilty of professional or other misconduct mentioned in the First Schedule to the Act and all cases where *prima facie* opinion is that the member is not guilty of any professional or other misconduct irrespective of schedules and passing of orders.

ii. To enquire into, arrive at a finding and thereafter award punishment in respect of guilty cases of any professional or other misconduct in First Schedule to the Act.

iii. To consider letter of withdrawal from complainants and permit withdrawal if the circumstances so warrant.

Section 21B of the Chartered Accountants (Amendment) Act, 2006 provides for the scope of work for the committee

i. To consider the *prima facie* opinion of the director discipline in respect of all information and complaints where opinion of the director is that the member is *prima facie* guilty of professional or other misconduct mentioned in the Second Schedule or in both the Schedules to the Act and passing of orders.

ii. To enquire into the allegations of professional or other misconduct issuing notices to the witnesses and their examinations, arrive at a finding and award punishment

in respect of guilty cases of any professional or other misconduct mentioned in Second Schedule or in both the Schedules to the Act.

iii. To consider letter of withdrawal from the complainants and permit withdrawal if the circumstances so warrant.

### **THE CRISIS:**

1) The ICAI is created by an Act of parliament to control and regulate the profession of Chartered Accountants in the country since 1949 and its members have creditably served the society as professionals, as industrialists, as CFOs, as business leaders, as parliamentarians, as social workers, as ministers in central and state cabinets.

2) The disciplinary directorate of the institute have been functioning also reasonably well in spite of various external factors like injunctions, stay petitions, interlocutory applications etc., which have mainly slowed down the process of quasi-judicial process including delayed production of relevant details at times by the complainants and also delayed response thereto by the accused.

3) Mr. Manoj Fadnis, past president of the Institute said in an interview in February 2015 as follows:-

“there is no delay as in each case is required to be examined based on facts and merits and due procedures under the rule has to be adhered to. The matter (Mukesh P. Shah) is receiving due attention and it would be our endeavour for an expeditious disposal. The matter is under examination for formation of *prima facie* opinion by the director (discipline) under Rule 9 of the Chartered Accountants (Procedure of Investigations of professional and other misconducts and conduct of cases) Rules 2007 and it is only thereafter the appropriate authority-board of discipline, disciplinary committee as the case may be would be required to consider and pass orders on the opinion.” He also stated that there is no timeline as such prescribed in the rules notified by the government of India for taking action against erring members. He also stated that “as on date there are 116 cases pending before the disciplinary committee and 18 cases before the board of discipline for enquiry.” Mr. Fadnis mentioned that between February 12, 2014 and February 11, 2015, 53 cases have been heard and concluded by the disciplinary committee. Board of discipline in the same time heard and concluded 9 cases. He stated that “the delay if any, in concluding a particular case is generally on account of adjournments sought by

the concerned parties. This could also be because of procedure required to be followed by citing and summoning of witnesses by the parties and witnesses to make their depositions or submissions before the committee so that interest (principle) of natural justice is maintained.

4) The Hon. Prime Minister himself questioned the efficacy of disciplinary mechanism. It was alleged that in spite of so many wrong things having taken place only 25 Chartered Accountants were punished in 10 years and around 1400 cases were pending for years. There had not been any denial or acceptance of such accusations, at least not to my knowledge.

5) From the foregoing paragraphs it can be seen that the charges sought to be levelled against ICAI are:

- ◆ Inaction or delayed action
- ◆ Principles of natural justice sought to be given is more in form than substance
- ◆ A disciplinary case may go on for a long time because there is no time frame to conclude the proceedings, not many Chartered Accountants were penalised
- ◆ An individual Chartered Accountant can be prosecuted but not his firm
- ◆ Self regulation.

Certain suggestions are given for pondering.

6) To my mind, the ICAI has sufficient powers under its legal mandate and regulations/rules. Therefore, just like any other law, if the intention is to upgrade the law to its desired level, the law itself requires amendments. The Amendments that have taken place in the Income Tax Act, The Companies Act, the Constitution itself are glaring examples of how the existing laws can be upgraded or modified to the satisfaction of the legislature.

7) I also believe that instead of amending the existing law, to its desired level, enactment of another law and allowing the new law to coexist with the existing law by demarcating its relative powers to judge cannot be a solution to the “so called” problems.

8) A regulatory mechanism that seeks to regulate listed companies, large unlisted companies and companies listed

abroad on the one side and leaving unlisted companies of lesser dimension with the disciplinary directorate of ICAI can have new set of challenges. Maintaining two parallel quasi-judicial authorities is definitely not in the best interest of the country as well as the profession.

9) The speed at which the notification under NFRA was issued after the PNB scam has raised the eyebrows.

10) It is surprising that even before the due process of law could be initiated charges and accusations have been levelled against the auditors.

11) It is widely reported in newspapers and sections of the media that:

- ◆ There was no concurrent audit of the branch concerned by Chartered Accountants

- ◆ Probably there was no inspection by RBI

- ◆ The branch in-charge (deputy manager) was in the same office for 11 years and it is also reported that he himself was the maker, checker and authoriser of the transactions routed through SWIFT without being routed via the CBS and

- ◆ He was allowing ever greening of LOUs issued without having applications for each LOU.

12) Profession or vocations do have few black sheep. That does not make or prove the entire profession to be full of black sheep. Adverse criticisms are bound to demoralize the entire community.

### **SUGGESTIONS FOR SOLUTION:**

- ◆ Amend Chartered Accountants Act /Regulations / rules to incorporate timeline for conclusion of proceedings of the disciplinary mechanism.

- ◆ Create appellate tribunal for redressal of grievances with respect to the orders pronounced under the Chartered Accountants Act

- ◆ For consideration of points of law which are in dispute, the aggrieved party pursuant to the order of the tribunal may prefer to file a second appeal before the Honourable Supreme court of India.

- ◆ High Courts shall have no jurisdiction to try any matter under the Chartered Accountants Acts and regulations.

- ◆ All applications, interlocutory applications, stay petitions, injunctions and/ or directions under the law, be only preferred before the tribunal

- ◆ If nexus can be proved, firm can also be prosecuted together with the concerned partner. However, such action against the firm should invariably be probed before inducting the firm as a party. The firms that are highly professionalised may have a system where partners are independently taking decisions with respect to handling of any client and such procedure is duly documented. The burden of proof that such independence exists in the firm and that the firm does not influence the partner shall rest on the firm itself.

- ◆ Repeal / Delay NFRA as a regulatory body and reintroduce NACAS as an advisory body.

The way NFRA is structured, and seemingly undermining the ICAI, will not bring intended results. Without adequate manpower, high calibre staff, investigative teeth, and infrastructure, NFRA could create a situation that was sought to be overcome.

Other questions and apprehensions that need to be addressed:

a. In terms of setting the standards, if ICAI were to still prepare the standards and NFRA were to approve, will it be a mere pass through or a hurdle in between?

b. Can there be different regulators for corporate and non corporate? It appears that NFRA will deal with large corporate only. Will auditors now be subjected to two sets of rules – one of the ICAI and one of NFRA?

c. Basis on which complaints will be accepted? How will it deal with frivolous complains? Will this body put Chartered Accountant profession into an unwarranted round of litigation? If the complainant is disproportionately large, how will an auditor represent himself to get a deal?

d. How will independence of members of NFRA be dealt with? Will there be detailed rules framed and some other body will regulate it?

e. Conflict of interest with other regulators: Say SFIO – could be a potential issue when a fraud matter is involved. The NFRA being quasi judicial will carry out both investigative and quasi judicial functions. Can an

enforcement agency – say SFIO which is part of MCA – be part of the NFRA?

f. Location of NFRA needs to be spread out and certainly not in Delhi and preferably kept where maximum corporate economic activity takes place, such as Mumbai.

g. QRRB has struggled to find people to carry out reviews. Can we expect qualified people with requisite experience, skill and judicious predisposition to join the NFRA?

h. Will the salary and fees be commensurate with qualification to pay such reviewers?

i. Will these Rules put Auditors at a disadvantage – with companies threatening to complain against auditors? Safeguards for false complaints are not visible.

The members of the CA Profession of their own volition have to rise and clean up the mess we are in. We ourselves have to regulate the way a profession should be run, as the ultimate users of our services is society at large. We have to prove our worth and if we consciously try to keep an image of honest professionals, then no other authority, such as NFRA would be necessary.

The ICAI has not fared badly when compared to other professional bodies and legal machinery. Look at the way justice is denied / delayed, with almost 3 crore cases pending in Courts! So friends, revamping of existing machinery of Regulation could have been a better proposition rather than having another Regulator.

## **COUNTERVIEW: NFRA IS A CHANGE FOR BETTER**

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The notification announcing the activation of a National Financial Regulatory Authority (NFRA) has set the proverbial fox within the Institute of Chartered Accountants of India. It is likely to see this move as a public humiliation of the profession; as a withdrawal of the recognition that the profession had had from Indian society in the past nearly seventy years. Long before the prime minister of India rebuked the profession at a meeting of a “competing” profession, the Companies Act had already framed the provision for the setting-up of the NFRA. The question is,

was this justified? Has the profession lost the trust implicit in self-regulation: that it would always place public interest over the interests of its own members, were there to be a conflict between the two? It is also important to understand that trust is based on both, fact as also perception. Indeed, because few members of the public have access to facts, it is perception of the profession’s functioning that determines its utility to society.

Indeed, the NFRA is only one more amongst many independent regulators of the accounting profession that have come up in many countries around the world. This has been the trend in most major jurisdictions and the regulation of the profession and the preparation of accounting standards had been taken away from professional bodies in many places. So, to that extent the change may well have been a result of overseas influence on the government. But, it would be self-deceiving if we failed to look at how the profession weakened its case to remain self-regulating, over the past couple of decades.

So long as the ICAI leadership inspired confidence in the public and in government officials by their intellectual breadth and dignified conduct, the profession’s trust was secure. Members were rightly held in high regard and their voice carried weight in business and government. Whilst there have always been black sheep, their numbers were smaller, the media was not interested in the topic and the high standards maintained by most members diluted the dark impact of a few maligned individuals.

Today, conversations with business people and other members of society clearly indicate a collapse in the dignity of the profession. As a body representing a profession that exists because of the capitalist system ironically it has done everything in its power to undermine the basic philosophy of that system in its own membership. It has created divisions in the profession between the larger firms and their smaller counterparts. Society struggles to see how that has been to its benefit.

The intellectual quality of the ICAI’s output has deteriorated even as the quantity has exploded. There is little originality in its publications and those that attempt to be so, often suffer from poor standards of expression and comprehension. Whilst the ICAI has postured to be a defender of India’s right to frame its own accounting and auditing standards, the sad reality is very different. Its commitments to international bodies expect it to harmonise its standards with international ones and the exceptions that have been

carved out are comparatively trivial, giving the lie to the original posture. Whilst there exists a mechanism for some degree of adherence to accounting standards (independent auditors and audit committee oversight), the self-governing mechanism that oversees adherence to auditing standards is ineffectual. The quality reviews by peers appear to be ineffectual. Apart from the bigger audit firms that must adhere to their respective firms' global standards and a few of the larger medium sized firms, the quality of audit is abysmal.

The profession's reputation in the field of taxation too is at a low. Whether true or not, repeated newspaper reports now name chartered accountants complicit in devious tax evasion schemes. The practice of "managing" public sector bank loans has been another disgrace. The author struggles to discover any concrete action by the institute and its office bearers to remedy this.

The spectacle of the undignified scramble for votes every time council elections come around, with a candidate's community being considered the principal reason for supporting him or her, creates the poorest of impressions. In this free-for-all, the best suited have no chance of success and the winners do not always prove to be thought leaders, a necessity for leadership of a learned profession.

Sadly, the disciplinary process too has had challenges. For one, proceedings take too long. There are valid reasons for this, the least of which are that part time members on the bench can only meet once a while. One can go on. To sum it up - if members and the council failed to see in the early years of this century the NFRA looming and to take corrective action, they have only themselves to thank.

The NFRA has taken away three roles from the ICAI – the right to discipline chartered accountants, the right to set accounting standards and the right to set auditing standards.

Let me first address the disciplinary process. I have been its object (the respondent) several times in my career. In every case, spread from the mid-1970's to the Harshad Mehta scam in the early 1990's, I was treated with spotless fairness. Major matters such as the Harshad Mehta scam's slew of disciplinary cases were concluded within a relatively short time. But the final case, originating in a dispute between two partners in a trading business (annual turnover one crore rupees) took nearly a decade to reach

conclusion. It is now slow, even when the complainants and respondents are not the reason for delay, and it is viewed by respondents from the large firms as not being scrupulously fair. Fair justice is a fundamental right. If there is a continuing perception that it is not so in even a few of those arraigned, a remedy is needed. Sadly, the ICAI did not heed the signs. Nor did it address the core issue: why are there so many complaints against members? Why are members with poor ethics proliferating? Why are members in practice stooping to conduct more suited to a trader than to a high-minded professional? What has the ICAI done effectively to set this right?

Another point is that the NFRA may proceed more strongly against members preparing financial statements (i.e., members in industry) and against their employers, something the ICAI was constrained from doing because of the nature of the process.

Moving to the standard setting role, once again, the institute has provided poor thought leadership. There was a time when its publications were a pleasure to read and provided enduring guidance to preparers of financial statements. Take, for example, the "Guidance note on Expenditure During Construction" or the one on "The Payment of Bonus Act". Examples of lucid expression, clarity of thought, conceptual soundness and comprehensiveness. Something that cannot be said for much of the material issued in recent years. It is unfair to not recognise the guidance on Ind AS issued in the past couple of years; that has been valuable. Transfer of this role from the ICAI to the NFRA is not a major issue. The ICAI will continue to have the right to issue guidance to its members. That is where the real value of its thought leadership will lie and it will retain it. It needs to work out a process by which it does not get into conflict with the NFRA. I read section 132 of Companies Act, 2013 to mean that the NFRA will restrict itself to accounting standards and that it will not issue further guidance. Were it to do so it would be important for the NFRA and the ICAI to be in harmony.

As for auditing standards, if all that the NFRA does is adopt the international standards with minor modifications, they would be doing what the ICAI currently does. However, if the NFRA seeks to impose on auditors uninformed public expectations of them, auditors may find their work becoming unduly onerous, to the point of impossible. That would be a matter for concern to the profession as also to industry and commerce. Here again, the ICAI would

need to build a harmonious relationship so that auditing standards and expectations are pitched right and so that the institute has sufficient time to prepare members for new expectations.

It is very early days. It is not possible to state categorically that the NFRA will be an improvement on the ICAI in the areas that are now being transferred to it. Only time will tell as to how it functions, the extent of political and bureaucratic influence over its functioning, its ability to remain independent of government and its protection of the public interest. The fact that it is to be in Delhi is an unhappy augury. Considering that most of its stakeholders (auditors and preparers of financial statements) reside in or near Mumbai, it should have been located there. That would have distanced it from the influence of politicians and the bureaucracy and would have offered convenient access to the stakeholders it has been created to deal with.

Finally, all is not lost for the ICAI. It has had for many years an admirable record and did command high regard from society. It is not impossible to win it back. But it is not easy either because it would require a total change in the profession. To do that it needs to reconsider how it has viewed its role. It is not a trade union for its members seeking to aggrandise. For too long has its leadership

manoeuvred to win more work for its practicing members, often regardless of industry and society that must bear the cost of that enhanced role. The institute's role is to ensure that its members make a positive contribution to industry and commerce. For that it must ensure that members undergo practical training that prepares them for making such a contribution. It should not be licensing members who stoop to unethical practices to succeed. The institute must be far more rigorous in vetting aspirants for its imprimatur so that people with a weak ethical grounding do not receive it. It should be zealous in protecting society from its cowboy members. Its leadership must not fall into the trap of bombast and high-sounding statements whilst, at the same time, behaving to the contrary. These leaders should demonstrate integrity in their thought, speech and behaviour. The process by which its leaders are selected should ensure that only individuals of such integrity and who possess a high intellect and are well regarded for their professional knowledge go to council.

I view the NFRA not as a lost battle but as a wake-up call to the whole profession. Chartered accountants have many centuries to go and one companies act does not mean that we cannot win-back the right to regulate ourselves.

Is the NFRA a change for the better? As with all such things, only time can answer that question. ■

