National Financial Reporting Authority (NFRA): Auditors' auditor

What is the issue?

NFRA will be headless from October 1 if the government in the next two days does not announce either a successor or another term to the incumbent Chairman.

What is NFRA?

- The NFRA is a national regulator for auditors set up under the Companies Act, 2013.
- It was set up specifically to investigate the role of auditors in frauds in listed and large public interest entities.
- It came into being in late-2018 in the wake of the IL&FS financial scandal.
- **Composition** - NFRA will have a chairperson who will be appointed by the Central Government and a maximum of 15 members.
- **Role of NFRA**
    1. Make recommendations on the foundation and laying down of accounting and auditing policies and standards
    2. Monitor and enforce the compliance of the accounting standards and auditing standards
    3. Oversee the quality of service of professionals and suggest measures required for improvement in the quality of service
- **Powers of NFRA**
    1. To investigate the matters of professional or other misconduct committed by a prescribed class of CA firms or CAs
    2. The same powers as a Civil Court under the Code of Criminal Procedure, in specific matters.
    3. the power to impose penalty and debar a member/firm from practice as a member of ICAI
- Previously, only the Institute of Chartered Accountants of India (ICAI) can bar chartered accountants from being appointed as auditors for a company.
- Also, Securities and Exchange Board of India (SEBI) was permitted to bar CAs from auditing listed companies.

What were the actions taken by NFRA in the past 3 years?

- The three Audit Quality Reports (AQR) that NFRA has produced since 2018 called out the sub-standard audit practices followed by well-known audit firms.
- This was the first time in the country that audit practices were put under the scanner with such serious intent and analysed in such great depth.
- NFRA has recently found errors in KIOCL Ltd's financial statements pertaining to the fiscal year 2019-20.

What are the challenges in effective functioning of NFRA?

- Apart from Chairman, there is just one whole-time director on the board, and three part-time directors who are nominees of ICAI.
- The ICAI opposed the NFRA even before it was notified and also now after NFRA’s AQRs that highlighted ICAI’s ineffective regulation.
- Conflict of interest between Auditing and Assurance Standards Board (AASB) of ICAI and the Quality Review Board (QRB) of NFRA is an issue.

How to address these challenges?

- It is the government’s responsibility to ensure its independence and autonomy — functional, financial and administrative.
- The government should streamline regulations under Section 132 of the Companies Act to increase the effectiveness of NFRA.
- NFRA needs an independent head who is not an ex or present office-bearer of ICAI.
- With greater participation of retail investors in the stock market and increasing shareholder activism, a strong and autonomous regulator is the need of the hour.

Source: The Hindu Businessline

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