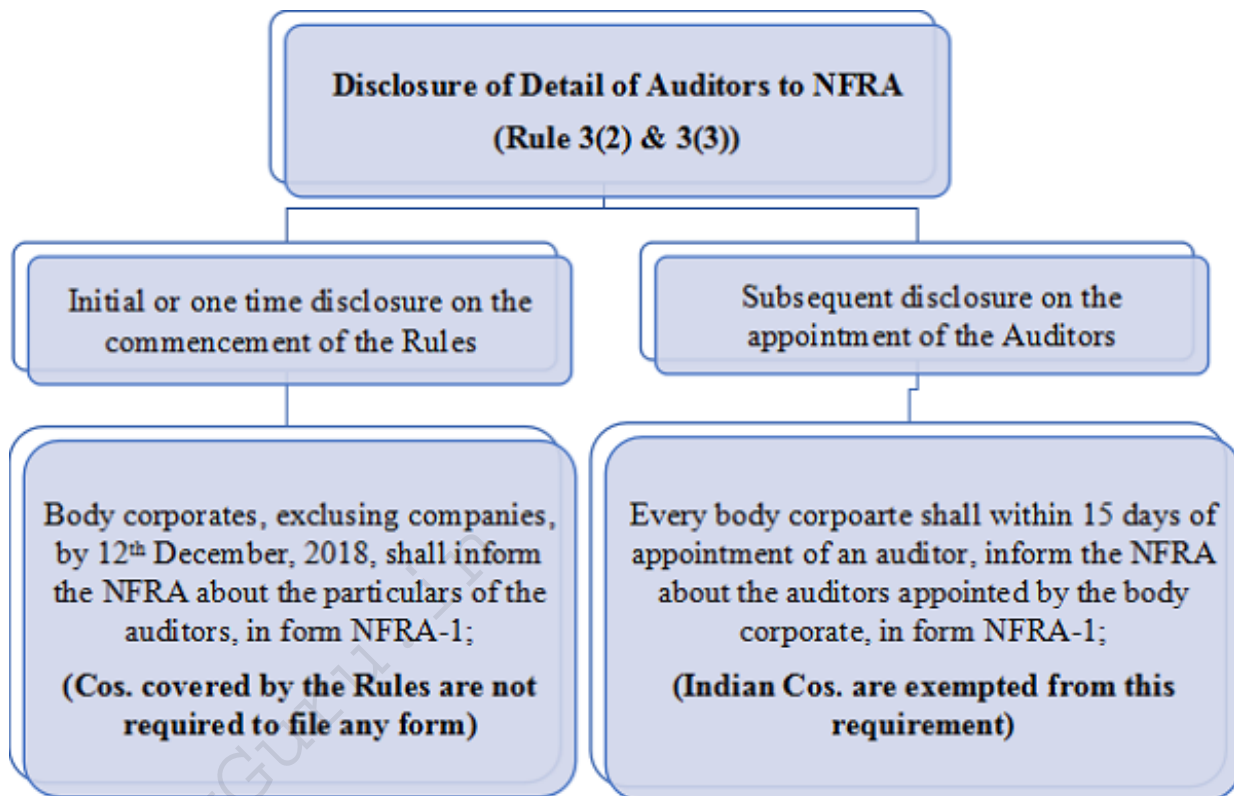


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Understanding The Applicability of NFRA Rules



Summary: National Financial Reporting Authority Rules, 2018 (NFRA Rules) notified by the MCA vide its Notification dated 13th November 2018, w.e.f 13th November 2018. The NFRA rules deal with the jurisdiction (scope), function, duties and powers of the NFRA. In this Article, we have covered applicability of the Rules and confusions among the corporate professionals due to ambiguities in the Rules.

Introduction

Five years after the Companies Act, 2013, MCA vide its Notification dated 01st October, 2018 constituted **National Financial Reporting Authority ("NFRA")** and notified sub-sections (1) and (12) of Section 132 of the Companies Act, 2013 ("Act") to establish an independent regulator to strengthen the audit profession and to provide for matters relating to accounting and auditing standards. Further, by notification dated 24th October 2018, the Ministry notified the remaining sub-sections of Section 132 of the Act.

Subsequently, the National Financial Reporting Authority Rules, 2018 ("**NFRA Rules**") notified by the Ministry vide its Notification dated 13th November 2018, w.e.f 13th November 2018. The NFRA rules deal with the jurisdiction (scope), function, duties and powers of the NFRA. In this Article, we have covered applicability of the Rules and

confusions among the corporate professionals due to ambiguities in the Rules.

Facts behind NFRA (An audit Super Regulator)

Section 210A of the Companies Act, 1956 empowered the Central Government to form a National Advisory Committee on [Accounting Standards](#) (“**NACAS**”) for making recommendation(s) on accounting policies and [accounting standards](#) to the Government. After introduction of [Companies Act, 2013](#), NACAS was replaced by National Financial Reporting Authority (NFRA). Further, the Standing Committee on Finance in its Thirty-Seventh Report on the Companies (Amendment) Bill, 2016 recommended for expansion of the role of NFRA.

Considering the above, through Section 132 of the Act, a new regulatory authority (NFRA) introduced with an enhanced independent power to shift from the existing self-regulatory mechanism to an independent regulatory model. NFRA has been constituted as a quasi-judicial body with larger remit than NACAS which only advised on accounting policies and standards.

Jurisdiction of NFRA (Applicability of the Rules)

As per the Rule 3 (1) of NFRA Rules, 2018, NFRA will have jurisdiction over the following class of companies or bodies corporate, namely:

1. Indian Companies whose securities are listed on any stock exchange in India or outside India;
2. Unlisted public companies falling under the below threshold as on 31st March of immediately preceding Financial Year:
 - a. having paid-up capital of not less than Rs. 500/- crores or;
 - b. having annual turnover of not less than Rs. 1,000/- crores or;
 - c. having, in aggregate, outstanding loans, debentures and deposits of not less than Rs. 500/- crores.
3. Insurance companies, banking companies, companies engaged in the generation / supply of electricity, companies governed by any special Act (i.e RBI, SBI, UTI, LIC, etc) and bodies corporate incorporated by an Act as the Central Government may specify by notification.
4. Body Corporate/Companies/Persons or any class of them referred by the Central Government to the NFRA in public interest;

5. Body Corporate Incorporated or registered outside India which is:

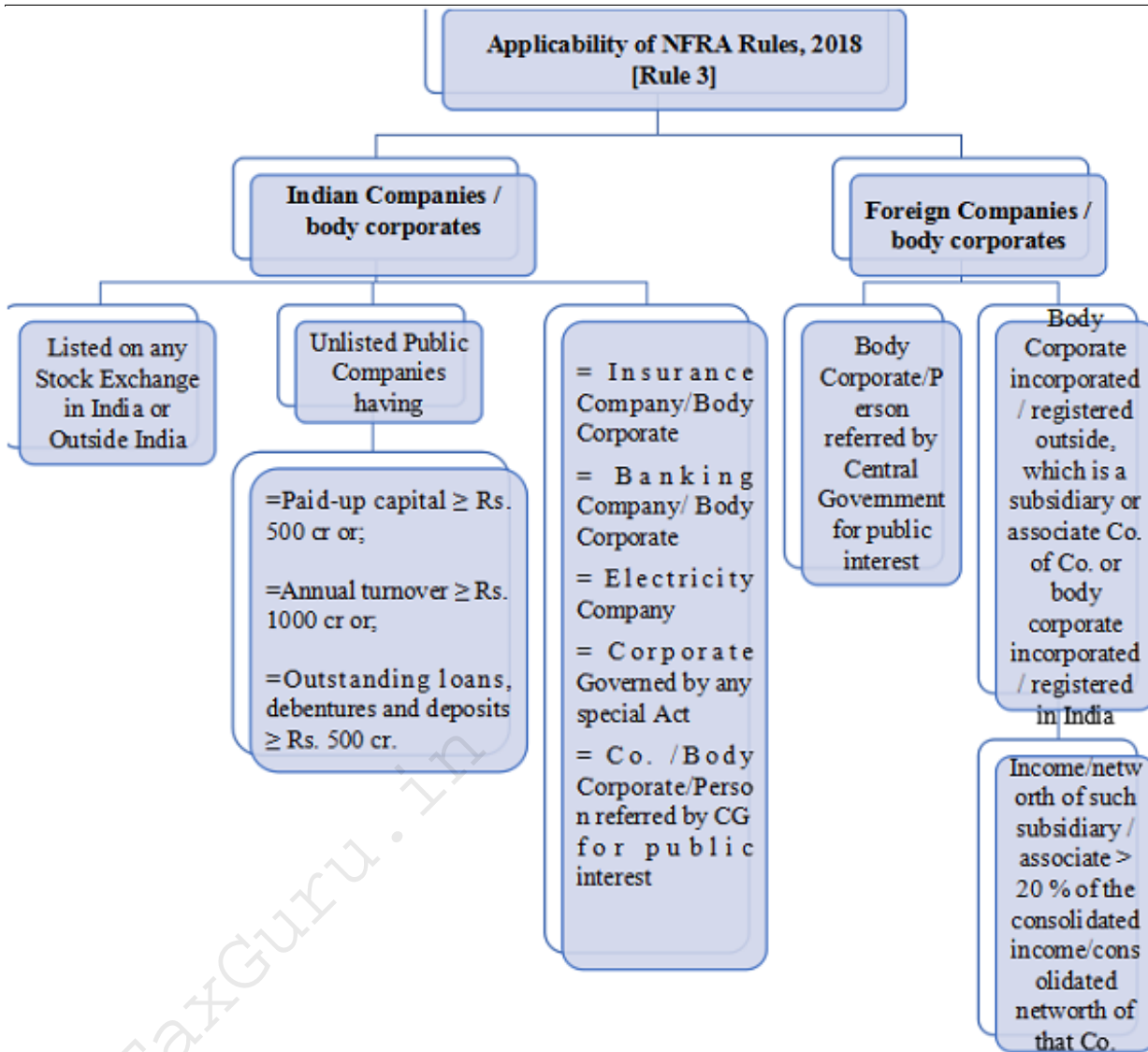
- a. Subsidiary company or Associate company of the company or body corporate registered in India as referred in point (1) to (4) above; and
- b. Income or net worth of such Subsidiary or Associate company exceeds 20% of the consolidated income or consolidated networth of such company or the body corporate.

Further, the companies or body corporates, ***other than a company governed under this rule***, shall continue to be governed by the Authority for a period of three (3) years after it ceases to be listed or its paid-up capital or turnover or aggregate of loans, debentures and deposits falls below the limit stated therein. (Rule 3(4))

[Note: here 3 years of monitoring period is applicable only for Body Corporates, if any referred by the CG as referred in point (3) and (4) above and for foreign Subsidiary or Associate company as referred in point (5) above]

Graphical Presentation of applicability of the NFRA Rules

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Non-Applicability of Rules

Considering the above rule 3, following classes of companies will not be governed by NFRA:

1. Private Companies;
2. Unlisted public companies with paid-up capital or turnover or aggregate of loans, debentures and deposits below the limit stated in Rule 3(1) and
3. Limited Liability Partnership (LLP)

[Note: this exemption is always subject to point (4) above where the Central Government may refer any Body Corporate/Companies (including Private Company)/Persons to the NFRA in public interest]

Reporting to NFRA & Ambiguities in the Rules

As per Rule 3(2), Every existing body corporate other than a company governed by these rules, shall inform the Authority about details of the auditor(s) as on 13th November 2018 by 12th December, 2018, in Form NFRA-1.

On a plain reading of Rule 3 (2), all existing companies which are not covered by the NFRA Rules, are also required to file form NFRA-1, intimating about the details of the auditors which is completely vague. Also, covering all type of companies, big and small to file the form about their auditor's details is NOT the intent of the Rules. Further, confusion persist as to reporting by the LLPs, as the rule states "every existing body corporate" which includes LLPs. The text of the provisions will be clear only if the punctuation is properly placed as below:

(2) Every existing body corporate, other than a company, governed by these rules, shall inform . . .

Otherwise, it can be read either ways – 'Stop! not let go or Stop not, let go'.

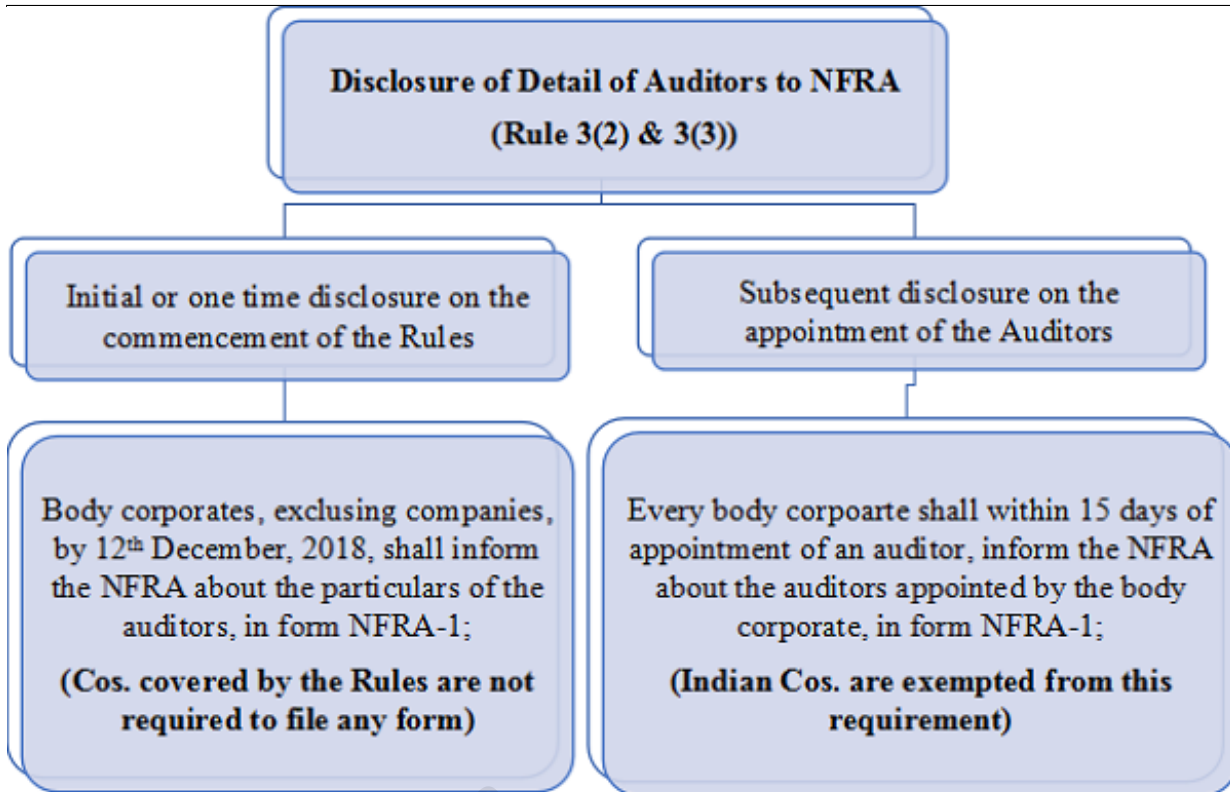
Therefore, considering the intent of the law, only "bodies corporate and companies governed by the Rule 3(1)", those that are not companies, will have to file form NFRA-1, on one-time basis under Rule 3 (2), and every time there is a change, under Rule 3 (3). In other words, only Body Corporates, if any referred/specified by the CG and foreign Subsidiary or Associate company as referred in rule 3(1) are required to file form NFRA-1 initially.

As per Rule 3(3), Every body corporate, other than companies incorporated under the Companies Act (i.e Indian Companies), formed in India and governed under this rule shall, within fifteen (15) days of appointment of an auditor under section 139(1), inform the NFRA

Further, a body corporate governed under Point 5 above (foreign body corporates) shall provide details of appointment of its auditor in Form NFRA-1. (i.e foreign Subsidiary or Associate company)

Subsequent disclosure about the appointment of auditor is governed by the Rule 3(3), as per the rule, Indian Companies are exempted from filing form NFRA 1. Only body corporate formed in India and governed under this Rule 3(1) and foreign Subsidiary company or Associate company as per Rule 3(1) are required to file form with NFRA. Here also confusion arises as to reporting by the LLPs, as the rule says "every body corporate formed in India" which again includes LLPs. Here, another ambiguity is, Whether all the foreign body corporates are required to file NFRA 1 or only those corporate falling under the threshold limits is required to file form with NFRA? Since, the rule 3(2) & 3(3) states "every body corporate" without referring the body corporate fulfilling the threshold limits of Rule 3(1).

Graphical Presentation of filing Requirements under the Rules



Note: e-form NFRA 1 is yet to be hosted by the MCA in its portal though the last date is 12-Dec-2018.

Annual Return by Auditor(s)

Every auditor governed by the NFRA (as referred to in Rule 3) shall file a return with the NFRA on or before 30th April every year in such form as may be specified by the Central Government.

Wherever the auditor is mentioned, it is only an auditor of a company or a body corporate under section 139 of the Act (i.e Statutory Auditor) or under any other Act for the time being in force. Hence, Internal Auditors (S. 138), Cost Auditors (S. 148) and **Secretarial Auditors** (S. 204) of the Company or body corporate are not subject to NFRA.

Conclusion

The new super regulator has been entrusted with independent powers and large number of responsibilities. Considering the wide powers, ambiguities in the Rules due to drafting error may be rectified or clarified by way of suitable circulars to avoid confusions among the corporate professionals and corporates and such clarifications alone will pave way for better understanding of scope and applicability of NFRA Rules.

DISCLAIMER: The information given in this document has been made on the basis of the provisions of the Companies Act, 1956/2013 and Rules made thereunder. It is based on the analysis and interpretation of applicable laws as on date. The information in this

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