

Is A Deformed National Financial Reporting Authority The Answer To ICAI's Flaws?

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The introduction of the National Financial Reporting Authority is a very good initial step, but the idea that the government would control a profession is a matter of concern. There is no shortage of institutions in this country. Instead of strengthening them, why are we creating more?

When some weaknesses are found in an established institution which is 70 years old—and has been the pillar of a profession for decades; has the second largest number of members in the world—these weaknesses need correction. The government should extend its support instead of dismantling the august institution with a hallowed past.

Can a profession be controlled by a government body, or should it be an independent professional body? After having created The Institute of Chartered Accountants of India by an act of Parliament, should there be another act of Parliament for creating NFRA?

There are a number of fundamental issues on constitution of NFRA, and these questions will come up every now and then, not only with ICAI, but also from various other stakeholders.

Problems With The Structure

The constitution of NFRA as planned today is completely different from what was originally conceived. The present requirement of a chairperson having 25 years of experience in the field of accountancy, auditing, finance, or law is fraught with serious danger. I think it is absolutely essential that he should be a professionally qualified chartered accountant with significant practical experience.

NFRA was brought in not because of the lack of an accounting or auditing standard setting process, but to supervise the quality of the profession and to punish the erring members. Hence, the basic question that arises is, can a person outside the profession supervise or control?

A lawyer being made the head of the Medical Council, or a doctor being the head of the Bar Council is unheard of.

A doctor heading the Medical Council or a lawyer heading the Bar Council is what the norm is. Hence, a member or the chairman of the NFRA should belong to the accountancy profession.

The government's earlier thinking was to include someone of the rank of a retired Supreme Court judge as one of the members, which would have brought in a lot of maturity and responsibility to the institution. In NFRA, that is not the case and it is likely to have serious ramifications on the quality of the supervision itself. In fact, the very objective for which NFRA was formed may be impacted by this serious infirmity.

The reason for including accounting standards and auditing standards is not very clear, and in fact, it simply replicates the work that is being done by the ICAI on the two areas.

This will certainly come in the way of providing high-quality supervision, monitoring compliance and punishing of the erring members.

Further, NFRA consists of a majority of the members being ex-officio, holding senior positions in the government. Therefore, the primary question of their understanding the issue, and then finding the time to attend to the NFRA issues is highly doubtful. In fact, it is doubtful whether a body like this could be run with just four full-time members, including the chairman, that too without an assurance that the majority of them will be from the profession.

Applicability To Companies

On the applicability of NFRA for companies, the original thought process was to carry out a phased transition. Now, it appears that there will be no phasing. It will be very difficult for NFRA to monitor the compliance for the large number of companies, as well as the audit

firms. In my opinion, bringing in a standard setting process, quality control, and disciplining the profession cannot go together.

NFRA will have neither the infrastructure, nor the technical expertise to handle all this.

If one looks at the enormous task ahead for NFRA only on compliance monitoring and disciplining the erring members and investigation, the infrastructure required will be huge and the funding requirement could go beyond Rs 50 crore per year. This will include both cost of technical experts and technical Infrastructure.

For NFRA to conclude a single investigation or review, it might easily require four to five technical experts, working exclusively on that investigation, for anything between two and four months.

While peer and quality reviews can take much less time and could be outsourced, investigation cannot be outsourced.

Let's take a look at the Public Company Accounting Oversight Board in the United States to understand why NFRA might be ill-equipped for its task at hand. The PCAOB was created by the 2002 Sarbanes-Oxley Act to oversee the audits of public companies and other issuers. Although it only does quality control exercise, the PCAOB has a huge budget, dedicated teams and high-quality resources. NFRA would fail if it does not get the technical resources or the budget the PCAOB enjoys, for a much narrower mandate.

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Scope Of Jurisdiction

The scope of NFRA's jurisdiction seems to be very wide and it also has to undertake a planned supervision as part of the quality review. The original plan was to include only audit firms which were handling more than 20 listed-company audits or 200 audits of all types of companies. This would have ensured the application of the Pareto principle—also known as the 80-20 rule—ensuring selective control of important firms which play a critical role in certifying financial statements. Other than this, the objective was to cover other cases as referred to NFRA by regulators or other government agencies. With adequate infrastructure and high-quality technical resources absent, these objectives will not be achieved.

A Viable Alternative

A viable structure would have been to make NFRA as a board with three committees – one for accounting standards, another for auditing standards, and the last for disciplinary action, monitoring, and investigation. This would have given sufficient legroom for each to achieve the stated objectives. The government may have to address this issue by forming sub committees with specific technically qualified experts from accounting, auditing, and governance/oversight backgrounds.

Proper reporting rules need to be formulated, as also norms on what's made public. The present rules only say that reasons for not publishing will be recorded in writing. As is the practice abroad, it would have been appropriate to segregate the report into public and confidential portions, and make the publication of the non-confidential section mandatory.

If the constitution of NFRA is indeed in public interest, and the objective is to bring in transparency as laid down in the Companies Act, 2013, it would be inappropriate to have bureaucratic rights for not disclosing.

While the objective for which NFRA has been formed is laudable, one doubts whether it makes provision for sufficient professional expertise in the system, whether detailed requirements have been estimated, if there is an adequate budgetary allocation, and whether proper technical committees have been constituted. All this needs to be examined. Otherwise, NFRA may get caught in the bureaucratic set-up and will not serve the purpose for which it was formed.

The ICAI enjoys its members' support, who voluntarily undertake work for 'their institute'. That's not going to be the case with NFRA. To make NFRA successful, it is essential to support its technical people, offer budgetary support, and above all provide alternate methods until it reaches a mature level.

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