

National Financial Reporting Authority : Regulating authority for Financial Reporting

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ABSTRACT: *National Financial Reporting Authority (NFRA) constituted under Section 132 of The Companies Act, 2013. NFRA constituted to set accounting and auditing standards and oversight the work of Chartered Accountants. Government approved the proposal for establishing the NFRA on 1st March, 2018. National Financial Reporting Authority 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. NFRA constituted due to dubious role of Chartered Accountants in every corporate scams like Harshad Mehta scam, C.R Bhansali scam, Cobbler Scam, Abdul Karim Telgi scam, UTI scam, Ketan Parekh scam, Dinesh Dalmia scam, Satyam Scam, PNB scam. Chartered Accountants failed to detect accounting irregularities in every fraud. That's why there is a need arise to constitute the NFRA to regulate Auditors to make them more responsible regarding accounting irregularities. Present study is to analyze the Section 132 of The Company Act, 2013. This paper is contextual in nature. Information collected from secondary sources. The study presented the roles, powers, jurisdiction of National Financial Regulating Authority.*

Keywords: *Accounting Standards, Auditing, Listed Companies, National Financial Reporting Authority.*

INTRODUCTION

National financial reporting authority constituted by Central Government as an independent regulator for auditors. NFRA is a quasi judicial regulator. NFRA is established under the section 132 of Companies Act, 2013. NFRA will replace the National Advisory committee on Accounting Standards (NACAS) under section 210A of Companies Act, 1956 but with more powers. NACAS is an organization of ICAI. NFRA proposed in Companies Act, 2013 but Union Cabinet approved the proposal for establishing for the same on 1st March, 2018. Originally concept and composition of NFRA introduced by the Companies Act, 2013. National Financial Reporting Authority (NFRA) constituted under Section 132 of The Companies Act, 2013. NFRA constituted to set accounting and auditing standards and oversight the work of Chartered Accountants. National Financial Reporting Authority 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. NFRA constituted due to dubious role of Chartered Accountants in every corporate scams like Harshad Mehta scam, C.R Bhansali scam, Cobbler Scam, Abdul Karim Telgi scam, UTI scam, Ketan Parekh scam, Dinesh Dalmia scam, Satyam Scam, PNB scam. Chartered Accountants failed to detect accounting irregularities in every fraud. That's why there is a need arise to constitute the NFRA to regulate Auditors to make them more responsible regarding accounting irregularities. Main reason behind the constitution of NFRA is dubious role of Chartered Accountants in every big scam like SATYAM SCAM and PNB SCAM. Main work of Chartered Accountants is to advise their clients on compliance with tax laws and tell them about the importance of paying tax and also motivate them to pay taxes timely. But in reality CAs give dubious advice on tax evasion using Shell Companies as an instrument. They devise aggressive methods of Tax Planning (often a mild alternative for Tax Avoidance). Chartered Accountants failed to detect Tax Evasion and Avoidances in most of the cases. Audit done by auditors give no assurance and auditors have always standard excuse that Auditors are not responsible for detection of frauds. In Satyam Scam chartered accountants found guilty and punished. Only in Satyam Scam timely action had been taken against guilty Auditors of the Satyam company.

Concept of NFRA

Concept of establishing NFRA was introduced in the draft law and endorsed by the standing committee on Finance – 15th Lok Sabha. Standing Committee report of August 2010, committee approved the creation of a new body that would not only set and oversee auditing and accounting standards but also to monitor the quality of audit undertaken across the corporate sector. Later, the same has been endorsed in another parliamentary committee report, by a government appointed company law committee and by the finance ministry and ministry of corporate affairs, across two governments.

LITERATURE REVIEW

Abbott , Park and Parker (2000) Researcher carried out a study on “The effects of audit committee activity and independence on Corporate Fraud”. Study’s main objective was to examine the effect of audit committee’s activity and independence on corporate fraud. In other words researcher studied the association between corporate governance characteristics and frauds based on audit committee’s activities and independence in the study period from 1980 to 1996. To attain the objectives of the study researcher collected data from 78 sample firms during the study period. Researcher used regression model and sensitivity test to analyze the data collected under study. Variables of the study was GROWTH, TROUBLE, AGEPUB, MGTOWN, COETENURE, BLOCK, OUTSIDE, ACENOEMP. Growth measured as average growth in total assets over the two years preceding the fraud. Trouble measured firms experienced three or more years losses in the past six years. AGEPUB was the number of years the firm has publicly traded. MGTOWN was the percentage of stock owned by the managers with board seats. COETENURE was the length of CEO board service. BLOCK was the proportion of stock controlled by unaffiliated owners who hold at least five percent of stock. OUTSIDE was the percentage of board members who were non employees. ACENOEMP was the audit committee which excludes employees and meets at least twice in a year. Researcher found that those audit committees have minimum limits on activity and independence are less associated with frauds and misstatements.

Ghosh, Marra and Moon (2010) Researcher carried out a study titled “Corporate Boards, Audit committees, and Earnings Management : Pre and Post – SOX Evidence”. Main objective of the study was to study the role of board and audit committee in earnings management pre and post Sarbanes Oxley Act years. Researcher examined the relationship between audit board characteristics and earning management in the study period from 1998 to 2005. Pre Sarbanes Oxley Act period from 1998 to 30th June, 2002 and post Sarbanes Oxley Act period from 1st July, 2002 to 2005. Researcher analyzed the impact of structure and composition of board on Financial Reporting. Variables of the study were composition of board in terms of percentage of independent directors, size of the board in terms of number of members on the board, structure in terms of separation of CEO and chair positions. Researcher collected data of sample of 9,290 observations during the study period. Researcher found that board size, audit committee size, activity effect the earning management. Researcher concluded that audit committee’s financial expertise, stock ownership, tenure of members of committee has also an effect on earning management. Researcher suggested that audit committee directors with longer tenure are more efficient in earnings management.

Gupta and Gupta (2015) Researcher conducted study titled “Corporate frauds in India – perceptions and emerging issues”. Main objective of the study was to study nature and perception of corporate frauds in India in the study period from 1991 to 2012. Study was exploratory in nature. Researcher collected data through structured questionnaires and interviews. Questionnaires filled by 346 companies employees and 43 interviews were also taken to take the opinions of the Corporate professionals, management investors, government offices employees. Researcher used descriptive statistics, ANOVA, SYSTAT to analyze the data. Variables of the study were Bribery, Misappropriation of Assets, Corporate espionage, procedural frauds, and financial statements frauds. Researcher found that Misappropriation of assets, financial statement frauds, procedural frauds, bribery were the main types of frauds in India. Researcher suggested that there should be uniformity in publication standards of fraud prevention policy. Researcher concluded that nexus between government officials and corporate officials also the reason behind the corporate frauds in India. Researcher also suggested that rotation of statutory auditors and compulsory appointment of qualified internal auditors will be helpful in minimizing and preventing frauds.

Loehlein (2017) researcher conducted study on “Measuring the independence of audit oversight entities: a comparative empirical analysis”. Main objective of the study was to analyze and compare the independence of oversight boards of 27 member countries and the USA. This study was aims to question the independence of independent audit oversight boards. Researcher collected data for the study through e-mail questionnaires. Questionnaire filled by audit board officials. Data collected from e-mail questionnaire analyzed through Partial Order Scalogram analysis with coordinate’s technique. Data analyzed to find out similarities and relative levels of independence of audit oversight boards. Researcher provided ranks to the audit oversight boards. Researcher found that countries like Latvia, Luxemburg, Italy, and Hungary have most powerful independent audit oversight boards with highest ranking in comparison to other countries like Portugal, Ireland, Belgium, have least independent audit oversight boards. Researcher concluded that there is still many gaps those hinders the independence of audit oversight boards in European member countries and USA.

Some Big Corporate Scams

WASTE MANAGEMENT SCAM (1998): It was a 1.7 billion dollar scam. Main officials involved in this scam were CEO, top executives, Auditors of the Waste management company.

ENRON SCAM (2001): It was a 74 billion dollar scam. Main officials involved in this scam were CEOs and Auditors of the firm.

WORLDCOM SCAM (2002): It was a 11billion dollar scam. Main officials include in this scam were CEO of the company Berine Ebbbers and auditors of the company.

TYCO SCANDAL (2002): It was a 150million dollar scam. Main officials include in this scam were CEO Dennis Kozlowski and CFO Mark Swartz.

HEALTHSOUTH SCANDAL (2003): It was a 1.4billion dollar scam. Main officials include in this scam was CEO Richard Scrushy of the company.

FREDDIE MAC SCANDAL (2003): It was a 5billion dollar scam. Main officials include in this scam were COO David Glenn, CEO Leland Brendsel, Ex-CFO Vaughn Clarke, former Senior Vice-Presidents Dean and Nazir Dossani.

AMERICAN INSURANCE GROUP SCANDAL (2005): It was a 3.9billion dollar scam. Main officials include in this scam was CEO Hank Greenberg.

LEHMAN BROTHERS SCANDAL (2008): It was a 50billion dollar scam. Main officials include in this scam were Lehman executives and company's auditors, Ernst and Young.

BERNIE MADOFF SCANDAL (2008): It was a 64.8billion dollar scam. Main officials include in this scam were Bernie Madoff and his accountant David Friehling and Frank DiPascalli.

SAYTAM SCANDAL (2009): It was a 1.5billion dollar scam. Main officials include in this scam were Chairman Ramalinga Raju and auditors of the company.

Role of Auditors In SATYAM SCAM

In 2009, SATYAM SCAM came in light when chairman of Satyam resigned and confessing manipulation of accounts of Rs.7000 Crore. SATYAM SCAM was the result of manipulation of accounts with the help of auditors and this was proved in investigation done by SEBI and ICAI. Price water house coopers (PWC) affiliates served as independent auditors of Satyam computer services when the report of scandal in the account books of Satyam computer services broke. The Indian arm of PWC was fined \$ 6 million by the SEC (US securities and exchange commission) for not following code of conduct and auditing standards in the performance of its duties related to auditing of the accounts of Satyam computer services. SEBI barred PWC from auditing the listed companies from 2018-2020. ICAI remove the guilty auditors permanently from register of member list of Chartered Accountants and also imposed a fine of Rs.5,00,000 each on them.

Special right to Auditors in Companies Act,2013: Section 143(12) of Companies Act,2013 has a specific provision that allows auditors to report an issue to the government, if they believe that “an offence involving fraud is being or has been committed against the company by officers or employees”.

But the irony is that not a single auditor has not been report this kind of issue to the government. If any auditor reported this kind of issue in PNB SCAM then it would not make as big scam as is appears today.

Finance Minister, Arun Jaitely had also expressed his concern over the role of Auditors.” What are our auditors doing?” Both internal and external auditors really have looked the other way or failed to detect....and of course, there is also an important challenge where the supervisory agencies now have to introspect what are the additional mechanism they have to put in place to make sure that stray cases don't become a pattern and they are nipped in the bud.

Role of National Financial Reporting Authority

- Make recommendations to the Central Government on the formulation and lying down of accounting and auditing policies for adoption by companies or class of companies or their auditors.
- Monitor and enforce the compliance of accounting standards and auditing standards.
- To oversee quality of service of the professions associated with ensuring compliance with such standards and suggest measures as require.

Powers of National Financial Reporting Authority:

Against Professional Misconduct

- NFRA has been empowered to investigate, either suo motu or on a reference to it by the central government into matters of professionals and other misconduct by any member of ICAI.

- NFRA can impose specified penalty including debarring the professional from the practice for a minimum period of six months or for such higher period not exceeding 10 years as may be decided by NFRA.
- If NFRA initiates proceedings, no other institute or body can not initiate or continue proceedings in the same matter.

Against Audit Firms

- Earlier on account of professional or other misconduct, ICAI was empowered to suspend individual partners of the audit firms but not an audit firm. For instance, in Satyam Scam, it was only the partners who signed the accounts and two employees were booked. The audit firms that prepared the company' accounts were never booked. To plug this loophole NFRA has been empowered to act against audit firms.

Jurisdiction of National Financial Reporting Authority

The jurisdiction of NFRA for investigation of Chartered Accountants and their firms would extend to listed companies and large unlisted companies. The threshold for Large Unlisted companies under the jurisdiction of NFRA has not yet been announced. However, as per draft NFRA Rules, Unlisted Companies with net worth not less than Rs. 500 Crore or paid –up capital not less than Rs. 500 Crore or Annual turnover not less than Rs. 1000 Crore as on 31st March of immediately preceding financial year and companies having securities listed outside India will be under jurisdiction of NFRA.

Conclusion and Suggestions

National Financial Reporting Authority constitute due to Failure of ICAI to handle the issues related to accounting irregularities and also failed to take actions against Chartered Accountants promptly who involved in reporting related scams in India. NFRA can only be successful initiative of the government if they appoint highly experienced persons those who have no connection with audit firms. NFRA implementation would bring certain positive results because this body has more power than earlier bodies like National Advisory Committee on Accounting Standards.

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