Accounting Profession: Changes in Regulatory Landscape in India

National Financial Reporting Authority (NFRA) has now replaced NACAS of the Companies Act, 1956. This article touches upon three elements that bear a link in the relationship between the regulatory powers of ICAI and NFRA.

A. Scope of NFRA:

(a) Who are covered? All companies listed in India or outside, as well as Banks, Insurance and Electricity entities governed by special statutes are covered irrespective of any threshold. Unlisted *public* companies whose paid up capital, turnover or borrowings exceed a prescribed threshold are covered. All the overseas associates or subsidiaries of Indian companies are covered if the overseas income or net worth exceeds 20% of consolidated income or net worth. In addition, Government of India (GOI) have the powers to refer cases to NFRA. It follows that firms or individuals auditing these companies or entities will be covered. On a rough estimate, NFRA's antenna can stretch to about 8500 out of one-million companies.

Who are *not* covered? An unlisted public company, whose paid-up capital is less than Rs.500 crores, turnover is less than Rs.1000 crores, and aggregate of borrowings, deposits etc., is less than Rs.500 crores is not covered. Also, the coverage does not apply to any private company, one person-company, a Section 8 Company, or a non-corporate body (e.g. Societies, Trusts, Partnership Firms, LLPs etc). Thus, firms or individuals auditing such entities will not be covered.

(b) What is covered? There are two responsibility areas. First is AS (largely Ind AS covered entities only), where the primary responsibility for compliance is that of Management, whereas auditors also have to report on compliance. Second is Standards on Auditing (SA), where the responsibility is that of Auditors. It is these areas that will be monitored by NFRA.

What is *not* covered? Work of the nature of tax-audit, internal audit carried out by any firm or individual, for any corporate or non-corporate entity does not come under the monitoring area of NFRA. These areas would continue to be regulated only by ICAI.

(c) Structure and constitution of NFRA: This is a body comprising 13 members. Of the 13, four are full time members and nine are part time members. ICAI is and will be represented in three out of these 13 positions. The representation will be by (i) the President (ii) Chairperson of ASB, and (iii) Chairperson of AASB of ICAI. There will also be two experts from the fields of Accounting, Auditing, Finance and Law. One cannot be blind to this presence or assume this to be insignificant or ineffective. ICAI will be well-engaged with NFRA, will work constructively, and will make significant contributions to NFRA functioning effectively, within the realm of what is entrusted to NFRA.

B. Regulatory powers of ICAI

(a) The CA Act and Regulations thereunder ***continue*** to remain the same. There is no change at all. All the powers of ICAI under the CA Act ***continue*** to vest in ICAI.

(b) The primary responsibility for compliance of Accounting Standards (AS) is that of the Company, its Management, its KMPs and its Directors. ICAI **never had** any powers to enforce compliance of AS and to take action for non-compliance if any, on Companies or their KMPs or Directors. NFRA steps in here. The Companies, KMPs or Directors will necessarily have to strengthen and improve their accounting and reporting functions, and where needed will induct additional CAs. Opportunities for and role of CAs in Industry will increase further. This will also enhance the effectiveness of Auditors, because the Companies are now expected to be more vigilant than ever, with the attendant benefit of the risk-level inherent in audit function coming down.

(c) ICAI **never had** powers to regulate Audit Firms. ICAI could never impose a ban on the practice of an accounting firm say for a year or two. Such powers have been exercised in some instances by other regulators such as RBI or SEBI. NFRA steps in here, complementing these other regulators.

(d) ICAI's regulatory powers with reference to individual members ***continue.*** ICAI's powers extend to all individual members either in industry or in practice. There is no exception here. The individuals who are members of accounting firms or companies even if covered by NFRA will continue to be subject to CA Act, Regulations and the Code of Ethics (the code of ethics is set to undergo a significant revision now for which Exposure Draft has already been issued).

(e) NFRA will engage with the Quality Review Board (QRB) of ICAI for performing the work of reviewing the quality of service of Audit firms, with specific reference to Monitoring and Compliance areas of NFRA. This is a recognition of the effective functioning of QRB of ICAI.

(f) The powers to draft AS and SA continues to be the **exclusive domain** of ICAI. Specific powers have been conferred under Sec. 133 of the Companies Act, 2013, recognising ICAI pre-eminent status of standard setting. In addition, the following points deserve to be taken note of:

- As of date, ICAI has completed the task of issuing all the AS and SA in line with International Standards. Those to be issued incrementally are in the nature of maintenance and upgrade of currently applicable Standards.
- NFRA would consider the Standards drafted and recommended by ICAI, incorporate their own views based on an assessment of criteria such as the state of the economy and advise the Government to notify the Standards as law. For example AS 11, require Exchange Differences to be recognised in P&L. In 2008-09, the depreciation in the value of rupee was quite steep (close to 30% in three months). Consequently, the exchange loss was huge. At this point in time, in the larger interest of economy and considering that India was a developing economy with exchange control regulations, the Government considered it appropriate to relax this 'expensing' prescription, and to give the Companies an option to amortise the exchange differences over a period (deferred write off). GSR 225(E) dated 31st March 2009 was notified to permit this relaxation in respect of long-term monetary exposures.
- ICAI would always prescribe only the best in class accounting treatment (in this example recognise exchange difference in P&L). But, the Government rightly

believed that a soft approach was required. To validate such changes, a body like NFRA (earlier NACAS) is required. This recommendatory and validation process also enables granting a *legal status* to the Standards recommended by ICAI.

(g) ICAI is understood by many as a Self-Regulatory Body. Often, this phrase is misunderstood to mean that there is no participation by GOI. The fact differs. In substance ICAI is a Statutory body. Twenty percent of the composition of the Central Council is represented by Government nominees. All along, there have always been Government nominees in key committees such as the Disciplinary Committee (two out of five are Government nominees). The Appellate Authority in ICAI comprises five persons including the Chairperson and two others being Government nominees, the remaining two being past council members whose appointment is approved by Government. The Audit committee of ICAI has always been headed by Government nominee. The Chairperson, and a majority of the eleven members of QRB are Government nominees. The other five who are ICAI nominees are also approved by the Government. There has never been an instance of Government nominees communicating ineffectiveness or bias in functioning of any arm of ICAI. The roles of Government nominees, and members of Central Council of ICAI have has always been a well-coordinated one, leading to effective functioning.

The Chartered Accountants are intellectually strong professionals, with a desire to contribute more and to be more effective. This attitude continues to drive constructive criticism for quality improvement.

C. A LOOK-BACK AT THE DEVELOPMENTS

1. Until 1998, Accounting Standards were binding only on *members* and *not on the management* of reporting entities.
2. Government recognised that the primary responsibility for preparing financial statements and for complying with AS, vested in the management of the Company. Thus came up with an amendment in 1998 to Companies Act making it mandatory for companies to comply, by inclusion of an affirmative statement of compliance by Directors in the Directors Responsibility Statement.
3. Government constituted its Advisory body, NACAS for the role described in section B above.
4. The new Companies bill in its draft stage in 2011, envisaged increasing the scope of NACAS to cover Auditing Standards and to form a body National Advisory Committee on Accounting and Auditing Standards (NACA&AS). This was welcome as the SA issued by ICAI would also be bestowed with legal status. It was anticipated that Companies will have a stronger engagement to support Auditors in the effective compliance of SAs. According a legal status to SAs is an empowerment to Auditors, to improve quality of financial reporting. Consider the example of SA 720 which requires a Company to share the draft of Directors Report to Auditors so that there is no inconsistency between financial statements and other information in the Annual report.
5. When the new companies bill was about to be tabled at Parliament, the then Government decided to add the power to monitor and enforce compliance with AS and SA. This was driven by the impact of the large financial scam in 2008 and the

arrival of oversight bodies such as PCAOB in USA, FRC in UK in the developed countries. The vision and foresight of the day was the regulatory landscape in a country (which is $ 3 trillion and set to become $ 5 trillion soon, the 4th largest economy in the world by 2022 and a developed nation in the next decade), has to necessarily undergo a change. For the world outside India, ICAI-India was not perceived as independent of its members. As a result, securing the membership of International Forum of Independent Accounting Regulators (IFIAR) has not been possible. The Government believes that a membership of this international body is the key for its overall efforts to increase FDI.

6. Ever since 2010, ICAI has been continually engaged with Government to ensure no duplication of the regulatory efforts. The Joint Parliamentary Committee in its 2016 report recommended the need to avoid duplication of regulatory efforts. As of February 2018, the GOI appeared convinced that there is a need to carry out an in-depth study of the post implementation effect of certain provisions of the Companies Act 2013, such as rotation of auditors, independent directors in the Board, before a final decision on notifying section 132 could be taken up. Circumstantially, a recent bank incident appears to have triggered the decision to notify section 132 so that confidence is quickly restored in the financial system in particular from international bodies.

ICAI continues to stay engaged with the Government for amending the CA Act, to bestow in ICAI the powers to regulate accounting firms also: this matter is at present *subjudice*. The GOI and ICAI leadership have to be complimented on the constructive engagement over the years and the last few months in particular where a large number of areas of potential conflict have been addressed, in the spirit of the JPC recommendation to avoid duplicity and the rules notified in Nov'18 are far more appropriate compared to what was initially envisaged. This process will continue. ICAI will always be alive to the needs of the Accounting profession in India and all its stakeholders.

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P.S:

The views in the article are in my individual capacity. These do not represent views of ICAI / Council of ICAI. I am a firm believer in building institution and institutional approach to issues and not expressing outside individual opinion while being part of an Institution. There has been unfortunately, a lot of misleading information in the recent past (ICAI has filed a complaint to Press Council of India). In my personal interaction, the members were convinced on getting right perspective and have recommended that I share same for benefit of all as I will not be able to meet all in person. I felt it appropriate on deep thinking to share my thoughts through this article.

Reference material:

1. Composition of NFRA: http://www.mca.gov.in/Ministry/pdf/ReportingAuthorityRule2103_21032018.pdf

2. NFRA Scope and functioning: http://www.mca.gov.in/Ministry/pdf/NFRARules2018_13112018.pdf

3. Position Paper on Regulation of Accounting Profession and Oversight Mechanism in India

https://www.icai.org/e-books/mobile/index.html