NFRA for Regulating Accountants

What is the issue?

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- ‘National Financial Reporting Authority’ (NFRA) was proposed recently as an independent regulator for accounting and auditing professionals.
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- But the authority is said to also constitute three part-time members from ICAI, which has raised troubling questions about its neutrality.
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How did NFRA evolve?

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- **The Beginnings -** The NFRA was first proposed as an independent regulator of accounting and auditing in the wake of the Satyam scandal.
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- As the scam went undetected for many years by the company’s auditors, there are clear indications of auditor collusion in the fiasco.
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- This created a public outcry for better regulations in the sector and a 2010 standing committee report had subsequently vouched for the creating NFRA.
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- **Stalemate -** NFRA was a part of the Companies Act 2013, which was notified in 2017, but interestingly the clause related to NFRA wasn’t notified.
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- Notably, Institute of Chartered Accountants of India (ICAI), which is currently the certifying and self-regulatory institution, had opposed NFRA.
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- ICAI had vouched that it is doing a good job and a new regulator isn’t needed as it would merely add regulatory levels.
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- Significantly, despite the strong support of the ministry of corporate affairs, NFRA couldn’t be notified, which indicates ICAI’s lobbying power.
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- **Revival -** The recent Rs. 13,000-crore Punjab National Bank (PNB) fraud

that seems to have broken the camel’s back on NFRA issue.
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- This case slipped through a variety of audits by CAs that public banks are mandated to undergo (statutory, branch, concurrent, and stock audit).
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- Also, the rising non-performing assets (NPAs) of banks have also raised questions about the failure of auditors to properly review asset quality.
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What is the composition of NFRA?

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- NFRA was touted to be a fully independent body that will consist of a chairperson, three full-time members and nine part-time members.
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- Among the part-time members, one each from Ministry of Corporate Affairs (MCA), CAG, RBI, and SEBI, will be part of NFRA
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- Additionally, two external experts (accountancy, auditing, finance, or law) and three ex-officio members from the ICAI (the president, and chairpersons of Accounting, and auditing boards) will also be members in NFRA.
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- While none of the previous proposal had a provision for ICAI members to be included in the board, the inclusion of the 3 ICAI members is intriguing.
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- Notably, ICAI members are practicing CAs, which clearly gives rise to a conflict of interest and also will bring the neutrality of NFRA into question.
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What is the way forward?

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- The separation of the regulator from those it regulates is a fundamental principle of good governance and followed universally.
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- This is true of the Securities Board of India (SEBI), the Telecom Regulatory Authority of India (TRAI), and the Competition Commission of India (CCI).
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- International Forum of Independent Audit Regulators (IFIAR) also stipulates to keep practicing auditors out of the regulatory mechanisms.

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- Formal independence of the regulator is necessary to maintain trust and public confidence and this mandates keeping the ICAI away from NFRA.
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- **Importantly -** CAs elect members of the ICAI’s council to represent their interests, and not the interests of investors, creditors and other stakeholders.
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- Allowing ICAI representatives to have a say in the working of the NFRA is like letting the fox guard the hen-house.
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Source: Business line

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