

# CONTENTS

PAGE

## DIVISION ONE

### **LAW GOVERNING NATIONAL FINANCIAL REPORTING AUTHORITY (NFRA) UNDER COMPANIES ACT, 2013**

#### 1

#### **GENESIS & ARCHITECTURE OF NATIONAL FINANCIAL REPORTING AUTHORITY**

<b>1.1</b>	Backdrop	<b>3</b>
<b>1.2</b>	Genesis of NFRA	<b>4</b>

#### 2

#### **FUNCTIONS, DUTIES & POWERS OF NFRA**

<b>2.1</b>	Functions & duties of NFRA	<b>7</b>
<b>2.1-1</b>	Recommending accounting standards and auditing standards	<b>9</b>
<b>2.1-2</b>	Advisory committees, study groups and task forces	<b>9</b>
<b>2.1-3</b>	Financial reporting advocacy and education	<b>10</b>
<b>2.1-4</b>	International associations and international assistance	<b>10</b>
<b>2.1-5</b>	Confidentiality and security of information	<b>10</b>
<b>2.1-6</b>	Avoidance of conflict of interest	<b>10</b>
<b>2.2</b>	Powers of NFRA [Section 132(4)]	<b>11</b>
<b>2.3</b>	Summary	<b>12A</b>

**3**

**CLASSES OF COMPANIES OR BODIES  
CORPORATE GOVERNED BY NFRA**

<b>3.1</b>	Powers of NFRA which are exercisable by it only in respect of companies and bodies corporate governed by it and auditors of such companies and bodies corporate [Rule 3(1), Section 132(2); Section 132(4)]	13
<b>3.1-1</b>	Auditor	13
<b>3.2</b>	Classes of companies and bodies corporate governed by the authority [Rule 3(1)]	14
<b>3.3</b>	Listed companies [Rule 3(1)(a)]	15
<b>3.4</b>	Unlisted companies whose paid-up capital or annual turnover or aggregate loans, debentures and deposits equal or exceed specified limits	15
<b>3.4-1</b>	“Paid-up share capital” [Section 2(64)]	16
<b>3.4-2</b>	Annual Turnover	17
<b>3.4-3</b>	Definition of “loan”	17
<b>3.4-4</b>	Debenture [Section 2(30)]	17
<b>3.4-5</b>	“Deposit” [Section 2(31)]	20
<b>3.5</b>	Companies or Bodies Corporate Specified in Clauses (b) to (f) of Section 1(4) of the Act [Rule 3(1)(c)]	25
<b>3.5-1</b>	Banking Company	26
<b>3.6</b>	Any Body Corporate/Company in Respect of Which a Reference is Made by Central Govt. to NFRA [Rule 3(1)(d)]	27
<b>3.7</b>	Material foreign subsidiary or material foreign associate of any company or body corporate	27
<b>3.7-1</b>	“Associate Company” [Section 2(6)]	28
<b>3.7-2</b>	Subsidiary	28
<b>3.7-3</b>	“Net Worth”	34

**4****DUTIES OF COMPANIES/BODIES  
CORPORATE GOVERNED BY NFRA**

<b>4.1</b>	Duty of bodies corporate existing on date of commencement of NFRA Rules which fall under rule 3(1)	37
<b>4.2</b>	Duties of bodies corporate formed in India and governed by these rules	37
<b>4.3</b>	Duties of foreign associates & foreign subsidiaries governed by rule 3(1)(e)	37
<b>4.4</b>	Punishment in case of non-compliance [Rule 13]	38

**5****AUDITORS GOVERNED BY NFRA**

<b>5.1</b>	Auditors Governed by NFRA	39
------------	---------------------------	----

**6****DUTIES OF AUDITORS GOVERNED BY NFRA**

<b>6.1</b>	Filing of annual return [Rule 5]	40
<b>6.2</b>	Duty of auditor to co-operate in NFRA's review of financial statements [Rule 7]	40
<b>6.3</b>	Duty of auditor to co-operate with NFRA in its monitoring and enforcement of compliance with auditing standards [Rule 8]	40
<b>6.4</b>	Duty to report on governance practices and internal processes of Auditor/Audit firm	41
<b>6.5</b>	Duty to furnish additional information to NFRA	41
<b>6.6</b>	Comply with directions of NFRA for improvement of audit Quality [Rule 9]	41
<b>6.7</b>	Duty to pay penalty imposed by NFRA in disciplinary proceedings within 30 days [Rule 12]	41
<b>6.8</b>	Punishment in case of non-compliance [Rule 13]	42

**7**

**MONITORING AND ENFORCEMENT OF COMPLIANCE  
WITH ACCOUNTING STANDARDS**

<b>7.1</b>	Review of financial statements for the purposes of monitoring & enforcement of compliance with accounting standards	43
<b>7.2</b>	Publication by NFRA of its findings of review of financial statements	43
<b>7.2-1</b>	Issues arising out of publication or non-publication by NFRA of findings of review of financial statements	44

**8**

**MONITORING AND ENFORCEMENT OF  
COMPLIANCE WITH AUDITING STANDARDS**

<b>8.1</b>	Monitoring & enforcing compliance with auditing standards [Rule 8]	45
<b>8.2</b>	NFRA may require the auditor to report on his governance practices & internal processes	46
<b>8.3</b>	Power of NFRA to seek additional information or require personal presence of the auditor	46
<b>8.4</b>	NFRA may perform monitoring/enforcement activities through its officers/experts with sufficient experience	46
<b>8.5</b>	Publication of NFRA's findings as to non-compliances with auditing standards	46
<b>8.6</b>	Proprietary or confidential information	47
<b>8.7</b>	Further investigation/enforcement in case of any violations by auditor	47

**9**

**OVERSIGHT OF QUALITY OF  
SERVICE OF AUDITORS**

<b>9.1</b>	Overseeing the quality of service and suggesting measures for improvement	48
------------	---	----

**10****POWER OF NFRA IN RELATION TO PROFESSIONAL  
OR OTHER MISCONDUCT OF AUDITORS  
GOVERNED BY NFRA IN TERMS OF RULE 3**

<b>10.1</b>	Scope of the term “professional or other misconduct”	49
<b>10.1-1</b>	Accepting auditorship without communicating in writing with predecessor auditor	52
<b>10.1-2</b>	Accepting auditorship without first ascertaining from the prospective client company whether provisions of Companies Act in respect of appointment have been complied with	56
<b>10.1-3</b>	Allowing any other person to sign on his behalf and any non-partner to sign on behalf of his firm any balance sheet/P&L/report	61
<b>10.1-4</b>	Certification or reporting sans examination of financial statements	63
<b>10.1-5</b>	Expressing opinion on financial statements of business or enterprise in which he or his firm or his partner has substantial interest	63
<b>10.1-6</b>	Not disclosing in audit report any material fact known to him but not disclosed in financial statements (being party to audit client’s suppression veri fraud)	65
<b>10.1-7</b>	Becoming a party to <i>suggestio falsi</i> fraud of the audit client	66
<b>10.1-8</b>	Not exercising due diligence or guilty of gross negligence	67
<b>10.1-9</b>	Inappropriate audit reporting-issuing an opinion where disclaimer of opinion was appropriate and issuing qualified opinion where adverse opinion was appropriate	71
<b>10.1-10</b>	Failure to invite attention in audit report to departure from generally accepted audit procedure applicable to the circumstances	72
<b>10.2</b>	Power of NFRA to investigate into professional or other misconduct of CA or CA firm	73

	PAGE
<b>10.3</b> NFRA vested with certain powers of Civil Court	74
<b>10.4</b> Reporting to Central Government non-compliance involving fraud of ₹ 1 Cr. or more	74
<b>10.5</b> Proceedings by ICAI barred in respect of matters of misconduct into which investigation is initiated by NFRA	74
<b>10.6</b> Disciplinary Proceedings [Rule 11]	75
<b>10.6-1</b> Show cause notice - Contents	75
<b>10.6-2</b> Enclosures to SCN	76
<b>10.6-3</b> Service of show cause notice on the auditor	76
<b>10.6-4</b> Where auditor is a firm	76
<b>10.6-5</b> Disposal of show cause notice by NFRA by an order	77
<b>10.6-6</b> Service of order of NFRA disposing of the show cause notice	78
<b>10.7</b> Manner of enforcement of orders passed in disciplinary proceedings	78
<b>Annex 10.1</b> Acts or omissions as per schedules to the Chartered Accountants Act, 1949 which amount to professional/other misconducts	80

## 11

### **APPEAL BY AUDITOR AGGRIEVED BY NFRA'S ORDER ON PROFESSIONAL OR OTHER MISCONDUCT**

<b>11.1</b> Appeal against NFRA's order on professional/other misconduct lies to NCLAT	85
<b>11.2</b> Appeal to Supreme Court against NCLAT order on question of law arising out of such order	85

## DIVISION TWO

### **LAW GOVERNING AUDIT & AUDITOR UNDER COMPANIES ACT, 2013**

## 12

### **AUDIT**

<b>12.1</b> Definition of "audit"	89
-----------------------------------	----

	PAGE
<b>12.1-1</b> Audit is generally accepted means of preventing and detecting frauds by employees	90
<b>12.2</b> Objectives of audit	90
<b>12.3</b> Process of audit	91
<b>12.4</b> Nature of audit	93
<b>12.5</b> Inherent limitations of an audit	94
<b>12.6</b> Audit is not an official investigation into alleged wrongdoing	95

### **13**

#### **QUALIFICATIONS FOR AUDITOR**

<b>13.1</b> Auditor should be independent	96
<b>13.2</b> Qualifications of auditors	96
<b>13.2-1</b> 'Chartered Accountant'	96
<b>13.2-2</b> "Firm" includes LLP	97
<b>13.2-3</b> Eligibility of LLPs to be appointed Auditors	97
<b>13.3</b> Signing of audit report of firm/LLP	99
<b>13.4</b> Proprietary firm whether qualifies for appointment as auditor in firm name	99

### **14**

#### **DISQUALIFICATIONS OF AUDITORS**

<b>14.1</b> Disqualifications of auditors	101
<b>14.2</b> Disqualification of bodies corporate other than LLPs	103
<b>14.3</b> Disqualification of officer or employee of the company	103
<b>14.3-1</b> Officer	104
<b>14.3-2</b> Employee of the company	106
<b>14.4</b> Partner or employee of officer or employee of company	106
<b>14.5</b> Holding security of the company	107
<b>14.5-1</b> Security	108
<b>14.5-2</b> Subsidiary	109

	PAGE
<b>14.5-3</b> "Holding Company" [Section 2(46)]	<i>109</i>
<b>14.5-4</b> Associate company	<i>110</i>
<b>14.5-5</b> Relative	<i>110</i>
<b>14.6</b> Disqualification due to indebtedness	<i>110</i>
<b>14.6-1</b> Drawing fees of progressive basis - Whether indebtedness?	<i>111</i>
<b>14.6-2</b> Where client allows auditor normal credit period allowed to other customers	<i>111</i>
<b>14.6-3</b> Disqualification of partner where firm indebted	<i>112</i>
<b>14.6-4</b> Disqualification of firm where partner indebted	<i>112</i>
<b>14.7</b> Disqualification of business relationship	<i>112</i>
<b>14.8</b> Disqualification - Relative is director/KMP of company	<i>113</i>
<b>14.9</b> Disqualification of person in full-time employment elsewhere	<i>113</i>
<b>14.10</b> Disqualification - Auditor of more than 20 companies	<i>114</i>
<b>14.11</b> Disqualified for 10 years if convicted for fraud	<i>114</i>
<b>14.12</b> Disqualification if engaged in consulting services	<i>116</i>
<b>14.13</b> Definition of subsidiary, holding company etc. for various disqualifications	<i>116</i>
<b>14.14</b> Casual vacancy - Vacancy caused by disqualification	<i>116</i>

## **15**

### **APPOINTMENT OF AUDITORS OF GOVT. COMPANIES**

<b>15.1</b> Definition of Government Companies	<i>117</i>
<b>15.2</b> Appointment of auditors by government companies [Section 139(5)/(7)/(8)]	<i>117</i>



**16****APPOINTMENT OF AUDITORS IN CASE OF  
COMPANIES OTHER THAN GOVERNMENT  
COMPANIES**

<b>16.1</b>	Appointment of auditors by non-government companies	119
<b>16.2</b>	Manner and procedure of selection of auditors	121
<b>16.2-1</b>	The procedure for selection of auditors or audit firms for appointment at AGM	121
<b>16.2-2</b>	Certificate from auditor proposed to be appointed	122
<b>16.3</b>	Ordinary resolution required for appointment at AGM	123

**17****COMPULSORY ROTATION OF AUDITORS**

<b>17.1</b>	Concept of mandatory audit firm rotation	124
<b>17.2</b>	Rationale of mandatory rotation of auditors - To enhance audit quality	124
<b>17.3</b>	Companies to which provisions for compulsory rotation of auditor's apply	125
<b>17.4</b>	Provisions as to compulsory rotation of auditors	125
<b>17.4-1</b>	Manner in which the companies to rotate their auditors on the expiry of term	127
<b>17.4-2</b>	Rotation of auditors to be factored in while appointing joint auditors	129

**18****ROTATION OF AUDIT PARTNERS**

<b>18.1</b>	Rotation of auditor/audit firm <i>vis-à-vis</i> rotation of audit partners	130
<b>18.2</b>	Enabling provision for rotation of audit partners	130

**19****REAPPOINTMENT OF RETIRING AUDITORS**

<b>19.1</b>	Reappointment of retiring auditor	132
<b>19.2</b>	Where at any AGM, no auditor is appointed/re-appointed	132

**20****REMUNERATION OF AUDITORS**

<b>20.1</b>	Fixing remuneration of auditors	133
<b>20.2</b>	Definition of 'remuneration'	133

**21****JOINT AUDITORS**

<b>21.1</b>	Appointment of joint auditors	134
<b>21.2</b>	Manner of appointment of joint auditors	134

**22****REMOVAL OF AUDITORS**

<b>22.1</b>	Removal of auditor before expiry of term	135
<b>22.1-1</b>	Procedure for obtaining previous approval of Central Govt.	135
<b>22.1-2</b>	Previous Approval of the Central Government	136
<b>22.1-3</b>	Removal of statutory auditors who have lost confidence of management is justified	136
<b>22.2</b>	Resolution at AGM appointing as auditor a person other than a retiring auditor	137
<b>22.2-1</b>	Special notice of intended resolution	137
<b>22.2-2</b>	Sending copy of special notice to the retiring auditor	138
<b>22.2-3</b>	Right of retiring auditor to make written representations	138

	PAGE
<b>22.2-4</b> Where auditor abuses his rights to make written representations	139
<b>22.2-5</b> Non-forwarding of notice to retiring auditors consequence of	141
<b>22.2-6</b> Whether, for appointment of branch auditors, procedure laid down in section 140(4) of the Act is to be followed	142
<b>22.3</b> Tribunal may direct the company to change its auditors	142
<b>22.3-1</b> Reasonable opportunity of being heard to the auditor sought to be removed by Tribunal	143
<b>22.3-2</b> Appeal against Tribunal's order	144
<b>22.3-3</b> Auditor against whom an order passed by Tribunal under section 140(5) is disqualified from appointment as auditor for 5 years	144

## 23

### RESIGNATION OF AUDITOR

<b>23.1</b> What constitutes 'resignation'	145
<b>23.2</b> Resignation of auditor	145
<b>23.3</b> Punishment for not complying with above provisions	149

## 24

### POWERS AND DUTIES OF AUDITORS

<b>24.1</b> Powers of the auditor of a company	150
<b>24.1-1</b> Right of auditor of holding company to access records of subsidiaries	150
<b>24.2</b> Duty of auditor to inquire into specified matters	151
<b>24.2-1</b> "Inquire"	151
<b>24.2-2</b> Matters which auditor is required to inquire into	151
<b>24.3</b> Auditor obliged to comply with the auditing standards	154

	PAGE
<b>24.3-1</b> Auditing standards specify 'standard of care' and not 'duty of care'	155
<b>24.3-2</b> Whether "every auditor" in section 143(9) includes the branch auditor?	155
<b>24.4</b> Auditor's Report to members on accounts	156
<b>24.4-1</b> "Make a report to the members of the company"	156
<b>24.4-2</b> No requirement to report on documents declared by the Act to be part or annexed to balance sheet & profit and loss	157
<b>24.4-3</b> 'A true and fair view'	157
<b>24.5</b> Statutory affirmations in auditor's report	158
<b>24.5-1</b> Information and explanations necessary for the purposes of audit - Whether sought and obtained	160
<b>24.5-2</b> Maintenance of proper books of account	167
<b>24.5-3</b> Branch audit report	168
<b>24.5-4</b> Agreement of balance sheet & P&L account with books of account and returns	168
<b>24.5-5</b> Compliance with accounting standards	168
<b>24.5-6</b> Observations or comments on matters which adversely affect the functioning of the company	168
<b>24.5-7</b> Disqualification of director under section 164(2)	169
<b>24.5-8</b> Qualification reservation or adverse remark on maintenance of accounts and connected matters	177
<b>24.5-9</b> Adequate internal financial controls with reference to financial statements	177
<b>24.5-10</b> Such other matters as may be prescribed	179
<b>24.6</b> Reasons for qualified or negative answers to matters in audit report	182
<b>24.7</b> Duties of auditor-general principles	182

	PAGE
<b>24.7-1</b> Reasonable and watchful care and not a constantly suspecting approach	183
<b>24.7-2</b> Auditor is not an insurer; not concerned with prudence or imprudence	183
<b>24.7-3</b> Auditor is a watchdog, but not a bloodhound	184
<b>24.7-4</b> Reliance on representations provided by company's servants/officers	185
<b>24.7-5</b> No guarantee of fraud detection	185
<b>24.7-6</b> No part of auditor's duty to take stock	185
<b>24.7-7</b> Auditor can take the help of experts	185
<b>24.7-8</b> Auditors' responsibilities for tracking out frauds	186
<b>24.7-9</b> Don't judge auditors based on hindsight	187
<b>24.7-10</b> Auditor must be honest and must exercise reasonable care and skill	187
<b>24.7-11</b> Reliance on explanation of Company's Officers	188
<b>24.7-12</b> Auditor's business is to ascertain and state true financial position of company at time of audit	188
<b>24.7-13</b> Verification of securities in custody of third parties (other than banks)	188
<b>24.7-14</b> Scope of checking vouchers	189
<b>24.7-15</b> It is duty of auditor to see that balance sheet and books exhibit true state of company's affairs	189
<b>24.7-16</b> Where directors of a company do not allow auditors time to conduct such investigations as are necessary	190

## 25

### REPORTING FRAUDS TO CENTRAL GOVERNMENT

<b>25.1</b> Duties of Auditor/Cost Auditor/Secretarial Auditor to report fraud to Central Government	191
--	-----

	PAGE
<b>25.2</b> Requirements of section 143(12) objective of the provisions	192
<b>25.3</b> Whether recoveries of amount defrauded to be netted in reckoning the threshold limit of ₹ 1 crore for reporting purpose?	194
<b>25.4</b> “Frauds in the company by officers or employees”	194
<b>25.5</b> ICAI’s clarifications on scope of auditors’ duty u/s 143(12)	197
<b>25.6</b> Section 143(12) <i>vis-a-vis</i> CARO, 2016	198
<b>25.7</b> No change in auditor’s responsibilities regarding fraud prevention/detection	199
<b>25.8</b> Reporting u/s 143(12) is not a substitute to reporting in audit report	210
<b>25.9</b> Offence of fraud	210
<b>25.10</b> Applicable to branch auditors also	212
<b>25.11</b> Punishment for contravention of section 143(12)	212

## 26

### **BRANCH AUDIT**

<b>26.1</b> Definition of ‘branch office’	213
<b>26.2</b> Audit of accounts of a branch office	213
<b>26.2-1</b> No role for general body in appointing branch auditor	214
<b>26.2-2</b> No power of Central Government to exempt branch offices from audit	214
<b>26.3</b> Duties and powers of branch auditor	214
<b>26.3-1</b> Whether branch audit can be conducted at head office without visiting branches	214
<b>26.3-2</b> Whether copy of branch audit report could be sent to Board of directors	215
<b>26.4</b> Duties and powers of the company’s auditor with reference to the audit of the branch and the branch auditor	215

**27****AUDIT IN CASE OF GOVERNMENT COMPANIES**

<b>27.1</b>	Audit report in case of Government Company or any Company Controlled by Govt.	216
<b>27.2</b>	Powers of C&AG to conduct a supplementary audit in case of Government Companies or any Company Controlled by Govt. [Section 143(6)]	216
<b>27.3</b>	Power of CAG to cause test audit of accounts	217
<b>27.4</b>	Duties of Govt. Company or Govt. Controlled Company as regards supplementary audit or test audit by C&AG	217
<b>27.5</b>	Summary of powers of CAG under sub-sections (5) to (7) of section 143	218

**28****AUDITOR NOT TO RENDER CERTAIN SERVICES**

<b>28.1</b>	Services which auditor should not provide to the auditee-company	219
<b>28.1-1</b>	Transitional provisions	219
<b>28.2</b>	“Directly or indirectly”	220
<b>28.2-1</b>	Whether the definition of “directly or indirectly” is inclusive or exhaustive	221

**29****SIGNING OF AUDIT REPORTS**

<b>29.1</b>	Signing of audit reports	222
<b>29.1-1</b>	Signing auditors’ report in firms name whether legally valid	222
<b>29.2</b>	Reading out auditor’s report in general meeting and inspection of the same by members	223

**30****AUDITORS TO ATTEND AGM**

<b>30.1</b>	Notices of general meetings to be forwarded to the auditor of the company	224
-------------	---	-----

	PAGE
<b>30.2</b> Auditor's duty to attend general meeting and right to be heard at general meeting	224
<b>30.3</b> Response by auditors to questions at general meetings	225
<b>30.3-1</b> Adequate and advance planning of auditor for attendance at general meetings	226
<b>30.3-2</b> Auditor's responses to questions at general meetings	226

## **APPENDICES**

APPENDIX 1 : <b>RELEVANT SECTIONS OF COMPANIES ACT, 2013</b>	233
APPENDIX 2 : <b>COMPANIES (AUDIT AND AUDITORS) RULES, 2014</b>	254
APPENDIX 3 : <b>NATIONAL FINANCIAL REPORTING AUTHORITY (MANNER OF APPOINTMENT AND OTHER TERMS AND CONDITIONS OF SERVICE OF CHAIRPERSON AND MEMBERS) RULES, 2018</b>	270
APPENDIX 4 : <b>NATIONAL FINANCIAL REPORTING AUTHORITY RULES, 2018</b>	276
APPENDIX 5 : <b>NOTIFICATIONS ISSUED UNDER NFRA</b>	286
APPENDIX 6 : <b>COMPANIES (AUDITOR'S REPORT) ORDER, 2016</b>	287