सीए. निहार एन जंबुसरिया
अध्यक्ष

CA. Nihar N Jambusaria
President

भारतीय सनदी लेखाकार संस्थान
(संसदीय अधिनियम द्वारा स्थापित)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
(Set up by an Act of Parliament)

**ICAI/CL&CGC/06/2021-22/Rep-11**

**22nd October, 2021**

**Shri Ashok Kumar Gupta**
Chairperson,
National Financial Reporting Authority
7th- 8th Floor, Hindustan Times House
18-20 Kasturba Gandhi Marg,
New Delhi - 110 001

Dear Sir,

**Sub: ICAI Concerns on:**

**(i) Returning of "Revision of Existing Accounting Standards: Approach Paper (2020) prepared by ICAI" by NFRA and**

**(ii) Issuance of NFRA Consultation Paper on "Statutory Audit and Auditing Standards for Micro, Small and Medium Companies**

We request your attention to NFRA communication dated 28th September 2021 returning therewith the Approach Paper on "Revision of Existing Accounting Standards" submitted by ICAI and the Consultation Paper on "Statutory Audit and Auditing Standards for Micro, Small and Medium Companies (MSMCs)".

We at ICAI; with a 72-year regulatory experience and enforcement of resilient framework ushering good governance practices all through in journey of public interest and growth story of Indian economy; are really concerned with the one-sided non-consultative obstinate approach of National Financial Reporting Authority (NFRA) as on date which has had huge impact on the interest of the Nation as a whole as well as Chartered Accountancy profession.

The policy parlance never intended ICAI and NFRA to be competing entities in each other's domain to tangentially intersect and infringe upon the powers of each other which the enabling statutes have conferred so far.

ICAI is of conviction that Power of Regulatory Oversight is to be in congruence with the existing framework and no new framework/ procedures, process of conduct of audit should be inferred which the Legislature never intended. Accordingly, ICAI believes that NFRA should not suggest/ prescribe measures in the name of improvement of audit quality including exemption from Statutory Audit, changes in the audit processes, quality control, and audit reports other than that which not only are already in existence but have sufficiently withstood efflux of time.

ICAI has an enviable history of harmonious and effective working with all Institutions and with the predecessor organisation NACAS, ICAI had well established working procedures, which led to improvement in quality of financial reporting over time.

**Once the objective of both ICAI and NFRA is to promote public good; it is important that the two organisations discuss and deliberate on respective mandate given to two bodies and work in a cohesive manner so as to work towards Nation Building.**



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We are sure that under leadership at NFRA, we will be able to work together for common objective of promoting quality financial reporting.

We now bring to your kind attention the concerns of ICAI on returning of the Approach Paper for revision of existing AS prepared by ICAI and the Consultation Paper on "Statutory Audit and Auditing Standards for Micro, Small and Medium Companies issued by NFRA.

**i. Returning of "Revision of Existing Accounting Standards: Approach Paper (2020) prepared by ICAI" by NFRA**

ICAI had embarked its journey to formulate a separate set of Accounting Standards (ASs) for other than Public-Interest Entities in the background of its view expressed way back in the year 2007 to converge with IFRSs atleast for large and listed entities in view of the emerging global trend of convergence with IFRSs.

After Ind ASs were hosted on MCA's website for Public Interest Entities (PIE) initially in the year 2011, the Core Committee of MCA (which included nominee of RBI/SEBI/IRDAI/C&AG and MoF) had requested ICAI to examine whether there should be one set or two sets of Accounting Standards and how one set of Accounting Standards can be applied for all companies including one person companies and small companies.

ICAI after in-depth examination and study recommended that there should be two sets of Accounting Standards - one set comprising Ind AS for large, public interest companies and the other set containing simplified measurement principles with fewer disclosures for smaller companies. It was also mentioned that a second set of Standards does not mean that the recognition and measurement principles would be significantly different from Ind AS in all cases and the said Report was submitted to MCA on 21.10.2013.

ICAI then developed an Approach Paper which was approved by NACAS; an independent body under the erstwhile regime in August 2016. The NACAS requested ICAI to continue with the process of upgradation of AS keeping in view a few suggestions. It suggested that efforts should be made to keep the standard simple, appropriate balance between fair presentation and prudence should be maintained and sufficient time for preparedness and implementation be given.

With the constitution of NFRA, ICAI held various informal meetings with Chairman and Member of NFRA such as meeting dated 02.11.2018 and 10.07.2020 wherein the background of the origin of the project of revision of existing AS and the status of the project as on date was also discussed with NFRA.

Accordingly, 11 Revised ASs were submitted to NFRA vide letter dated October 8, 2020 (and at request of NFRA, re-submitted, in the format prescribed by the NFRA vide letter dated June 18, 2021) and 7 Revised ASs were submitted to NFRA vide letter dated August 17, 2021.

ICAI has been relentlessly working on developing revised ASs since 2015. Till 2018, revised ASs were formulated and prepared in close consultation with NACAS and on the basis of principles that were agreed upon.



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Every standard developed as per NACAS approved approach paper went through the due process of issuing Exposure Draft for inviting comments from public at large and deliberation of each and every comment received at ASB of ICAI and then brought to Council and forwarded to NACAS for final recommendation to MCA.

ICAI is committed to quality financial reporting and best practices. Over a period of time, ICAI has built a huge reputation on quality of standard setting and confidence of all stakeholders on the same. ICAI and the Government have developed best accounting principles for all companies (including small companies) with a lot of hard work in tandem with the ground realities.

We are **extremely astounded and surprised to see that the Approach Paper on Revision of Existing Accounting Standards has now been returned by NFRA**. It may be mentioned that while formulating the revised ASs as per the Approach Paper; transparent mechanism was followed by ICAI through all stages wherein exposure drafts were issued, comments thereon were discussed at ASB of ICAI (which broadly comprised of members from SEBI, MCA, RBI, C&AG, Industry Bodies). ICAI's Council and NACAS meetings were held wherein detailed discussions had taken place. The entire exercise of issue of Exposure Drafts, considering the comments of stakeholders at ASB of ICAI meetings and then sending the draft revised ASs itself meets the requirement of the intended Regulatory Impact Assessment.

**NFRA has in the last 15 months, not discussed a need for Regulatory Impact Assessment either with members of NFRA at its meeting or with ICAI.** The ICAI submitted the Approach Paper **in May 2020 and a 2 hour presentation was also made to the Chairman, NFRA wherein inputs were given by him to submit the standards as a set on some logical division**. **Infact NFRA requested to submit the revised standards in a prescribed format vide letter dated March 11, 2021, which were subsequently submitted.** NFRA action of returning the Approach Paper on Revision of Existing Accounting Standards on account of not conducting Regulatory Impact Assessment (RIA), without due deliberations at the Authority meeting is not appropriate.

Further, the Executive Body of the NFRA does not have authority on ASs and SAs and therefore anything related to ASs and SAs has to be mandatorily deliberated in NFRA Board meeting and therefore **NFRA action of rejection/return of Approach Paper without discussion at the Board Meeting is outside its functional jurisdiction.** The NFRA Board meeting was held as recent as on 20th September 2021 and the matter pertaining to the Approach Paper could have been easily discussed there.

We request NFRA to consider the Approach Paper and the standards already submitted at its Board. The set of revised standards need to be issued as this will include the Standards on the subjects where at present there is no Standard, for example, share based payments and financial instruments. We are sure that you will appreciate our contentions.

**ii. NFRA Consultation Paper on "Statutory Audit and Auditing Standards for Micro, Small and Medium Companies"**

NFRA has issued a Consultation Paper on "Statutory Audit and Auditing Standards for Micro, Small and Medium Companies (MSMCs)" inviting comments thereon upto 10th November, 2021.



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The Consultation Paper is focused on the analysis of companies having Net worth of less that INR 250 crores and the same has been referred as Micro, Small and Medium companies (MSMCs) for the purpose of the Consultation Paper. It has been contended by NFRA in the Consultation Paper that the MSMCs shall be exempted from the requirement of Statutory Audit under the Companies Act, 2013 as no role is played by Statutory Audit in case of such companies.

**At the outset, it is pertinent to note that the Consultation Paper issued by NFRA is outside its functional authority. It is not within its purview to propose whether an audit of a particular class is required or not.**

**Also, the statement that Statutory Audit has no role to play in case of companies having Net worth less than INR 250 crores is without any research.**

We all recognize the fact that the Companies Act has in recent past included vast changes to foster the culture of integrity, transparency, compliances, disclosures and accountability by promoting Good Corporate Governance practices.

Audit is considered as one of the pillars of the effective Corporate Governance system in companies, as it also helps in mitigating the risk of failure in implementation of Corporate Governance.

The Consultation Paper has stated that out of the total companies which have made filings, 99.41% (5,99,487 Companies) have reported Net Worth below INR 250 Crores (MSMCs for the purpose of this consultation paper) and the same should be exempted from the requirement of Statutory audit based on certain criteria and accordingly, there should be no regulatory check on them.

An audit is a preventive check on all the companies, whether small or big, which enjoy limited liability of their shareholders. In the absence of audit, a small net worth company is also vulnerable to the massive risks of unaudited financial statements such as:

- Unaccounted transactions
- Lack of financial discipline
- Charging of personal expenses to books
- Non-maintenance of books and accounts and statutory records
- Unaccounted liabilities or Contingent Liabilities
- Unaccounted Assets or Recording Assets belonging to others
- Siphoning of Funds, Diversion of Funds and misuse of funds
- Money Laundering
- Non-adherence of requirements under various laws.

This list is only illustrative and not exhaustive.

Removal of requirement of Statutory Audit from such vast number of companies will only devastate the Corporate Governance framework and consequently, will hugely impact the economy and the nation adversely.



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An audit provides opinion on the true and fair view of Companies' financial performance and financial position to stakeholders including lenders, vendors and Government Departments such as Income Tax Dept., GST Dept., RBI, etc., and enable orderly functioning of markets by improving the confidence in the integrity of financial statements. The Government has also recently instituted a law on Insolvency and for effective administration of this law (pre-packages insolvency is proposed as well) which applies to all companies including MSMCs audited financial statements are important. There are also issues like determination of criteria for implementing several legislations like FEMA, tender criteria, etc.

**In the instant Consultation Paper, Global practices have been referred for determining audit exemption threshold, however it is important to note that India is a developing country and the GDP of India and such other countries are not at par with each other.**

Further, every country has its own procedures/policies etc. which are determined on the basis of economical and geographical conditions of such country. Therefore, the International practices should be considered only after taking into account all the factors.

Further, the Ministry of Corporate Affairs has already granted required relief to various Companies from the reporting requirements such as OPC and Small Companies are granted relief from reporting under CARO and ICFR, and similarly Private Limited Companies as defined under Section 2(86) of the Companies Act, 2013 have been allowed exemption from reporting under CARO and IFCR based on certain thresholds.

We are of the firm view that the provisions relating to mandatory statutory audit under the Companies Act, 2013 should remain the same and there should not arise any question of not having **Statutory Audit as it is the backbone of Financial Reporting Chain.**

However, on the sole basis of merit, ICAI views on the questions posed by the NFRA related to issues about the Auditing areas of MSMCs are as follows:

- **Question No. 1 -** Do you think that Micro, Small and Medium Companies (MSMCs) depending upon some criteria and threshold should be exempted from the mandatory statutory audit under Companies Act, 2013? If not, why not and if yes, what would be the criteria and thresholds for exemption?

  We are of the view that the provisions relating to mandatory statutory audit under the Companies Act, 2013 should remain the same and there should not arise any question of not having **Statutory Audit as it is the backbone of Financial Reporting Chain**

- **Question No. 2 -** Do you think there is a requirement for a separate set of auditing standards for MSMCs as it exists for accounting standards? If no, why not and if yes, what should be the basis for the same?

  As we all know that an audit is an independent examination of financial information of an entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.



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Standards on Auditing are critical in ensuring and enhancing quality in audits of financial statements and they have been designed in a way, considering the same. It is therefore necessary that for audit of less complex entities/ SMEs, separate set of Standards on Auditing be developed.

This is to mention here that many countries have realized the need for separate set of Standards on Auditing for SMEs and raised their concern from time to time at various International Forums regarding compliance cost for implementing full set of ISAs in audit of SMEs.

Also, ICAI has already decided to either develop separate set of Standards on Auditing for SMEs (an Exposure draft of same has been issued for public comments in Jan 2021) or to insert the scalability in the extant set of auditing standards, as appropriate.

- **Question No. 3** – The cost of conducting an audit as per the prescribed standards is an important input for the responses to Questions 1 and 2. Do you agree with the approach for estimating standard cost of audit computed by NFRA? If not, which areas/ assumptions need changes?

  The whole issue is to be researched further, beginning from the audit fees paid by PSUs including Public Sector Banks, where there is lot of public interest.

  The observations of the Executive body are totally ill founded and hence not considered appropriate to respond to individual points.

  Importantly, **there is no direct corelation between quality of audit and the cost of conducting audit as mentioned in Consultation Paper by NFRA as the auditors have to comply with the Standards of Auditing and other relevant standards while conducting an audit.**

- **Question No. 4-** Do you think the current exemption thresholds for CARO, ICFR and statutory audit applicability need to be standardised and made uniform? If no, why not and if yes, what would be the criteria and thresholds?

  The Internal Controls over Financial Reporting (ICFR) relates to the reporting requirement by the Auditor that whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls and The Companies (Auditor's Report) Order i.e. CARO relates to certain additional reporting requirement by Auditor's in respect of every company other than the companies that have been exempted under the said Order.

  The thresholds for ICFR and CARO are fixed considering that Statutory Audit would address these aspects for the other entities through the requirement of provisions like SA 315, etc.



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**iii. Other Issues**

There are several other instances of one side working of NFRA executive body which we seek a consultative approach with ICAI

- Issuance of Draft Procedure for submission of Audit Files to NFRA
- Formation of Technical Advisory Committee
- Issuance of Form NFRA- 2 by NFRA
- Information sought from various firms for the years from 2015-2019 to study matters relating to the independence of Statutory Audit
- Regarding the presence of part-time members in NFRA meetings and the number of meetings of NFRA as per NFRA (Meeting for Transaction of Business) Rules, 2019
- Differentiation between Inspection and Investigation by NFRA
- How to deal with Conflict within the Sections of the Companies Act 2013

**Further, different approach of MCA/ICAI on one hand and NFRA on the other, is leading to a lot of confusion in preparers and auditors for consistent application of various laws and regulations.**

**Conclusion**

1. ICAI proposes that NFRA deliberate the Revised approach paper and the standards at its full meeting of its members.

2. Consultation Paper on Statutory Audit and Auditing Standards for MSMCs, be withdrawn forthwith and deliberated at a Full meeting of its members.

This is to mention here that the mode of communication opted by NFRA i.e., talking through media should not be opted and this kind of matters of relevance should be discussed with the Board Members at the NFRA Board Meeting.

We look forward to work with you with a more collaborative approach for improvement of quality of financial reporting in the country.

With regards,

Yours sincerely,

N. Jambusaria

(CA. Nihar N Jambusaria)



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