

CONSULTATION PAPER - JUNE, 2021
ENHANCING ENGAGEMENT WITH STAKEHOLDERS

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 28th March, 2021

To

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

Sir,

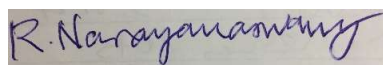
It is our privilege and honour to present the Report on **Enhancing Engagement with Stakeholders** of the Technical Advisory Committee of the National Financial Reporting Authority. The Committee was set up under rule 15 of the NFRA Rules, 2018 by Office Memorandum No. NF-12042/3/2020 dated July 17th,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

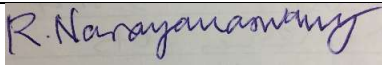
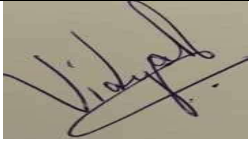





5. We thank you for providing us the opportunity to study the matter.

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.¹ 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.”²

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.³ 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 |

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

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

³ <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.⁴

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.⁵

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

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

⁵ 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’.⁶
- 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.⁷
- 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.

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

Source: *primeinfobase.com*⁸

⁶ 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.

⁷ 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.

⁸ 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.⁹ 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.¹⁰
- 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

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

¹⁰ <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.¹¹

- 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.¹² 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.¹³
- 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

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

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

¹³ 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 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.¹⁴ The RBI's ban on EY affiliate S R Batliboi from auditing banks for one year¹⁵ and SEBI's ban on various PwC affiliates from auditing listed companies for two years¹⁶ 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.

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

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

¹⁶ <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?¹⁷
- 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

¹⁷ 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.¹⁸

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

¹⁸ 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.

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

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

| Table 3.2 | | | |
|--------------------------------------|--------------|----------------------------------|---------------|
| Discussions with Stakeholders | | | |
| Date | Group | Description | Number |
| 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 |
| Total | | | 22 |

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?”.

| Table 3.3 | | | | | |
|--|--------------------------|----------------|-----------------|-------------|------------------|
| Familiarity with the Authority and its Work | | | | | |
| Familiarity (Score) ¹⁹ | Per cent to Total | | | | |
| | All | Auditor | Preparer | User | Academics |
| 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 |
| Total | 100 | 100 | 100 | 100 | 100 |

| | | | | | |
|--------------------------|------|------|------|------|------|
| Average score (out of 5) | 3.50 | 4.00 | 3.17 | 3.44 | 3.22 |
|--------------------------|------|------|------|------|------|

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

¹⁹ 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).²⁰ 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.

²⁰ 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.

| | |
|---|--|
| Auditor of financial statements | |
| Preparer of financial statements | |
| User of financial statements | |
| • Business journalist | |
| • Investor, lender | |
| • Security analyst, investment adviser | |
| • Teacher, researcher | |

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

| | |
|------------------|--|
| Very high | |
| High | |
| Moderate | |
| Poor | |
| Very poor | |

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

| | |
|------------|--|
| Yes | |
| No | |

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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