

MCA notifies NFRA Rules

Understanding the scope and applicability of NFRA Rules

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Introduction

With an aim to establish an independent regulator to strengthen the audit profession, MCA vide Notification¹ dated October 01, 2018 appointed October 01, 2018 as the date of constitution of National Financial Reporting Authority (“NFRA” or “Authority”) and notified sub-sections (1) and (12) of Section 132 of the Companies Act, 2013 (“Act”). In view of this, the National Financial Reporting Authority Rules, 2018 (“NFRA Rules, 2018”) notified by the Ministry vide Notification² dated November 13, 2018, effective from November 14, 2018.

Background

Section 210A of the erstwhile Companies Act, 1956 empowered the Central Government to form a National Advisory Committee on Accounting Standards (“NACAS”) for making recommendation(s) on accounting policies and accounting standards to the Central Government. With a shift from the existing Self-Regulatory Organisation model to an independent regulatory model, through Section 132 of the Companies Act, 2013, a new regulatory authority named National Financial Reporting Authority has been introduced with enhanced independent powers. This move was a result of the recommendations of the Standing Committee on Finance which recommended for expansion of the role of NFRA to ensure better quality of audit with a view to enhance the investors’ and public confidence in the audit profession.

NFRA has been constituted as a quasi-judicial body with larger remit than NACAS. It shall be responsible for recommending auditing and accounting standards, to monitor and enforce compliances with the said standards and oversee the quality of service and suggesting measures for improvement unlike NACAS which only advises on accounting policies and standards. The set of duties and functions to be performed by the Authority is discussed below in detail.

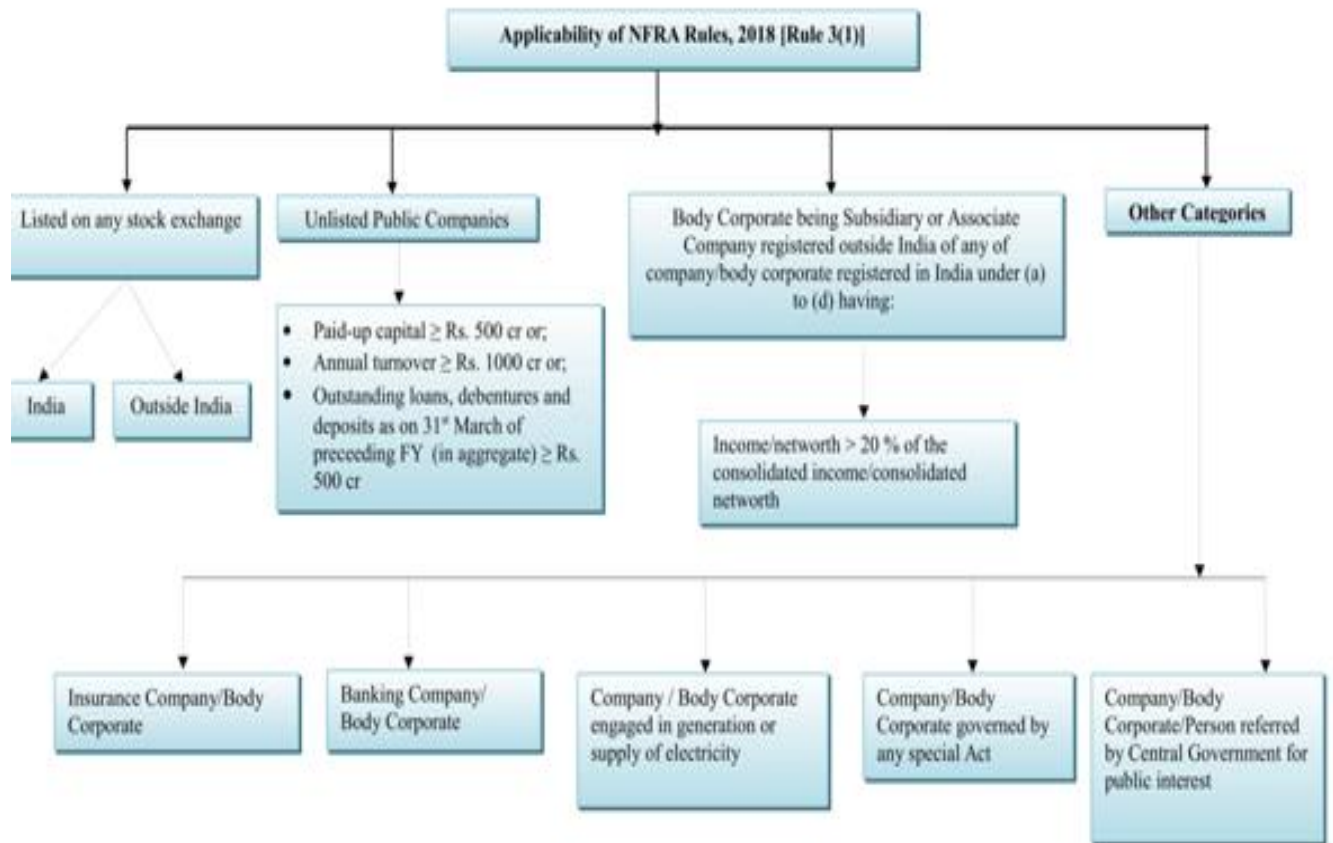
Applicability of the Rule 3

Rule 3 has 3 important and distinct clauses:

1. Clause 1 refers to the class of entities which will be regulated by NFRA, that is to say the class of entities which will be under the scanner of NFRA;
2. Clause 2 refers to the body corporates which will be required to do the one-time filing of NFRA-1
3. Clause 3 refers to the class of body corporates which will be required to do the filing of NFRA-1 each time on appointment of auditor

¹http://www.mca.gov.in/Ministry/pdf/ConstitutionNotificationNFRA_04102018.pdf

²http://www.mca.gov.in/Ministry/pdf/NFRARules2018_13112018.pdf



Pursuant to the Rule 3 (1) of NFRA Rules, 2018, following class of **companies or bodies corporate** will be governed by the Authority:

1. Companies whose securities are listed on any stock exchange in India or outside India;
2. Unlisted public companies fulfilling any of the following criteria as on the 31st March of immediately preceding Financial Year:
 - a. having paid-up capital of not less than Rs. 500 crores or;
 - b. having annual turnover of not less than Rs. 1000 crores or;
 - c. having, in aggregate, outstanding loans, debentures and deposits of not less than Rs. 500 crores.
3. Insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act or bodies corporate incorporated by an Act in accordance clauses (b), (c), (d), (e) and (f) of section 1(4) of the Act;
4. Body corporate/companies/persons or any class of them referred by Central Government to the Authority in public interest;
5. Body corporate which is:

- a. incorporated or registered **outside India**, which is a subsidiary company or associate company of the company or body corporate registered in India as referred in point (1) to (4) above; **and**
- b. income or net worth exceeds 20% of the consolidated income or consolidated networth of such company or the body corporate.

The class of companies which will be regulated by NFRA has been presented below graphically:

In addition to the above, the Authority will govern and oversee the auditing functions performed by the auditors and professionals associated in providing auditing services.

Also, the companies and body corporate within the ambit of NFRA that eventually ceases to fall within the criteria, “will continue to be governed by NFRA” for three years after ceasing to meet such criteria.

Companies not covered by the NFRA Rules

Considering the provisions of applicability of the Rules, following companies shall not be governed by the Authority:

1. Unlisted private companies (unless referred by Central Government to the Authority in public interest); **and**
2. Unlisted public companies with paid-up capital or turnover or aggregate of loans, debentures and deposits below the limit stated under Rule 3(1).

Ambiguity in the Rules wrt class of entities which are required to file NFRA 1

On a plain reading of the provisions of Rule 3 (2) of the NFRA Rules, there seems to be a confusion on the applicability of the Rule, as the provisions requires all the body corporates which are not company covered by the NFRA Rules, to file form NFRA-1, intimating about the details of the auditors..

The provisions are as follows:

*“(2) Every existing body corporate **other than a company governed by these rules**, shall inform the Authority within thirty days of the commencement of these rules, in Form NFRA-1, the particulars of the auditor as on the date of commencement of these rules.”*

The text of the provisions will make you feel like reading "stop not let go", which, without punctuation, can be read either ways – ‘Stop! not let go or Stop not, let go’.

Before interpreting Rule 3(2), one needs to understand the purport of filing NFRA-1 which is to intimate the particulars of the auditors being appointed. It is to be noted that all Indian companies anyway file details of appointment of auditor in e-Form ADT-1. Accordingly, making the NFRA-1 filing applicable on the Indian companies will be unnecessary and not rational. It is only body corporates (other than companies) which are big in size or substantial whose auditor details are not registered with the government. Accordingly the NFRA-1 filing

is required only for such body corporates (which are not companies) on which clause 1 of Rule 3 is applicable.

Further, there are two types of filing to be done:

1. One time – clause 2; and
2. each time on appointment of auditor - clause 3

One time filing is to be done within 31.07.2019³.

Filing as required in clause 3 of Rule 3 on appointment of auditor is to be done within 15 days of appointment by the body corporates.

It is to be noted that in the first proviso of Rule 3(3), the time limit of filing of the Form by material foreign subsidiary / associates is missing.

Filing of Annual Return by the auditors

Every auditor governed by the Authority shall file a return with the Authority on or before 30th April every year in such form as may be specified by the Central Government.

Functions and duties of the Authority

Following duties and responsibilities shall be performed by the Authority:

<i>Function and Duties</i>	<i>Actionable and Power of Authority</i>
To recommend accounting standards and auditing standards for approval by the Central Government.	<p>Before recommending accounting standards and auditing standards for approval by the Central Government, the Authority shall:</p> <ol style="list-style-type: none">a. Receive recommendations from ICAI on proposals for new accounting standards or auditing standards or for amendments to existing one;b. to seek additional information from ICAI on the recommendations received. <p>Authority shall mandatorily consider their recommendations but may or may not accept.</p>
To monitor and enforce compliance with accounting and auditing standards	<p>To monitor and enforce the compliance with the accounting standards the Authority may review the financial statements of any company or body corporate governed, for which it may issue written notice to such company/body corporate or its auditor directing to provide further information, explanation or any relevant documents within the time prescribed.</p> <p>To monitor and enforce compliance with auditing standards following actions may be taken by the Authority:</p>

³http://www.mca.gov.in/Ministry/pdf/FormNFRA1_0207019.pdf

<i>Function and Duties</i>	<i>Actionable and Power of Authority</i>
	<ol style="list-style-type: none"> 1. Review working papers, audit plan and other documents and communication related to audit 2. Evaluate the quality control system, documentation system of the auditor. 3. Testing the audit supervisory and quality control procedures of the auditor. 4. Require the auditor to submit a report on its governance practices and internal processes designed to promote audit quality, protect its reputation and reduce risks including risk of failure of the auditor and may take such action on the report as may be necessary. <p>Further, following common action may be taken by the authority:</p> <ol style="list-style-type: none"> a) Require personal presence of officers of the company/body corporate and its auditors for seeking further information and explanation. b) Where the Authority finds or has reason to believe that any accounting standard has or may have been violated, it take further course of investigation or enforcement action through its concerned Division. c) The Authority shall publish its findings relating to non-compliances on its website and in such other manner as it considers fit, unless it has reasons not to do so in the public interest and it records the reasons in writing. d) The Authority shall not publish proprietary or confidential information, unless it has reasons to do so in the public interest and it records the reasons in writing. e) The Authority may send a separate report containing proprietary or confidential information to the Central Government for its information.
<p>Overseeing the quality of service and suggesting measures for improvement</p>	<ol style="list-style-type: none"> 1. Authority may direct the auditor to take measures for improvement of audit quality and specify detailed plan with time-limits. 2. Auditor shall make the required improvements and submit a detailed report. 3. The Authority shall monitor the improvements made by the auditor and take such action as it deems fit depending on the progress made by the auditor. 4. The Authority may refer the case to Quality Review Board

<i>Function and Duties</i>	<i>Actionable and Power of Authority</i>
	constituted under the Chartered Accountants Act, 1949 and seek any other information required.
Powerto investigate	<p>Authority shall forward the following matter to its division dealing with enforcement for carrying out investigation and other action:</p> <ol style="list-style-type: none"> 1. Matters of professional or other misconduct under section 132(4) received from Central Government. 2. Matters of professional or other misconduct undertaken <i>suomoto</i> 3. Matter undertaken on the basis of its compliance or oversight activities. <p>Note:</p> <ol style="list-style-type: none"> a. If, during the investigation, the Authority has evidence to believe that any company/body corporate has not complied with the requirements under the Act or rules which involves or may involve fraud amounting to rupees one crore or more, it shall report its findings to the Central Government. b. No other institute or body except the Authority has the power to initiate any proceedings against any such matters of misconduct.
Disciplinary proceedings	Where the Authority believes that sufficient cause exists to take actions permissible under Section 132(4) of the Act, it shall refer the matter to the concerned division, which shall cause a show-cause notice to the auditor in the manner prescribed and the necessary order shall be passed.
Miscellaneous functions of Authority	<ol style="list-style-type: none"> 1. Maintain details of particulars of auditors appointed in the companies and bodies corporate governed by the authority 2. Co-operating with national and international organisations of independent audit regulators in establishing and overseeing adherence to accounting standards and auditing standards 3. Promote awareness in relation to the compliance of accounting standards and auditing standards 4. Perform such other functions and duties as may be necessary or incidental to the aforesaid functions and duties

Conclusion

The Authority has been entrusted with a large number of responsibilities with independent decision making. The move to establish an independent powerful body will not only improve the auditing and accounting standards, but will enhance the quality of services provided by professional during the course of corporate audit, which will result in development the profession of audit.

With the good intent behind the framework, the same is having some drafting glitches, as discussed above, which we expect to be made good with the Rules coming into force and the Form also becoming live.

Links to other related article is as follows-

<http://vinodkothari.com/2018/11/applicability-of-nfra-body-corporates-under-strict-scanner/>