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*Title: NFRA: A 'Need' For New Audit Governance in India, Authored By:
Ms. Smarnika Srivastava (B.A.LL.B), O.P. Jindal Global University.
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ABSTRACT:

*“The government of India saw an immediate need for setting up of an independent and special body for governing the functioning of auditors and audit firms, after the **IL&FS (Infrastructure Leasing & Financial Services, hereinafter referred to as IL&FS)** crisis. Post a lot of debate and opposition from the **ICAI (Institute of Chartered Accountants of India, hereinafter referred to as ICAI)**, the **NFRA** finally came into existence in 2018. The **NFRA (National Financial Reporting Authority, hereinafter referred to as NFRA)** is a special regulator and has supremacy over all other bodies governing auditing standards in India, including **ICAI**. **NFRA** has been vested with wide powers by taking away most of the jurisdiction of the **ICAI**. Much to the shock of the audit fraternity, the **NFRA** has been vigorously involved in forming reports and demanding accountability from major audit firms by sending notices to each of them, which has led to an increase in their auditing fees and auditor resignations. Since the **NFRA** is an addition to the already existing framework of audit regulation in India, its powers are bound to overlap with the **ICAI**. Even though the Government has clarified that the powers of the **ICAI** will remain, this does not seem to be true since **NFRA** has taken up most of its functions and retains overriding powers. The **ICAI** has tried to disrupt the setting up of the new watchdog. For its efficient functioning, there must be no tolerance for any obstructions against it. A reconciliation between the two bodies is necessary, which could be achieved by looking at how this problem has been solved internationally, as well as forming a Committee which ponders on the same.”*

I. INTRODUCTION:

The **Satyam Scandal** in 2009 was a blow to the collective conscience of corporate governance in India.¹ It highlighted the various fraudulent audit practices, all in alleged connivance with chartered accountants and auditors. Nearly a decade after the Satyam scandal, the **Securities Exchange Board of India (SEBI)** formed the **SEBI Committee on Corporate Governance (also known as the Kotak Committee)**, which was aimed to improve the standards of

¹ Madan Bhasin, *India's Satyam Accounting Scandal: How the story unfolded?*, 2, Int. Rev. of Eco. Mang. 22, 22 (2012).

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governance of listed companies in India.² One of the issues which was listed to reflect upon, was the issue of fraudulent practices in accounting and auditing firms in listed companies in India. In 2018, SEBI approved and partially implemented the recommendations made by the Kotak Committee report in 2018.³ These changes were expected to magnify India's position with respect to corporate governance⁴ as well as to reduce the amount of corporate scandals happening in India. These recommendations were also made in conjunction with the global practices and amendments to achieve the desired level of credibility and transparency in the corporate environment. But soon after, these changes proved to be a big failure when the *Infrastructure Leasing & Financial Services (IL&FS)* crisis came into limelight, in 2018. Coupled with previous other scams that were happening with respect to audit firms, this crisis resulted in the falling of the "**Big Four**" audit firms of India.⁵

With regards to corporate governance, India has observed and adopted the ways of the West and has some of the most stringent laws on paper for the same.⁶ Time and again, theoretical changes aiming to strengthen laws have been made, still, there exists lacunae in the law and its implementation, which is leading to various audit scandals. One such example is the delay in setting up of the National Finance Reporting Authority (NFRA)⁷. Post the Satyam scandal, the *Companies Bill, 2009* recommended the need for an independent audit regulator⁸, after which, the revised *Companies Act of 2013* prescribed the framework for its constitution and laid down

² Circular for implementation of certain recommendations of the committee on corporate governance under the chairmanship of Shri Uday Kotak, Circ. No.: SEBI/HO/CFD/CMD/CIR/P/2018/79, SEBI (2018), https://www.sebi.gov.in/legal/circulars/may-2018/circular-for-implementation-of-certain-recommendations-of-the-committee-on-corporate-governance-under-the-chairmanship-of-shri-uday-kotak_38905.html - header-bottom.

³ *Id.*

⁴ Jaya Sharma, *Implementation of Kotak Committee Recommendations*, TAX GURU (Mar. 25, 2019), <https://taxguru.in/sebi/implementation-kotak-committee-recommendations-closer-corporate-governance-practices.html>.

⁵ Vedant Sangit, *Too big to fail? Big four accounting firms are falling down in India*, REGTECH TIMES, <https://www.regtechtimes.com/too-big-to-fail-big-4-finally-failed/>.

⁶ Rajesh Chakraborty, *Audit quality and board independence*, 30,1, NLS Ind. Rev., 51 (2009), www.jstor.org/stable/26743932.

⁷ Ministry of Corporate Affairs, *Delay in Constitution of NFRA*, MIN. OF CORP. AFF. (Apr. 3, 2018) http://www.mca.gov.in/Ministry/pdf/rs389_04042018.pdf.

⁸ Standing Committee on Finance, *21st Report, The Companies Bill, 2009*, MINISTRY OF CORPORATE AFFAIRS, <http://www.icsi.edu/>.

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its main functions in *Section 132⁹ of the Act*. As a watchdog, the NFRA was statutorily proposed as a single independent regulatory authority under the Ministry of Corporate Affairs (MCA), for looking over the establishment and enforcement of auditing standards and keeping a check on the work done by independent auditors as well as audit companies in India. But, this was merely black letter law, the implementation of which was done after 5 years, on March 1, 2018, when the Union cabinet officially approved its establishment.¹⁰

Before the NFRA came into existence, auditors and their firms were governed by regulatory bodies such as the SEBI, MCA and Institute of Chartered Accountants of India (ICAI). ICAI was the main regulatory institute, the function of which was to regulate the audit firms and chartered accounting firms and to take any action against alleged misconduct of their members, under the *Chartered Accounting Rules, 2007*. Since the NFRA is a new set up, it is imperative to ponder on how its birth will pan out for ICAI, who had been overlooking the functioning of independent auditors and audit firms previously. It becomes apparent that the continuation of both these entities together would result in some clashes, which need to be accorded for. The ICAI has previously expressed its disapproval in the setting up of the NFRA and handing over most of the powers and cases to the latter's special jurisdiction. A cumulative analysis of various news portals and articles will show that the NFRA has been working vigorously to bring the audit governance of India back on track. The debate with respect to its present working and its clash with the ICAI has become a hot topic on which the audit fraternity seems to be divided.

Keeping these issues in mind, this paper is divided into two parts. In Part-I of the paper, the author briefly discusses about a shift in the global trend with respect to corporate governance schemes, and what prompted the Government of India to finally give a push to the setting up of the NFRA, five years post its statutory inception. The author then delves into a discussion on the functions and powers vested in the NFRA, an analysis of the work done by it so far,

⁹ Companies Act, 2013, S 132, Acts of Parliament, 2013 (India).

¹⁰ Press Information Bureau, *Cabinet approves establishment of NFRA*, MIN. OF CORP. AFF. (Mar. 1, 2018), <https://pib.gov.in/newsite/PrintRelease.aspx?relid=176919>.

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various opinions of people with respect its working, and its repercussions on the audit fraternity. Part-II of the paper then discusses on whether the NFRA has replaced the ICAI, the latter's reaction to the inception and setting up of the new independent audit regulator, and a reconciliation between the two bodies, if possible. This is followed by the concluding section, where the author makes final comments and expresses their views on the research and analysis in the article.

With respect to corporate governance, most studies have focused on the quantitative aspect, with key variables being legal structure of country, independence or directors, size of the board of directors, etc. There is an increasing need to bring forth the qualitative aspects of corporate governance and have a discussion on the same.¹¹ With respect to research methodology, this paper has compiled and qualitatively analysed various sources, ranging from committee reports, case laws and scholarly articles in order to give insights and conclude the statements mentioned in the paper. The research has further been aided with the help of various online news forums and websites to formulate a robust view with respect to the conflict between the powers and functioning of the ICAI and the NFRA and to provide an informed and holistic view based upon the research and findings.

"PART-I"

II. CORPORATE GOVERNANCE MODELS: A SHIFT IN THE INDIAN STRUCTURE:

Global trends have indicated a shift away from *Self-Regulatory Organization (SRO)* model of governance, which contributes to a greater efficiency in the financial market and the development of a regulatory policy, which results in a higher level of industry compliance.¹² But, a grave and major downfall of it is the tendency to get influenced by the industry while formulating regulatory policies. This leads to a conflict of interest between business operations

¹¹ *Self-Regulation in Financial Markets: An Exploratory Survey*, INT. COUN. SEC. ASSOC. (Sept. 2006), <https://icsa.global/sites/default/files/Self-RegulationFinancialMarkets.pdf>.

¹² *Id.*

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and regulatory responsibilities.¹³ Over the past few years, public interest at large has leaned towards an increase in the need of effective and vigorous regulations to ensure that there is adequate protection extended to the investors. Financial scams were happening all over the world due to a feeble corporate governance regime and weak standards of information disclosure in auditing and accounting standards. Thus, global trends gradually shifted from an SRO model of corporate governance to a model of independent statutory regulators. India too, finally saw the need for a strong framework to curb the audit mishaps happening in the country over a period of several years.¹⁴ Before NFRA, it was mainly the ICAI which laid down the regulations related to the audit services in India.¹⁵

But, confidence in the ICAI was plummeting, due to repeated incidences of accounting frauds such as the *Satyam Scandal and the IL&FS crisis*, with the final nail in the coffin being the *fraud of Punjab National Bank worth Rs. 13,000 Crore* where auditors were once again being questioned.¹⁶

According to the comments made by the *MCA in the Standing Committee Report*, out of almost 2000 cases taken up by the ICAI, a strict action of permanently removing members was only taken in the case of Satyam computers, whereas in other cases, members were either only reprimanded, or a penalty of just one year has been imposed.¹⁷ These subdued actions taken by the ICAI made it clear that it was following a very liberal approach with respect to regulations involving auditors. Post a plethora of cases involving suspicion regarding the role of auditors,

¹³ Palak Bhandari, *Corporate Governance: A Comparative Analysis in India and the US*, BRYANT UNIVERSITY, (Mar. 2018),

https://digitalcommons.bryant.edu/cgi/viewcontent.cgi?article=1018&context=honors_accounting.

¹⁴ Ministry of Corporate Affairs, *Findings and recommendations on regulating audit firms and the networks*, MIN. OF CORP. AFF. (Oct 25, 2018),

http://www.mca.gov.in/Ministry/pdf/2018_CommitteeExperts_Report_08112018.pdf.

¹⁵ THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA, <https://www.icai.org/indexbkp.html> (last visited Oct. 23, 2020).

¹⁶ *Punjab National Bank hit by 11,400 crore fraud*, HINDUSTAN TIMES (Feb. 20, 2018),

<https://www.hindustantimes.com/india-news/punjab-national-bank-fraud-an-explainer-on-what-we-know-so-far/story-d6LHHPoimqorJtaUZ3QoBK.html>.

¹⁷ Jayshree P. Upadhaya, *Proposed auditing watchdog should keep distance from ICAI, says expert*, LIVE MINT (Mar. 5, 2018), <https://www.livemint.com/Companies/RSKdKPGXwMvFfWh1ozTIKJ/Proposed-auditing-watchdog-should-keep-distance-from-ICAI-s.html>.

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the Supreme Court gave the landmark judgement of *S. Sukumar vs. The Secretary, Institute of Chartered Accountants of India*, in 2018.¹⁸ In this case, a writ petition was filed under Article 226 of the Constitution of India, 1950, for seeking directions to exercise of power under Section 21 of the Chartered Accountants Act, 1949. These directions were sought to initiate an investigation against *Multinational Accounting Firms (MAFs)* for breach of the Chartered Accountants Act, 1949, as well as the Code of Conduct which prohibited advertisements and fee sharing.¹⁹ The Big Four audit firms were consequently added as respondents. The Apex Court ruled that the MAFs were engaging in illegal activities and expressed the need to immediately curb these fraudulent practices happening all over the country and amend the existing laws with respect to corporate governance in India. Subsequently, a direction was issued for the Center to constitute a 3-member *Committee of Experts (CoE)* to examine whether the MAFs were working in consonance with the *Chartered Accountants Act, 1949 (CA Act)*.²⁰ Accordingly, the CoE was formed and it successfully submitted its report in October 2018. By taking the influence of the *Sarbanes Oxley Act, 2002, Consumer Protection Act, 2010 and the Dodd Frank Wallstreet Reform of the USA*, the Committee recognized the need for appropriate legislations for audit services in India.²¹ Briefly, the Sarbanes Oxley Act, 2002 lays down the rules for efficient functioning of specifically audit companies and firms, with a goal to prevent them from benefitting at the cost of interests of the public. This was recommended as a basis of the new legislative rules to be formed. The establishment of the NFRA was also founded to be a necessary institutional reform.²² Subsequently, the Ministry or Corporate Affairs (MCA) notified the National Financial Reporting Authority Rules, 2018, and laid down its jurisdiction, duties and powers.²³ The foundation of the NFRA was already laid down in Section 132 of the Companies Act, 2013, but its implementation took about 5 years from when the idea first got introduced.

¹⁸ S. Sukumar vs. The Secretary, Institute of Chartered Accountants of India, Civil Appeal no. 2422 (2018).

¹⁹ Kanishka Dasmohapatra, *S Sukumar versus The Secretary*, RMLNLU Law Rev. Blog. (Aug. 17, 2018), <https://rmlnlulawreview.com/2018/08/17/case-comment-s-sukumar-v-institute-of-chartered-accountants-of-india-ors-with-centre-for-public-interest-litigation-v-union-of-india-ors/>.

²⁰ *Id.*

²¹ *Supra* note 14, at 14.

²² *Id.*

²³ National Financial Reporting Authority Rules, Acts of Parliament, 2018 (India), <https://nfra.gov.in/rules>.

III. NATIONAL FINANCE REPORTING AUTHORITY: A NEW WATCHDOG:

III.I Functionality and Jurisdiction:

The NFRA physically came into being vide Section 132 of the Companies Act, 2013, five years after it was first conceptualised and laid down in the Act. The NFRA had been bestowed with the power to regulate certain classes of companies prescribed to it through investigations and quality reviews. *Under Section 132 and Rule 3(b) of National Financial Reporting Authority Rules, 2018*, the new watchdog authority has the power to regulate such companies whose securities are listed on any stock exchange inside or outside India and unlisted companies having a paid-up capital of **Rs. 500 Crore** and more, or having an annual turnover of **Rs. 1000 Crore**, and not less or having, in aggregate, outstanding loans, debentures and deposits of not less than rupees five hundred crores as on the 31st March of immediately preceding financial year. Thus, the NFRA has been given a wide reach, to take into its purview even companies situated outside India. Its tasks include investigation, imposing sanctions and undertaking punitive actions against independent auditors and audit firms in the form of debarment and monetary penalties, recommending accounting standards and taking suo moto review of financial statements of companies, to name a few.²⁴

III.II Failure of Incorporating Network Liability:

There is no doubt that these new rules of the NFRA and the powers vested therein have resulted in strengthening the audit framework of India which was its main aim. But it cannot be understood why two key recommendations made by the CoE in the 2018 report were not adopted. First recommendation was that every auditor or audit firm working in India as a part of an international network must submit an annual transparency report to the NFRA. This would ensure that the NFRA can gather information with respect to every such firm operating in India as part of the same network and effectively track their actions in case any liability needs to be imposed on such companies.²⁵ Second recommendation was to impose civil

²⁴ *Supra* note 14.

²⁵ SHARMA, *supra* note 4.

liability in the form of monetary penalties on any such international entity or network with whom an Indian audit firm enters into membership or networking. This would deter the commission of frauds due to any faulty working methods followed by any such network. Both of these regulations were essential in order to strengthen network liability with respect to various international audit networks functioning in India. However, the new NFRA rules failed to consider both of these recommendations, the rationale for which cannot be gauged, since these recommendations would definitely have helped achieve its agenda of strict liability in an even more efficient manner.²⁶

III.III Major Work Done by the NFRA:

Within one year of the functioning of the NFRA itself, compliance norms were tightened to a great level. Auditors have been asked to file key findings with respect to the companies that they work with within a strict deadline, including those who have been involved in major scams. The NFRA has taken up investigations of the IL&FS scandal and the latest Infosys case, which were previously under the jurisdiction of the ICAI.²⁷ In 2019, the NFRA issued notices to *EY, KMPG, and Deloitte* to furnish the past few years' financial details, for a detailed scrutiny of the audit firms due to their involvement in the IL&FS case. This was the first major probe it undertook since it started working in 2018. Later on, the NFRA found various lapses and compliance failures with respect to audit standards in IL&FS for the year of 2017-2018, done by BSR and Associates. It proceeded to issue an *Audit Quality Review Report (AQRR) for 2017-18* for BSR and had found that their appointment as statutory auditors of IFIN was ab initio illegal and void.²⁸ Similarly, an AQRR has also been issued for Deloitte Haskins & Sells for the year 2017-18, who were providing audit services for IL&FS.²⁹ *Udayan Sen*, one of its

²⁶ Suhail Nathani and Mahendra Singh, *The National Financial Reporting Authority: A case of new audit governance in India*, BUSINESS WORLD (Oct. 22, 2020), www.businessworld.in/article/The-National-Financial-Reporting-Authority-NFRA-A-case-Of-New-Audit-Governance-In-India-/23-02-2019-167457/.

²⁷ Ruchika Chitravanshi, *After long wait, NFRA gets own address*, BUSINESS STANDARD (Nov. 28, 2019), https://www.business-standard.com/article/economy-policy/after-long-wait-national-financial-reporting-authority-gets-own-address-119112800048_1.html.

²⁸ *Audit Quality Review Report for BSR and Associates LLP, 2017-2018*, National Financial Reporting Authority, Government of India, nfra.gov.in.

²⁹ *Audit Quality Review Report for Deloitte Haskins and Sells LLP, 2017-2018*, National Financial Reporting Authority, Government of India, nfra.gov.in.

auditors, was banned for 7 years and a hefty penalty of 25 lakh rupees was slapped on him.³⁰ It also debarred *Rukshad Daruwala* for 5 years and imposed a penalty of 5 lakh on him, for his involvement in the IL&FS case.³¹ Consequently, a writ petition was filed in the Delhi High Court challenging the jurisdiction of the NFRA to pass such orders. It was averred that the NFRA was not formed when these alleged frauds occurred, hence, it is passing orders retrospectively, which must not be allowed.³² Consequently, the Delhi High Court granted them an interim relief against the orders of the NFRA.³³ Price Waterhouse Network of Firms in India have also declared that they would no longer be providing any non-audit services such as tax consultancy or advisory to any company that they audit for, which are governed by the NFRA.³⁴ In June 2020, the NFRA had sent a form to the top 20 multinational audit firms in India seeking details with respect to their client fee structures, money earned from providing non-audit services, etc. Reportedly, some firms, including the Big Four, are against this move because according to them, this would mean risking their proprietary information by bringing it into the public domain.³⁵ It is thus obvious, that the NFRA has been working vigorously to ensure that audit firms are working in a legal manner by demanding accountability from them. Presently, it has been reported that the NFRA has also taken up the issue of abrupt auditor resignations for investigation.³⁶

³⁰ Sachin Dave, *NFRA bars ex-Deloitte CEO for 7 years*, ECONOMIC TIMES (Jul. 22, 2020), <https://economictimes.indiatimes.com/industry/services/consultancy/-audit/nfra-bars-ex-deloitte-ceo-for-7-years-slaps-rs-25l-fine-for-his-role-in-ilfs-fraud/articleshow/77107746.cms>.

³¹ Sachin Dave, *NFRA bans Rukshad Daruwala for 5 years; Rs. 5 Lakh fine imposed*, ECONOMIC TIMES (Jul. 24, 2020), <https://economictimes.indiatimes.com/industry/services/consultancy/-audit/ilfs-case-nfra-bans-another-auditor-for-5-years-rs-5-lakh-fine-imposed-on-rukshad-daruwala/articleshow/77145280.cms>

³² Sachin Dave, *Delhi High Court grants interim relief to IL&FS audit partners from NFRA order*, ECONOMIC TIMES (Aug. 18, 2020), <https://economictimes.indiatimes.com/industry/banking/finance/delhi-high-court-grants-interim-relief-to-ilfs-audit-partners-from-nfra-order/articleshow/77614365.cms>.

³³ *Id.*

³⁴ Sachin Dave, *Price Waterhouse to stop offering any non-audit services to their audit clients regulated by the NFRA*, ECONOMIC TIMES (Feb. 13, 2020), <https://economictimes.indiatimes.com/industry/services/consultancy/-audit/price-waterhouse-to-stop-offering-any-non-audit-services-to-their-audit-clients-regulated-by-nfra/articleshow/74116765.cms>.

³⁵ Vinod Mahanta and Sachin Dave, *Tell us how you conduct your business: NFRA asks top professional services firms*, ECONOMIC TIMES (Jul. 1, 2020), <https://economictimes.indiatimes.com/industry/services/consultancy/-audit/tells-us-how-you-conduct-your-business-nfra-asks-top-professional-services-firms/articleshow/76723347.cms>.

³⁶ Sachin Dave, *PwC, others under NFRA lens for abrupt auditor resignations*, ECONOMIC TIMES (Aug 19, 2020), <https://economictimes.indiatimes.com/industry/services/consultancy/-audit/national-financial-reporting-authority-nfra-to-probe-pwc-quitting-auditors/articleshow/77625671.cms?from=mdr>.

III.IV Opinions and Repercussions:

Observing the new and strengthened powers which the NFRA has been vested with, some experts have opined that **"NFRA is like a video camera, placed right above the head of the auditors"**.³⁷ Being a special corporate governance body aimed to regulate audit services in India, there have been reports that this independent "super audit regulator" has instilled fear in the minds of auditors and audit companies/firms, because they can now be held liable for their professional misconduct.³⁸ On the one hand, NFRA's coming into existence is a source of encouragement for auditors because they now have a special audit body, which possesses enough powers to be able to resolve their particular issues and is a body of redressal in that respect. But, on the other hand, its formation has led to a spurt in the number of auditor resignations, as noted by the *Managing Director of the Prime Database Group*. Data from a website has indicated that in the financial year 2019-20, a record breaking number of auditors have resigned in its first six months of working itself.³⁹ The NFRA is currently probing into this matter. It becomes obvious that this is due to an increase in the regulatory scrutiny. It has also been reported that due to the high cost of litigation and increase in compliance work due to trouble being received from the watchdog, some of the top audit firms are considering increasing their fees by 25%.⁴⁰ Even though the ICAI has been a threat to the efficient and smooth functioning of the NFRA, its former president has publicly accepted the fact that there is no doubt about the fact that the NFRA is **"on track in their oversight"**.⁴¹ But some experts have opined that since a considerable amount of time has not passed since the NFRA started functioning properly and without interventions, it is too early to pass any judgement with respect to its performance.⁴²

³⁷ Mannu Arora, *One year of NFRA: Auditing the Super Audit Regulator*, BSFI ECONOMIC TIMES (Oct 18, 2019), <https://bfsi.economicstimes.indiatimes.com/news/industry/one-year-of-nfra-auditing-the-super-audit-regulator/71642139>.

³⁸ *Id.*

³⁹ ARORA, *supra* note 38.

⁴⁰ Vinod Mahanta and Sachin Dave, *Auditors claim that compliance work has gone up and they are being paid pittance*, ECONOMIC TIMES (Jul. 29, 2020), <https://economicstimes.indiatimes.com/industry/services/consultancy/-/audit/the-big-four-and-other-auditors-look-for-risk-premium-from-clients-during-the-pandemic/articleshow/77234434.cms>.

⁴¹ MAHANTA, *supra* note 34.

⁴² *Id.*

“PART-II”

IV. HAS NFRA REPLACED ICAI? : DIFFERENCES AND CONFLICTS:

There are some significant differences between the new powers vested in the NFRA as compared to the powers which the ICAI had, before the NFRA came into existence. According to the new rules, the NFRA has the power to impose compliance with auditing and accounting standards, the service quality of the professionals, etc. The question to be considered in this respect is whether the NFRA has replaced the ICAI⁴³ and who is the ultimate authority for auditing standards in India. The objective of the NFRA, according to Companies Act, 2013, is to protect the interest of the public, regulate audit bodies, pass decisions and give penalties with respect to the same. The ICAI too, has the same objectives. In its report, the CoE has noted that the NFRA is inconsistent neither with the Companies Act, 2013, nor the Chartered Accountants Act, 1949.⁴⁴ The Act has given the NFRA non-obstante powers to demonstrate its supremacy over other legislations, which signifies an intent to overhaul the existing regimes with respect to audit standards in India. Nevertheless, the CoE report mentions that the ICAI will perdure as the primal body for auditors and that the powers of the NFRA will not exclude the jurisdiction of ICAI.⁴⁵ As per the Rules, one of the requirements is for the ICAI to give recommendations to the NFRA for new auditing standards or new amendments, however, the NFRA has the liberty to regard or disregard any recommendations made by the ICAI in the manner which it deems most fit, thus, rendering the latter non-binding.⁴⁶ Experts like the former chairman of NACAS, *Mr. Amarjit Chopra* said, that after the NFRA comes into being, the *Quality Review Board (constituted by the ICAI)* will become redundant, since inter alia, the NFRA will overlook the quality of the services provided by the auditors.⁴⁷ This has been

⁴³ *NFRA to replace ICAI as regulator over auditors*, INDIA INFOLINE NEWS SERVICE (Nov. 16, 2018), https://www.indiaonline.com/article/news-top-story/nfra-to-replace-icai-as-regulator-over-auditors-118111600497_1.html.

⁴⁴ *Supra* note 14, at 47.

⁴⁵ *Id.*, at 51.

⁴⁶ NATHANI, *supra* note 26.

⁴⁷ K.R. Vats, *NFRA rules notified, ICAI wings clapped*, THE HINDU (Nov. 15, 2018), <https://www.thehindubusinessline.com/money-and-banking/nfra-rules-notified-icai-powers-clipped/article25508419.ece>.

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evident as the NFRA had conducted its own reviews for BSR and Deloitte Haskins in its investigation of the IL&FS case, in the form of Audit Quality Review Report (AQRR). One of the critical limitations of the ICAI was that it could only penalize members and not audit firms themselves, which the NFRA has overcome. Now, it can initiate proceedings against audit firms too, which is one of its highlighting differentiating power from the ICAI. The NFRA has been using this extended power vigorously and has already started investigating audit mishaps in the top audit companies of India (refer to Part 1). The name shame approach has also found its way into the NFRA rules, which is in consonance with the Sarbanes Oxley Act, 2002, whereby the NFRA has the discretion to publish audit inspection results. While this will ensure a greater level of transparency, it is clear that NFRA is a step ahead of the ICAI in its regulations, thus, making it a better governance body. After the vigorous investigations and the strict liabilities imposed by the NFRA, the difference between the working of the NFRA and ICAI have been noticed by the audit fraternity; before the existence of the NFRA, the ICAI did yearly quality reviews of some accounts, but seldom was any major firm fined so exorbitantly.⁴⁸ This is also because the new audit body has the power to investigate and penalise audit companies, which was not the case with the ICAI.

Although private companies and public unlisted companies below a certain threshold have been left outside the jurisdiction of the NFRA (and within the jurisdiction of the ICAI), the Central government has been granted the discretion to refer even these types of companies to the NFRA, 'in public interest'. Here too, it seems, that the powers of the NFRA override the powers of the ICAI since the latter cannot exercise control on the companies which are in the jurisdiction of the former, but it seems possible for NFRA to interfere with ICAI's jurisdiction. Another inconsistency between the powers granted to both the bodies becomes clear through the recent case⁴⁹ where the Supreme Court strengthened the powers of the ICAI to hold disciplinary proceedings against a member if their act brings disrepute to their profession. However, the NFRA has been imbued with the power to conduct investigations against a person charged for professional misconduct (under its purview) and no other body shall have the

⁴⁸ *Id.*

⁴⁹ Institute of Chartered Accountants of India v. Gurvinder Singh and Ors, Civil Appeal no. 11034 (2018).

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jurisdiction to try any case where proceedings have already been initiated by the NFRA. It also has the power to issue penalty on an individual or a firm registered with the ICAI for misconduct, another instance where it has overpowered the latter. Further, the NFRA is an independent regulator which overlooks only the functioning of independent auditors and audit firms with new special powers, hence it is a special audit regulator. The ICAI, on the other hand, overlooks accountancy too, apart from audit services, and thus, it a general body with general rules. Hence, whenever conflict would prevail, NFRA being the special body for audit services, would always have jurisdiction and preference over ICAI, due to the legal maxim 'special prevails over general'. It is obvious that these new and elaborate powers vested in the NFRA have taken away the same from the jurisdiction of the ICAI. Prior to the constitution of the NFRA, the ICAI made recommendations to the Central Government, based on which, the government used to prescribe accounting standards. To make these recommendations, the ICAI had to consult the *National Advisory Committee on Accounting Standards (NACAS)*, which was an extension of the ICAI. NACAS used to provide their recommendations to the ICAI, only after which it made recommendations to the Government. Now, since the NFRA has come into being, instead of the NACAS, the ICAI will have to consult with the NFRA. Thus, the NFRA has effectively replaced NACAS.

The ICAI has previously posed continuous objections to the NFRA being formed; instead, it suggested that endeavours must be made to strengthen the already existing regulations of the ICAI.⁵⁰ In fact, the statutory inception of the NFRA was mainly opposed by the ICAI which lead to the prolongation in the notification of the NFRA rules.⁵¹ There is an obvious tension between the two bodies. News reports have mentioned that the president of the ICAI and Chartered Accountant Mr. Naveen Gupta has declared that the setting up of the NFRA is legally invalid, unconstitutional and is encroaching upon the powers given to the ICAI. There has also been a suggestion that the task of handling audit services must be left to ICAI alone⁵², the main

⁵⁰ *Supra* note 14.

⁵¹ *Supra* note 7.

⁵² *NFRA may not be legally valid, says auditor body*, TIMES OF INDIA (Oct. 30, 2018), <https://timesofindia.indiatimes.com/business/india-business/nfra-may-not-be-legally-valid-says-auditor-body/articleshow/66423467.cms>.

argument being that after the addition of the NFRA, multiple regulatory bodies have been created which is causing a lot of confusion.⁵³ The CoE has stated in its report, much to the relief of the ICAI, that the regulations under the ICAI would be strengthened and streamlined without adding more layers to the regulatory bodies⁵⁴. However, looking at the powers given to the NFRA, it seems like this statement was made to assuage the ICAI, owing to the precarious role it has played in opposing the setting up of the NFRA. Despite the fact that the Government of India has also clarified that there is no conflict between ICAI and NFRA since both have different functions and jurisdictions, the NFRA had the power to take over the IL&FS case and ICAI was asked to “back off” from the case.⁵⁵

It is imperative to also mention the views opposing the setting up of the NFRA. Supreme Court’s Advocate on Record MP Shorwala had expressed that the setting up of the NFRA was a **“knee-jerk” reaction** of the government to the ongoing crisis, and would prove to be redundant. Such a hasty decision of the government has been made previously, after the Enron case, which culminated in the setting up of the Serious Fraud Investigation Office. Even after it became functional, it just added to the layers of regulatory bodies and was inefficient in handling its tasks and affairs. Due to this failed trajectory, it was suggested that instead of adding another body (NFRA) which would increase confusion with respect to its jurisdiction and authority, it would be wise to **“streamline the present system”** by adding to the powers resting with the RBI and ICAI.⁵⁶

The CoE has recognized that the constitution of the NFRA was a necessary step taken by India, in line with the best international practices.⁵⁷ While the NFRA has taken away certain monitory and disciplinary powers of the ICAI, it has also filled in the gaps by strengthening auditor liability regime, hence, aiming for greater accountability standards of corporate governance in

⁵³ DAVE, *supra* note 31.

⁵⁴ *Id.*

⁵⁵ MAHANTA, *supra* note 35.

⁵⁶ MP Shorwala, *National Financial Reporting Authority: Is there really a need for another independent regulator?*, FINANCIAL EXPRESS (Mar. 12, 2018), <https://www.financialexpress.com/opinion/national-financial-reporting-authority-is-there-really-a-need-for-yet-another-regulator/1094816/>.

⁵⁷ *Supra* note 14, at 46.

India.⁵⁸ The overlapping powers of the NFRA and the ICAI, as well as the heightened powers given to the NFRA, makes reconciliation an important aspect which must not be overlooked. Even though NFRA does not seem to have replaced ICAI altogether because ICAI still works as an advisory body for the NFRA and has its own jurisdiction with respect to a few companies, still, its establishment signifies the departure of the monopoly that ICAI held over the audit profession. Before the setting up of the NFRA was completed, experts had warned that this new audit watchdog must be ***“kept independent from the ICAI”***, must consist of integrous independent experts and persons elected in the ICAI must be kept away from its board. Finance Minister Arun Jaitley had expressed that there is no intention to interfere with the professional autonomy and functioning of the ICAI.⁵⁹ The Standing Committee on Finance had also cautioned against function overlapping to the Ministry, warning them not to create parallel bodies governing the same issues while setting up the NFRA.⁶⁰ Before its formation, the MCA opposed the ICAI in favour of NFRA, recognizing how other countries have also established independent regulatory authorities like the PCAOB in the USA and the Financial Reporting Council (FRC) in the UK⁶¹, and bashed the former for not being able to initiate any preliminary action against 132 companies suspended by the SEBI.⁶² Thus, the need for a stronger, independent body was reiterated by bringing out the faults in the functioning of the ICAI.

India was always in need of an independent regulatory body like the NFRA. Looking at the wide powers it has been given to take control of audit governance in India, it overrides almost every other regulatory body, including the ICAI. It does not need mentioning that both the bodies, i.e. the NFRA and the ICAI have important functions of their own which help in controlling audit mishaps in India, but NFRA is equipped to handle cases better than ICAI, which can be gauged from the increasing powers vested in it. Even though the ICAI has tried

⁵⁸ ARORA, *supra* note 37.

⁵⁹ *NFRA not meant to replace ICAI jurisdiction*, ECONOMIC TIMES (Mar. 1, 2018), <https://economictimes.indiatimes.com/news/economy/policy/nfra-not-meant-to-replace-icai-jurisdiction-jaitley/videoshow/63130902.cms?from=mdr>.

⁶⁰ *Standing Committee on Finance (2016-2017), The Companies (Amendment) Bill, 2016*, Ministry of Corporate Affairs, New Delhi, http://164.100.47.193/lssccommittee/Finance/16_Finance_37.pdf.

⁶¹ *Id.*, at 48-49.

⁶² Amresh Vashisht, *NFRA stunned ICAI members*, TAX GURU (Mar. 2, 2018), <https://taxguru.in/chartered-accountant/nfra-stunned-icai-members.html>.

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to stop the setting up of the NFRA and has recommended the need to strengthen its already existing rules and regulations, it is seemingly impossible for it to be able to investigate all the cases with as much efficiency that the NFRA can, mainly because the NFRA is a special body specifically handling audit mishaps. Hence, most of its jurisdiction has been taken away and has been vested in the NFRA.

Reconciliation of both the bodies has become difficult since the ICAI has always been against the implementation of the NFRA as well as the wide range of powers which have been given to it, thus undermining the authority of the former. The government is also not been active in reconciling the bodies and clarifying their niches. While it cannot be affirmatively said whether reconciliation between the two bodies is possible, guidance must be taken from how international communities have dealt with the problems of having multi-authoritative bodies with respect to auditing standards.

One such example is the recommendation given by the Director of FSA Japan on how to reconcile the working of PCAOB (which works like the NFRA) and FSA (which works like the ICAI) of the USA. In the context of the situation of conflict in India, two of the recommended principles seem to be important- one, the two bodies (ICAI and NFRA) need to mutually respect each other's jurisdictional sovereignty and overview of the audit governance, and, two, the need to ***"recognize substantially equivalent auditor oversight system"***, functioning in foreign jurisdictions.⁶³ One thing is clear, the two Indian regulatory bodies need to mutually accept the authoritative positions held by one another, especially the ICAI, which needs to stop hampering with the functioning of the NFRA. Further, a committee should be formed and assigned the task of studying how foreign jurisdictions have dealt with this issue and check how far those reconciliation methods can work in the Indian context and then form rules. This would result in neatly niching the separate jurisdiction of both the bodies as well as prescribing rules to be followed by them which would lead to disciplining the work of the bodies.

⁶³ Letter of the Financial Services Agency, Government of Japan (Jun. 27, 2003), <https://www.sec.gov/rules/pcaob/pcaob200303/fsagoj062703.htm>.

V. CONCLUSION & REMARKS:

Auditing is an area of corporate governance which, in the Indian scenario, falls into the zone of main regulatory bodies such as SEBI and MCA, and more specific and self-regulatory bodies such as the ICAI and NFRA. Before 2018, ICAI was the main body which overlooked auditing standards in India, and it has always smirked at any recommendations made for another better regulatory body for overlooking the auditors, viewing it as a *“serious turf tension”*.⁶⁴ Looking at the trajectory of how ICAI used to handle the cases of audit mishaps before the setting up of the NFRA, it becomes clear that commencement of the NFRA was a necessary and positive step taken by the government to curb these audit scandals and restore public faith in the audit fraternity. The debates with regard to the need for a body like NFRA had resulted in a five-year delay in its set up, but now that it has come into existence, it has added to the already present bodies which have their own regulations. The NFRA was set up with the hope that audit mishaps would be curbed and accountability of such corporate bodies would increase. Opposing views were expressed with respect its setting up because the trajectory of “knee-jerk reactions” such as the functioning of SFIO have were not successful.

But, looking at the work that the NFRA has done in such a short while, there is no iota of doubt that the NFRA has been working well and expeditiously and its implementation was a boon to corporate governance structure of India which was absolutely needed. The new independent regulator has taken strict action against a lot of audit firms and their auditors and has been quick in formulating reports and sending notices demanding accountability. All this points out to the fact that the NFRA has completed the need for an independent body dedicated solely to overlooking of audit services in India. It is able to perform its functions and duties, and conduct inquiries in a vigorous manner owing to a lot of new powers which have been assigned to it. It has taken up most of the powers which previously, the ICAI monopolized over. This was exactly what the ICAI was avoiding by opposing its implementation, which can be said by looking at the tactics it has adopted to delay the implementation of the NFRA, as well as the

⁶⁴ Rajesh Chakraborty, *Audit quality and board independence*, 30, 1, NLS Ind. Rev. 56 (2018), https://www.jstor.org/stable/pdf/26743932.pdf?ab_segments=0%252Fbasic_SYC-5055%252Ftest&refreqid=excelsior%3A049a7cbf3bcd364b41588dd33f7d52cc

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statements made by some of its members. It is still trying to sabotage the efficient working of the NFRA and has challenged its constitutionality in the court. While the Government has tried to clear that the ICAI and NFRA would be independent of each other and that the powers of the ICAI will remain, it seems like this statement was only made in order to assuage the members of the ICAI and to avoid any further disruptions to the setting up of the NFRA.

By observing the dejected state of audit affairs in India and the amount of time it took for the NFRA to become a reality, obstructions aimed at its prosperity and efficiency must not be welcome at all. There is an immediate need to reconcile the regulations of both these bodies and to clear the confusion in the same regards. While one way could be by forming a committee like the CoE, where experts can sit and discuss about the overlapping functions of both the bodies and the possible ways through which this can be rectified, the other way could be by observing how this problem has been solved internationally.⁶⁵

A reconciliation between both the bodies is the need of the hour, so that the audit framework is better governed in a disciplined manner and full attention can be devoted to the tasks assigned to each of the bodies, rather than criticizing and disrupting the working quality of one another.

⁶⁵ *Supra* note 65.