



New Delhi, the 3rd November, 2024

LEGAL OPINION

Querist: National Financial Reporting Authority

Through: Zoheb Hossain, Advocate

Subject: Legal Opinion sought by the querist vide letter dated 10.10.2024 and addendum email dated 20.10.2024

- (1) My opinion has been sought for by the National Financial Reporting Authority, (in short "the NFRA") on several issues. However, before proceeding to answer the queries, it would be apposite to reflect upon the legislative background behind the creation of the NFRA.
- (2) NFRA was notified on 1st October 2018 under section 132 of the Companies Act 2013. The objective of NFRA is laid down in Rule 4 of NFRA Rules, which states that the Authority shall protect the public interest and the interests of investors, creditors and others associated with the companies or bodies corporate which are under NFRA purview by establishing high quality standards of accounting and auditing and exercising effective oversight of accounting functions performed by the companies and bodies corporate and auditing functions performed by auditors. NFRA's purview includes companies that have a high degree of public interest involved in them (PIEs) and includes listed companies, unlisted companies meeting certain financial thresholds, insurance, banking and electricity generation companies etc, as provided under Rule 3 of NFRA Rules 2018.
- (3) The NFRA was created as an independent regulatory body which would have the power to recommend accounting and auditing standards to the government and oversee, monitor and supervise the quality of service of professionals associated with ensuring compliances with such standards with respect to a class of companies as defined in Rule 3 of NFRA Rules hereinafter referred to as Public Interest Entities (PIEs).

- (4) Various parliamentary and expert committee reports which recommended the formation of a statutory body like NFRA was intended to shift from a model of self-regulation by ICAI under the Chartered Accountants Act, 1949 towards an independent oversight mechanism over professionals based on global standards.
- (5) In the Twenty- First Report of the Standing Committee on Finance (2009-2010) (Fifteenth Lok Sabha) related to the Companies Bill, 2009 in August 2010 it was noted that there is *“a need to promote an independent regulatory regime” and “to consider giving regulatory power to NACAAS at appropriate stage to enforce the compliance with standards in respect of matters”*.
- (6) The Parliamentary Standing Committee on Finance (2012) considered the Companies Bill, 2011 and reaffirmed the need for an independent regulator for accounting and auditing. The 57th Report of the Standing Committee on Finance (2011-12) observed inter alia as under:
- *National Advisory Committee on Accounting and Auditing Standards (NACAAS) proposed to be renamed as National Financial Reporting Authority (NFRA) with a mandate to ensure monitoring and compliance of accounting and auditing standards and to oversee quality of service of professionals associated with compliance.*
 - *The Authority shall consider the International Financial Reporting Standards and other internationally accepted accounting and auditing policies and standards while making recommendations on such matters to the Central Government which will improve the competitiveness of our companies with other companies. The Authority is also proposed to be empowered with quasi judicial powers to ensure independent oversight over professionals.*
- (7) In February 2016, the Companies Law Committee was set up by the Ministry of Corporate Affairs to make recommendations on the implementations of the provisions of the Act. More importantly, while doing so, the concerns of the ICAI with respect to the constitution of the NFRA were rejected by the Committee. Some of the critical findings worthy of mention are as follows:
- *"The Committee deliberated in detail on the matter and felt that in view of the critical nature of responsibilities wherein lapses have been seen to cause serious repercussions, the need for an independent body to oversee the profession is a*

requirement of the day. Major economies of the world have already established such regulatory bodies..."

- (8) In the Thirty- Seventh Report of the Standing Committee on Finance (2016-2017) (Sixteenth Lok Sabha) related to the Companies Bill, 2016 in December 2016 noted the shortcomings of the self-regulatory model under the ICAI and strongly recommended notification of the NFRA as an independent regulator of auditors. The relevant extract of the report is reproduced hereinbelow: (*See relevant at Page 50-57 of the Comprehensive Handbook on the National Financial Reporting Authority by the Respondent*):

Constitution of National Financial Reporting Authority (Section 132 of the Companies Act 2013)

3.18. Sec 132 of the Act provides for the creation of National Financial Reporting Authority (NFRI) for matters relating to accounting and auditing standards under the Act. However this section is yet to be notified. The key functions of NFRA as envisaged by the Act include:

- Recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or their auditors.
- Monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed.
- 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.
- Have the power to investigate, either suo motu or on a reference made to it by the Central Government, for specified class of bodies corporate or persons, into the matters of professional or other misconduct committed by any member or firm of Chartered accountants.

3.21. The Ministry of Corporate Affairs have furnished their comments on the concern and suggestion of ICAI on the above issue as under:

(vi) World over, the number of independent audit regulators have increased over a period as can be seen from the membership of International Forum of Independent Audit Regulators (IFIAR) which was established in 2006 by independent audit regulators from 18 jurisdictions and now covers 51 jurisdictions (including PCAOB and FRC). IFIAR, inter alia, promotes international collaboration between the regulators. The oversight structure of auditors within ICAI has not been recognized as independent by IFIAR and India is not represented on this body.

(ix) Ministry of Finance and Chairman, SEBI has recently written to MCA for the establishment of NFRA as it would lead to enhanced institutional oversight over auditors and would lead to enhanced market integrity and transparency as well as protection of the interest of investors and other stakeholders like banks, lending institutions, suppliers, etc.

(x) Complaints received against its members are examined by the Institute of Chartered Accountants of India (ICAI) through its mechanism of Director (Discipline), Board of Discipline and Disciplinary Committee and an Appellate Authority. Information was obtained on the complaints against its members available with it. Analysis of the details provided by ICAI is as below:

a) Of the 1972 cases taken up by the Disciplinary Committee/Board of Discipline of the ICAI, only in the matter relating to Satyam Computers have the members been permanently removed. Only in 14 of these cases, members have been imposed penalty of one year or more. In majority of the cases, the members have been found as not guilty. Further, in majority of the cases where members have been found guilty, they have been merely reprimanded or cautioned.

b) 1226 cases were closed at prima facie stage by the Board of Discipline/Disciplinary Committee. Of these, 117 cases were referred by various Government agencies/regulators. 49 of these cases were referred by MCA/SEBI and the professional involved were found to be not guilty at the prima facie stage. The closure of these cases took from 1-4 years.

c) Only 4 percent of the 746 cases which proceeded beyond the prima facie stage before the Disciplinary Committee/Board of Discipline of the ICAI since 2007 have been on a suo-moto basis. Other than Satyam matter, only in 6 of these cases have the Members been found guilty and they have been reprimanded or cautioned.

d) 137 of 746 cases taken up for considered beyond the prima facie stage by the Disciplinary Committee/Board of Discipline were based on complaints by government/regulatory agencies. The Committee found members guilty in 54 of these cases, of which in 5 cases, the Committee imposed a penalty of name removal for one year or more and/or fine.

(xi) It may also be pertinent here to draw attention to the reference in November 2015 to ICAI by MCA for examining the role of auditor and possible misconduct on their part in case of 132 listed companies whose scrips were suspended by SEBI for abnormal price rise which was not supported by the fundamentals of the companies, non-existent companies,

etc. and on which even preliminary action had not been initiated by the ICAI despite several reminders. In another example, SFIO, in its report in a specific case had identified 56 professionals, including 34 chartered accountants, who worked as mediators in money laundering with the help of a group of companies. A copy of the report was submitted to SIT on Black Money on 25.04.2016, which in turn issued directions to the ICAI to identify all the Chartered Accountants involved in the money laundering and initiate disciplinary proceedings against them. ICAI vide letter dated 20.07.2016 informed that it had identified five chartered Accountants and initiated proceedings against them while for the remaining chartered accountants, ICAI had asked SFIO to furnish details of membership number and professional addresses.

(xii) The Chartered Accountants Act, 1949 provides for self-regulation through an electoral process and, therefore, the present provisions in respect of quality review and discipline provided therein rely substantially on such principles. In view of this, envisaging an independent body under the Act would be difficult. In order to address the overlap between the two Statutes with regard to quality review and professional and other misconduct, the provisions under the CA-13 provide for regulation of such aspects only for specified (bigger) classes of companies/auditors and further that overriding effect over other laws has been specifically provided under the CA-13.

(xiii) NFRA is proposed to be established as an independent body with representation from concerned stakeholders including ICAI. Once it is constituted, the authority would function in accordance with the mandate and role provided under the Act/Rules to be made thereunder. The accountability of the authority to the Parliament has also been provided through laying of report on its functioning in Parliament every year like any other statutory regulator.

(xiv) This Ministry would, therefore, reiterate its views that the self-regulatory mechanism of ICAI has inherent weaknesses as far as disciplining and enforcement is concerned and increasingly in different jurisdictions an independent regulator is being established for such oversight. NFRA is, therefore, required to be established. As far as overlap of jurisdiction is concerned, kind attention is drawn to Section 132 (4) of the CA-13 which specifically provides that notwithstanding anything contained in any other law for the time being in force, the NFRA shall have the power to investigate the matters of professional or misconduct for prescribed class of body corporate or persons. It further provides that in case NFRA has initiated action no other Institute or Body shall initiate or continue any proceedings in such matters of misconduct. Further, once the authority is constituted and starts functioning, it would be recognized in international forums also, and some of the difficulties being expressed viz

parity in respect of legal action/liability of Indian partners/firms vis-à-vis global/multinational and other similar aspects would get evolved as per international practices. It may be noted that the Ministry has already initiated the process for establishment of NFRA and would be in a position to establish the body before the close of this financial year.

- (9) Even the Hon'ble Supreme Court in *S. Sukumar v. ICAI*, (2018) 14 SCC 360 highlighted the fact that accounting firms should not be left to self-regulate themselves. In particular, Hon'ble Supreme Court, *inter alia*, observed as under:

"Consideration of the issue

44. *The above resume of facts and pleadings shows the following:*

44.3. *Need for amendment of law to separate regulatory regime for auditing services on the pattern of the Sarbanes-Oxley Act enacted in US making a foreign public accounting firm preparing audit reports to be accountable to the public company accounting. Similar oversight body may need to be considered in India.*

49. *It can hardly be disputed that profession of auditing is of great importance for the economy. Financial statements audited by qualified auditors are acted upon and failures of the auditors have resulted into scandals in the past. The auditing profession requires proper oversight. Such oversight mechanism needs to be revisited from time to time. It has been pointed out that post Enron Anderson Scandal, in the year 2000, the Sarbanes-Oxley Act was enacted in US requiring corporate leaders to personally certify the accuracy of their company's financials. The Act also lays down rules for functioning of audit companies with a view to prevent the corporate analysts from benefitting at the cost of public interest. The audit companies were also prohibited from providing non-audit services to companies whose audits were conducted by such auditors. Needless to say that absence of adequate oversight mechanism has the potential of infringing public interest and rule of law which are part of fundamental rights under Articles 14 and 21. It appears necessary to realise that auditing business is required to be separated from the consultancy business to ensure independence of auditors. The accounting firms could not be left to self-regulate themselves.*

50. *While we appreciate that it is for the policy-makers to take a call on the issue of extent to which globalisation could be allowed in a particular field and conditions subject to which the same can be allowed. Safeguards in the society and economy of the country in the process are of*

paramount importance. This Court may not involve itself with the policy-making but the policy framework can certainly be looked at to find out whether safeguards for enforcement of fundamental rights have been duly maintained. In the present context, having regard to the statutory framework under the CA Act, current FDI Policy and the RBI Circulars, it may prima facie appear that there is violation of statutory provisions and policy framework effective enforcement of which has to be ensured. Statutory regulatory provisions intended to advance the object of law have to be enforced meaningfully. No vested interest can flout the same by manifesting compliance only in form. Compliance has to be in substance. The law-enforcing agencies are expected to see the real situation. As found by the Expert Committee in its report, there is a compliance by MAFs only in form and not in substance, by having got registered partnership firms with the Indian partners, the real beneficiaries of transacting the business of chartered accountancy remain the companies of the foreign entities. The partnership firms are merely a face to defy the law. The principle of lifting the corporate veil has to apply when the law is sought to be circumvented. In expanding horizons of modern jurisprudence, it is certainly permissible. Its frontiers are unlimited. The horizon of the doctrine is expanding. While the company is a separate entity, the Court has come to recognise several exceptions to this rule. One exception is where corporate personality is used as a cloak for fraud or improper conduct or for violation of law. Protection of public interest being of paramount importance, if the corporate personality is to be used to evade obligations imposed by law, the real state of affairs needs to be seen [State of Rajasthan v. Gotan Lime Stone Khanij Udyog (P) Ltd., (2016) 4 SCC 469, paras 24 to 28; State of Karnataka v. J. Jayalalitha, (2017) 6 SCC 263, paras 205 to 211 : (2017) 3 SCC (Cri) 1 : (2017) 2 SCC (L&S) 179] . The same principle applies while overseeing the compliance with applicable ethics of not permitting profit-sharing or complying with the ceiling limit for the business which is violated by using the technique of sub-contracts for outsourcing. If the premises are same, phone number/fax number is same, brand name is same, the controlling entity is same, human resources are same, it will be difficult to expect that there is full compliance on mere separate registration of a firm. The prohibition under Section 25 of the CA Act can be held to be defeated. It is perhaps for this reason that the network firms avoided giving the information sought by the Committee. The issue of separate oversight body for auditing work and updating existing legal framework appear to be necessary.

52. Absence of revisiting and restructuring oversight mechanism as discussed above may have adverse effect on the existing chartered accountancy profession as a whole on the one hand and unchecked

auditing bodies can adversely affect the economy of the country on the other. Moreover, companies doing chartered accountancy business will not have personal or individual accountability which is required. Persons who are the face may be insignificant and real owners or beneficiary of prohibited activity may go scot free. As already noted, the Reports of the Study Group and Expert Group show that enforcement mechanism is not adequate and effective. This aspect needs to be looked into by experts in the Government. It may consider whether on the pattern of the Sarbanes-Oxley Act corporate leaders be required to personally certify the accuracy of the financial statements. Further, how to prevent corporate analysts from benefitting from the conflict of interests, how to check audit companies from providing non-audit services and how to lay down protocol for auditors. It has also been brought to our notice that another law in US "Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010" to ensure more transparency and accountability of financial institutions to decrease the risk of investing needs consideration. It sets up an oversight body called the Financial Stability Oversight Council (FSOC).

53.1. The Union of India may constitute a three-member Committee of Experts to look into the question whether and to what extent the statutory framework to enforce the letter and spirit of Sections 25 and 29 of the CA Act and the statutory Code of Conduct for the CAs requires revisit so as to appropriately discipline and regulate MAFs. The Committee may also consider the need for an appropriate legislation on the pattern of the Sarbanes-Oxley Act, 2002 and the Dodd Frank Wall Street Reform and Consumer Protection Act, 2010 in US or any other appropriate mechanism for oversight of profession of the auditors. Question whether on account of conflict of interest of auditors with consultants, the auditors' profession may need an exclusive oversight body may be examined. The Committee may examine the Study Group and the Expert Group Reports referred to above, apart from any other material. It may also consider steps for effective enforcement of the provisions of the FDI Policy and the FEMA Regulations referred to above. It may identify the remedial measures which may then be considered by appropriate authorities. The Committee may call for suggestions from all concerned. Such Committee may be constituted within two months. Report of the Committee may be submitted within three months thereafter. The UoI may take further action after due consideration of such report."

(emphasis supplied)

(10) With the above backdrop in mind, I will proceed to answer the queries raised for my opinion.

(I) Whether the National Financial Reporting Authority under section 132(2)(a) of the Companies Act, 2013 can make independent recommendations on some of the accounting and auditing standards to the Central Government when the ICAI has not included them in its recommendations even after being requested and whether the Central Government would be empowered to notify such standards under section 133 or 143(10) of the Companies Act, 2013? [NFRA Board includes three representatives of ICAI – President of ICAI, Chairman of Account Standard Board, ICAI, and Chairman of Auditing Standard Board, ICAI.]

(11) In order to answer the above query, it would be relevant to extract the relevant provisions of the Companies Act, 2013 which would require examination.

132. Constitution of National Financial Reporting Authority. – (1) The Central Government may, by notification, constitute a National Financial Reporting Authority to provide for matters relating to accounting and auditing standards under this 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.

133. Central Government to prescribe accounting standards. – The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949 (38 of 1949), in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

Provided that until the National Financial Reporting Authority is constituted under section 132 of the Companies Act, 2013 (18 of 2013), the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949 (38 of 1949), in consultation with and after examination of the recommendations made by National Advisory Committee on Accounting Standards Constituted under section 210A of the Companies Act, 1956.

143. Powers and duties of auditors and auditing standards. – (10) The Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949 (38 of 1949), in consultation with and after examination of the recommendations made by the National Financial Reporting Authority:

Provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India shall be deemed to be the auditing standards.

- (12) Sub-section (2) to section 132 starts with a non-obstante clause giving overriding effect over any other law to the powers of the NFRA to “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.” Therefore, the NFRA has a power coupled with duty to make recommendations to the Central Government on the formulation and laying down of accounting and auditing standards.
- (13) The NFRA Rules, 2018 reiterates the above power in the following terms in rule 4(2)(b):

“4. Functions and duties of the Authority.— (1) The Authority shall protect the public interest and the interests of investors, creditors and others associated with the companies or bodies corporate governed under rule 3 by establishing high quality standards of accounting and auditing and exercising effective oversight of accounting functions performed by the companies and bodies corporate and auditing functions performed by auditors.

(2) In particular, and without prejudice to the generality of the foregoing, the Authority shall:—

...

(b) recommend accounting standards and auditing standards for approval by the Central Government;

- (14) Section 132(2)(a) gives NFRA a wide power to make recommendations to the Central Government *not only* on the basis of the recommendations already submitted by ICAI, but more generally on the formulation and laying down of accounting and auditing standards as well as policies.
- (15) It is pertinent to note that ICAI finds no mention in this general power, and the power conferred on the NFRA under this provision is to achieve the

object of protecting the interests of investors, creditors etc., *inter alia*, through establishment of standards of accounting and auditing.

(16) Further, rule 4(1) also gives NFRA an extremely general power to:

“protect the public interest and the interests of investors, creditors and others associated with the companies or bodies corporate governed under rule 3 by establishing high quality standards of accounting and auditing...”.

(17) Neither Section 133 nor section 143(10), in any manner, trammel upon or restrict the power of the NFRA to make independent recommendations to the Central Government on accounting and auditing standards. In fact, the background and genesis of NFRA would reveal that the NFRA was meant for, *inter alia*, giving independent recommendations to the Central Government on auditing and accounting standards without being, in any manner, bound by the recommendations or views of the ICAI. In fact, even in order for the “*consultation*” to be effective and meaningful, the NFRA would be free to make its own independent recommendations.

(18) Rule 6 of the NFRA Rules 2018 also supports the above interpretation: -

6. *Recommending accounting standards and auditing standards.- (1) For the purpose of recommending accounting standards or auditing standards for approval by the Central Government, the Authority-*

(a) shall receive recommendations from the Institute of Chartered Accountants of India on proposals for new accounting standards or auditing standards or for amendments to existing accounting standards or auditing standards;

(b) may seek additional information from the Institute of Chartered Accountants of India on the recommendations received under clause (a), if required.

(2) The Authority shall consider the recommendations and additional information in such manner as it deems fit before making recommendations to the Central Government.

(19) However, while making such independent recommendations, the NFRA will be guided by its rules whereby Rule 4 of the NFRA Rule 2018, requires the NFRA to protect the public interest and the interest of investors, creditors and others by establishing high quality standards of accounting

and auditing and exercising effective oversight of auditing functions performed by the auditors.

II. Whether having received the recommendations from the ICAI in terms of section 133 and upon receipt of the independent recommendations from NFRA, is the Central Government obliged to again consult the ICAI on the independent recommendations from NFRA especially in light of Rule 6 of the NFRA Rules, 2018?

(20) From the plain language of Section 133 or section 143(10) it does not appear mandatory to again consult with the ICAI on the recommendations made by the NFRA. Both section 133 and 143(10) mandates consultation with NFRA and if it is construed that there must be mandatory consultation with ICAI after NFRA has made its recommendations to the Central Government, then the consultative process will become endless. However, having said that if the Central Government, so desires, it is always free to seek further inputs from either the ICAI or the NFRA.

III. Whether the Standards on Quality Control and Standards on Quality Management can be considered as auditing standards or their addendum under section 143(9) & 143(10) of the Companies Act, 2013?

(21) Section 143(9) states that "Every auditor shall comply with the auditing standards". However, the expression auditing standards has not been defined in the Act or the Rules except to state that "auditing standards means the standards of auditing or any addendum thereto for companies or class of companies referred to in sub-section (10) of section 143". [Section 2(7) of the Companies Act, 2013.]

(22) Even the Rule 2(1)(c) of the NFRA Rules 2018 defines auditing standards to mean "the 'auditing standards' as defined in clause (7) of section 2 of the Act;". In fact, there is no substantive definition provided for in the law as to what comprises of "auditing standards". It appears that the legislature deliberately left these expression fluid to enable the Central Government to adapt to changing needs of the times to address myriad unforeseen problems and decide what will constitute the auditing standards or addendum thereto.

(23) Therefore, in terms of sub-section (10) of section 143, whatever the Central Government prescribes as the standards of auditing will be construed as the auditing standards. If the Central Government is of the view that SQMs should be notified as auditing standards, it will be within its powers to notify them as Auditing Standards. Until and unless the Central Government prescribes the Standards on Quality Control and Standards on Quality Management as auditing standards, said 'standards' would not fall within the purview of

“auditing standards” as understood in the extant law. The Central Government, alone, is empowered to prescribe any standards as ‘auditing standards.’

IV. In terms of Rule 10(3)(a) and(b) of the NFRA Rules 2018 read with section 132(4)(a) and its proviso under the Companies Act, 2013, whether the ICAI under the Chartered Accountants Act, 1949 can initiate any investigation into the auditors of class of companies covered under rule 3(3) of the NFRA Rules 2018?

(24) In order to answer the above query, it would be necessary to examine the proviso to Section 132(4)(a) of the Companies Act, 2013 which reads as follows:

(4) Notwithstanding anything contained in any other law for the time being in force, the National Financial Reporting Authority shall –

(a) have the power to investigate, either suo motu or on a reference made to it by the Central Government, for such class of bodies corporate or persons, in such manner as may be prescribed into the matters of professional or other misconduct committed by any member or firm of chartered accountant, registered under the Chartered Accountants Act, 1949:

Provided that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the National Financial Reporting Authority has initiated an investigation under this section;

(25) Rule 10(3)(a) & (b) of the NFRA Rules read as under:

10. Power to investigate.—

(3) On the commencement of these rules-

(a) the action in respect of cases of professional or other misconduct against auditors of companies referred to in rule 3 shall be initiated by Authority and no other institute or body shall initiate any such proceedings against such auditors:

Provided that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the Authority has initiated an investigation under this rule;

(b) the action in respect of cases of professional or other misconduct against auditors of companies or bodies corporate other than those referred to in rule 3 shall continue to be proceeded with by the Institute of Chartered Accountants of India as per

provisions of the Chartered Accountants Act, 1949 and the regulations made thereunder.

(26) Rule 3 of the NFRA Rules provides for the class of bodies corporates or persons over whom the NFRA exercises jurisdiction.

3. Classes of companies and bodies corporate governed by the Authority.—

(1) The Authority shall have power to monitor and enforce compliance with accounting standards and auditing standards, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors of the following class of companies and bodies corporate, namely:-

(a) companies whose securities are listed on any stock exchange in India or outside India;

(b) unlisted public companies having paid-up capital of not less than rupees five hundred crores or having annual turnover of not less than rupees one thousand crores or having, in aggregate, outstanding loans, debentures and deposits of not less than rupees five hundred crores as on the 31st March of immediately preceding financial year;

(c) insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act for the time being in force or bodies corporate incorporated by an Act in accordance with clauses (b), (c),

(d), (e) and (f) of sub-section (4) of section 1 of the Act;

(d) any body corporate or company or person, or any class of bodies corporate or companies or persons, on a reference made to the Authority by the Central Government in public interest; and

(e) a body corporate incorporated or registered outside India, which is a subsidiary or associate company of any company or body corporate incorporated or registered in India as referred to in clauses (a) to (d), if the income or networth of such subsidiary or associate company exceeds twenty per cent. of the consolidated income or consolidated networth of such company or the body corporate, as the case may be, referred to in clauses (a) to (d).

(27) It is well settled that subordinate legislation once validly made becomes part of the Act. [*Annamalai University v Information & Tourism Deptt.* (2009) 4 SCC 590 at 607 Para 42]

(28) A plain reading of the above provisions of law leads to the following irresistible conclusions:

- a. The NFRA has been conferred with exclusive power to investigate into matters of professional or other misconduct by any member or firm of chartered accountant for such class of bodies corporate or persons as prescribed under Rule 3 quoted above;
- b. The use of the non-obstante clause in sub-section (4) of Section 132 gives overriding power to NFRA over any other body conferred with similar power under any other law including the ICAI;
- c. The proviso to section 132(4)(a) r/w rule 10(3)(a) makes it even more explicit that even pending proceedings cannot be continued by any other institute or body over such class of bodies corporate or persons over whom NFRA has jurisdiction.
- d. The ouster of jurisdiction of ICAI is, however, not absolute and is limited to “*such class of bodies corporate or persons*” as prescribed in rule 3 of the NFRA Rules 2018.

(29) A non-obstante clause is a legislative device which is used to give over-riding effect to certain provisions over some contrary provisions either in the same enactment or some other statute. In this regard reliance is placed on the Hon'ble Supreme Court's observations in *Vishin N. Khanchandani v. Vidya Lachmandas Khanchandani*, reported in (2000) 6 SCC 724 wherein it was held as under:

“... There is no doubt that by the non obstante clause the legislature devises means which are usually applied to give overriding effect to certain provisions over some contrary provisions that may be found either in the same enactment or some other statute. In other words, such a clause is used to avoid the operation and effect of all contrary provisions. The phrase is equivalent to showing that the Act shall be no impediment to the measure intended.”

(30) Therefore, on a plain reading of Section 132(4)(a) including the proviso therein read with Rule 10(3)(a), it is clear that the jurisdiction of the ICAI has been ousted insofar as it cannot initiate or continue any investigation into auditors of such class of companies covered under Rule 3 of the NFRA Rules, 2018 over whom the NFRA has exclusive jurisdiction.

V. Whether the executive body of NFRA in terms of its obligations under section 132(2)(a), (b), (c) and (d) read with rule 4(2)(c), (d) & (e) can issue general circulars to companies/auditors of the class covered under Rule 3 pointing out non-compliances and requiring auditors/companies to ensure that such non-compliances do not occur in future?

- (31) Section 132(2)(b) & (c) casts an obligation upon the NFRA to ensure compliance with accounting and auditing standards as prescribed and the rules made thereunder.
- (32) Rule 4(1) requires the Authority to protect the public interest and the interest of investors, creditors and others associated with the companies governed under Rule 3 by establishing high quality standards of accounting and auditing and exercising effective oversight of auditing functions performed by the auditors.
- (33) Clauses (c), (d) and (e) of Rule 4(2) *inter alia* requires monitoring and enforcing compliance with Auditing Standards, suggesting measures for improvement in the quality of service and promoting awareness in relation to the compliance of auditing standards.
- (34) Rule 3 of the NFRA Rule 2018, mandates protection of the public interest and the interests of investors, creditors and others associated with prescribed class of companies or bodies corporate by establishing high quality standards of accounting and auditing and exercising effective oversight over accounting and auditing functions performed by the companies/bodies corporates and auditors, respectively.
- (35) Therefore, even though there is no explicit power conferred upon the NFRA to issue general circulars to companies/auditors of the class covered under Rule 3 pointing out non-compliances and requiring auditors/companies to ensure that such non-compliances do not occur in future, nevertheless one of the functions of the NFRA under Rule 4(2)(e) is to promote awareness in relation to the compliance with accounting and auditing standards. If such awareness is sought to be created by way of a circular, then the power to issue such circulars is implicit in the duties and functions of the NFRA.

VI. Whether in case of professional and other misconduct observed in an audit done by a firm, does Section 132 (4) of the Companies Act confer power on the Executive Body to impose penalty on both the audit Firm as well as individual partners of the firm who were involved in the said audit on behalf of the firm?

- (36) The power conferred upon the NFRA to impose penalty on both the individual CA as well as the firm can be found in S. 132(4)(c) of the Companies Act, 2013 which reads as follows:

Where professional or other misconduct is proved, have the power to make order for— (A) imposing penalty of—

*(I) not less than one lakh rupees, but which may extend to five times of the fees received, **in case of individuals**; and*

*(II) not less than ten lakh rupees, but which may extend to ten times of the fees received, **in case of firms**;*

*(B) debarring the **member or the firm** from—*

I. being appointed as an auditor or internal auditor or undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate; or

II. performing any valuation as provided under Section 247, for a minimum period of six months or such higher period not exceeding ten years as may be determined by the National Financial Reporting Authority.]

Explanation.—For the purposes of this sub section, the expression "professional or other misconduct" shall have the same meaning assigned to it under section 22 of the Chartered Accountants Act, 1949 (38 of 1949)

- (37) The law confers explicit power on the NFRA to levy a penalty both on the firm and the individual CA where professional or other misconduct is proved. Needless to state that such professional or other misconduct must be proved both at an individual level as well as at the level of the firm before NFRA can exercise its power to levy penalty on both the individual and the firm. There is no infirmity in the law which seeks to impose penalty both upon the firm as well as the individual depending upon the role played by them in the commission of professional or other misconduct. It is well settled that penalty can be imposed on firms or bodies corporate even under penal statutes. Moreover, the role of the firm in the functioning of the auditors and in their duty to comply with Auditing Standards would be integral to their statutory functions.

VII. Can ICAI after the notification of the NFRA on 1.10.2018 under s 132 of CA 2013, and also given MCA letter dated 11.8.2021 (attached), issue and notify SQMs and consequent amendments to SAs or issue amendments to other SAs (citing its powers under the proviso to S 143(10)) without a review by NFRA and without sanction of the Central Government especially in respect of entities prescribed under Rule 3 of NFRA Rules 2018, given provisions in s. 132 (2), 132 (4) of CA 2013 read with NFRA Rules 2018 including Rule 4 (1)?" [Additional query sent by Vidhu Sood, Secretary, NFRA vide email dated 20.10.2024]

- (38) In order to answer this query, certain provisions of law as it stands today needs to be examined.
- (39) NFRA is constituted under sub-section (1) of section 132. Sub-section (2) lays down the powers and duties of the NFRA. Section 132(2)(a) confers upon NFRA a wide power to make recommendations to the Central Government on, *inter alia*, accounting and auditing standards with respect to class of companies or their auditors. The provision states:

"(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;"

(40) The NFRA Rules, 2018 reiterates the above in the following terms in rule 4(2)(b):

"4. Functions and duties of the Authority.— (1) The Authority shall protect the public interest and the interests of investors, creditors and others associated with the companies or bodies corporate governed under rule 3 by establishing high quality standards of accounting and auditing and exercising effective oversight of accounting functions performed by the companies and bodies corporate and auditing functions performed by auditors.

(2) In particular, and without prejudice to the generality of the foregoing, the Authority shall:—

*...
(b) recommend accounting standards and auditing standards for approval by the Central Government;*

(41) It may be noted that when it comes to recommending both accounting and auditing standards, the NFRA Rules lay down a clear manner which is to be followed by NFRA while making the recommendations. Rule 6 states:

"6. Recommending accounting standards and auditing standards.—

(1) For the purpose of recommending accounting standards or auditing standards for approval by the Central Government, the Authority—

(a) shall receive recommendations from the Institute of Chartered Accountants of India on proposals for new accounting standards or auditing standards or for amendments to existing accounting standards or auditing standards;

(b) may seek additional information from the Institute of Chartered Accountants of India on the recommendations received under clause (a), if required.

(2) The Authority shall consider the recommendations and additional information in such manner as it deems fit before making recommendations to the Central Government."

(42) Sections 133 and 143(10) (supra) would reveal that NFRA is a mandatory consultee in the process of the Central Government prescribing the standards of accounting/auditing or any addendum thereto.

- (43) Secondly, the NFRA has been conferred with power under Section 132(2)(a) to make recommendation to the Central Government on the formulation and laying down of accounting and auditing policies and standards, notwithstanding any provision in any other law.
- (44) Section 132(2) starts with a non-obstante clause which is meant to give NFRA overriding powers over any other law for the time being in force.
- (45) A proviso in sub-section (10) of section 143 being general in nature cannot be made the basis to render a specific and special provision nugatory contained in S. 132(2).
- (46) Moreover, if the proviso to sub-section (10) of section 143 is seen in its correct perspective it will be clear that the same is a transitory provision wherein until the auditing standards are notified by the Central Government, the existing standards which are in force prior to the coming into force of the Companies Act 2013 would be deemed to be the auditing standards. However, it is well settled that such a transitory provision cannot be the source of power in perpetuity for carrying out further amendments to the existing auditing standards. Therefore, any standard/s already specified by the ICAI when the Companies Act 2013 came into force would be deemed to be the auditing standards until the Central Government prescribes the standards of auditing.
- (47) It is well settled that that a proviso cannot be allowed to swallow up the general rule. Normally the main provision of law has to be followed. When the main provision of law is mandatory, then all efforts have to be made to follow it. Exception to the main provision is not an alternative provision or alternate source of power. The authority has no privilege to choose one of them and cannot be said to be free to follow any of the provision on his sweet will. Mandatory provisions of law cannot be ignored in the guise of the power under proviso. Proviso has to be followed in the category of cases, mentioned in it, i.e. until the Central Government prescribes the standards of auditing.
- (48) In Principles of Statutory Interpretation, by Mr. Justice G.P. Singh, 12th Edition of 2010, at page 208 it is stated that a proviso will not be normally construed as reducing the purview of enactment to a nullity or to take away a right clearly conferred by the enactment.
- (49) Hon'ble Supreme Court in *Raghuthilakathirtha Sreepadangalavaru Swamiji vs. State of Mysore and others*, AIR 1966 SC 1172, has held that a proviso is normally in the nature of a qualification or exception and therefore, it does not nullify the enactment. In *Director of Education (Secondary) vs. Pushpendra Kumar*, AIR 1998 SC 2230, it is held that, a provision in the nature of an exception cannot be so

construed as to subsume the main provision and thereby nullify the right conferred by the main provision. In *Southern Petrochemical Industries Company Ltd. vs. Electricity Inspector*, AIR 2007 SC 1984, it is held that a proviso is used to remove special cases from the purview of general enactment.

- (50) Moreover, there appears to be no other provision under the Chartered Accountants Act, 1949 or the Companies Act, 2013 which empowers the ICAI to specify/lay down/notify standards of auditing. ICAI cannot seek to issue circulars in exercise of its executive powers which is not traceable to any provision of law and end up usurping a specific power conferred on the Central Government by sub-section (10) of section 143 of the Companies Act, 2013.
- (51) While dealing with the power of the Pharmacy Council of India to impose a moratorium for 5 years on starting of new pharmacy colleges in India, the Hon'ble Supreme Court in *Pharmacy Council of India v. Rajeev College of Pharmacy & Ors.* was pleased to reject the argument of the Pharmacy Council that the word "*regulate*" in the preamble of the Act was sufficient to confer a source of power to impose moratorium by way of a policy decision and while striking down the moratorium it was held that a statutory body can do only such acts as are authorized by the statute creating it and that the powers of such a body cannot extend beyond what the statute provides expressly or by necessary implication.
- (52) Therefore, the correct interpretation of the proviso to sub-section (10) of section 143 seems clear and it is meant to only fill the gap as a transitory measure till the Central Government prescribes the auditing standards and until such time, the auditing standards already specified by the ICAI, i.e. at the time of commencement of the Companies Act 2013, will continue to hold the field.
- (53) The understanding of the Ministry of Corporate Affairs as expressed in its letter dated 11.8.2021 (attached with the brief for opinion) appears to be consistent with the above view.
- (54) Therefore, the ICAI cannot continue to issue and notify SQMs and consequent amendments to SAs or issue amendments to other SAs by citing its powers under the proviso to S 143(10) as the said power is only transitory in nature and it is meant to only fill the gap as a transitory measure till the Central Government prescribes the auditing standards and until such time the auditing standards already specified by the ICAI at the time of commencement of the Companies Act 2013, will continue to hold the field.
- (55) In light of the above, the queries raised for my opinion are being disposed of in the following manner:

No.	Queries	Answers
I.	<p><i>Whether the National Financial Reporting Authority under section 132(2)(a) of the Companies Act, 2013 can make independent recommendations on some of the accounting and auditing standards to the Central Government when the ICAI has not included them in its recommendations even after being requested and whether the Central Government would be empowered to notify such standards under section 133 or 143(10) of the Companies Act, 2013? [NFRA Board includes three representatives of ICAI – President of ICAI, Chairman of Account Standard Board, ICAI, and Chairman of Auditing Standard Board, ICAI.]</i></p>	<ul style="list-style-type: none"> • Section 132(2)(a) gives NFRA a wide power to make recommendations to the Central Government <i>not only</i> on the basis of the recommendations already submitted by ICAI, but more generally on the formulation and laying down of accounting and auditing standards as well as policies. • Neither Section 133 nor section 143(10), in any manner, trammel upon or restrict the power of the NFRA to make independent recommendations to the Central Government on accounting and auditing standards. In fact, the background and genesis of NFRA would reveal that the NFRA was meant for, <i>inter alia</i>, giving independent recommendations to the Central Government on auditing and accounting standards without being, in any manner, bound by the recommendations or views of the ICAI. In fact, even in order for the “consultation” to be effective and meaningful, the NFRA would be free to make its own independent recommendations.
II.	<p><u>Whether having received the recommendations from the ICAI in terms of section 133 and upon receipt of the independent recommendations from NFRA, is the Central Government obliged to again consult the ICAI on the</u></p>	<ul style="list-style-type: none"> • From the plain language of Section 133 or section 143(10) it does not appear mandatory to again consult with the ICAI on the recommendations

	<p><u>independent recommendations from NFRA especially in light of Rule 6 of the NFRA Rules, 2018?</u></p>	<p>made by the NFRA. Both section 133 and 143(10) mandates consultation with NFRA and if it is construed that there must be mandatory consultation with ICAI after NFRA has made its recommendations to the Central Government, then the consultative process will become endless.</p> <ul style="list-style-type: none"> • However, having said that if the Central Government, so desires, it is always free to seek further inputs from either the ICAI or the NFRA.
<p>III.</p>	<p><u>Whether the Standards on Quality Control and Standards on Quality Management can be considered as auditing standards or their addendum under section 143(9) & 143(10) of the Companies Act, 2013?</u></p>	<p>In terms of sub-section (10) of section 143, whatever the Central Government prescribes as the standards of auditing will be construed as the auditing standards. If the Central Government is of the view that SQMs should be notified as auditing standards, it will be within its powers to notify them as Auditing Standards. Until and unless the Central Government prescribes the Standards on Quality Control and Standards on Quality Management as auditing standards, said 'standards' would not fall within the purview of "auditing standards" as understood in the extant law. The Central Government, alone, is empowered to prescribe any</p>

		standards as 'auditing standards.'
IV.	<u>In terms of Rule 10(3)(a) and(b) of the NFRA Rules 2018 read with section 132(4)(a) and its proviso under the Companies Act, 2013, whether the ICAI under the Chartered Accountants Act, 1949 can initiate any investigation into the auditors of class of companies covered under rule 3(3) of the NFRA Rules 2018?</u>	On a plain reading of Section 132(4)(a) including the proviso therein read with Rule 10(3)(a), it is clear that the jurisdiction of the ICAI has been ousted insofar as it cannot initiate or continue any investigation into auditors of such class of companies covered under Rule 3 of the NFRA Rules, 2018 over whom the NFRA has exclusive jurisdiction
V.	<u>Whether the executive body of NFRA in terms of its obligations under section 132(2)(a), (b), (c) and (d) read with rule 4(2)(c), (d) & (e) can issue general circulars to companies/auditors of the class covered under Rule 3 pointing out non-compliances and requiring auditors/companies to ensure that such non-compliances do not occur in future?</u>	Even though there is no explicit power conferred upon the NFRA to issue general circulars to companies/auditors of the class covered under Rule 3 pointing out non-compliances and requiring auditors/companies to ensure that such non-compliances do not occur in future, nevertheless one of the functions of the NFRA under Rule 4(2)(e) is to promote awareness in relation to the compliance with accounting and auditing standards. If such awareness is sought to be created by way of a circular, then the power to issue such circulars is implicit in the duties and functions of the NFRA.
VI.	<u>Whether in case of professional and other misconduct observed in an audit done by a firm, does Section 132 (4) of the Companies Act confer power on the Executive Body to impose penalty on both the audit Firm as well as individual partners of the firm who were involved in the said audit on behalf of the firm?</u>	The law confers explicit power on the NFRA to levy a penalty both on the firm and the individual CA where professional or other misconduct is proved. Needless to state that such professional or other misconduct must be proved both at an individual level as well as at the level of the firm before NFRA can exercise its power to levy penalty on both the individual and the firm. There is no infirmity in the law which seeks to impose

		penalty both upon the firm as well as the individual depending upon the role played by them in the commission of professional or other misconduct. It is well settled that penalty can be imposed on firms or bodies corporate even under penal statutes. Moreover, the role of the firm in the functioning of the auditors and in their duty to comply with Auditing Standards would be integral to their statutory functions.
VII.	<i>Can ICAI after the notification of the NFRA on 1.10.2018 under s 132 of CA 2013, and also given MCA letter dated 11.8.2021 (attached), issue and notify SQMs and consequent amendments to SAs or issue amendments to other SAs (citing its powers under the proviso to S 143(10)) without a review by NFRA and without sanction of the Central Government especially in respect of entities prescribed under Rule 3 of NFRA Rules 2018, given provisions in s. 132 (2), 132 (4) of CA 2013 read with NFRA Rules 2018 including Rule 4 (1)?" [Additional query sent by Vidhu Sood, Secretary, NFRA vide email dated 20.10.2024]</i>	The ICAI cannot continue to issue and notify SQMs and consequent amendments to SAs or issue amendments to other SAs by citing its powers under the proviso to S. 143(10) as the said power is only transitory in nature and it is meant to only fill the gap as a transitory measure till the Central Government prescribes the auditing standards and until such time the auditing standards already specified by the ICAI at the time of commencement of the Companies Act 2013, will continue to hold the field.

I have nothing further to add.



[Tushar Mehta]
Solicitor General of India