National Financial Reporting Authority

Why in news?

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The recent report of Parliament's standing committee on finance on the Companies (Amendment) Bill 2016 has reopened what appeared to be the settled position on auditor regulation.

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What is the issue?

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- The Companies Act 2013 provides for setting up a National Financial Reporting Authority (NFRA).
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- The ministry of corporate affairs issued rules that will give the National Financial Reporting Authority (NFRA) an overarching role to regulate chartered accountants and set standards.
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- The current regulator ICAI is against it.
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- NFRA has a larger remit than NACAS (National Advisory Committee on Accounting Standards), which it is meant to replace. NACAS only recommends accounting standards. NFRA will set accounting and auditing standards, monitor and enforce compliance with the standards, and oversee the accounting profession's record of ensuring compliance.
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- The authority will also have the power to investigate misconduct committed by any member or firm of chartered accountants.
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- It will take away significant regulatory powers from the Institute of Chartered Accountants of India (ICAI). What has worried the CA community the most is the fact that in cases where the NFRA initiates the investigation, no other institute or body can initiate or continue any proceedings.
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Why ICAI is against it?

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They are of the view that NFRA should not be given the power of investigation as the ICAI is doing the same work. Also, the multiplicity of regulators will not serve any purpose as steps suggested by the government are already being undertaken by the institute.

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Why self-regulation is detrimental?

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- Self-regulation works only up to a point. Society expects that the professions will police themselves effectively as a deviant conduct damages the reputation of an entire community, so there is incentive for them to punish the bad guys.
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- But there is a lot to commend in this market-based argument. Unfortunately, the market fails quickly in a self-regulatory mechanism. An individual member engaging in aberrant conduct is unlikely to be deterred unless the punishment is swift and appropriate.
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- Neither is probable because the **members elect representatives who decide whom to punish** and what the punishment should be.
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- It is no longer the well-intentioned mechanism at work. The **political process** takes over and there will inevitably be compromises.
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- More importantly, self-regulation hurts those outside the accounting community. Investors and lenders are often victims of dodgy accounting and incompetent auditing.
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- They would have **no confidence in the fairness** of the process when their complaints are heard by other accountants. For this reason, many who have suffered at the hands of accountants are unlikely to have even complained to the ICAI. This is the reason for a relatively **low number of complaints**.
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Why new regulator is desirable?

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- That is why in most countries outsiders oversee the work of accountants. The Public Company Accounting Oversight Board (PCAOB) in the US and the Financial Reporting Council (FRC) in the UK are examples of effective outside regulation.
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- The ICAI and its members will be the biggest beneficiaries of external regulation. When there is **greater assurance** that improper conduct will be punished, the value of the ICAI's franchise will go up.
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- They don't have to fear losing clientele. They can expect to be paid more for being strict. They can **invest more in training and technology** and pay their employees better. Eventually, inferior firms will drop out of the audit market.
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- NFRA can **enhance investor protection** by effective oversight of accounting and auditing. It will fill a critical gap in the current arrangements by enforcing compliance with standards. Dumping NFRA will be a clear case of regulatory capture by the accounting industry.
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- Accounting is one of the professions most threatened by **automation**. The Bank of England's chief economist said that chances of accountants being replaced are "a whopping 95 per cent".
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- Outsourcing regulation will free resources for the ICAI to work on developing new and complex skills needed in the uncertain world of technology.
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- Therefore ICAI should facilitate NFRA's work by training expert witnesses who can provide independent opinion in disciplinary cases.
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