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REGULATING AUTHORITY FOR FINANCIAL REPORTING WITH REFERENCE TO INDIA AND OTHER COUNTRIES

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Abstract

The financial system plays an important role in the economic development and stability of any country. Ensuring effective regulation and supervision of the financial system is inevitable for any country that has a rapidly growing economy and a diverse range of financial institutions. As an example, In India, the responsibility of overseeing and regulating the financial system is divided among several regulatory authorities, each entrusted with specific sectors of the financial market. These regulatory bodies function to promote stability, transparency, and investor protection along with innovation and growth within the Indian financial system. National Financial Regulating Authority is one such regulatory authority is a regulating authority for financial reporting that takes care of accounting standards and auditing policies. This paper provides insights regarding NFRA and similar audit regulators in other countries.

Keywords: National Financial Reporting Authority (NFRA), Institute of Chartered Accountants of India (ICAI)

Introduction

Exercising effective control over accounting and auditing policies is crucial for an economy. Historically, the role of an auditor has been that of a financial ‘gatekeeper’, which makes it imperative for the auditor to be independent and free from any conflict of interest, both in fact and in appearance. This becomes even more important for public companies with hundreds of thousands of investors, who suffer from severe information asymmetry. Hence, The presence of a regulatory body to oversee these policies is essential. Just as the Reserve Bank of India oversees the movement of money and its effects on the economy, the National Financial Reporting Authority (NFRA) is the regulatory body that administers accounting and auditing policies. The National Financial Reporting Authority (NFRA) was constituted on 01st October 2018 by the Government of India under Sub Section (1) of Section 132 of the Companies Act, 2013.

Need for NFRA

The National Financial Reporting Authority is constituted as an independent regulator for the auditing profession to improve the transparency and reliability of financial statements and information of listed companies and large unlisted companies. It was established to fill a gap in the oversight of auditors by independent regulatory bodies. Many corporate scams like the Satyam Scam, PNB Scam, tax evasions and non-performing assets where the role of auditors became questionable are the key factors that led to a shift from a self-regulatory framework to an independent regulatory framework with the constitution of NFRA.

Objective in setting up NFRA:

The primary objective in establishing NFRA is to have an independent oversight body to oversee the quality of accounting and auditing services for listed companies as well as unlisted public companies above a prescribed threshold..

Evolution of NFRA:

The Institute of Chartered Accountants of India (ICAI) was against the constitution of NFRA initially, contending that it would affect their disciplinary power vis-à-vis their members and create a regulatory overlap. However, the contention of ICAI ran contrary to international best practices, which show a distinct shift from self-regulation to independent oversight of auditors, accounting for about 80% of global stock market capitalisation.

The objections raised by ICAI on the need for NFRA, were considered by the Companies Law Committee (CLC), constituted in 2016, to suggest amendments to the Companies Act, 2013, and it was concluded that an independent body to oversee the audit profession in India was essential in the light of the inherent conflict of interest in the SRO model in USA and to align India with international best practices. While announcing the decision to create the body, Finance Minister Arun Jaitley said the NFRA would cover all listed companies and large unlisted companies, the benchmark size for which would be set down in the rules. Smaller unlisted companies would continue to be audited by the ICAI, he said, adding that the Centre could also refer other entities for investigation “where public interest would be involved.”

Role of NFRA:

- As an advisory board, NFRA can recommend certain standards related to accounting and finance. They can also promote awareness to comply with accounting standards.

- As an enforcement organisation, NFRA can keep auditors' records and monitor their performance. Apart from overseeing the quality of service professionals provide, they can also cooperate with national and international organisations to establish policies adhering to accounting standards.

- The NFRA can also investigate professional or financial misconduct and take disciplinary actions or impose penalties on auditors or finance professionals.

- Rules 4(1) and 4(2) of the NFRA Rules, 2018 state the regulatory power of NFRA in safeguarding public interests. The Central government confers NFRA's power to oversee all financial institutions and their auditing. It also aims to promote consciousness in dealing with financial entities.

Composition of the NFRA

The Companies Act requires the NFRA to have a chairperson who will be appointed by the Central Government and a maximum of 15 members. The appointment of such chairperson and members is subject to the following qualifications:

- should have expertise in accountancy, auditing, finance or law. They are required to make a declaration to the Central Government that there is no conflict of interest or lack of independence in their appointment.

- All the members including the chairperson who are in full-time employment should not be associated with any audit firm (including related consultancy firms) during their term of office and 2 years after their term.

Along with a Chairperson who is a Chartered Accountant and a person of eminence having expertise in accountancy, auditing, finance or law; NFRA consists of

- Member – Accounting;
- Member – Auditing;
- Member – Enforcement;
- One representative of the MCA not below the rank of Joint Secretary or equivalent (ex-officio)
- One representative of RBI, being a member of the RBI Board is to be nominated by the RBI;
- One representative of SEBI, being the Chairman of SEBI or whole-time member of SEBI is to be nominated by SEBI;
- A retired chief justice of high court or a person who has been the judge of a high court for more than 5 years is to be nominated by the Central Government,
- President of the Institute of Chartered Accountants of India (ex-officio)

The Chairman may also invite any other person to the meeting to give their expert opinion.

Powers of the NFRA:

Following the policies developed by the central government, the financial reporting authority can exercise certain powers, which are as below:

- Investigating the functioning of Chartered Accountant firms and looking for potential misconduct. Moreover, no other organisation can investigate proceedings initiated by NFRA.

- NFRA has the power to act as a Civil Court under the Code of criminal procedure for:

1. Introducing books of account and other documents specified by NFRA.

2. Ensuring attendance and oath-taking of summoned persons.
3. Investigation of books, journals and registers in matters of public interest.
4. Commissioning of examiners to take control of witnesses and documents.
5. Matters of misconduct whereby NFRA is liable to impose punishments such as:

Individuals charged under cases of proven misconduct are to pay penalties of Rs. 1,00,000 or five times the received fees.

Firms charged under instances of misconduct to pay penalties of Rs. 5, 00,000 or five times the received fees. Negating the validity of one's office as a member of ICAI from 6 months to 10 years.

Regulating authority for Financial Reporting in other countries

Public Company Accounting Oversight Board (PCAOB) - United States

The Public Company Accounting Oversight Board (also known as the PCAOB) is a private-sector, nonprofit corporation created by the Sarbanes-Oxley Act of 2002 to oversee accounting professionals who provide independent audit reports for publicly traded companies. The PCAOB's responsibilities include:

- registering public accounting firms;
- establishing audit, quality control, ethics, independence, and other standards relating to audits of public company audits;
- conducting inspections, investigations, and disciplinary proceedings of registered accounting firms; and
- enforcing compliance with the Sarbanes-Oxley Act.

PCAOB Board - The five members of the PCAOB Board, including the Chair, are appointed to staggered five-year terms by the SEC, after consultation with the Chair of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury.

SEC (U.S Securities and Exchange Commission) has the authority to oversee the PCAOB's operations, to appoint or remove members, to approve the PCAOB's budget and rules, and to entertain appeals of PCAOB inspection reports and disciplinary actions.

Professional Oversight Body - Financial Reporting Council - UK

The Financial Reporting Council (FRC) is an independent regulator in the UK and Ireland based in London Wall in the City of London, responsible for regulating auditors, accountants and actuaries, and setting the UK's Corporate Governance and Stewardship Codes. The Financial Reporting Council (FRC) is The parent overall regulator responsible for the regulation of accounting, auditing and actuarial profession in the UK. Its Roles include setting overall strategy and priorities, making appointments to various operating boards and ensuring effectiveness.FRC monitors the operation of the Combined Code on Corporate Governance, approves changes to it, and provides advice on strategy, budgets and structure. Council membership is largely drawn from senior figures in the business, professional and financial community. The FRC seeks to promote transparency and integrity in business by aiming its work at investors and others who rely on company reports, audits and high-quality risk management.The FRC effectively provides oversight of the main operating boards under it.Professional Oversight Board (POB) is one such board which provides oversight of operation and regulation of auditing profession by RSBs and RQBs, and to monitor the quality of auditing function for listed companies and major public interest bodies, and also to reviews regulatory procedures and processes of accountancy bodies and actuarial profession.

Conclusion:

Despite adopting internationally accepted accounting principles like GAAP and IFRS, due to several accounting scandals that shook investor confidence, the significance of conducting thorough and accurate audits has been amplified. These scandals triggered the introduction of stricter corporate governance and financial reporting regulations, along with the creation of audit oversight bodies to safeguard the integrity of financial reporting in many countries of the world like Kenya, Ireland, Malaysia, US, UK etc., NFRA is such an oversight body in India which was established as a consequence of many corporate scams in our country. In the present situation, to protect the investors there is a need for an independent regulatory like NFRA. The decisions of NFRA since its establishment till date shown consistency in their approach proving that it is somewhere different from other financial regulators in our country.

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