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WATCHING THE WATCHDOGS: THE NATIONAL FINANCIAL REPORTING AUTHORITY AND THE CONSTITUTIONAL LIMITS OF REGULATORY POWER OVER AUDITORS

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ABSTRACT

Auditors are often described as the watchdogs of corporate finance. Their opinion tells investors, lenders and the public whether a company's accounts can be trusted. When that watchdog fails, as it did in a series of corporate collapses in India, the question becomes who is to watch the watchdog. For decades, India answered that question through self-regulation by the Institute of Chartered Accountants of India. In 2018, after repeated audit failures, Parliament's earlier decision to create an independent audit regulator was finally put into effect, and the National Financial Reporting Authority (NFRA) began work with powers to set standards, review audit quality and discipline auditors of large companies. This paper examines NFRA through the lens of constitutional and administrative law. It traces the failures that led to its creation, explains its statutory architecture under Section 132 of the Companies Act, 2013 and the NFRA Rules, 2018, and analyses the constitutional questions its powers raise under Articles 14, 19(1)(g) and 20(1). It gives particular attention to the Delhi High Court's 2025 decision in Deloitte Haskins & Sells LLP v. Union of India, which upheld NFRA's powers but quashed its show cause notices because the same body had both reviewed audits and decided to initiate disciplinary action, and to the subsequent proceedings before the Supreme Court. Drawing on the experience of the United States, the United Kingdom and the European Union, the paper argues that the legitimacy of a strong audit regulator depends on internal separation of functions, procedural fairness and effective appellate review, and proposes reforms to secure all three.

KEYWORDS

National Financial Reporting Authority, Audit Regulation, Companies Act 2013, Separation of Functions, Natural Justice, Article 14, Regulatory Independence, Professional Misconduct

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Abstract

Auditors are often described as the watchdogs of corporate finance. Their opinion tells investors, lenders and the public whether a company's accounts can be trusted. When that watchdog fails, as it did in a series of corporate collapses in India, the question becomes who is to watch the watchdog. For decades, India answered that question through self-regulation by the Institute of Chartered Accountants of India. In 2018, after repeated audit failures, Parliament's earlier decision to create an independent audit regulator was finally put into effect, and the National Financial Reporting Authority (NFRA) began work with powers to set standards, review audit quality and discipline auditors of large companies. This paper examines NFRA through the lens of constitutional and administrative law. It traces the failures that led to its creation, explains its statutory architecture under Section 132 of the Companies Act, 2013 and the NFRA Rules, 2018, and analyses the constitutional questions its powers raise under Articles 14, 19(1)(g) and 20(1). It gives particular attention to the Delhi High Court's 2025 decision in *Deloitte Haskins & Sells LLP v. Union of India*, which upheld NFRA's powers but quashed its show cause notices because the same body had both reviewed audits and decided to initiate disciplinary action, and to the subsequent proceedings before the Supreme Court. Drawing on the experience of the United States, the United Kingdom and the European Union, the paper argues that the legitimacy of a strong audit regulator depends on internal separation of functions, procedural fairness and effective appellate review, and proposes reforms to secure all three.

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1. Introduction

Every set of published company accounts carries a short document that most readers never study closely: the auditor's report. Yet that report is the foundation on which investors, banks, regulators and the public rely when they decide whether a company is what it claims to be. An independent auditor is expected to examine the accounts with professional scepticism and to say plainly whether they present a true and fair view. When auditors do their job well, markets function. When they fail, the consequences can reach far beyond a single company, wiping out savings, destabilising lenders and eroding confidence in the entire financial system.

India learned this lesson painfully. The confession of the chairman of Satyam Computer Services in January 2009 that the company's accounts had been falsified for years, and the collapse of Infrastructure Leasing & Financial Services (IL&FS) in 2018, raised the same uncomfortable question: how could such large irregularities pass through the hands of reputed auditors? The answer, at least in part, lay in the structure of audit oversight. For most of India's history after independence, the auditing profession regulated itself through the Institute of Chartered Accountants of India (ICAI), a statutory body governed by members of the profession.

The Companies Act, 2013 provided for a different model. Section 132 empowered the Central Government to constitute a National Financial Reporting Authority with responsibility for accounting and auditing standards and with power to investigate and penalise professional misconduct by auditors of specified companies. The provision remained dormant until the IL&FS crisis gave it urgency, and NFRA was constituted with effect from 1 October 2018. Since then it has reviewed audits, issued penalty orders and debarred auditors, including partners of some of the largest audit networks.

NFRA's arrival has raised a set of questions familiar to students of administrative law. How much power may Parliament give to a regulator? May the same body review an audit, decide that misconduct has occurred and impose a penalty? What procedural safeguards must it observe? And how should courts review its decisions? These questions were sharply posed in the litigation brought by audit firms, which culminated in a significant judgment of the Delhi High Court in February 2025 and an appeal before the Supreme Court.

This paper examines these questions. Part 2 traces the audit failures and the limits of self-regulation that led to NFRA. Part 3 explains NFRA's statutory architecture, including its role in standard-setting. Part 4 analyses the constitutional foundations and limits of its powers. Part 5 examines the principle of separation of functions and the Delhi High Court's decision. Part 6 considers appellate and judicial oversight. Part 7 draws comparative lessons from the

United States, the United Kingdom and the European Union. Part 8 proposes reforms and Part 9 concludes.

2. The Road to NFRA: Audit Failure and the Limits of Self-Regulation

2.1 Audit Failures and Public Confidence

The Satyam fraud was a defining moment. When the chairman admitted that cash and bank balances had been inflated by thousands of crores, attention turned at once to the statutory auditors, who had certified the accounts for years. The Securities and Exchange Board of India (SEBI) later passed an order against the auditing firm and its network entities, restraining them from issuing audit certificates to listed companies for a period of two years, on the basis that the auditors had failed in their duties in a manner that facilitated the fraud.[1] The point is reinforced by the common law's traditional reluctance to make auditors liable to investors in negligence. In *Caparo Industries plc v. Dickman*, the House of Lords held that auditors ordinarily owe a duty of care to the company and its shareholders as a body, not to individual investors who rely on the accounts when buying shares.[2] Where private law offers investors limited redress, public regulation of audit quality assumes even greater importance. The episode exposed both the scale of the harm that audit failure can cause and the absence of a dedicated regulator able to act quickly and authoritatively against auditors.

The collapse of IL&FS a decade later reinforced the point. The group's defaults on its obligations sent shocks through the market for non-banking finance, and investigations again focused on how the auditors had certified accounts that did not reflect the group's true position. Proceedings were initiated against the auditors under Section 140(5) of the Companies Act, which allows the National Company Law Tribunal to direct a change of auditors who have acted fraudulently or colluded in fraud. When the auditors argued that their subsequent resignation ended those proceedings, the Supreme Court disagreed. It upheld the constitutional validity of Section 140(5) and held that an auditor cannot escape an enquiry into alleged fraud simply by resigning.[3] The judgment signalled a strong judicial commitment to auditor accountability.

2.2 The Limits of Self-Regulation

Before NFRA, discipline of auditors rested almost entirely with the ICAI under the Chartered Accountants Act, 1949. The Act defines professional and other misconduct by reference to detailed schedules and provides a disciplinary mechanism through a Disciplinary Directorate, a Board of Discipline and a Disciplinary Committee.[4] This structure was itself the product of

[1] Securities and Exchange Board of India, Final Order in the matter of Satyam Computer Services Ltd. against Price Waterhouse and its network entities (Jan. 10, 2018).
[2] *Caparo Industries plc v. Dickman* [1990] 2 AC 605 (United Kingdom).
[3] *Union of India v. Deloitte Haskins and Sells LLP*, 2023 SCC OnLine SC 557.
[4] The Chartered Accountants Act, 1949 (Act 38 of 1949), ss. 21, 21A, 21B and 22.

reform. The Chartered Accountants (Amendment) Act, 2006 overhauled the earlier disciplinary process, introducing the Disciplinary Directorate and the two-tier system of a Board of Discipline and a Disciplinary Committee, and creating an Appellate Authority to hear appeals.[5] The reform was intended to make discipline faster and more credible, and it included non-members nominated by the government on the disciplinary bodies. Even after these changes, however, the system remained anchored in the profession's own institute, and concerns about delay and leniency in high-profile cases persisted. Self-regulation has real strengths. Members of a profession understand its technical standards better than outsiders, and peer judgment can carry moral weight.

But self-regulation also has well-known weaknesses. Disciplinary bodies drawn largely from the profession may be reluctant to impose severe sanctions on colleagues, proceedings can be slow, and the profession's interest in its own reputation and economic welfare may not always coincide with the public interest. The sociologist Michael Power has argued that modern societies increasingly rely on audit as a ritual of verification that produces comfort rather than genuine assurance, which makes independent scrutiny of auditors all the more important.[6] Internationally, the trend over the last two decades has been decisively towards independent public oversight of auditors of public interest entities. India's creation of NFRA followed that trend, though late.

3. The Statutory Architecture of NFRA

3.1 Functions and Powers under Section 132

Section 132 of the Companies Act, 2013 sets out NFRA's mandate.[7] Its functions include recommending accounting and auditing policies and standards to the Central Government, monitoring and enforcing compliance with those standards, overseeing the quality of service of the professions associated with compliance with such standards and suggesting measures for improvement, and performing other prescribed functions. Its most consequential power lies in Section 132(4), which allows NFRA to investigate, either on its own or on a reference from the Central Government, matters of professional or other misconduct committed by any member or firm of chartered accountants for prescribed classes of companies. For this purpose it has the powers of a civil court in respect of discovery, inspection, summoning and examination of witnesses.

Where misconduct is proved, NFRA may impose a monetary penalty on individuals and on firms calculated by reference to the fees received, with a higher range for firms, and may debar the member or firm from practice for a period ranging from six months to ten years.

[5] The Chartered Accountants (Amendment) Act, 2006 (Act 9 of 2006).
[6] Michael Power, *The Audit Society: Rituals of Verification* (Oxford University Press, Oxford, 1997).
[7] The Companies Act, 2013 (Act 18 of 2013), ss. 132, 133, 140(5), 143 and 144.

Importantly, once NFRA has initiated an investigation, no other institute or body may initiate or continue proceedings in the same matter. The Explanation to Section 132(4) adopts the meaning of professional or other misconduct assigned by Section 22 of the Chartered Accountants Act. NFRA thus enforces the profession's existing standards of conduct, but through an independent public body rather than the profession itself.

Section 132 was amended in 2017 to strengthen the scheme. The amendments provided, among other things, that NFRA shall perform its functions through such divisions as may be prescribed, and that it shall have an executive body to discharge certain functions.[8] These provisions, which received little attention at the time, later became central to the litigation discussed in Part 5.

3.2 The NFRA Rules, 2018

The detailed operation of NFRA is governed by the National Financial Reporting Authority Rules, 2018.[9] The Rules define the classes of companies and bodies corporate over which NFRA has jurisdiction, which include listed companies, large unlisted public companies above specified thresholds of paid-up capital, turnover or borrowings, and insurance, banking and electricity companies. They set out the procedure for monitoring compliance with standards, the conduct of audit quality reviews and the initiation and conduct of disciplinary proceedings, including the issue of show cause notices and the opportunity of hearing. The Rules thus establish a summary disciplinary procedure, distinct from the more elaborate procedure followed under the Chartered Accountants Act.

3.3 Relationship with Other Bodies

NFRA does not operate in isolation. The ICAI continues to regulate the profession generally and to discipline auditors of companies outside NFRA's jurisdiction. SEBI exercises powers over market intermediaries and issuers, and has acted against auditors in the context of securities fraud. The National Company Law Tribunal has power under Section 140(5) to remove auditors found to have acted fraudulently. Appeals against NFRA's orders lie to the National Company Law Appellate Tribunal. This multiplicity of bodies creates the potential for overlap and inconsistency, and part of NFRA's challenge has been to establish its role within this crowded landscape.

3.4 The Standard-Setting Role

NFRA's disciplinary powers attract the most attention, but its standard-setting role is equally significant. Under the Companies Act, the Central Government prescribes accounting standards as recommended by the ICAI, in consultation with and after examination of the

[8] The Companies (Amendment) Act, 2017 (Act 1 of 2018).
[9] The National Financial Reporting Authority Rules, 2018.

recommendations made by NFRA. The Indian Accounting Standards, converged with international financial reporting standards, were notified in 2015 and apply in phases to listed and large companies.[10] This arrangement gives NFRA a voice in shaping the very standards it later enforces. That combination is common internationally and has clear benefits, since a regulator that sees how standards operate in practice is well placed to recommend improvements. But it also reinforces the importance of fair procedure in disciplinary matters: a body that helps write the rules, reviews compliance with them and then judges alleged breaches must take particular care to ensure that each of these roles is exercised with an open mind.

4. The Constitutional Foundations and Limits of NFRA's Power

4.1 Freedom of Profession and Reasonable Restrictions

Article 19(1)(g) guarantees to every citizen the right to practise any profession, subject under Article 19(6) to reasonable restrictions in the interests of the general public, including laws prescribing professional or technical qualifications. A regime that can impose heavy financial penalties and debar a chartered accountant from practice for up to ten years plainly restricts this right. The question is whether the restriction is reasonable.

The Supreme Court's proportionality framework provides the test. A restriction on a fundamental right must pursue a legitimate aim, be suitable to achieve it, be necessary in the sense that no less restrictive measure would be equally effective, and strike a proper balance between the benefit to the public and the harm to the right holder.[11] The protection of investors and the integrity of financial reporting are legitimate aims of the highest order, and independent disciplinary oversight is rationally connected to them. The experience of repeated audit failure under self-regulation supports the argument that a less intrusive alternative would not be equally effective. The real constitutional pressure points therefore lie not in the existence of NFRA's powers but in the manner of their exercise, particularly the fairness of the procedure and the proportionality of individual sanctions.

4.2 Equality and Arbitrariness

Article 14 prohibits arbitrary State action. Audit firms argued that the NFRA scheme was arbitrary in subjecting them to a separate and more summary procedure than other chartered accountants, and in imposing liability on firms for the acts of their partners. The Delhi High Court rejected these arguments, holding that Section 132 was neither an overreach nor arbitrary but a necessary mechanism to enforce professional accountability, and that the liability of an audit firm for audit work done in its name is permissible.[12] The classification of

[10] The Companies (Indian Accounting Standards) Rules, 2015.
[11] *Modern Dental College and Research Centre v. State of Madhya Pradesh* (2016) 7 SCC 353.
[12] *Deloitte Haskins & Sells LLP v. Union of India*, 2025 SCC OnLine Del 641.

large and listed companies as a distinct category subject to closer oversight is also readily justified by the greater public interest in their accounts. Nonetheless, Article 14 continues to require that each exercise of power be fair, reasoned and free from bias, which is where the scheme's operation has been most vulnerable.

4.3 Retrospectivity and Article 20(1)

Article 20(1) provides that no person shall be convicted of an offence except for violation of a law in force at the time of the act, nor be subjected to a greater penalty than that which might have been inflicted under the law in force at that time. Auditors argued that NFRA could not proceed in respect of audits conducted before it came into existence, or impose penalties higher than those available under the Chartered Accountants Act at the relevant time. The Delhi High Court rejected the challenge, reasoning that Section 132 enforced a pre-existing concept of professional misconduct defined by the Chartered Accountants Act, and that it changed the forum and procedure rather than creating new misconduct. This reasoning is persuasive as far as the definition of misconduct is concerned. The question of whether higher penalties may be imposed for conduct preceding NFRA's establishment is more delicate, and courts will need to apply the guarantee in Article 20(1) carefully in individual cases where the penalty imposed exceeds what could have been imposed at the time.

4.4 Delegated Legislation

Much of the NFRA scheme is found in rules rather than in the Act. Since *In re Delhi Laws Act*, Indian law has permitted Parliament to delegate rule-making power provided it lays down the essential legislative policy and does not abdicate its function.[13] Section 132 sets out NFRA's functions, the core definition of misconduct, the range of penalties and the right of appeal, which comfortably satisfies this requirement. But the reliance on rules for matters such as the classes of companies covered and the procedure of disciplinary proceedings means that safeguards of great importance to those affected depend on subordinate legislation that can be amended by the executive. A stronger statutory statement of procedural protections would add to the scheme's legitimacy.

5. Separation of Functions and the Rule against Bias

5.1 The Principle

A foundational principle of natural justice is that no one should be a judge in their own cause. In administrative law, this principle extends beyond personal interest to situations where the same person or body performs roles that may lead it to prejudge an issue. In *A.K. Kraipak v. Union of India*, the Supreme Court held that the rules of natural justice apply to administrative proceedings that affect rights, and that a selection process was vitiated where a

[13] *In re The Delhi Laws Act, 1912*, AIR 1951 SC 332.

person with an interest in the outcome participated, because the test is whether there is a reasonable likelihood of bias.[14] *Maneka Gandhi v. Union of India* later established that any procedure depriving a person of liberty must be fair, just and reasonable, extending the reach of procedural fairness across administrative action.[15]

Modern regulators commonly combine investigative, prosecutorial and adjudicatory functions, and Indian law does not treat such combination as unlawful in itself. The concern is that when the same individuals investigate a matter, form a firm view that misconduct has occurred and then sit in judgment on it, the person accused faces a decision-maker who has, in substance, already decided. The Financial Sector Legislative Reforms Commission recognised this danger and recommended that financial regulators maintain a clear internal separation between investigation and adjudication.[16]

5.2 The Delhi High Court's Decision

The Deloitte litigation brought these principles to bear on NFRA. A batch of petitions by individual chartered accountants and audit firms, including Deloitte Haskins & Sells LLP and SRBC & Co LLP, challenged the validity of Section 132(4) and several of the NFRA Rules, along with show cause notices issued to them, largely in matters arising from the IL&FS audits. In February 2025, a Division Bench of the Delhi High Court upheld the validity of Section 132 and the challenged Rules, rejecting the arguments based on retrospectivity, vicarious liability and Article 20(1). It also held that the summary procedure under the Rules was not inherently unfair where notice, disclosure of material and a hearing were provided.

The Court nonetheless quashed the show cause notices and the final orders that had followed. It found that the Act and Rules required NFRA to maintain a division of functions between the review of an audit and the formation of an opinion that disciplinary proceedings should be initiated. In the cases before it, the same Executive Body had prepared the audit quality review reports, which contained conclusive findings of fault, and had then decided to issue show cause notices on the basis of those findings. This created a reasonable apprehension of bias and predetermination. The Court left it open to NFRA to begin proceedings afresh from the stage of issuing fresh notices, in a manner consistent with its findings.

The decision is significant because it located the requirement of separation not merely in general principles of natural justice but in the statutory scheme itself. The 2017 amendments, which required NFRA to work through divisions and an executive body, were read as a legislative command to keep different functions apart. A regulator cannot claim efficiency as a justification for disregarding a structure that Parliament has prescribed.

[14] *A.K. Kraipak v. Union of India* (1969) 2 SCC 262.
[15] *Maneka Gandhi v. Union of India* (1978) 1 SCC 248.
[16] Financial Sector Legislative Reforms Commission, *Report of the Financial Sector Legislative Reforms Commission*, Vol. I (Ministry of Finance, Government of India, New Delhi, Mar. 2013).

5.3 The Supreme Court Proceedings and NFRA's Response

NFRA appealed to the Supreme Court. At the first hearing in February 2025, the Solicitor General argued that NFRA was a composite body with only a small number of members and could not realistically work in strictly separate divisions. The Court issued notice but declined to stay the High Court's judgment. It permitted NFRA to continue disciplinary proceedings, including in cases where no audit quality review report had been prepared, provided that it acted in accordance with the High Court's directions on separation, and indicated that final orders should not be enforced for the time being.[17]

NFRA's institutional response is instructive. In April 2026, it issued an order creating, as an interim measure, separate divisions for monitoring and oversight, investigation, determination and discipline, requiring each to function independently and preventing a member who works in one division from participating in another division in the same case.[18] Whatever the final outcome in the Supreme Court, this development shows that the High Court's insistence on separation has already reshaped the regulator's internal structure. It also demonstrates that separation of functions is achievable in practice, even for a small regulator, provided it is designed deliberately.

5.4 The Hearing Must Be Real

A related principle holds that the authority that decides must itself hear the person affected. In *Gullapalli Nageswara Rao v. Andhra Pradesh State Road Transport Corporation*, the Supreme Court held that a hearing conducted by one official and a decision taken by another offended the principles of natural justice, because the right to be heard is meaningful only if the decision-maker personally considers the objections.[19] For NFRA, the lesson complements the requirement of separation. The body that adjudicates misconduct should be separate from the body that reviewed the audit, but it must itself engage with the auditor's response and the material on record, rather than adopting conclusions reached elsewhere. Separation without genuine engagement would satisfy the form of fairness while defeating its purpose. A hearing in which the outcome has already been settled by the findings of an earlier review is no hearing at all.

[17] "NFRA Moves Supreme Court against Delhi HC Decision to Quash Notices against Audit Firms", *Bar & Bench*, available at: https://www.barandbench.com/news/nfra-moves-supreme-court-delhi-hc-decision-quash-notices-against-audit-firms (last visited on Oct. 7, 2026).
[18] "NFRA in 2026: From Enforcement Authority to Continuous Audit Supervision", *Legal Era*, available at: https://www.legaleraonline.com/zoom-in/nfra-in-2026-from-enforcement-authority-to-continuous-audit-supervision-989524 (last visited on Oct. 7, 2026).
[19] *Gullapalli Nageswara Rao v. Andhra Pradesh State Road Transport Corporation*, AIR 1959 SC 308.

6. Appellate Oversight and Judicial Review

6.1 Appeals to the Appellate Tribunal

Orders of NFRA imposing penalties or debarment may be challenged before the National Company Law Appellate Tribunal. A specialist appellate forum has clear advantages. It can examine technical questions of accounting and auditing in depth, apply consistent standards across cases and provide a remedy more quickly than ordinary courts. The quality of this oversight, however, depends on the independence and expertise of the appellate body.

The Supreme Court has repeatedly emphasised that tribunals which exercise functions previously performed by courts must possess independence comparable to that of the judiciary. In *Union of India v. R. Gandhi*, the Court upheld the creation of the company law tribunals but required changes to their composition and conditions of service to secure judicial independence.[20] In *Madras Bar Association v. Union of India*, it struck down the National Tax Tribunal Act on the ground that it transferred core judicial functions to a body lacking the essential attributes of a court.[21] These principles apply with equal force to the appellate review of NFRA. A tribunal hearing appeals from a powerful regulator must include members with the technical expertise to assess audit judgments and the independence to disagree with the regulator where necessary.

6.2 The Role of Constitutional Courts

High Courts retain their power of judicial review under Article 226 even where a statutory appeal is available, although they generally decline to intervene where an effective alternative remedy exists. The Deloitte litigation illustrates the circumstances in which writ jurisdiction remains important: where the challenge is to the validity of the statute or rules themselves, or where the defect lies in the structure of the decision-making process rather than in the merits of a particular finding. Courts must, however, exercise restraint in reviewing technical regulatory judgments. The legitimacy of judicial review lies in ensuring that regulators act within their powers, follow fair procedures and reason their decisions, not in substituting the court's judgment on matters of accounting expertise. Scholars of Indian regulation have observed that the design of regulatory institutions, and not only the substance of their rules, determines whether they earn public trust.[22]

6.3 Reputation and the Publication of Findings

NFRA publishes its audit quality review reports and disciplinary orders, a practice that promotes transparency and deters misconduct. Publication, however, carries consequences of

[20] *Union of India v. R. Gandhi, President, Madras Bar Association* (2010) 11 SCC 1.
[21] *Madras Bar Association v. Union of India* (2014) 10 SCC 1.
[22] Devesh Kapur and Madhav Khosla (eds.), *Regulation in India: Design, Capacity, Performance* (Hart Publishing, Oxford, 2019).

its own. For an individual chartered accountant or an audit firm, a published finding of deficiency can damage professional standing long before any penalty is imposed or any appeal decided. The Supreme Court has recognised that reputation is an integral part of the right to life under Article 21.[23] This does not mean that NFRA should stop publishing its work, which serves an important public purpose. It does mean that findings should be published only after the affected parties have had a fair opportunity to respond, that published reports should clearly distinguish preliminary observations from final determinations, and that the outcome of any successful appeal should be published with equal prominence.

7. Comparative Perspectives

7.1 The United States: The PCAOB and Separation of Powers

The United States created the Public Company Accounting Oversight Board through the Sarbanes-Oxley Act of 2002, in response to the collapse of Enron and the demise of its auditor, Arthur Andersen.[24] The Board registers and inspects audit firms, sets auditing standards and disciplines firms and individuals, subject to oversight by the Securities and Exchange Commission. Its constitutional position was tested in *Free Enterprise Fund v. Public Company Accounting Oversight Board*, where the Supreme Court held that the double layer of protection against removal enjoyed by Board members violated the constitutional separation of powers because it unduly insulated them from presidential control. The Court severed the offending provisions, leaving the Board otherwise intact.[25] The case is a reminder that the constitutional design of an audit regulator can itself become a subject of litigation, and that independence must be balanced against accountability.

7.2 The United Kingdom: Reforming the Regulator

In the United Kingdom, a series of corporate failures led to an independent review of the Financial Reporting Council, which concluded that the existing regulator should be replaced by a new statutory body with clearer powers, greater independence and a stronger focus on the public interest.[26] The government subsequently set out proposals for a new Audit, Reporting and Governance Authority with wider powers over audit and corporate reporting.[27] The British debate shows that even mature regulatory systems must periodically rethink the structure and powers of audit oversight, and that questions of procedure and accountability are central to that rethinking.

[23] *Board of Trustees of the Port of Bombay v. Dilipkumar Raghavendranath Nadkarni* (1983) 1 SCC 124.
[24] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, s. 101, 116 Stat. 745 (United States).
[25] *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 561 U.S. 477 (2010).
[26] Sir John Kingman, *Independent Review of the Financial Reporting Council* (Department for Business, Energy and Industrial Strategy, London, Dec. 2018).
[27] Department for Business, Energy and Industrial Strategy, *Restoring Trust in Audit and Corporate Governance* (CP 382, London, Mar. 2021).

7.3 The European Union: Independent Oversight of Public Interest Audits

The European Union reformed its framework in 2014. A regulation on the statutory audit of public interest entities introduced requirements including mandatory rotation of audit firms after a maximum period and restrictions on the provision of non-audit services to audit clients.[28] An accompanying directive requires each Member State to designate a competent authority responsible for public oversight of auditors, governed by non-practitioners and independent of the profession.[29] The European model confirms the global shift away from self-regulation, while embedding oversight within a framework of rules that limit the discretion of the oversight body and protect the rights of those it regulates.

8. Towards a Constitutionally Robust Audit Regulator: Recommendations

First, the separation of functions within NFRA should be placed on a permanent statutory footing. The interim order of 2026 creating separate divisions is welcome, but a matter so central to the fairness of disciplinary proceedings should not depend on an internal order that can be changed administratively. Parliament should amend Section 132 to specify that the bodies responsible for audit quality review, investigation and adjudication of misconduct shall be distinct, and that no member who has participated in one stage of a matter shall participate in another.

Second, NFRA's membership and capacity should be expanded. The argument that a regulator with few whole-time members cannot work in separate divisions is an argument for adding members and staff, not for diluting procedural fairness. A larger body with adequate technical staff would allow genuine separation while maintaining the pace of enforcement that the public interest demands.

Third, audit quality review reports should be treated as preliminary findings, shared in draft with the audit firm and partner concerned, with a meaningful opportunity to respond before they are finalised. Disciplinary proceedings should then begin with a show cause notice framed by a separate division on the basis of an independent assessment of the material.

Fourth, the procedural safeguards now contained in the NFRA Rules, including disclosure of material, the right to a hearing and the requirement of reasoned orders, should be incorporated into the Act itself. Penalty decisions should be guided by published criteria addressing the seriousness of the misconduct, the degree of responsibility, any prior record and the need for deterrence, so that sanctions are proportionate and consistent.

[28] Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on Specific Requirements regarding Statutory Audit of Public-Interest Entities.
[29] Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on Statutory Audits of Annual Accounts and Consolidated Accounts.

Fifth, the appellate framework should be strengthened by ensuring that benches of the Appellate Tribunal hearing appeals from NFRA include members with expertise in accounting and auditing, and that such appeals are decided within defined timelines.

Finally, the relationship between NFRA, the ICAI, SEBI and the company law tribunals should be clarified through formal memoranda of understanding and, where necessary, legislative amendment, so that an auditor is not subjected to overlapping proceedings for the same conduct and the public receives a coherent and predictable system of oversight.

9. Conclusion

The creation of NFRA was a necessary response to a real problem. Repeated audit failures showed that self-regulation alone could not protect investors and the public, and the move to independent oversight brought India into line with international practice. The courts have broadly endorsed this choice. The Supreme Court in 2023 refused to allow auditors to escape scrutiny by resigning, and the Delhi High Court in 2025 upheld the constitutional validity of Section 132 and the NFRA Rules against wide-ranging challenges.

Yet the same High Court decision drew an important line. A regulator with power to end a professional career must exercise that power fairly, and fairness requires that those who review an audit and form conclusions about it are not the same people who decide whether to charge the auditor with misconduct. This is not a technicality. It reflects the oldest principle of natural justice, and in NFRA's case it is also written into the structure Parliament prescribed. NFRA's creation of separate divisions in 2026 shows that the principle can be honoured in practice.

The question in the title of this paper, who watches the watchdogs, has two answers. NFRA watches the auditors, and the Constitution, through the courts, watches NFRA. A strong audit regulator and a fair one are not competing goals. The authority of NFRA's decisions, and therefore their deterrent value, depends on their being reached through a process that the regulated and the public alike can accept as just. By placing separation of functions, procedural safeguards and effective appellate review on a firm statutory footing, India can build an audit regulator that is both feared by wrongdoers and respected by all.