

भारत सरकार / Government of India  
राष्ट्रीय वित्तीय रिपोर्टिंग प्राधिकरण / National Financial Reporting Authority  
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Press Release

Date: 09.07.2021

**Consultation Paper on Enhancing Engagement with Stakeholders- Extension of last date for  
submission of public comments to 30th July, 2021**

National Financial Reporting Authority (NFRA) has extended the last date for submission of comments on its Consultation Paper titled "*Enhancing Engagement with Stakeholders: Report of Technical Advisory Committee (March 2021)*" from 10th July, 2021 to 30th July, 2021. Consultation paper may be viewed at [https://nfra.gov.in/consultation\\_papers](https://nfra.gov.in/consultation_papers)

**Consultation Paper - June, 2021**  
**on**  
**Enhancing Engagement with Stakeholders**  
**Report of Technical Advisory Committee (March 2021)**  
**Last date for receipt of comments 10 July 2021**



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ENHANCING ENGAGEMENT WITH STAKEHOLDERS

This Consultation Paper -June 2021 ‘Enhancing Engagement with Stakeholders: Report of Technical Advisory Committee (March 2021)’ is issued by National Financial Reporting Authority (NFRA) for comments by its stakeholders and the last date for receipt of the comments is **10 July 2021**. The comments should be submitted in writing either by email or by post.

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**National Financial Reporting Authority**

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**LIST OF ABBREVIATIONS**

AQR	Audit Quality Review
ASIC	Australian Securities and Investments Commission
BOD	Board of Directors
CFO	Chief Financial Officer
DAQRR	Draft Audit Quality Review Report
DHFL	Dewan Housing Finance Corporation Ltd.
EDGAR	Electronic Data Gathering, Analysis, and Retrieval system
EDIFAR	Electronic Data Information Filing and Retrieval System
FRC	Financial Reporting Council (U.K.)
FRQR	Financial Reporting Quality Review
GDP	Gross Domestic Product
IL&FS	Infrastructure Leasing & Financial Services Ltd.
MCA	Ministry of Corporate Affairs, Government of India
MNC	Multi National Corporation
NBFC	Non-Banking Finance Company
NCLAT	National Company Law Appellate Tribunal
NFRA	National Financial Reporting Authority, Government of India
NSEL	National Spot Exchange Limited
PCAOB	Public Company Accounting Oversight Board (U.S.)
PIE	Public Interest Entity
PNB	Punjab National Bank
PPP	Public-Private-Participation
RoMM	Risk of Material Misstatement
SA	Standards on Auditing
SEBI	Securities and Exchange Board of India
SEC	Securities and Exchange Commission (U.S.)
TAC	Technical Advisory Committee
UK	United Kingdom
US	United States of America

## 1 EXECUTIVE SUMMARY

- 1.1 National Financial Reporting Authority (“NFRA”), established as an independent regulator for accounting and auditing in India in October 2018 has a responsibility to protect the public interest and the interests of investors, creditors and others associated with Public Interest Entities (“PIEs”) falling within its jurisdiction. NFRA’s remit comprehensively covers financial reporting by PIEs i.e., right from Standard-setting, to monitoring and ensuring effective compliance with those Standards by stakeholders. NFRA’s Charter positions it as an organisation that should be known for *Objectivity, Integrity, Impartiality, Independence, Fairness, and Transparency*.
- 1.2 NFRA has set up a Technical Advisory Committee (TAC) to, inter alia, provide NFRA with inputs from the perspective of users, preparers, and auditors of financial statements; and advise on suitable methods for promoting awareness relating to compliance with accounting and auditing standards. The TAC submitted its first report and recommendations on “Enhancing Engagement with Stakeholders” in March 2021.
- 1.3 NFRA has formulated its preliminary views on the recommendations of the TAC. NFRA considers it appropriate to seek the comments and suggestions of stakeholders on the TAC recommendations along with NFRA’s preliminary views/proposed actions thereon.
- 1.4 Accordingly, NFRA has prepared this Consultation Paper. The recommendations on which stakeholder views are sought are:

### **Stakeholder Engagement**

Formation of Stakeholders Advisory and Consultancy Groups;  
Fellowship Programmes for Practitioners and Academics; and  
Participation by NFRA Members/Staff in public events/forums.

### **Inspection**

Communication of NFRA’s Inspection Policy

### **Communication and Advocacy**

Redesign of NFRA’s Website to meet the key information needs of stakeholders.  
(Webinars, Newsletters, Videos and Apps etc to be used to communicate the views of NFRA in matters of interest to the stakeholders).

Collaboration with academic institutions to promote awareness about financial reporting.

### **Medium Term Roadmap and Building Regulatory Capacity**

Develop a strategic and operating plan covering next Five-year horizon.

Building Regulatory Capacity: Staffing Plan and Training Programmes

### **Independence, Funding and Accountability of NFRA**

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- 1.5** NFRA requests views/comments of stakeholders on specific questions in relation to the key areas mentioned above.

The last Date for receipt of Comments is **10 July 2021**.

Email for receipt of comments: **comments-tac.paper @nfra.gov.in**

- 1.6** NFRA gratefully acknowledges the efforts put in by the members of the TAC and wishes to place on record its appreciation for their valuable contribution in this public interest activity.

## **2 INTRODUCTION – SETTING THE CONTEXT**

### **2.1 Indian Economy, Corporate Structure and Financial Markets**

**2.1.1** Historically, India has been a significant contributor to global trade and commerce. It is said that ‘For more than three-fourths of known economic history, India has been the dominant economic power globally (Maddison, 2007)<sup>1</sup>. Its contribution to world gross domestic product (“GDP”) has been as significant as 40% until the 18<sup>th</sup> Century.

**2.1.2** Currently, India is the Fifth largest economy by GDP size of US\$ 2.87 Trillion in 2019<sup>2</sup>. Overall, India’s vision and mission are to develop the nation as a significant contributor in the global economy and society over the next few decades and occupy a sheet-anchor role as one of the main Engines of Global growth in the 21<sup>st</sup> century.

**2.1.3** India has adopted corporate structures for trade and commerce since a long time. As of 31 March, 2021, there are total of 13,44,857 active companies<sup>3</sup>. Of these total number of companies, 65,942 companies are public limited companies and 6,740<sup>4</sup> are listed on stock exchanges. India has a well-established legal and prudential regulatory framework for the corporate sector. Indian company law underwent a comprehensive review a few years ago and a new Companies Act, 2013 has come into force. While the nation has three vibrant national stock exchanges with market capitalisation of approx. US\$ 3.03 Trillion as of 28 May 2021<sup>5</sup>, there are many Indian Companies who are listed on overseas stock exchanges also. Many multi-national corporations (“MNCs”) have well-established sizeable business operations operating as companies registered under the Indian Companies Act. During the last three decades, the Indian economy has witnessed large scale liberalisation. While many large public sector undertakings operate on a fully commercial basis, there has been increased use of public-private- participation (“PPP”) model in many infrastructure development areas of the Nation.

### **2.2 About NFRA and the TAC**

#### **2.2.1 National Financial Reporting Authority**

NFRA was established by the Central Government in October 2018 with the fundamental objective of driving systemic change in the Indian Financial Reporting System for PIEs. NFRA has been constituted under section 132 of the Companies Act, 2013 (Companies Act or The Act).

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<sup>1</sup> Economic Survey 2019-20, Volume I, Government of India

<sup>2</sup> World Bank Data (<https://databank.worldbank.org/data/download/GDP.pdf>)

<sup>3</sup> Monthly Information Bulletin on Corporate Sector 31 March 2021, MCA

<sup>4</sup> Ibid

<sup>5</sup> BSE (<https://www.bseindia.com/markets/equity/EQReports/allindiamktcap.aspx>)

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**2.2.2** It is pertinent to note the following prescriptions of sub-section (2) of section 132 of the Companies Act.

“(2) Notwithstanding anything contained in any other law for the time being in force, the National Financial Reporting Authority shall—(a) make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be;

(b) monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed;

(c) oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed; and

(d) perform such other functions relating to clauses (a), (b) and (c) as may be prescribed.

According to sub-section 3B of Section 132 of the Companies Act, there shall be an executive body of the National Financial Reporting Authority consisting of the Chairperson and full-time Members of such Authority for efficient discharge of its functions under sub-section (2) [other than clause (a)] and sub-section (4).

**2.2.3** NFRA was set up in the backdrop of a major fraud that shook the entire Indian Banking Sector in the beginning of 2018 (Punjab National Bank (“PNB”)-Nirav Modi scandal); this incident was followed by another mega corporate scandal i.e., sudden collapse of a major infrastructure Non-Banking Finance Company (“NBFC”) viz. Infrastructure Leasing & Financial Services Ltd. (“IL&FS”). During this time, another major economy among the G20, the United Kingdom (“UK”), also witnessed a few major corporate and audit failures; notable one is the collapse of Carillion Plc, a strategic supplier to the UK Public Sector, with huge adverse impact on society at large in the UK.

**2.2.4** India has not been immune to frauds and scandals involving PIEs and the consequential loss of public wealth and money. A few notable ones have been the Haridas Mundhra Scam (1950s<sup>6</sup>), the Harshad Mehta Securities Scam (1992), Tri-sure India Limited (1975-76), the Global Trust Bank and Ketan Parikh Scams (2000-01), Satyam Computers Limited (2008), Ranbaxy Laboratories (2008), National Spot Exchange Limited (“NSE”) (2013) and the recent ones of Jaypee Infrastructure (2017), Nirav Modi-PNB (2018), IL&FS (2018), Yes Bank (2018-19), and Dewan Housing Finance Corporation Ltd. (“DHFL”) (2020). These scams also brought into focus the role and effectiveness of the statutory audit by Independent Auditors.

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<sup>6</sup> The Bank and the Mundhra Affair (source <https://rbidocs.rbi.org.in/rdocs/content/PDFs/90045.pdf>)

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**2.2.5** NFRA is the first independent regulator for accounting and auditing in India. It is a unique body considering the scope of its functions and duties encompassing a wide engagement with the financial reporting aspects of PIEs i.e., right from a critical role in Standard-setting, to ensuring effective compliance with those Standards by stakeholders.

NFRA intends to be known for

**Objectivity-** No subjective action from either members or staff, openness to all facts/views/opinions without any pre-conceived conclusions, or pre-judging any matter.

**Integrity-** Across cases/persons/firms, absence of multiple standards, uniform treatment of all those identically/similarly placed.

**Impartiality-** Discharge of its functions without fear or favour.

**Independence-** Equidistant from all stakeholders.

**Fairness-** Not imposing unfair burdens, especially with the benefit of hindsight.

**Transparency-** Fair and open processes.

(Refer website of NFRA (<https://nfra.gov.in/about-us>) for more details about the Authority.

### **2.3 Technical Advisory Committee (“TAC”)**

**2.3.1** In order to adequately reflect and express the views and concerns of the users of corporate financial statements, and preparers, NFRA set up a TAC in July, 2020 under Rule 15 of the NFRA Rules, 2018. The overall aim in setting up the TAC is to obtain relevant input that will assist NFRA in effective performance of its functions, and to advise on matters related to accounting and auditing standards. The TAC has seven part-time members. The following are its functions.

- i) Aid and advise the executive body of NFRA on issues relating to the drafts of accounting and auditing standards;
- ii) Advise on improvements to the processes followed by the executive body, especially relating to Audit Quality Reviews (“AQRs”);
- iii) Provide inputs from the perspectives of users, preparers and auditors of financial statements;
- iv) Advise on suitable methods for promoting awareness (a) relating to compliance with accounting and auditing standards and (b) of the role of NFRA in protecting investors through independent audit regulation;
- v) Advise on development of measures of audit quality;
- vi) Any other matters that may be referred to the Committee by the executive body.

(Refer website of NFRA (<https://nfra.gov.in/sites/default/files/TAC.pdf>) for more details about the TAC).

### **3 SUMMARY AND INVITATION TO COMMENT**

#### **3.1 About the Consultation Paper**

- 3.1.1** The TAC's functions include "providing inputs from the perspectives of users, preparers and auditors of financial statements." As part of its remit and in consultation with the executive body, the TAC decided to review the current engagement of the Authority with its stakeholders, users, preparers and auditors of financial statements and others working in the public interest and recommend ways to enhance its engagement so as to achieve its objective to continuously improve the quality of all corporate financial reporting in India.
- 3.1.2** The TAC has submitted a comprehensive report of its review of NFRA's engagement with its stakeholders. The report contains the detailed description of methodology adopted, its thoughts on the financial reporting supply chain, views of stakeholders and recommendations. The report is attached as **Appendix I** to this Consultation Paper.
- 3.1.3** NFRA acknowledges the highly valuable contribution made by the members of the TAC in undertaking this activity and wishes to place on record its appreciation of the work of the TAC.
- 3.1.4** NFRA is in the process of evaluating the recommendations of the TAC and developing an action plan for implementing them in a phased manner taking into consideration their relevance to fulfilling its mandate, and its time and resource constraints.

#### **3.2 Structure of the Consultation Paper**

- 3.2.1** The Consultation Paper is organised as follows:

**Section 1:** Executive Summary

**Section 2:** Introduction-Setting the Context. This section sets the background information about the constitution of the independent accounting regulator which would be useful and relevant to stakeholders and public at large to respond to the specific questions in the Consultation Paper.

**Section 3:** Summary and Invitation to Comment.

**Section 4:** Consultation Paper- Enhancing Engagement with Stakeholders- Report of the TAC (March 2021). This section contains extracts of recommendations of the TAC in its report, NFRA's preliminary views/action plan on the specific recommendations of the TAC, and the Specific Questions for stakeholders' comments and suggestions.

**Appendix I:** Full text of the TAC's Report titled 'Enhancing Engagement with Stakeholders March 2021'.

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**3.3 Why is NFRA issuing this Consultation Paper?**

**3.3.1** NFRA and the TAC consider that it would be useful to invite the views of the wider stakeholder group and the public at large on the recommendations of the TAC, and NFRA's preliminary views. While the TAC report includes various views and expectations expressed by different stakeholders, the TAC's own recommendations are in Chapter 4 of the report. Views of stakeholders, and the public at large, are invited on these specific recommendations of the TAC and NFRA's preliminary views in this regard.

**3.4 Invitation to Comment**

**3.4.1** NFRA invites comments on specific recommendations of the TAC listed in Section 4 of the Consultation Paper.

In particular, the comments and responses would be useful if,

- a) those are given to the specific questions listed;
- b) the comments/suggestions are supported by a clear rationale; and
- c) the comments/suggestions contain alternative options that can be evaluated by NFRA.

Last date for receiving the comments is **10 July 2021**.

The comments can be provided as per the following contact details, and not later than <b>10 July 2021</b> .	
<b>Mode</b>	<b>Details</b>
Email	comments-tac.paper @nfra.gov.in
Postal	The Secretary, National Financial Reporting Authority 7th-8th Floor, Hindustan Times House, 18-20, Kasturba Gandhi Marg, New Delhi 110001.

**4. CONSULTATION ON NFRA RESPONSE TO THE REPORT OF THE TAC (MARCH 2021) “ENHANCING ENGAGEMENT WITH STAKEHOLDERS”**

<b>4.1 Recommendations of the TAC and NFRA’s Preliminary Views</b>	
<b>TAC Report Reference</b>	<b>Subject Matter</b>
<b>4.1</b>	<b>Stakeholder Engagement</b>
<b>4.1.1 to 4.1.2</b>	<b>Overall recommendation by the TAC</b>
<b>4.1.1</b>	<i>The Committee recommends the Authority’s continuous engagement with investors and other users, academics, media, preparers, and auditors by forming advisory groups and establishing fellowships.</i>
<b>4.1.2</b>	<i>Engagement with stakeholders will result in a better understanding of the stakeholders’ concerns and the Authority’s expectations.</i>
	<b>NFRA’s Preliminary Views</b>
	NFRA has been established to serve an overarching objective to protect the public interest and the interests of investors, creditors and others associated with the companies or bodies corporate. NFRA is to achieve this objective through a high-quality financial reporting framework. In order to effectively discharge this public interest role, NFRA welcomes the TAC recommendation to maintain a continuous engagement with various stakeholder groups.
<b>4.1.3 to 4.1.5</b>	<b>Formation of Consultative and Advisory Groups</b>
	<p><i>The Committee suggests setting up the following consultative and advisory groups:</i></p> <ul style="list-style-type: none"> <li><i>a. Investor Advisory Group;</i></li> <li><i>b. Academic Advisory Group;</i></li> <li><i>c. CFO Advisory Group; and</i></li> <li><i>d. Auditor Advisory Group.</i></li> </ul> <p><i>Separate groups for each of the major stakeholder categories would enable the participation of many industries, organizations, and individuals in the activities of the Authority.</i></p> <p><i>The purpose and composition of these advisory groups may be as follows:</i></p> <ul style="list-style-type: none"> <li><i>a. Investor Advisory Group:</i></li> </ul> <p><i>Purpose: To provide the Authority with the views and advice of users of financial statements.</i></p> <p><i>Size: 10 to 15 persons.</i></p>

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<b>4.1 Recommendations of the TAC and NFRA's Preliminary Views</b>	
<b>TAC Report Reference</b>	<b>Subject Matter</b>
	<p><i>Members: Equity analysts, credit analysts, fund managers, investment advisers, business journalists and lawyers.</i></p> <p><i>Eligibility: Persons with (a) extensive experience in equity analysis, credit analysis or investment advice, (b) a strong record of investor protection, professional independence, and personal integrity.</i></p> <p><i>b. Academic Advisory Group:</i></p> <p><i>Purpose: To provide the Authority with the views and advice of accounting and auditing educators.</i></p> <p><i>Size: 10 to 15 persons.</i></p> <p><i>Members: Teachers or researchers in accounting or auditing in universities, institutes or colleges.</i></p> <p><i>Eligibility: Persons with (a) extensive experience in accounting and auditing education, (b) a strong record of teaching or research, professional independence, and personal integrity.</i></p> <p><i>c. CFO Advisory Group:</i></p> <p><i>Purpose: To provide the Authority with the views and advice of preparers of financial statements.</i></p> <p><i>Size: 10 to 15 persons.</i></p> <p><i>Members: CFOs, controllers and audit committee chairs of large or medium listed entities.</i></p> <p><i>Eligibility: Persons with (a) extensive experience in preparation of financial statements, and (b) a strong record of accounting and disclosure quality, professional independence, and personal integrity.</i></p> <p><i>d. Auditor Advisory Group:</i></p> <p><i>Purpose: To provide the Authority with the views and advice of auditors of financial statements.</i></p> <p><i>Size: 10 to 15 persons.</i></p> <p><i>Members: Partners of large or medium accounting firms.</i></p> <p><i>Eligibility: Persons with (a) extensive experience in audit of large or medium listed companies, and (b) a strong record of audit quality, professional independence, and personal integrity.</i></p> <p><i>The Authority may designate an Executive Director each as the chair of the above advisory groups.</i></p>

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<b>4.1 Recommendations of the TAC and NFRA's Preliminary Views</b>	
<b>TAC Report Reference</b>	<b>Subject Matter</b>
	<i>Setting up and managing groups would call for considerable time and resources that the authority may not have in the early years. Therefore, a single group called the Stakeholder Advisory Group with 8 to 12 members drawn equally from among auditors, preparers, users and academics may be considered for the next few years.</i>
	<b>NFRA's Preliminary Views and Proposed Action Plan</b>
	NFRA recognises the importance of formal institutional structures for a sustained, focused, and productive engagement with its key stakeholders. The TAC recommendation for an initial umbrella Stakeholder Advisory Group is accepted. Membership of this Group will be by inviting nominations, as well as by selection by NFRA. Since there would be a need to include all the four main stakeholder categories that have been identified by the TAC, the number of members will be fixed at 12. A formal, yet flexible, remit, and procedures for the meetings of the Group, will be drawn up. With experience, and the build-up of NFRA's resources and capacity to service the Groups, NFRA will consider whether, and, if so how, the four focused and specialised Groups, as suggested by the TAC, will be progressively set up.
	<b>Question # 1 Formation of Stakeholder Consultation and Advisory Groups</b>
	<p>a) What would be a suitable list of subjects that should form the standing agenda of the Stakeholder Advisory Group?</p> <p>b) What would be an appropriate method for filling up positions on the Stakeholder Advisory Group?</p> <p>c) Would a single, comprehensive, Stakeholder Advisory Group lead to better quality of deliberations and advice, taken in an integrated perspective, rather than four separate groups that could, perhaps, lead to thinking in silos?</p>
<b>4.1.6</b>	<b>Fellowship Programmes</b>
	<p><i>The Authority may establish a fellowship programme in order to strengthen its interaction with practitioners and academics. Two types of fellowships may be considered:</i></p> <p><i>a. <u>The NFRA Practice Fellowships</u>: Two fellowships may be awarded annually for a term of one year on a competitive basis. Partners or staff of accounting firms and CFOs and finance and accounting staff in listed entities would be</i></p>

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<b>4.1 Recommendations of the TAC and NFRA's Preliminary Views</b>	
<b>TAC Report Reference</b>	<b>Subject Matter</b>
	<p><i>eligible to apply. The Authority would announce the topics of interest and these would typically include: application or implementation of accounting and auditing standards; auditing internal financial reporting controls'; auditing estimates, including fair value; and use of technology to improve audit quality.</i></p> <p><i>b. <u>The NFRA Academic Fellowships</u>: One fellowship may be awarded annually for a term of one year on a competitive basis. Faculty members or PhDs in economics, finance, accounting or a related area would be eligible to apply. The Authority would announce the topics of interest and these would typically include: audit firms' quality control systems; audit quality indicators; audit report communication; and preventing and detecting financial reporting fraud.</i></p>
	<b>NFRA's Preliminary Views and Proposed Action Plan</b>
	<p>NFRA appreciates the reasoning behind the TAC's recommendation. However, the resources, both financial and professional, of NFRA are not likely to be adequate, in the near, or even, medium term, to be able to design and run such a programme on a sustained basis. NFRA feels that without an assurance of such sustainability, it would not be advisable to start such a Fellowship programme. Nevertheless, there are questions about the details of such a programme on which NFRA would like suggestions/comments.</p> <p>Feedback on these issues would be of help to NFRA to design the programme.</p>
	<p><b>Question # 2 Fellowship Programmes</b></p> <p>a) Would a nominal Fellowship amount, as opposed to a full living allowance/compensation for loss of income attract high quality professionals/academics?</p> <p>b) Should the Fellowship be full-time, or part-time?</p> <p>c) If it is to be part-time, what is the kind of minimum involvement that should be insisted upon?</p> <p><b>d)</b> In the light of the above, is a one-year tenure appropriate, or should it be for a longer period? Or should it be only for a few months, and tailored to the specific subject that is chosen for study?</p>

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<b>4.1 Recommendations of the TAC and NFRA's Preliminary Views</b>	
<b>TAC Report Reference</b>	<b>Subject Matter</b>
<b>4.1.7</b>	<b>Public Speeches etc.</b>
	<i>Wherever possible, the Authority's Chairperson and Members may make use of speeches in industry or other forums to communicate their thinking on matters of interest to the stakeholders.</i>
	<b>NFRA's Preliminary Views and Proposed Action Plan</b>
	This recommendation will be acted upon whenever suitable opportunities present themselves. NFRA's communication will be based on what it understands to be the central pillars of its mandate, and the manner in which the same can be executed, and will be based on its assessment of audit quality as revealed by its reviews. NFRA would also need to reckon with the fact that the jurisprudence in this area is still to evolve and get confirmation from the highest judicial forums. Given the need to rigorously anchor its communication in the facts of extant audit quality, the build-up in communication would have to be performed gradual.
	<b>Question # 3 Public Speeches etc.</b>
	a) Do you agree with NFRA's general approach to public communication?
<b>4.2</b>	<b>Inspection, Investigation and Enforcement</b>
<b>4.2.1 to 4.2.2</b>	<i>The Committee recommends that the Authority formulate a policy for inspection and make it public.</i> <i>The proposed policy may cover the process for inspections including criteria for selection of companies and the procedure to be followed.</i>
	<b>NFRA's Preliminary Views and Proposed Action Plan</b>
	The Policy for Inspection proposed to be adopted by NFRA is at present work-in-progress. The preliminary thinking in this regard is summarised below. NFRA Rules 2018 lay down how NFRA should protect the public interest and the interests of investors, creditors and others associated with the companies or bodies corporate falling within its jurisdiction. Rule 7 to 9 of the NFRA Rules 2018 specifically require the Authority to monitor and enforce compliance with accounting standards and auditing standards and oversee the quality of audit services. These Rules also lay down the processes by which such functions are to be carried out. The <b>Inspection Programme</b> that NFRA has instituted, pursuant to the above, has two components. The components, as well as what is comprehended by each, are described below.

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<b>4.1 Recommendations of the TAC and NFRA’s Preliminary Views</b>	
<b>TAC Report Reference</b>	<b>Subject Matter</b>
	<p>1) <b>Financial Reporting Quality Reviews (“FRQR(s)”)</b></p> <p>Financial statements are presented as an integral part of the Annual Report of the Company. The Annual Report has many inter linkages amongst its constituent parts. NFRA’s primary role, as explained in Rule 4 of the NFRA Rules, is to protect the public interest and the interests of investors, creditors, and others associated with companies or bodies corporate. The Annual Report is the mechanism through which all the information required by these stakeholders is sought to be provided. The primary objective of the FRQR is to assess and evaluate how well the information needs of these stakeholders has been met.</p> <p>In undertaking the FRQR, NFRA’s role, inter alia, will include monitoring compliance with accounting standards.</p> <p>The FRQR will focus on the role of <b>preparers</b>, i.e., those responsible for the preparation of financial statements and reports in accordance with the applicable accounting standards. Therefore, the FRQR will evaluate how well the Chief Financial Officer (“CFO”), and the rest of the Management, and the Board of Directors (“BOD”) of the Company, have performed in preparing financial statements that show a true and fair view as required under the Companies Act, and in accordance with the applicable accounting standards. The FRQR will conclude with an advisory to the preparers, highlighting the matters that need improvement. In case there are violations of accounting standards and the law that require action to be taken under the law, the matter will be reported to the competent authorities.</p> <p>In order to discharge NFRA’s role effectively and efficiently, the FRQR Process will subject all important elements of the Annual Report to the four-fold tests of appropriate Recognition, Measurement, Presentation, and Disclosure, and whether they are:</p> <ol style="list-style-type: none"> <li>i. In compliance with the law and the applicable accounting standards; and</li> <li>ii. Relevant, verifiable, comparable, and understandable, as explained in the conceptual framework.</li> </ol>

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	<p>2) <b>Audit Quality Reviews (AQRs)</b> of the work performed by the statutory auditors of the companies.</p> <p>The AQR has the objective of verifying compliance with the requirements of Standards on Auditing relevant to the performance of the Engagement by the Audit Firm. The AQR also has the objective of assessing the Quality Control system of the Audit Firm and the extent to which the same has been complied with in the performance of the engagement. NFRA’s AQR process starts by asking the Audit Firm to provide to NFRA the Audit File (as defined by Para 6(b) of SA 230). Thereafter, the Audit Firm is issued a questionnaire. Once the Audit Firm provides its response to the questionnaire, the matters raised in the questionnaire are examined by referring to the relevant portion of the Audit File as identified by the Audit Firm. Subsequently, NFRA conveys its prima facie observations/comments/conclusions on the various issues in the questionnaire to the Audit Firm. Once the Audit Firm provides its response to NFRA’s prima facie observations, a Draft Audit Quality Review Report (“DAQRR”) is issued after examining the responses. The Audit Firm then submits its written reply in response to the DAQRR which is followed by a presentation to NFRA. After considering all the submissions made by the Audit Firm, NFRA completes its review and publishes the final report as mandated by the law.</p> <p>NFRA’s present thinking on the methodology and criteria for selection of companies, and focus areas, for FRQR and AQR is given below.</p> <p><b>METHODOLOGY AND CRITERIA FOR SELECTION OF COMPANIES /AUDITORS/SUBJECTS FOR FRQR and AQR</b></p> <p><b>Introduction</b></p> <ol style="list-style-type: none"> <li>1. The choice of companies/auditors/subjects for the conduct of an AQR is best done when the logic therefor is built from first principles.</li> <li>2. The NFRA framework is built around a foundational concept of PIEs. These entities are to be identified on the basis of clear public interest criteria. The objective of such identification is to set in place procedures and mechanisms for the protection of the public interest and the interests of investors, lenders,</li> </ol>

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	<p>creditors, and others are associated with and who have significant stake in the financial health of such entities.</p> <p>3. This paramount objective of NFRA is clearly enunciated in Rule 4 of the NFRA Rules, 2018.</p> <p>4. With this objective in view, Rule 3 of the NFRA Rules, 2018, lays down a skeleton framework of the criteria that should be used to identify PIEs. The criteria included in Rule 3 are essentially twofold:</p> <ul style="list-style-type: none"> <li>(i) Listing of any of the securities of a company on any recognized Stock Exchange, whether in India or abroad; and</li> <li>(ii) Public Limited Companies above a certain threshold in terms of turnover, or outstanding debt, or paid-up share capital.</li> </ul> <p>5. There are a few more criteria listed in Rule 3 which are largely subsumed in the two categories explained above.</p> <p>6. However, the scope of NFRA’s jurisdiction, as provided by Rule 3 of the NFRA Rules, 2018, is not described in sufficient detail in the said Rule as to enable the drawing up of an operational action plan for NFRA. In order to finalize the principles and the methodology that should be the basis of an operational action plan, the broad framework of considering only PIEs, defined as above, would have to be used as the starting point for a further classification that can help in drawing up the operational action plan.</p> <p>7. Keeping all the above in view, the criteria to be used in the selection methodology can be divided into two groups that may have some overlap:</p> <ul style="list-style-type: none"> <li>(i) External Impact Factors; and</li> <li>(ii) Risk of Material Misstatement (“RoMM”) Factors</li> </ul> <p>8. Each of the above two broad categories will have to be drilled down into a number of specific metrics in such a manner as to be able to assess the combined effect of all these metrics on the overall criteria. The division of the overall criteria into two broad categories as explained above is not meant to create two water tight groups but is meant to be used more as an analytical device that helps to clarify and guide the application of the methodology in an objective manner. Any metric, classified in any one category could, possibly,</p>

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	<p>have an impact on the other category as well. The methodology should provide for:</p> <ol style="list-style-type: none"> <li>i. A clear definition of the metric, so as to enable computation of its value in a consistent manner across companies;</li> <li>ii. Specific data sources for each metric, that present the same according to accepted, standard definitions;</li> <li>iii. Computation of the metric from published sources; and</li> <li>iv. A weighting diagram for integrating the numbers from all the metrics into an overall figure.</li> </ol> <p><b>External Impact Factors</b></p> <p>9. This group of factors will cover all metrics that seek to understand, identify and measure the financial impact that a company has on the economy and environment.</p> <p><b>RoMM Factors</b></p> <p>10. In this category, the attempt will be to identify metrics that can potentially predict the RoMM that may either escape the attention of auditors, or could be overlooked by auditors.</p> <p>11. In respect of each of these two broad categories of indicators, companies would be classified into one of three buckets based on substantial, moderate and low external impact in terms of the External Impact Factors, and high, moderate and average RoMM.</p> <p>12. Once the comprehensive list of metrics and their calculation methodology are detailed, a suitable method for calculating the Composite Index of the metrics under each category and the ranges for each of the three buckets under each category will have to be developed.</p> <p>13. The result of the above classification would be a 3X3 matrix:</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left;"><b>External Impact\RoMM</b></th> <th style="text-align: center;"><b>High</b></th> <th style="text-align: center;"><b>Moderate</b></th> <th style="text-align: center;"><b>Average</b></th> </tr> </thead> <tbody> <tr> <td>Substantial</td> <td style="text-align: center;">Highest priority</td> <td></td> <td></td> </tr> <tr> <td>Moderate</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Low</td> <td></td> <td></td> <td style="text-align: center;">Least priority</td> </tr> </tbody> </table>	<b>External Impact\RoMM</b>	<b>High</b>	<b>Moderate</b>	<b>Average</b>	Substantial	Highest priority			Moderate				Low			Least priority
<b>External Impact\RoMM</b>	<b>High</b>	<b>Moderate</b>	<b>Average</b>														
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	<p>NFRA will give the highest priority to companies which are in the high RoMM/substantial external impact cell. Whereas companies which are in the average RoMM/low external impact cell would normally not be subject to detailed enquiry, unless the resource position of NFRA so permits.</p> <p>14. The detailing of this methodology will be finalized based on feedback and further internal review and periodically revised, if found necessary, based on experience.</p> <p>The selection criteria of companies and audits for Inspections will also include random methods of selection so as to ensure that appropriate responses are possible to emerging situations NFRA is conscious of the need for transparency in the approach to Inspection. However, NFRA has also to consider any unintended consequences that could follow upon complete and detailed disclosure of the risk-based methodology, in terms of the potential risk of loss of the element of surprise. This could prove detrimental to the effective discharge of NFRA’s functions and duties. NFRA will disclose only the high-level principles of its Inspections approach, which is in line with the public disclosures made by its peer group e.g., Public Company Accounting Oversight Board (U.S.) (“PCAOB”), Financial Reporting Council (U.K.) (“FRC”) and Australian Securities and Investments Commission (“ASIC”).</p>
	<p><b>Question # 4 Inspection Policy</b></p> <p>a) What are your comments on the objectives and scope of the FRQR/AQR Inspection Programme?</p> <p>b) What are your suggestions regarding the Risk-Based Methodology for choice of companies as described above?</p>
<b>4.3</b>	<b>Settlement of Disciplinary Matters and Remediation</b>
<b>4.3.1 to 4.3.3</b>	<p><i>The Committee recommends that the Authority examine the desirability and feasibility of a policy on settlement of disciplinary matters.</i></p> <p><i>Under Section 132 (4), the Authority has the power to impose monetary penalty and debar an auditor or the audit firm in case of “misconduct”. This requires a determination of “misconduct” by the auditor or the firm after investigation and adjudication.</i></p>

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	<p><i>Currently, there is no provision for settlement of disciplinary matters in the Act or the Rules without such determination. Disciplinary proceedings take time, effort and resources. Litigation of disciplinary orders before courts and the National Company Law Appellate Tribunal (NCLAT) not only costs time, effort and resources but also causes uncertainty.</i></p> <p><i>Settlement of disciplinary matters would expedite enforcement action. The PCAOB and the FRC have settlement of disciplinary cases prior to adjudication. In India, SEBI has procedures for settlement of proceedings under the securities laws. The Authority may consider taking up the matter with the Government.</i></p>
	<b>NFRA's Preliminary Views and Proposed Action Plan</b>
	<p>NFRA appreciates the reasoning behind the recommendation. As clarified by the TAC itself, settlement procedures require statutory backing. NFRA will examine the matter further and take it up with the government appropriately, if found warranted.</p> <p>NFRA looks at a likely statutory settlement process as one element of a comprehensive stand-alone legislation that, ideally, should cover all aspects of NFRA's functioning. This is the pattern that has been followed in the case of other regulators as well. Any such proposed legislation should provide adequately for the institutional, functional and financial autonomy of NFRA, and provide for all the procedural safeguards necessary as far as the regulated entities are concerned. The law should also empower NFRA to fill out the operational details and requirements within its overall framework. NFRA will work on the draft of such a law.</p>
	<p><b>Question # 5 Settlement of Disciplinary Matters and Remediation</b></p> <p>a) Do you have any specific suggestions on the contents of the stand-alone law that should govern NFRA?</p>
<b>4.4</b>	<b>Communication and Advocacy</b>
<b>4.4.1-4.4.2</b>	<b>Website</b>
<b>4.4.1</b>	<i>The Committee recommends expansion of the Authority's communication and advocacy activities by redesigning its website, posting videos, starting a newsletter, and organizing webinars.</i>

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<b>4.4.2</b>	<p><i>The Authority may redesign its website to make it more informative and accessible.</i></p> <p><i>The new website should include the following:</i></p> <p><i>a. Separate tabs for auditors, preparers, investors, and academics;</i></p> <p><i>b. Videos on the Authority’s purpose, powers and functions, interviews on new accounting and auditing standards, panel discussions on implementation of accounting and auditing standards, and so on;</i></p> <p><i>c. A whistle-blower contact email address.</i></p>
	<b>NFRA’s Preliminary Views and Proposed Action Plan</b>
	<p><b>Website structure and layout</b></p> <p>NFRA considers the website to be a key means of communication of the Authority’s role and responsibilities, and to disseminate information about its various activities. NFRA agrees with the TAC that its website should serve the critical information needs of its key stakeholder groups in an effective and efficient manner. While it may be useful to consider the typical structure and layout of the Authority’s global peer group as a benchmark, the differences in the scope of functions and duties also need to be borne in mind. This will be an area of constant attention, and effort for improvement, as far as NFRA is concerned. Considering the present status, nature and volume of activities of the Authority and the scope of its role and responsibilities, the information disclosed on the Authority website is proposed to be broadly divided into following Tabs.</p> <ul style="list-style-type: none"> <li>❖ About Us+</li> <li>❖ Financial Reporting Quality Reviews</li> <li>❖ Audit Quality Reviews</li> <li>❖ Investigations and Enforcements</li> <li>❖ Standard-setting Activities</li> <li>❖ Media and Gallery</li> </ul> <p><b>Videos on the Authority’s purpose, powers and functions, interviews on new accounting and auditing standards, panel discussions on implementation of accounting and auditing standards</b></p> <p>NFRA, as an Independent Audit and Accounting regulator, is in its formative years. NFRA’s remit is different from that of some of the prominent global bodies such as PCAOB, US. Therefore, NFRA agrees that there is a need to</p>

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	<p>clearly articulate the scope of NFRA's role and responsibilities and unambiguously communicate the same to its stakeholders. Audio-visual modes such as Videos and Interviews would definitely be useful means of communication, supplementing documents published on the website. However, NFRA needs to evaluate the need for and suitability of videos on new accounting and auditing standards, and panel discussions on their implementation, bearing in mind the scope and extent of its role and responsibility in this area, and the role assigned to the relevant professional bodies. Therefore, NFRA will further examine this matter for a suitable action plan.</p> <p><b>Whistle-blower contact email address</b></p> <p>In regard to whistle-blower contact email address, NFRA wishes to clarify that there is already a separate tab titled "Public Grievance" on its website which contains detailed guidelines on the procedure for complaint handling in NFRA along with the process and documents required to be submitted along with complaint. The procedure also contains the course of action to be followed by complainant in case he wants to keep his identity details confidential.</p>
	<p><b>Question # 6 Communication and Advocacy: Website Structure and Layout</b></p> <p>a) Do you have any specific model that is ideal keeping in mind NFRA's functions and duties enshrined in the Companies Act, 2013 and the related the NFRA Rules 2018?</p>
<b>4.4.3</b>	<b>Newsletters</b>
	<i>The Authority may start a quarterly newsletter to report current developments in accounting and auditing. The newsletter can also have articles from the staff on such matters.</i>
	<b>NFRA's Preliminary Views and Proposed Action Plan</b>
	NFRA recognises the importance of Newsletters (particularly in electronic form in this technology enabled world) to remain connected with stakeholders. In relation to the purpose and contents of the Newsletters as indicated in the TAC report, NFRA will have to evaluate whether the use of Newsletters to disseminate information about accounting and auditing standards has the potential of information overload in the areas of accounting and auditing, and also the

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	potential risk of legal ramifications of interpretation of accounting and auditing standards that are part of the law in India.
	<b>Question # 7 Communication and Advocacy: Newsletters</b> a) What, in your opinion, would be the subjects/areas that Newsletters from NFRA should focus on?
<b>4.4.4</b>	<b>Webinars</b>
	<i>The Authority may organize webinars to discuss new standards and current developments. To begin with, one webinar per month may be planned and the number can be increased depending on feedback. Inviting suggestions from stakeholders would help in identifying relevant topics for webinars.</i>
	<b>NFRA's Preliminary Views and Proposed Action Plan</b>
	For the same reasons as explained above in relation to Newsletters, NFRA will examine this recommendation in detail to understand what value can be added by the webinars suggested.
<b>4.4.5</b>	<b>NFRA App</b>
	<i>An NFRA app may be developed to facilitate easy access to information.</i>
	<b>NFRA's Preliminary Views and Proposed Action Plan</b>
	NFRA's work is connected with a well-defined group of stakeholders. NFRA does not provide any services to the public at large. Nor do NFRA's activities require real time, interactive, contact with its stakeholders. Considering all this, there does not appear to be any value addition that an App would provide over what a well-designed website would. Hence, NFRA does not think that an App is necessary to facilitate easy access to information.
<b>4.4.6</b>	<b>Press and Media Guidance</b>
	<i>The Authority may provide a short non-technical note to business journalists on standards, AQRs, disciplinary orders, and other documents in order to enable them to understand the content and report the matter in a timely manner.</i>
	<b>NFRA's Preliminary Views and Proposed Action Plan</b>
	NFRA appreciates the role of Press and Media as the 4 <sup>th</sup> Pillar of Indian Democracy in the larger public interest area of quality of financial reporting and auditing. Material regularly posted on the website is designed to also assist

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	business journalists to understand the contents and import of FRQR/AQRs, disciplinary orders etc. Even currently, executive summaries are posted along with the detailed reports. In respect of AQRs and Disciplinary Orders, NFRA will be evaluating potential use of issuing Press Releases, in addition to Executive Summaries, in cases of material or significant impact to public interest.
	<b>Question # 8 Press and Media Guidance</b> a) Do you agree with NFRA's preliminary views on communication with Press and Media on reports by the Authority? Do you have any alternative suggestions?
<b>4.4.7</b>	<b>Collaboration with Universities, Institutes and Colleges</b>
	<i>The Authority may collaborate with universities, institutes and colleges for publicising its role and activities.</i>
	<b>NFRA's Preliminary Views and Proposed Action Plan</b>
	NFRA believes that academic and professional institutions associated with critical area of financial reporting are fundamental building blocks of a High-Quality Financial Reporting Framework which is a <i>sine qua non</i> for development of robust and sound economy and financial markets. These institutions can play a critical role in furthering the goals and objectives for which NFRA has been established. NFRA will explore various ways and means to collaborate with academic and professional institutions.
	<b>Question # 9 Collaboration with Universities, Institutes and Colleges</b> (a) Do you have any suggestions on viable modalities for collaboration with educational institutes?
<b>4.5</b>	<b>Data Dissemination</b>
<b>4.5.1 to 4.5.3</b>	<i>The Committee recommends making auditors' and preparers' filings with it available to the public.</i> <i>Easy access to data would enable research in accounting and auditing. In addition, the Authority may commission research on topics of interest and publish the results as working papers or discussion papers.</i> <i>The Authority may set up a database service similar to SEBI's EDIFAR (now not available) or the SEC's EDGAR for the filings with it.</i>

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	<i>The information to be made available would exclude any confidential filings and submissions.</i>
	<b>NFRA’s Preliminary Views and Proposed Action Plan</b>
	<p>a) Companies are required to file, on a periodic basis, certain important information, and documents useful to the public, with Ministry of Corporate Affairs, Government of India (“MCA”), Securities and Exchange Board of India (SEBI) and Stock Exchanges. NFRA feels that creation of multiple databases in the public domain, covering the same areas, may not be beneficial to users and it could cause confusion.</p> <p>b) As far as the filings by auditors are concerned, NFRA will examine the extent to which they can be put in the public domain, without violating any confidentiality stipulations that may be in force.</p>
<b>4.6</b>	<b>Road Map</b>
<b>4.6.1 to 4.6.3</b>	<p><i>The Committee recommends that the Authority develop a road map to guide its direction and activities and convey its priorities to stakeholders.</i></p> <p><i>The Authority may develop a road map consisting of a five-year strategic plan and an annual operating plan and publish them in advance. The road map should reflect the Authority’s priorities, resources and experience. The draft version of the road map may be issued first for public comment.</i></p> <p><i>The policy for inspection recommended in Section 4.2 may be included in the annual plan.</i></p>
	<b>NFRA’s Preliminary Views and Proposed Action Plan</b>
	<p>NFRA is of the view that the suggestion made by the TAC for developing a road map to guide its direction is of utmost importance. NFRA will endeavour to develop a</p> <p><b>1)Strategic Plan</b> covering a time horizon of Five Years say 2022-2027. The overall theme of the Strategic Plan will be “Institutional Development for Delivering on NFRA’s Mandate”. This will be achieved through the following Five Strategic Goals.</p> <p><b>GOAL 1</b> Effective and Efficient Operating Model for Monitoring Audit Quality and Financial Reporting, and Enforcing Compliance.</p> <p><b>GOAL 2</b> Develop High Calibre Technical Resources</p>

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	<p><b>GOAL 3</b> Promote Awareness, Establish Stakeholder Engagement, And Enhance Transparency/Accessibility</p> <p><b>GOAL 4</b> Standard-Setting – Accelerate Convergence with Global Best Frameworks</p> <p><b>GOAL 5</b> Build Global Partnerships and Contribute in Global Initiatives</p> <p><b>2)Operating Plan:</b> In order to achieve the goals and priorities set in the Strategic Plan referred above, a comprehensive, but achievable and measurable, operating plan is proposed to be developed and operationalised. This instrument will have detailed plans and actions including the resources required.</p> <p>NFRA will be separately publishing the Strategic Plan for public comments and feedback.</p>
	<p><b>Question # 10 Roadmap: Strategic Plan and Operating Plan</b></p> <p>(a) Do you have any suggestions on NFRA’s Strategic Goals and Priorities for the medium term?</p>
<b>4.7</b>	<b>Building Regulatory Capacity</b>
<b>4.7.1 to 4.7.4</b>	<p><i>The Committee recommends that the Authority build up its capacity steadily in the next five years.</i></p> <p><i>The staffing plan may describe the number of personnel, levels and skills and the timeline for recruitment and training.</i></p> <p><i>Regular training should help the staff be up to date in their area of work and increase their productivity. Annual training hours may be specified and included in the performance appraisal. The Committee suggests a minimum of 100 hours for each member of the staff. The topics and hours of training would depend on the current and expected responsibilities of the staff and should also be related to their long-term career progression. Typically, the training calendar should have accounting and auditing standards, business law, inspection and investigation procedures, forensic investigation, technological developments, analytical tools and techniques, written communication and report writing, team working, operations management, and so on.</i></p>

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	<p><i>The Authority may consider two-way short-term staff exchanges with auditors and preparers and leading overseas regulators such as the PCAOB and the FRC.</i></p> <p><i>Appropriate legal and ethical arrangements should be put in place for exchange of staff in order to ensure confidentiality and eliminate potential conflict of interest and excessive familiarity that could impair objectivity.</i></p>
	<b>NFRA's Preliminary Views and Proposed Action Plan</b>
	<p><b>Human Resources</b></p> <p>NFRA's role and responsibility is crucially dependent on its technical competence, and its ethical standards. As a result, Human resource management is a key pillar in NFRA's success. As part of its Operating Plan, NFRA will address this area in a holistic manner.</p> <p><b>Training</b></p> <p>The world of financial reporting and auditing needs to rapidly change to keep pace with technology, and new methods and practices of globalised businesses over a period of time and continues to evolve in line with trade, commerce and information technology. Certain areas of financial reporting require specialist skill-sets relating to finance and risk management. While NFRA has already initiated training programmes for its professional staff, NFRA agrees with the TAC recommendations to develop and implement well-designed and structured training programmes that comprehensively cover areas that are relevant and important to the staff in NFRA.</p> <p><b>Short-term staff exchanges with Auditors, Preparers and Global Peer Group</b></p> <p>While NFRA agrees that staff exchanges with Auditors and Preparers could potentially be of benefit, an important factor to consider is any unintended impact it could have on Independence. Initially, therefore, NFRA would prioritise staff exchange programmes with global peer groups. The best, and most effective methods of exchanges with auditors and preparers that can lead to mutual benefit, without any compromises, would require examination before they can be adopted.</p>

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	<p><b>Question # 11 Building Regulatory Capacity</b></p> <p>a) Do you agree with NFRA’s overall approach to building regulatory capacity, as explained above? Or do you feel that this approach needs to be different, and, if so, how?</p>
<b>4.8</b>	<b>Decision-making</b>
<b>4.8.1 to 4.8.3</b>	<p><i>The Committee recommends that the Authority ensure transparency in decision making.</i></p> <p><i>The Authority may publish a handbook containing the various steps to be followed in reaching decisions.</i></p> <p><i>Rule 17 of the NFRA Rules, 2018 provides for maintenance of “complete confidentiality and security of the information provided” to the Authority and persons and organizations associated with it. Therefore, the Committee does not make any recommendation in this regard.</i></p>
	<b>NFRA’s Preliminary Views and Proposed Action Plan</b>
	<p>NFRA agrees with the TAC’s view about the need for maintaining confidentiality and security of the information provided to NFRA. The steps in the FRQR/AQR processes have already been detailed above in paragraph 4.2 above. The various steps to be followed in Disciplinary Proceedings are laid down in Rule 11 of the NFRA Rules.</p>
<b>4.11</b>	<b>Independence, Funding and Accountability</b>
<b>4.11.1</b>	<p><i>Currently, the Authority is fully funded by the Government (Ministry of Corporate Affairs). Any changes in funding arrangements would require amendments to the law. The independence of the Authority is guaranteed by the Companies Act, 2013 and NFRA Rules. In particular, sub-sections (3A) and (3B) of section 132 protect the objectivity, integrity and independence of the monitoring, compliance review, and disciplinary processes, and prevent the capture of the regulator by the regulated entities and the accounting industry associations. As for accountability, the section provides for submission of an annual report on its activities to Parliament. These matters are outside the scope of this report.</i></p>

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<b>4.1 Recommendations of the TAC and NFRA's Preliminary Views</b>	
<b>TAC Report Reference</b>	<b>Subject Matter</b>
	<b>NFRA's Preliminary Views and Proposed Action Plan</b>
	While NFRA is broadly in agreement with the above views of the TAC, it is of the opinion that these matters need to be specified by a stand-alone legislation, as explained in response to paragraph 4.3 above.

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<b>Section 4.2 Summary of Questions for Respondents</b>	
<b>TAC Report Reference</b>	<b>Subject Matter</b>
<b>4.1.3 to 4.1.5</b>	<b>Question # 1 Formation of Stakeholder Consultation and Advisory Groups</b>
	<p>a) What would be a suitable list of subjects that should form the standing agenda of the Stakeholder Advisory Group?</p> <p>b) What would be an appropriate method for filling up positions on the Stakeholder Advisory Group?</p> <p>c) Would a single, comprehensive, Stakeholder Advisory Group lead to better quality of deliberations and advice, taken in an integrated perspective, rather than four separate groups that could, perhaps lead to thinking in silos?</p>
<b>4.1.6</b>	<b>Question # 2 Fellowship Programmes</b>
	<p>a) Would a nominal Fellowship amount, as opposed to a full living allowance/compensation for loss of income attract high quality professionals/academics?</p> <p>b) Should the Fellowship be full-time, or part-time?</p> <p>c) If it is to be part-time, what is the kind of minimum involvement that should be insisted upon?</p> <p>d) In the light of the above, is a one-year tenure appropriate, or should it be for a longer period? Or should it be only for a few months, and tailored to the specific subject that is chosen for study?</p>
<b>4.1.7</b>	<b>Question # 3 Public Speeches etc.</b>
	a) Do you agree with NFRA's general approach to public communication?
<b>4.2.1 to 4.2.2</b>	<b>Question # 4 Inspection Policy</b>
	<p>a) What are your comments on the objectives and scope of the FRQR/AQR Inspection Programme?</p> <p>b) What are your suggestions regarding the Risk-Based Methodology for choice of companies as described above?</p>
<b>4.3.1 to 4.3.3</b>	<b>Question # 5 Settlement of Disciplinary Matters and Remediation</b>
	a) Do you have any specific suggestions on the contents of the stand-alone law that should govern NFRA?
<b>4.4.1 to 4.4.2</b>	<b>Question # 6 Communication and Advocacy: Website Structure and Layout</b>

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	a) Do you have any specific model that is ideal keeping in mind NFRA's functions and duties enshrined in the Companies Act, 2013 and the related NFRA Rules 2018?
<b>4.4.3</b>	<b>Question # 7 Communication and Advocacy: Newsletters</b> a) What, in your opinion, would be the subjects/areas that Newsletters from NFRA should focus on?
<b>4.4.6</b>	<b>Question # 8 Press and Media Guidance</b> a) Do you agree with NFRA's preliminary views on communication with press and media on reports by the Authority? Do you have any alternative suggestions?
<b>4.4.7</b>	<b>Question # 9 Collaboration with Universities, Institutes and Colleges</b> a) Do you have any suggestions on viable modalities for collaboration with educational institutes?
<b>4.6.1 to 4.6.3</b>	<b>Question # 10 Roadmap: Strategic Plan and Operating Plan</b> a) Do you have any suggestions on NFRA's Strategic Goals and Priorities for the medium term?
<b>4.7.1 to 4.7.4</b>	<b>Question # 11 Building Regulatory Capacity</b> a) Do you agree with NFRA's overall approach to building regulatory capacity, as explained above? Or do you feel that this approach needs to be different, and, if so, how?

**Appendix I**

**Enhancing Engagement with Stakeholders**

**Report of Technical Advisory Committee (March 2021)**

**Technical Advisory Committee  
National Financial Reporting Authority**

**Enhancing Engagement with  
Stakeholders**

**March 2021**



सत्यमेव जयते

Government of India

**Government of India  
Ministry of Corporate Affairs**

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## Report on Enhancing Engagement with Stakeholders

New Delhi, the 28<sup>th</sup> March, 2021

To

Honourable Chairperson  
National Financial Reporting Authority  
Government of India  
Ministry of Corporate Affairs  
New Delhi

Sir,

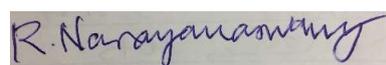
It is our privilege and honour to present the Report on **Enhancing Engagement with Stakeholders** of the Technical Advisory Committee of the National Financial Reporting Authority. The Committee was set up under rule 15 of the NFRA Rules, 2018 by Office Memorandum No. NF-12042/3/2020 dated July 17<sup>th</sup>, 2020.

2. The Report provides a review of the current engagement of the Authority with its stakeholders – users, preparers and auditors of financial statements and others working in the public interest – and recommends ways to enhance its engagement so as to achieve its objective.

4. The Committee met with various stakeholders in order to understand their problems, concerns and expectations in accounting and auditing regulation.

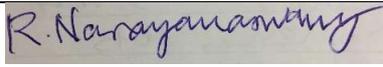
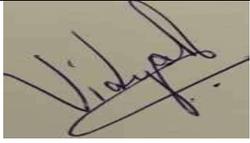
5. We thank you for providing us the opportunity to study the matter.

Yours sincerely,



Dr. R. Narayanaswamy

Chair, Technical Advisory Committee, National Financial Reporting Authority

 Dr. R. Narayanaswamy Chair		
 Vidya Rajarao Member	 Gargi Ray Member	 Anantha Narayan Member
 Shriram Subramanian Member	 S. Subramaniam Member	 Suhas Tuljapurkar Member

## **Acknowledgments**

The Committee thanks all the stakeholders who provided valuable insights into the practice of accounting and auditing by responding to its questionnaire and interacting with it. The complete list appears in Appendix B.

Ms. Janani Sri Sree Ganesh, Pre-doctoral Research Associate, Indian Institute of Management, Bangalore collated questionnaire responses and meeting proceedings. Ms. Kavitha Sandeep, Secretarial Administrative Assistant, Indian Institute of Management, Bangalore provided valuable secretarial and administrative support.

The Committee is grateful to the Chairperson, Member and Officers of the National Financial Reporting Authority for their extremely useful feedback on an earlier draft of the report.

The usual disclaimer on errors applies.

## **List of Abbreviations and Acronyms**

AQI	Audit quality indicator
AQR	Audit quality review
Authority	National Financial Reporting Authority
Big Four	Deloitte, EY, KPMG and Price Waterhouse network audit firms
CCI	Competition Commission of India
CFO	Chief financial officer
ESG	Environmental, social and governance
FASB	Financial Accounting Standards Board
FRC	Financial Reporting Council (U.K.)
IASB	International Accounting Standards Board
ICAI	The Institute of Chartered Accountants of India
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
IFRS	International Financial Reporting Standards
Ind AS	Indian Accounting Standards
IRDAI	Insurance Regulatory and Development Authority of India
ISA	International Standards of Auditing
LLP	Limited Liability Partnership
MCA	Ministry of Corporate Affairs
NBFC	Non-banking finance company
NCLAT	National Company Law Appellate Tribunal
NFRA	National Financial Reporting Authority
NSE	National Stock Exchange
PCAOB	Public Company Accounting Oversight Board (U.S.)
PFRDA	Pension Fund Regulatory and Development Authority of India
RBI	Reserve Bank of India
SA	Standards of Auditing
SEBI	Securities and Exchange Board of India
SEC	Securities and Exchange Commission (U.S.)
SFIO	Serious Fraud Investigation Office
TRAI	Telecom Regulatory Authority of India
XBRL	eXtensible Business Reporting Language

## Chapter 1

### Introduction and Background

#### 1.1 Introduction

1.1.1 The National Financial Reporting Authority (hereafter the Authority) is the first independent regulator for accounting and auditing in India.<sup>1</sup> It was set up in 2018 under section 132 of the Companies Act, 2013. Its mandate is to protect the public interest, and the interests of investors, creditors and others who use financial statements of companies and other entities. Its objective is “to continuously improve the quality of all corporate financial reporting in India.”<sup>2</sup>

It has to achieve this objective by:

- (a) establishing high quality accounting and auditing standards; and
- (b) exercising effective oversight of accounting functions performed by companies and auditing functions performed by auditors.

1.1.2 The Authority has set up the Technical Advisory Committee (hereafter the Committee) under rule 15 of the NFRA Rules, 2018 to advise on matters related to accounting and auditing standards.<sup>3</sup> The Committee’s functions include “providing inputs from the perspectives of users, preparers and auditors of financial statements.” As part of its remit and in consultation with the Authority, the Committee decided to review the current engagement of the Authority with its stakeholders – users, preparers and auditors of financial statements and others working in the public interest – and recommend ways to enhance its engagement so as to achieve its objective.

#### 1.2 Composition of the Committee

1.2.1 The Committee’s composition is as follows:

- |   |        |
|---|--------|
| 1. Dr. R. Narayanaswamy, Professor, Indian Institute of Management, Bangalore           | Chair  |
| 2. Ms. Vidya Rajarao, Founder, Fraudopedia  | Member |
| 3. Ms. Gargi Ray, CFO, Infosys Consulting   | Member |
| 4. Mr. Anantha Narayan, Former Director of Research at Credit Suisse and Morgan Stanley | Member |
| 5. Mr. Shriram Subramanian, MD, InGovern  | Member |

<sup>1</sup> <https://nfra.gov.in> accessed on March 24, 2021.

<sup>2</sup> <https://nfra.gov.in/charter-national-financial-reporting-authority> accessed on March 24, 2021.

<sup>3</sup> <https://nfra.gov.in/sites/default/files/TAC.pdf> accessed on March 24, 2021.

- |   |        |
|---|--------|
| 6. Mr. S. Subramanian, CFO, Titan Company Limited   | Member |
| 7. Mr. Suhas Tuljapurkar, Managing Partner, Legasis | Member |

### **1.3 Method of Work**

- 1.3.1 At its second meeting on December 21, 2020, the Committee decided to examine the Authority's engagement with its stakeholders.
- 1.3.2 As a first step, a questionnaire was sent to selected auditors, preparers and users of financial statements.
- 1.3.3 Next, the Committee met with questionnaire respondents who were willing to participate. The online meetings lasted two hours. Participants were requested to give their views on the current engagement of the Authority with them and suggest ways of enhancing engagement in future. A summary of the main points from the meetings that came up in the meetings was sent to them for their record.
- 1.3.4 A draft report was prepared after studying the inputs from the meetings and questionnaire responses and circulated to the Committee. The Committee approved the draft report with changes. The final report was submitted to the Authority.

### **1.4 Organization of this Report**

- 1.4.1 Chapter 2 describes the financial reporting supply chain and the role of the Authority as a background to understanding the rest of the report. Chapter 3 presents the views expressed by the stakeholders in the meetings and in their responses to the questionnaire. Chapter 4 gives the Committee's recommendations. Chapter 5 concludes.

### **1.5 Disclaimers**

- 1.5.1 *The Committee wants to state that the views expressed in this report are its own and not necessarily those of the Authority or the Government. The views of the participants who interacted with the Committee or responded to its questionnaire are their own and are not necessarily those of their organizations.*

## Chapter 2

### The Financial Reporting Supply Chain

#### 2.1 The Transformation of Financial Reporting

2.1.1 Financial reporting in India underwent a profound transformation in the decade 2011-2020 as a result of radical changes in regulations, technology, and capital markets. The following are notable:

- Adoption of Ind AS (Indian Accounting Standards), the Indian version of International Financial Reporting Standards (IFRS), giving them legal force;
- Adoption of SA (Standards of Auditing), the Indian version of International Standards of Auditing (ISA), giving them legal force;
- Introduction of mandatory auditor and audit firm rotation;
- Prohibition on auditor's provision of certain non-audit services;
- Requirement of auditor's report on company's internal financial controls;
- Issue of Listing Obligations and Disclosure Regulations (LODR) with more powers and responsibilities for audit committee members and independent directors;
- Establishment of the Authority, India's first independent regulator of accounting and auditing;
- Ban on two Big Four firms by Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI);
- Filing of charges by the Serious Fraud Investigation Office (SFIO) against Deloitte Haskins & Sells (affiliate of the Deloitte network) and BSR and Associates (affiliate of the KMPG network) with failure in the audit of IL&FS Financial Services;
- Increasing role of blockchain, cloud computing, analytics, artificial intelligence, machine learning, and big data in accounting and auditing;
- Widespread use of non-GAAP (or pro forma) earnings measures by preparers and users;
- Rise of digital media in dissemination of information.

2.1.2 The past decade has been like no other in the breadth and depth of the changes in the financial reporting landscape in India. It is safe to think that auditors, preparers, and users are still absorbing the effect of these changes and taking time to work out their responses.

## **2.2 The Financial Reporting Supply Chain**

2.2.1 The International Federation of Accountants (IFAC) describes the financial reporting supply chain as follows:

The financial reporting supply chain refers to the people and processes involved in the preparation, approval, audit, analysis and use of financial reports. All links in the chain need to be of high quality and closely connected to supply high quality financial reporting. The cycle both starts and ends with the investors and other stakeholders, who want to make informed economic decisions about a company and, therefore, require financial information to do so. Subsequently, it is management that, under the general direction of the board of directors (supervisory board), prepares the financial information for eventual approval by the board and, in some countries, the general meeting of shareholders. The auditors interact with management and the board while auditing the financial information and provide independent opinions. The media and others distribute financial information, and analysts and credit-rating agencies evaluate it, to be used by the investors and other stakeholders.<sup>4</sup>

2.2.2 Auditors, preparers, users, and, if we may add, regulators and academics, constitute the financial reporting supply chain.

## **2.3 Auditors**

2.3.1 Auditors provide independent assurance to the shareholders that the directors and managers have prepared the financial statements properly and that the financial statements give a true and fair view. Auditors are information intermediaries between preparers and users. Paragraph 3 of SA 200 states:

The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.<sup>5</sup>

Competent and independent auditing is vital to public confidence in the functioning of business organizations and capital markets.

2.3.2 Over the years, a number of auditing standards have been issued providing a better measure of audit quality. Prohibition on the provision of certain non-audit services by the auditor, mandatory auditor rotation, and reporting on internal financial controls with

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<sup>4</sup> The International Federation of Accountants, *Financial Reporting Supply Chain*, New York, 2008.

<sup>5</sup> SA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing*, The Institute of Chartered Accountants of India, New Delhi, 2008.

reference to financial statements by the auditor are designed to strengthen auditor independence and raise audit quality.

- 2.3.3 Despite these regulatory advances, there are serious concerns about audit quality and auditor independence, as symbolised by the controversies involving IL&FS entities, DHFL, Reliance Capital, GVK Power, Yes Bank, and others. Put mildly, auditing faces a crisis of confidence. Its continued relevance as a social and economic institution depends squarely on its ability to keep an uncompromising focus on audit quality and independence.
- 2.3.4 Auditors talk of an ‘expectation gap’ between them and the users of financial statements. It may be a good idea to explain what an audit is and what it is not. However, the effort should be to fill the ‘gap’ by raising the standards of performance and conduct rather than lowering the ‘expectation’.<sup>6</sup>
- 2.3.5 There are complex matters that require tricky assumptions, estimates and judgments. Here auditors have been found to be wanting in applying ‘professional scepticism’, an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. In this context, auditors’ acceptance of management representations and reliance on the work of experts figure frequently in regulators’ disciplinary orders.<sup>7</sup>
- 2.3.6 Auditors vary widely in size ranging from large, industrial-scale LLPs with scores of partners and thousands of staff to small-scale partnerships and microscale single-person outfits. Table 2.1 presents the share of the Big Four in audit of companies listed in the National Stock Exchange based on number of companies and on market capitalization in fiscal year 2020-21.

<b>Table 2.1</b>		
<b>Share of Big Four in Audit of Listed Companies, Fiscal Year 2020-21</b>		
<b>Reference Group</b>	<i>Per cent to Reference Group Total</i>	
	<b>Number</b>	<b>Market Capitalization</b>
NSE 200 Index	26	70
NSE 500 Index	57	68

Source: *primeinfobase.com*<sup>8</sup>

<sup>6</sup> According to a survey by Institutional Investor Advisory Services, a proxy advisory firm, 57 per cent of investors and analysts do not have any faith in the Big Four. “57% investors say Big-4 auditors have no credibility: IiAS survey” *The Economic Times* May 20, 2020.

<sup>7</sup> A recent example is the finding of lack of professional scepticism, among other things, by the U. K. Disciplinary Tribunal in the audit of Autonomy PLC by the auditor, Deloitte in 2020.

<sup>8</sup> We thank Mr. Sundaresha Subramanian of The Economic Times for making this analysis available.

Large companies may have limited choice of auditors, because they believe that there are just a handful of firms that have the scale, technology, expertise and investor acceptability to audit them.

- 2.3.7 Auditors use blockchain, cloud computing, analytics, artificial intelligence, machine learning, and big data. Drones, robotics, and augmented reality have considerable potential for use in auditing. The bigger accounting firms are already spending billions on technology.<sup>9</sup> The high cost of investment in technology is bound to widen the difference between the Big Four and the others.
- 2.3.8 The flip side of technological advances is that audit firms may have to compete with technology firms in auditing. The data gathering phase of auditing can be split from analysis of the data and outsourced to technology firms at a lower cost. While technology has the potential to make auditing more effective, companies around the world are eyeing big tech consulting firms like Accenture and IBM as audit alternatives to the Big Four accounting firms.<sup>10</sup>
- 2.3.9 Poor audit quality and lack of independence make auditing a weak link in the financial reporting supply chain and it needs fixing, *here and now*. To be sure, it is not the only weak link and there are others, as discussed below.

## **2.4 Preparers**

- 2.4.1 The steps in the preparation of financial statements are as follows:
1. Managers prepare the financial statements.
  2. The audit committee reviews the financial statements and recommends them to the board.
  3. The board approves the financial statements.
- 2.4.2 Management's performance and rewards depend in part on the numbers in the financial statements. So it is inherently conflicted in the preparation of financial statements. The audit committee consisting solely or largely of independent directors is expected to exercise oversight on financial reporting by reviewing the financial statements independently and taking up its concerns with the external auditors. SEBI's LODR gives audit committees and boards considerable powers and makes them accountable. If the spate of accounting scandals in listed companies is any indication, this process doesn't appear to be working well. Corporate governance in practice needs to be

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<sup>9</sup> Mathew Vincent, Accountants see IT investment pay off in pandemic, *Financial Times*, January 25, 2021.

<sup>10</sup> <http://www.canadian-accountant.com/content/business/is-big-tech-a-threat-to-big-four-audit> accessed on March 24, 2021.

strengthened by adhering to the spirit rather than the letter of the law. According to investment advisers, accounting quality is the most underestimated investment risk in India.<sup>11</sup>

- 2.4.3 The annual report contains the financial statements, directors' report, and management discussion and analysis. The annual report is considered long and difficult to read and to have redundant material. Layers of reporting have been added over the years including the business responsibility report introduced recently. As a result, there is information overload. Nevertheless, there are demands from institutional investors for additional information such as the ESG (environmental, social and governance) disclosures. All of these have made it hard for many users to focus on the important parts of the annual report and the financial statements, in particular. Preparers may have to think of ways of making reports shorter, yet informative.
- 2.4.4 Standards have become more complex, especially after the implementation of Ind AS. For example, Ind AS 109 requiring fair value accounting has increased subjectivity in management's accounting policy decisions. Changes in laws and unexpected events have created the need for guidance on matters not dealt with earlier. These include the new Labour Code and the disruption caused by covid-19.
- 2.4.5 A non-GAAP, or pro forma, measure excludes (includes) items that are (are not) a part of the comparable measure in the GAAP financial statements. EBIT (earnings before interest and tax), EBITDA (earnings before tax, depreciation and amortization) and EBITDAR (earnings before tax, depreciation, amortization and restructuring or rental) are commonly used non-GAAP financial measures. Companies have used EBITDAC (earnings before tax, depreciation, amortization and covid-19) to mask dismal business results.<sup>12</sup> Pro forma measures reported by Indian companies include value added, human resources and brand valuation, and oil and gas reserves, besides the ones mentioned above.<sup>13</sup>
- 2.4.6 Pro forma measures have reduced the importance of reported profit and earnings per share and could potentially mislead the users of financial statements. Regardless of their problems, pro forma measures will not go away. In fact, because they are oversimple

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<sup>11</sup> Saurabh Mukherjea and Ashvin Shetty, "The central role of accounting quality in investment decisions", *BloombergQuint*, February 4, 2020.

<sup>12</sup> Sachin Dave and Vinod Mahanta, Companies using Covid-19 adjustments to shore up numbers, *The Economic Times*, June 6, 2020.

<sup>13</sup> R. Narayanaswamy, The Use and Abuse of Non-GAAP Financial Measures: An Exploratory Study of Indian Companies. Working paper, 2021. [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3807818](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3807818) accessed on March 24, 2021.

as compared to GAAP performance measures, they are bound to become even more popular.

- 2.4.7 Most companies make their reports available on their websites. Online reporting is not just uploading a pdf file. The high potential of online reporting including explanatory videos and interactive features is not fully realized.
- 2.4.8 Users complain that the financial statements comply with the letter of the law rather than its spirit. The effort seems to be aimed at ticking the boxes for compliance with the accounting standards and other requirements. As a result, financial statements are not much useful to them in making decisions.
- 2.4.9 Transaction processing is highly automated. Artificial intelligence and machine learning have made it possible to analyse and process all kinds of transactions including those that would seem to need judgment. As a result, year-end procedures have become less tedious and financial statements can be prepared faster than in the past.
- 2.4.10 Mandatory audit firm rotation is associated with increased market share of the Big Four.<sup>14</sup> The RBI's ban on EY affiliate S R Batliboi from auditing banks for one year<sup>15</sup> and SEBI's ban on various PwC affiliates from auditing listed companies for two years<sup>16</sup> further reduced auditor choice among the Big Four. A knock-on effect is that the Big Four may have become even more 'too big to fail'.

## 2.5 Users

- 2.5.1 The purpose of financial reporting is to provide information principally to investors and creditors that would help them make decisions. Equity analysts, credit analysts, rating agencies and proxy advisory services advise investors and creditors and are important users. It may be noted that users have access to multiple sources of financial and other information and financial reports are just one, though important, source of information.
- 2.5.2 Companies have been filing XBRL (eXtensible Business Reporting Language) financial statements for many years. The "tags" in XBRL enable automated processing of data by software and allow users to compile and format information on their own. XBRL can reduce data processing costs, improve comparability of data across companies, and increase accuracy in classification of financial statement line items.

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<sup>14</sup> Aman Kapadia. How Indian audit firms lost out to the Big 4, *BloombergQuint*, August 20, 2019.

<sup>15</sup> <https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR2848F72A702CDA0643CC9A5E414921380C90.PDF> accessed on March 24, 2021.

<sup>16</sup> <https://www.sebi.gov.in/enforcement/orders/jan-2018/order-in-respect-of-m-s-price-waterhouse-bangalore-m-s-price-waterhouse-and-co-bangalore-m-s-price-waterhouse-and-co-kolkata-m-s-lovelock-and-lewes-hyderabad-m-s-lovelock-and-lewes-mumbai-m-s-p-37354.html> accessed on March 24, 2021.

- 2.5.3 The increasing complexity of accounting standards and policies has made financial statements less intelligible to users. The use of fair value has further increased the difficulty of understanding the numbers in the financial statements. Some users may be confused by the volatility of results caused by fair value accounting.
- 2.5.4 Financial statements could lose their relevance because of the growing importance of intangible assets to businesses. Accounting does a poor job of capturing the value of what may be the most crucial assets for pharmaceutical, technology, services and consumer goods companies.
- 2.5.5 While Ind AS has increased the quantity of disclosure in the financial statements, navigating the information is not easy for an ordinary user. Over time, financial statements have come to be aimed at the professional user rather than the lay user.
- 2.5.6 Users expect auditors to be the guardians of financial reporting but feel that auditors let them down. The following quote neatly sums up users' frustration with frequent audit mishaps:
- In most instances, investors seemed to *sense* (italics in original) that something is amiss, well before an auditor raised red flags. This has been reflected in either a steadfast deterioration in the company's stock price, or a systematic contraction in the company's access to debt. Therefore, if the 'market knows' based on largely publicly available information, why are auditors – who have access to much better quality of internal information – unable to see the writing on the wall? Can what the 'market knows' be embedded into the audit process?<sup>17</sup>
- 2.5.7 Users are unconvinced when auditors disown responsibility for detecting fraud. Metaphors about watchdog and bloodhound don't find any takers in the face of a large-scale fraud. This is more so in cases like Satyam or Wirecard where even basic procedures such as external confirmation of bank balances were reportedly not followed and no deep, philosophical questions of professional judgment were involved.
- 2.5.8 Users complain about auditors churning out the same boilerplate audit reports. Arguably, the most important of the changes in auditing in recent years is the requirement to report on key audit matters following the adoption of SA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* effective for

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<sup>17</sup> Institutional Investor Advisory Services, *CIO Dialogue with Auditors*, November 2019. We thank Mr. Amit Tandon of IiAS for making this document available.

audits of financial statements for periods beginning on or after April 1, 2018. Investors can benefit from information on audit quality indicators.

- 2.5.9 Users feel that preparers are too focused on compliance with accounting standards rather than on reporting the underlying economics of the business.<sup>18</sup>

## **2.6 Regulators**

- 2.6.1 Regulators issue accounting and auditing standards, monitor compliance, and take action for non-compliance. They are designed to be insulated from the electoral pressures of the accounting industry association and so can act independently. Therefore, users often see regulators as their last hope, a shining white knight of sorts ready to rush to their rescue. For the same reason, regulatory failure is far more unacceptable than failure by auditors or preparers.
- 2.6.2 Regulators' powers to impose monetary and non-monetary penalties are powerful deterrents for auditors and preparers. Also, the fear of being named and shamed in AQR (audit quality review) reports is expected to have a chastening effect on auditors. If asked, users would undoubtedly vote for a stricter than a lenient regulator.
- 2.6.3 Regulation is also in the interests of auditors and preparers, because of the imperfections of the capital market and the audit market. Regulation raises the cost of poor reporting and auditing and thus helps to drive out inferior auditors and preparers from the market or at least set apart superior auditors and preparers from inferior ones. This addresses the 'lemons problem' in these markets. By increasing trust in financial reports, regulation can reduce the risk premium and the required rate of return and thereby raise the level of savings, investment, output, employment, taxes and public welfare.

## **2.7 Academics**

- 2.7.1 Academics use financial reports in teaching and research. They develop educational material such as textbooks and cases that explain how accounting and auditing regulations are prepared and applied in various circumstances. Even more, they can encourage critical thinking that develops the problem-solving skills of their students. Also, they study the implementation of standards and other regulations and the consequences of changes in them. Finally, academics play an important role in advocacy by providing evidence in support of reforms in the regulations and the

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<sup>18</sup> The International Federation of Accountants, *Financial Reporting Supply Chain*, New York, 2008.

institutional arrangements for education, certification and disciplining of accountants and managers.

- 2.7.2 Unlike auditors, preparers and users, generally academics have no conflict of interests. Since their remuneration and career prospects are unaffected by the positions they take on accounting and auditing matters, they are arguably more independent than the others in the financial reporting chain. As a result, their opinions are less likely to be biased.

## **2.8 Others**

- 2.8.1 The financial reporting supply chain also has professionals such as lawyers, investment bankers, and valuers. Though accounting and auditing data aggregation services are formally not a part of the financial reporting supply chain, they provide analysis of information in financial reports and play an influential role in their use.
- 2.8.2 Government authorities and regulators such as the Income Tax and Goods and Services Tax authorities, the Competition Commission of India (CCI), the Securities and Exchange Board of India (SEBI), the Reserve Bank of India (RBI), the Telecom Regulatory Authority of India (TRAI), the Insurance Regulatory and Development Authority of India (IRDAI), and the Pension Fund Regulatory and Development Authority (IRDAI) are also important users of financial reports.

## Chapter 3

### Views of Stakeholders

#### 3.1 Stakeholders in Financial Reporting

3.1.1 From the standpoint of the Authority, the following would be the key stakeholders in financial reporting:

- a. Auditors;
- b. Preparers;
- c. Users; and
- d. Academics.

3.1.2 Auditors impart credibility to the information presented in the financial reports. Preparers produce the financial reports and are primarily responsible for the accuracy and reliability of the information in them. Users are the *raison d'être* of financial reporting and, therefore, are central to its purpose. Academics use financial reports in their teaching and research. Auditors, preparers, users, and academics have significant stakes in the development of accounting and auditing regulations and in their effective monitoring and enforcement.

#### 3.2 The Consultation Process

3.2.1 The Committee consulted with auditors, preparers, users, and academics in order to understand their views on enhancing the Authority's engagement with stakeholders in financial reporting. For the purpose of this exercise, the Committee defined these groups as follows:

- a. *Auditors*: Partners in accounting firms that audit large listed companies.
- b. *Preparers*: Chief financial officers, controllers and audit committee chairs of large listed companies.
- c. *Users*: Investors, analysts, advisers, and business journalists.
- d. *Academics*: Accounting teachers and researchers from universities, institutes and colleges.

3.2.2 The Committee sent a questionnaire to a total of 50 auditors, preparers, users and academics. These individuals were identified on the basis of suggestions from the members of the Committee. The Committee would have liked to consult with a larger number and a wider spectrum of stakeholders in order to get more and diverse views. Time and resource constraints and non-availability of relevant information limited the sample size to 50.

3.2.3 Table 3.1 presents the composition of the stakeholder groups in the survey.

<b>Table 3.1</b>			
<b>Composition of Participants in the Stakeholder Survey</b>			
<b>Group</b>	<b>Questionnaire Sent <i>Number</i></b>	<b>Response Received <i>Number</i></b>	<b>Response Rate <i>Per cent</i></b>
Auditors	10	10	100
Preparers	12	6	50
Users	14	9	64
Academics	14	9	64
<b>Total</b>	<b>50</b>	<b>34</b>	<b>68</b>

3.2.4 The Committee interacted with selected respondents. Table 3.2 presents information about these interactions.

<b>Table 3.2</b>			
<b>Discussions with Stakeholders</b>			
<b>Date</b>	<b>Group</b>	<b>Description</b>	<b>Number</b>
January 13, 2021	Auditors	▪ Partners of Big Four firms	4
		▪ Partners of non-Big Four firms	4
January 15, 2021	Preparers	▪ Chief financial officers	4
		▪ Controllers	1
		▪ Audit committee chairs	1
January 18, 2021	Users	▪ Analysts	1
		▪ Advisers	3
		▪ Business journalists	4
<b>Total</b>			<b>22</b>

3.2.5 Appendix 1 contains the Committee’s questionnaire. Appendix 2 has the names and affiliations of those who responded to the questionnaire and/or participated in the discussions.

3.2.6 *This views summarised in this chapter were those of the participants as expressed in questionnaire responses and meetings. The Committee’s position is given in the form of recommendations in Chapter 4.*

### **3.3 Awareness about the Authority and Its Work**

3.3.1 Table 3.3 presents the summary response to the question “How would you describe your familiarity with the Authority and its work?”.

<b>Table 3.3</b>					
<b>Familiarity with the Authority and its Work</b>					
<b>Familiarity (Score) <sup>19</sup></b>	<b>Per cent to Total</b>				
	<b>All</b>	<b>Auditor</b>	<b>Preparer</b>	<b>User</b>	<b>Academics</b>
Very high (5)	15	30	0	11	11
High (4)	29	40	17	33	22
Moderate (3)	47	30	83	45	45
Poor (2)	9	0	0	11	22
Very poor (1)	0	0	0	0	0
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Average score (out of 5)	3.50	4.00	3.17	3.44	3.22
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The overall score of 3.50 (out of 5) would place awareness about the Authority and its activities between moderate and high. Considering that the Authority was set up in late 2018, this might seem reasonable. The high score of 4.0 for auditors could be the effect of media coverage of the Authority’s AQR reports and disciplinary orders.

3.3.2 In response to the question “Have you ever visited the Authority’s website?”, 84 per cent respondents answered in the affirmative. Not only is this very high, it also does not square with the score of 3.50 for familiarity. It’s not clear whether respondents meant visiting the website *before* or *after* receiving the questionnaire. As a result, it’s not possible to rule out error in the response contributing to a higher number of affirmative answers. Therefore, we would estimate the number to be much less than 84 per cent.

### 3.4 Expectations from the Authority

3.4.1 Stakeholders, especially preparers and users, welcomed the establishment of the Authority and hoped that it can greatly improve the quality, credibility and use of information in the financial reports. They believed that the Authority has a golden opportunity to set the standards of conduct for financial reporting and auditing and monitor and enforce compliance. They expected that in about ten years the Authority would shape into a mature and respected regulator like the RBI and SEBI in India and overseas regulators like the PCAOB and the FRC. These high expectations may indicate a strongly positive public sentiment in favour of the Authority.

3.4.2 Stakeholders observed that the introduction to the Authority happened in a grim setting in the wake of the IL&FS and the Punjab National Bank scandals. The timing might have influenced perceptions of auditors about the regulator, in turn affecting its engagement with them. Preparers stated that since international audit firms work with

<sup>19</sup> Respondents were requested to describe their familiarity with the Authority and its work as one of the following: Very high, High, Moderate, Poor, Very poor. The responses were later coded as 5, 4, 3, 2, 1, respectively.

the PCAOB and the FRC, they should have no reason to be disposed unfavourably to the regulator in India.

- 3.4.3 Stakeholders encouraged the Authority to continue aligning Indian accounting and auditing standards with IFRS (International Financial Reporting Standards) and auditing standards with ISA (International Standards of Auditing).<sup>20</sup> They wanted the Authority to work towards further reducing differences between Ind AS and IFRS by phasing out carve-outs over time. They noted that it was not clear why non-banking finance companies (NBFCs) are required to follow Ind AS but banks which are bigger and systemically more important are not.

### **3.5 India's Accounting and Audit Landscape**

- 3.5.1 Users pointed out that the quality of financial statement information is the most important consideration for investors. Since accounting has moved away from historical cost (or prudence) to fair value, the loss of verifiability of the numbers has conceivably made the work of auditing harder.
- 3.5.2 They felt that many audit failures are caused by auditors compromising on independence in order to obtain non-audit services. While bigger firms have the skills to do quality audits, they may lack independence in some cases. Also, there has been very little effective peer review of audits.
- 3.5.3 Class action by shareholders or creditors is difficult in India because the threshold is high and there is no provision to recognize a lead plaintiff. Therefore, users rely far more on the regulator's work than in other jurisdictions such as the United States where class action is an economical and easy option. The Authority has a special responsibility in this situation. Since the Authority does not work for anyone in the financial reporting process, it has independence.
- 3.5.4 Stakeholders stated that questions about the constitutional validity of the Authority should be resolved early for it to become fully effective.

### **3.6 Scope of the Authority's Work and Relation to Other Regulators**

- 3.6.1 Stakeholders expected the Authority to define the scope of its work and the entities covered by it. In particular, auditors proposed that the Authority's scope should include preparers, since management and board are primarily responsible for the preparation of financial statements and the establishment and operation of internal controls.

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<sup>20</sup> IFRS and ISAs are issued by the International Accounting Standards Board and International Auditing and Assurance Standards Board, respectively. They are followed, with or without modifications, in many countries.

- 3.6.2 Stakeholders observed that dealing with multiple regulators was a problem and wanted the Authority to clarify its scope. In particular, they wanted the Authority to define its relationship and overlap with other regulators such as the RBI, SEBI, and the IRDAI in matters such as accounting standards and auditor regulation. This is necessary to reduce uncertainty about the activities of the various regulators and the compliance burden. For this purpose, stakeholders suggested regular consultations among the various regulators.
- 3.6.3 It was felt that the Authority should clarify its role and responsibilities and how it was different from The Institute of Chartered Accountants of India (ICAI) as it seemed that some responsibilities in auditor regulation could be overlapping. The Authority should clearly focus on the purpose for which it has been formed, take stock of what it has done, and set out its plans to achieve its purpose.

### **3.7 Engagement with Stakeholders**

- 3.7.1 Stakeholders noted that the Authority has had little interaction with them so far. They were of the view that the Authority should engage with auditors, chief financial officers, investors, fund managers, analysts, advisers, independent directors, audit committee chairs and members, chief executives, and others connected with financial reporting.
- 3.7.2 They felt that engagement will help the Authority to inspire trust in and appreciation of its approach, expectations, competence, methods and actions. Regular engagement and consultation between the Authority and the stakeholders would be very useful in improving the quality of financial reporting. They noted that older regulators in India such as the RBI and SEBI and overseas regulators such as the PCAOB and the FRC regularly interact with their stakeholders on standards and implementation problems and have established mechanisms for the purpose.
- 3.7.3 Stakeholders thought that active engagement will be seen as a strong sign of the Authority's strength. At the same, they cautioned that engagement should not compromise the Authority's independence. Therefore, matters specific to individual auditors, audit firms or companies should not be part of engagement. They felt that regular engagement could help to reduce auditors' and preparers' unfounded and unhealthy fears and anxieties. There is an apprehension about the Authority in the audit community partly due to lack of information. The best way for the Authority to dispel this fear is to share its expectations and create more awareness of its work.
- 3.7.4 Stakeholders suggested several ways of engagement. Speeches at conferences and industry forums by the Chairperson and Members of the Authority can be used to

express the Authority's point of view on emerging issues and can lead to fruitful discussions. They wanted the Authority to raise its public profile by holding seminars and conferences. Regular meetings with the audit community can help in improving understanding of the Authority's AQR process. Business journalists urged the Authority to engage actively with print, electronic and digital news media. They stated that regular engagement with them was necessary for the Authority in order to reach the public.

- 3.7.5 There should be open discussions with stakeholders on all matters. The Authority could consider publishing the minutes of its meetings on matters relating to common interests of stakeholders.
- 3.7.6 It was felt that the Authority should consider public consultation on accounting and auditing standards, publish comments received, and provide feedback on implementation of standards.

### **3.8 Decision-making**

- 3.8.1 Stakeholders wanted the Authority to ensure transparency in decision-making. For this purpose, they wanted it to make public the process to be followed in reaching decisions, especially those that might result in major changes from current practices. Also, they asked for clarity on rule-making, suggesting that a good way would be to have extensive public consultations and receive inputs. The process could include preliminary consultations, issue of discussion paper, and response to comments on discussion paper with adequate time given for these activities.
- 3.8.2 On the Authority's inspections and investigations, stakeholders would like to see a graded procedure of request for information, inquiry, comment letter, response to comment letter and action may be followed.
- 3.8.3 In order to avoid confusion and panic in the market, it was suggested that the Authority may note in its communication to auditors and preparers that there is no implication of wrong-doing until it makes a decision.
- 3.8.4 The Authority should clarify how it initiates investigations i.e. on its own, on a whistleblower complaint, in response to a reference from the Government or based on news reports. A group of two or more senior officers instead of one may be entrusted with responsibility for investigations in order to avoid bias.
- 3.8.5 The Authority should put in place safeguards to ensure complete confidentiality of information in audit workpapers.

3.8.6 Academics suggested consultations with them as part of plans to issue new standards. They wanted the Authority to sponsor academic studies on topics that are relevant to its agenda. They felt that academic research can be a useful input into decision-making. They proposed setting up academic and practice fellowships in order to foster greater collaboration. They suggested that the Authority give its views and priorities, since these would be helpful as sources of research topics for doctoral students in accounting and finance.

### **3.9 Providing Guidance**

- 3.9.1 Auditors and preparers emphasised the need for the Authority's guidance on issues faced by them in their work. They mentioned new standards such as revenue and leases and the unusual circumstances such as covid-19 as examples. Further, preparers mentioned about matters such as physical verification of assets during the time of covid-19 and the major changes in labour laws. Auditors and preparers wanted timely guidance on accounting for the effect of changes in the gratuity law and investment in equity instruments by provident fund trusts.
- 3.9.2 Guidance on the information to be provided in the directors' report/MD&A, financial statements and notes would be useful. The FRC provides such guidance.
- 3.9.3 Auditors said that it would be useful to know the Authority's view of laws in advance when it is different from what is generally understood, so that there can be greater conformity with its interpretation.
- 3.9.4 Auditors and preparers stated that the Securities and Exchange Commission (SEC) has a special wing that gives guidance on queries. It is even possible to approach the Chief Accountant of the SEC for guidance. A similar arrangement here would be useful. For this purpose, the Authority should work towards becoming a repository of high-quality technical expertise.
- 3.9.5 Users said that it would be useful to have guidance on non-standard accounting practices and cases of accounting frauds. Academics stated that they would find guidance on issues concerning non-standard accounting practices followed by various entities, common auditing lapses, cases of accounting frauds, diversion of funds cases useful. Articles on developments in international accounting, including the latest accounting scandals and the way they were handled by the respective regulators would be valuable.

3.9.6 Stakeholders wanted the regulator to publish a digest of findings or observations on common mistakes, lapses and shortcomings reported by auditors or noticed by the Authority.

3.9.7 The Authority should publish position papers and practice alerts which will guide preparers and auditors.

### **3.10 Settlement and Remediation**

3.10.1 Auditors were of the view that while monetary penalty and debarment from practice were important, they were not the only methods of enforcement. They proposed settlement and remediation, where appropriate, as cost-effective and time-saving, yet highly effective, methods of enforcement. Settlement can save time and cost for the Authority, auditors and preparers.

3.10.2 Auditors wanted a transparent settlement policy to be devised and announced. Remediation plans may be given wherever possible and compliance reports may be required. Auditors and preparers feel that there should be more focus on remedial action rather than just penal action.

3.10.3 Auditors stated that the inspection process should include review of remedial actions taken by auditors and preparers.

### **3.11 Communication, Advocacy and Research**

3.11.1 Stakeholders stated that the Authority's communication and visibility were highly important to them. They wanted it to launch communication and advocacy activities and suggested the following initiatives:

- a. *Newsletter*: A quarterly newsletter may be issued to report current developments with articles from the Authority staff on accounting and auditing.
- b. *Videos*: Videos containing short interviews or discussions may be used for spreading awareness of the Authority's work. Videos featuring auditors, preparers and users may be used for this purpose.
- c. *Webinars*: Webcasts may be used to discuss new standards and current developments.
- d. *App*: An would be highly useful, since a lot of access these days is from mobile devices using apps.

3.11.2 Journalists and academics wanted the Authority to provide access to its data and invite research on accounting policies and practices. This would help them conduct high quality research and come up with well-argued news articles and academic research papers.

- 3.11.3 Journalists stated that they would benefit from workshops conducted by the Authority on new accounting and auditing standards, such revenue, leases and key audit matters. They wanted the Authority to conduct training workshops for them in accounting and auditing when they enter the field and thus help enhance the quality of reporting and public discourse. They observed that some journalists might be unaware of why the Authority was established and what it was doing. The regulator should publish case studies to raise awareness about its work.
- 3.11.4 Journalists stated that so far the Authority has published reports on one scandal-hit company listed in the debt market but variety would be necessary to appeal to a wider audience. They suggested that it provide an initial release soon after a scandal surfaces with a detailed report later. This would make the Authority visible in critical moments.
- 3.11.5 Journalists wanted periodic (quarterly) engagements by the Authority with media after crucial board meetings. In addition to these, detailed interactions with senior journalists could also help in communicating the broader vision and strategic direction of the regulator. Public speeches by the Chairperson and Members would also help stakeholders understand the bigger picture.
- 3.11.6 Analysts, advisers and investors mentioned a number of ways in which the Authority can support them in their work. They suggested the following initiatives:
- a. *Easy access to data:*
    - i. A service like SEBI's EDIFAR (no longer available) would be useful.
    - ii. Filings in an easily usable manner e.g. big data, machine-readable formats, meta-data, etc.
    - iii. Company filings on financial reporting and auditing with the MCA especially to retail investors.
  - b. *Analysis of data:*
    - i. Thematic reports based on analysis of AQR reports.
    - ii. Query-based information about auditors (e.g. names of companies with an auditor, auditor tenure and auditor resignations).
  - c. *Simplification and additional disclosures:*
    - i. A shorter annual report that excludes compliance-type documents and promotional material.
    - ii. More text information such as an ESG report.
    - iii. The usefulness of voluntary disclosures such as pro forma earnings may be left to the market to decide.

d. *Timeliness:*

- i. Investors take interest when news reports go viral, so quick response is necessary.
- ii. AQR reports should be brought out in say, two or three months after a scandal surfaces.
- iii. The Authority should examine how it could complement the market's information.
- iv. The Authority should have a list of important media resource persons and circulate its orders and AQR reports to them as soon as they were finalised.

3.11.7 Stakeholders wanted the Authority's website to be more informative and suggested the following to be available:

- a. Upcoming areas of interest.
- b. Speeches of the Chairperson and Members of the Authority.
- c. Accounting and auditing alerts or announcements.
- d. A professional grievances section.
- e. Improved search and navigation.
- f. Glossary and FAQs for accounting and audit matters.
- g. Questions raised by auditors and preparers and answers given.

### **3.12 Road Map**

3.12.1 Stakeholders wanted the Authority to develop a road map that would have both a long-term strategic plan containing the broad direction for the next five years and an annual operating plan that spells out its immediate priorities. They felt that it would be better to develop a vision in good times rather than in the middle of a crisis. The road map should be realistic given the Authority's resources and experience.

3.12.2 The strategic plan should provide an overview of where the Authority would want to be in the next five years and how it planned to get there. It should contain the following:

- a. Plan for technical, human and financial resources;
- b. Broad areas for new standards and modification of existing standards; and
- c. A strategic direction that would guide the Authority's vision of what needs to be done;
- d. Timelines.

- 3.12.3 Annual plans should present the outlook for the year ahead. They should contain matters such as planned staff strength in numbers and skills, funding, and specific standards to be introduced.
- 3.12.4 The criteria for selection of companies for AQR could be announced in the annual plan. The criteria would include size, industry, trigger events, risk characteristics and other relevant factors.
- 3.12.5 The Authority should eventually aim to produce at least 25 AQR reports per quarter in order to make an impact on the market. Infrequent reports cannot sustain investors' interest. Large companies with equity listing should get priority while selecting companies for AQR. The Authority should state both what are and what are not its priorities.
- 3.12.6 The Authority should publish its work plan for the current financial year and if feasible the next financial year on a rolling basis, so that auditors are aware of the upcoming developments.
- 3.12.7 The Authority should develop and publish a document on the proportionality of responsibility between management, board, internal auditors, and external auditors. Such a publication will provide clarity to the stakeholders.

### **3.13 Building Regulatory Capacity**

- 3.13.1 Stakeholders were concerned about the Authority's regulatory capacity at various levels in order to execute its mandate. Since it would take time to develop staff calibre, a phased plan is necessary. They made the following suggestions:
- a. The Authority should work towards attracting the best talent from industry, just as the PCAOB seems to be able to do.
  - b. Its inspection staff should be thoroughly trained in accounting and auditing standards to ensure that the team has adequate and appropriate audit experience.
  - c. Auditors and preparers were concerned about the size and quality of its staff and offered support in building up its capacity in the following ways:
    - i. Conducting regular training for staff in current and new standards in order to equip them with the necessary technical knowledge;
    - ii. Seconding its staff to auditors and preparers for short periods to shadow audit and accounting teams to get a realistic understanding of the thinking involved in auditing in general and interpretation of accounting standards and legal requirements;

- iii. Seconding staff from auditors and preparers to the Authority for short periods for specific tasks such as development of standards and study of post-implementation issues;
  - iv. Training its staff by auditors on their proprietary software in order to increase efficiency and reduce costs for both the Authority and the auditors.
- d. It could invite inspection staff from leading overseas financial reporting regulators to work in its inspection department. The aim of this exchange program should be to enable its staff to get international exposure and attract bright and experienced CAs, lawyers and other professionals to join the Authority.
  - e. Divisions/verticals specialising in specific industries should be established.
  - f. The focus of regulatory review should be on matters that are not black or white but those that need judgment, estimates and assumptions for application of standards. For this, it should start with identifying potential areas of judgment it plans to examine.
- 3.13.2 Auditors felt that membership of the International Forum of Independent Audit Regulators (IFIAR) would be useful to the Authority in getting exposure to the practices of regulators from around the world, as also in influencing the development of regulation at the international level.
- 3.13.3 It is critical for the Chairperson and Members to engage with other regulators in India and overseas who have a role in financial reporting and agree on information sharing to avoid duplication.
- 3.13.4 The Authority should build a compendium of best global practices in accounting, use of audit/accounting tools, and governance, which can be a ready reference for auditors and CFOs.
- 3.13.5 A clear policy on whistleblower protection by the regulator will encourage early detection and reporting of breaches.

### **3.14 Audit Quality Indicators and Audit Firm Evaluation**

- 3.14.1 The Authority should consider requiring disclosure of audit quality indicators (AQIs). This would be particularly useful for audits done by mid-sized and small firms. AQIs would include matters such as time spent on the audit, previous experience of the auditor and the audit team, and staff training.

3.14.2 Audit firms should evaluate themselves similar to board evaluation. The evaluation should cover independence, quality and other matters of interest to users.

3.14.3 The Authority should assess accounting firms' early warnings systems for their clients' risks.

### **3.15 Independence, Funding and Accountability**

3.15.1 In order to maintain its independence, the Authority may explore the possibility of funding from the RBI, SEBI, the Investor Education and Protection Fund, and credit rating agencies, besides a levy on auditors and preparers.

3.15.2 The Authority should conduct a periodical benchmark survey to find out how well it is meeting its purpose.

3.15.3 Academics suggested that a good place to start would be to compare against the functions of the PCAOB. While there are differences between the Authority and the PCAOB, the similarities are sufficient enough to suggest using the PCAOB as a template.

## Chapter 4

### Recommendations

#### 4.1 Stakeholder Engagement

4.1.1 *The Committee recommends the Authority's continuous engagement with investors and other users, academics, media, preparers, and auditors by forming advisory groups and establishing fellowships.*

4.1.2 Engagement with stakeholders will result in a better understanding of the stakeholders' concerns and the Authority's expectations.

4.1.3 The Committee suggests setting up the following consultative and advisory groups:

- a. Investor Advisory Group;
- b. Academic Advisory Group;
- c. CFO Advisory Group; and
- d. Auditor Advisory Group.

Separate groups for each of the major stakeholder categories would enable the participation of many industries, organizations, and individuals in the activities of the Authority.

4.1.4 The purpose and composition of these advisory groups may be as follows:

a. ***Investor Advisory Group:***

*Purpose:* To provide the Authority with the views and advice of users of financial statements.

*Size:* 10 to 15 persons.

*Members:* Equity analysts, credit analysts, fund managers, investment advisers, business journalists and lawyers.

*Eligibility:* Persons with (a) extensive experience in equity analysis, credit analysis or investment advice, (b) a strong record of investor protection, professional independence, and personal integrity.

b. ***Academic Advisory Group:***

*Purpose:* To provide the Authority with the views and advice of accounting and auditing educators.

*Size:* 10 to 15 persons.

*Members:* Teachers or researchers in accounting or auditing in universities, institutes or colleges.

*Eligibility:* Persons with (a) extensive experience in accounting and auditing education, (b) a strong record of teaching or research, professional independence, and personal integrity.

c. ***CFO Advisory Group:***

*Purpose:* To provide the Authority with the views and advice of preparers of financial statements.

*Size:* 10 to 15 persons.

*Members:* CFOs, controllers and audit committee chairs of large or medium listed entities.

*Eligibility:* Persons with (a) extensive experience in preparation of financial statements, and (b) a strong record of accounting and disclosure quality, professional independence, and personal integrity.

d. ***Auditor Advisory Group:***

*Purpose:* To provide the Authority with the views and advice of auditors of financial statements.

*Size:* 10 to 15 persons.

*Members:* Partners of large or medium accounting firms.

*Eligibility:* Persons with (a) extensive experience in audit of large or medium listed companies, and (b) a strong record of audit quality, professional independence, and personal integrity.

The Authority may designate an Executive Director each as the chair of the above advisory groups.

4.1.5 Setting up and managing groups would call for considerable time and resources that the Authority may not have in the early years. Therefore, a single group called the Stakeholder Advisory Group with 8 to 12 members drawn equally from among auditors, preparers, users and academics may be considered for the next few years.

4.1.6 The Authority may establish a fellowship programme in order to strengthen its interaction with practitioners and academics. Two types of fellowships may be considered:

- a. *The NFRA Practice Fellowships:* Two fellowships may be awarded annually for a term of one year on a competitive basis. Partners or staff of accounting firms and CFOs and finance and accounting staff in listed entities would be eligible to apply. The Authority would announce the topics of interest and these would typically include: application or implementation of accounting and auditing

standards; auditing internal financial reporting controls'; auditing estimates, including fair value; and use of technology to improve audit quality.

- b. *The NFRA Academic Fellowships:* One fellowship may be awarded annually for a term of one year on a competitive basis. Faculty members or PhDs in economics, finance, accounting or a related area would be eligible to apply. The Authority would announce the topics of interest and these would typically include: audit firms' quality control systems; audit quality indicators; audit report communication; and preventing and detecting financial reporting fraud.

4.1.7 Wherever possible, the Authority's Chairperson and Members may make use of speeches in industry or other forums to communicate their thinking on matters of interest to the stakeholders.

## **4.2 Inspection, Investigation and Enforcement**

4.2.1 *The Committee recommends that the Authority formulate a policy for inspection and make it public.*

4.2.2 The proposed policy may cover the process for inspections including criteria for selection of companies and the procedure to be followed.

4.2.3 Investigation and enforcement may follow inspection or receipt of a complaint or reference. Therefore, it would be difficult to lay down a policy for these activities.

## **4.3 Settlement of Disciplinary Matters and Remediation**

4.3.1 *The Committee recommends that the Authority examine the desirability and feasibility of a policy on settlement of disciplinary matters.*

4.3.2 Under Section 132 (4), the Authority has the power to impose monetary penalty and debar an auditor or the audit firm in case of "misconduct". This requires a determination of "misconduct" by the auditor or the firm after investigation and adjudication. Currently, there is no provision for settlement of disciplinary matters in the Act or the Rules without such determination. Disciplinary proceedings take time, effort and resources. Litigation of disciplinary orders before courts and the National Company Law Appellate Tribunal (NCLAT) not only costs time, effort and resources but also causes uncertainty.

4.3.3 Settlement of disciplinary matters would expedite enforcement action. The PCAOB and the FRC have settlement of disciplinary cases prior to adjudication. In India, SEBI has procedures for settlement of proceedings under the securities laws. The Authority may consider taking up the matter with the Government.

4.3.4 Rule 9 of the NFRA Rules, 2018 provides for direction by the Authority to an auditor to make improvements and for monitoring improvements made by the auditor. Therefore, the Committee does not make any recommendation on remediation.

#### **4.4 Communication and Advocacy**

4.4.1 *The Committee recommends expansion of the Authority's communication and advocacy activities by redesigning its website, posting videos, starting a newsletter, and organizing webinars.*

4.4.2 The Authority may redesign its website to make it more informative and accessible. The new website should include the following:

- a. Separate tabs for auditors, preparers, investors, and academics;
- b. Videos on the Authority's purpose, powers and functions, interviews on new accounting and auditing standards, panel discussions on implementation of accounting and auditing standards, and so on;
- c. A whistleblower contact email address.

4.4.3 The Authority may start a quarterly newsletter to report current developments in accounting and auditing. The newsletter can also have articles from the staff on such matters.

4.4.4 The Authority may organize webinars to discuss new standards and current developments. To begin with, one webinar per month may be planned and the number can be increased depending on feedback. Inviting suggestions from stakeholders would help in identifying relevant topics for webinars.

4.4.5 An NFRA app may be developed to facilitate easy access to information.

4.4.6 The Authority may provide a short non-technical note to business journalists on standards, AQRs, disciplinary orders, and other documents in order to enable them to understand the content and report the matter in a timely manner.

4.4.7 The Authority may collaborate with universities, institutes and colleges for publicising its role and activities.

#### **4.5 Data Dissemination**

4.5.1 *The Committee recommends making auditors' and preparers' filings with it available to the public.*

4.5.2 Easy access to data would enable research in accounting and auditing. In addition, the Authority may commission research on topics of interest and publish the results as working papers or discussion papers.

4.5.3 The Authority may set up a database service similar to SEBI's EDIFAR (now not available) or the SEC's EDGAR for the filings with it.

4.5.4 The information to be made available would exclude any confidential filings and submissions.

#### **4.6 Road Map**

4.6.1 *The Committee recommends that the Authority develop a road map to guide its direction and activities and convey its priorities to stakeholders.*

4.6.2 The Authority may develop a road map consisting of a five-year strategic plan and an annual operating plan and publish them in advance. The road map should reflect the Authority's priorities, resources and experience. The draft version of the road map may be issued first for public comment.

4.6.3 The policy for inspection recommended in Section 4.2 may be included in the annual plan.

#### **4.7 Building Regulatory Capacity**

4.7.1 *The Committee recommends that the Authority build up its capacity steadily in the next five years.*

4.7.2 The staffing plan may describe the number of personnel, levels and skills and the timeline for recruitment and training.

4.7.3 Regular training should help the staff be up to date in their area of work and increase their productivity. Annual training hours may be specified and included in the performance appraisal. The Committee suggests a minimum of 100 hours for each member of the staff. The topics and hours of training would depend on the current and expected responsibilities of the staff and should also be related to their long-term career progression. Typically, the training calendar should have accounting and auditing standards, business law, inspection and investigation procedures, forensic investigation, technological developments, analytical tools and techniques, written communication and report writing, team working, operations management, and so on.

4.7.4 The Authority may consider two-way short-term staff exchanges with auditors and preparers and leading overseas regulators such as the PCAOB and the FRC.

4.7.5 Appropriate legal and ethical arrangements should be put in place for exchange of staff in order to ensure confidentiality and eliminate potential conflict of interest and excessive familiarity that could impair objectivity.

#### **4.8 Decision-making**

4.8.1 *The Committee recommends that the Authority ensure transparency in decision-making.*

4.8.2 The Authority may publish a handbook containing the various steps to be followed in reaching decisions.

4.8.3 Rule 17 of the NFRA Rules, 2018 provides for maintenance of “complete confidentiality and security of the information provided” to the Authority and persons and organizations associated with it. Therefore, the Committee does not make any recommendation in this regard.

#### **4.9 Timely Guidance**

4.9.1 The Committee appreciates auditors’ and preparers’ need for timely guidance on some emerging accounting and auditing questions. Under the law, the Authority does not have powers to issue any guidance. The Government (Ministry of Corporate Affairs) issues accounting and auditing standards, which have the status of subordinate legislation under the law. Given this position, it needs to be examined if even the Ministry can provide clarifications and guidance. Therefore, the Committee does not make any recommendation in this regard.

#### **4.10 Audit Quality Indicators and Audit Firm Evaluation**

4.10.1 The Committee thinks that a requirement to disclose audit quality indicators (AQIs) has the potential to encourage audit firms to take a critical look at their audit processes and raise audit quality. Evaluation of internal culture, remuneration policies, reporting relationships, and independence, among others, by audit firms would help them identify their strengths and weaknesses and take remedial measures in advance rather than in the middle of a crisis. However, these matters are outside the scope of this report. The Committee would like to leave it to the Authority to consider them as part of its strategic plan.

#### **4.11 Independence, Funding and Accountability**

4.11.1 Currently, the Authority is fully funded by the Government (Ministry of Corporate Affairs). Any changes in funding arrangements would require amendments to the law. The independence of the Authority is guaranteed by the Companies Act, 2013 and the NFRA Rules. In particular, sub-sections (3A) and (3B) of section 132 protect the objectivity, integrity and independence of the monitoring, compliance review, and disciplinary processes, and prevent the capture of the regulator by the regulated entities and the accounting industry associations. As for accountability, the section provides for

submission of an annual report on its activities to Parliament. These matters are outside the scope of this report.

## **Chapter 5**

### **Conclusions**

#### **5.1 Stakeholder Expectations, Engagement and Support**

5.1.1 The Authority came into existence in the wake of massive accounting scandals in the financial firms. Stakeholders have high expectations from the Authority mainly because of its independence from auditors and preparers. They expect the Authority to become a world-class regulator very quickly.

5.1.2 While these expectations are completely understandable, building a high-quality regulatory organization takes time. In the early years, a lot of time goes into getting various approvals, recruiting and training staff, developing process manuals, writing AQRs and disciplinary orders, and dealing with litigation, all with limited staff.

5.1.3 Equally, stakeholders are ready to support the Authority in capacity building, so that it will be up and running very soon. Engagement with stakeholders will enable the Authority to get the required technical expertise in accounting and auditing and give them confidence in its skills, processes and purpose.

#### **5.2 Next Steps**

5.2.1 The Committee believes that the Authority will examine its recommendations and develop an action plan for implementing them in a phased manner taking into consideration their relevance to fulfilling its mandate and its time and resource constraints. It would be useful to invite the views of stakeholders and the public on the recommendations and the action plan.

## **Appendixes**

## Appendix A

### Committee's Questionnaire

#### Interaction with Stakeholders, Constituents and Experts on Enhancing Engagement

##### Introduction and Background

The National Financial Reporting Authority (NFRA) is the independent regulator for accounting and auditing in India. It was set up in 2018 under section 132 of the Companies Act, 2013. Its mandate is to protect the public interest, and the interests of investors, creditors and others who use financial statements of companies and other entities. Its objective is “to continuously improve the quality of all corporate financial reporting in India.”

It has to achieve this objective by:

- (a) establishing high quality accounting and auditing standards; and
- (b) exercising effective oversight of accounting functions performed by companies and auditing functions performed by auditors.

##### Enhancing Engagement

The NFRA has requested the Technical Advisory Committee (TAC), set up under rule 15 of the NFRA Rules, 2018, to examine its current engagement with its stakeholders and constituents – investors, preparers, auditors, and others working in the public interest – and recommend ways to enhance its engagement so as to achieve its objective. For this purpose, the TAC plans to interact with the above groups to understand their views. The following questions (by no means exhaustive) are intended as a basis for the proposed interactions.

**Q. 1 Which of the following best describes your role in financial reporting? Please tick (✓) the relevant box.**

<b>Auditor of financial statements</b>	
<b>Preparer of financial statements</b>	
<b>User of financial statements</b>	
• <b>Business journalist</b>	
• <b>Investor, lender</b>	
• <b>Security analyst, investment adviser</b>	
• <b>Teacher, researcher</b>	

**Q. 2 How would you describe your familiarity with the NFRA and its work? Please tick (✓) the relevant box.**

<b>Very high</b>	
<b>High</b>	
<b>Moderate</b>	
<b>Poor</b>	
<b>Very poor</b>	

**Q. 3 Have you ever visited the NFRA's website? Please tick (✓) the relevant box.**

<b>Yes</b>	
<b>No</b>	

**Q. 4 Please describe the kind of information on the NFRA's website that would be useful in your work.**

**Q. 5 Please suggest ways by which the NFRA can engage effectively with its stakeholders and constituents. Engagement may be in the form of communication of strategic direction, consultation on accounting standards and auditing standards, publicizing comments received, feedback on implementation of standards, response to queries on accounting and auditing matters, and so on.**

**Q. 6 Any suggestions that you believe would be useful in enhancing engagement.**

## **Appendix B**

### **Stakeholders Consulted by the Committee**

#### **A. Responded to the Questionnaire and Interacted with the Committee**

##### ***Auditors***

1. Mr. Raghu Aiyar, Partner, K. S. Aiyar & Co.
2. Mr. Vishesh Chandiook, Partner, Walter Chandiook & Co. LLP
3. Mr. Daraius Z. Fraser, Kalyaniwalla & Mistry LLP
4. Ms. Padmini Khare, Partner, B. K. Khare & Co.
5. Mr. Jamil Khatri, Partner, BSR & Co. LLP
6. Mr. Viren H. Mehta, Partner, S. R. Batliboi & Co. LLP
7. Mr. P. R. Ramesh, Former Partner, Deloitte Haskins & Sells LLP
8. Mr. Harinderjit Singh, Partner, Price Waterhouse Chartered Accountants LLP

##### ***Preparers***

9. Mr. P. B. Balaji, Group Chief Finance Officer, Tata Motors Limited
10. Mr. Jatin Dalal, President and CFO, Wipro Limited
11. Mr. Kamal Kedia, Head of Accounting, Nestlé India Limited
12. Mr. Srinivas Phatak, Executive Director, Finance and IT and CFO, Hindustan Unilever Limited
13. Mr. Ashwini Puri, Chair, Audit Committee, Titan Company Limited
14. Ms. Puja Thakur, Vice President Finance and CFO, GlaxoSmithKline Pharmaceuticals Limited

##### ***Users***

15. Mr. Ashish Gupta, Head of Research, Credit Suisse
16. Mr. J N Gupta, Co-founder & Managing Director, Stakeholder Empowerment Services
17. Mr. Sandeep Kothari, Founder CEO, Eastlane Capital
18. Mr. Sachin Mampatta, Assistant Editor, Business Standard
19. Mr. Raghuvir Srinivasan, Editor, The Hindu Business Line
20. Mr. Sundaresha Subramanian, Editor Corporate & Regulatory Affairs, ET Prime, The Economic Times
21. Mr. Amit Tandon, Founder & Managing Director, Institutional Investor Advisory Services
22. Ms. Jayshree Pyasi Upadhyay, Writer, Markets and Regulatory Affairs, The Morning Context

## **B. Responded to the Questionnaire**

### ***Auditors***

23. Mr. Manoj Daga, Partner, Haribhakti & Co. LLP

24. Mr. Gokul Dixit, Partner, R. Subramaniam & Co.

### ***Preparers***

25. Mr. R. Shankar Raman, Whole-time Director & Chief Financial Officer, L & T Group

### ***Users***

26. Ms. Menaka Doshi, Managing Editor, BloombergQuint

### ***Academics***

27. Dr. Madhumita Chakraborty, Associate Professor, Indian Institute of Management,  
Lucknow

28. Dr. Arindam Gupta, Professor, Vidyasagar University, Midnapore, West Bengal

29. Dr. Ram Kumar Kakani, Professor, Indian Institute of Management, Kozhikode

30. Dr. Sanjay Kallapur, Professor, Indian School of Business, Hyderabad

31. Dr. K. Raghunandan, Professor, Florida International University, Miami, Florida and  
Visiting Professor, Indian Institute of Management, Bangalore

32. Dr. Srinivasan Rangan, Associate Professor, Indian Institute of Management,  
Bangalore

33. Ms. Aparna Vemulapalli, Assistant Professor, Stella Maris College, Chennai

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