

ACCOUNTS AND AUDIT

Various compliance and regulation under the

COMPANIES ACT, 2013

Presented at:
(WIRC-ICAI Nagpur Branch)

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Why there was a need for change? Benefits...

Why there was need for change?

- Big scams like Satyam, Sahara etc. influenced to change Old Companies law.
- For smooth and seamless application of corporate governance to all companies.
- Old Companies Act was a voluminous document, very procedural in nature and prescribed certain quantitative limits which were irreverent on account of changes in economy.

Benefits of re-enacting the new Companies Law:

- Bringing flexibility & adoption of Internationally accepted practices (IFC reporting, Mandatory auditor rotation, Ind AS reporting, restatement of past financial statements, etc.)
- Self regulation with more disclosure
- Stringent punishment for violation
- Effective protection for different sections of society (like introduction of class action suit)
- E-Governance
- Professionals' enhanced roles and accountability
- New Regulator set ups: NFRA, SFIO, NCLT

Accounts and Audit - Companies Act perspective:

<u>Sl. No.</u>	<u>Key concepts</u>
1	Introduction of uniform financial year-end year i.e. April to March
2	Financial statements – Definition
3	Mandatory preparation of consolidated financial statements
4	Restatement of past financial statements
5	Mandatory rotation of auditors and appointment (requirement for ratification of auditors appointment removed in recent amendment)
6	More stringent requirement for auditors disqualification
7	Restriction on Non-audit services to auditee
8	Auditors additional reporting requirement: IFC reporting
9	Whistle blower: Fraud reporting
10	Mandatory applicability of internal and secretarial audit
11	Corporate social responsibility
12	Role and responsibility of NFRA, NCLT, SFIO & Class Action Suit

Key concepts:

Books of accounts - section 128(1):

- Every company shall prepared and keep at its registered office and its branches such books of accounts and other relevant papers.
- The Company can maintain such books and records in electronic mode.
- Books of accounts should be kept on accrual basis and according to double-entry system.
- The Company shall maintain books of accounts and relevant records for a period of 8 financial years.

Financial year - Section 2(41):

- “Financial Year” to mean the period ending on 31st March of every year.
- Different financial year can be adopted by getting approval of the National Company Law Tribunal (Tribunal) in the case of subsidiary company of an overseas parent have adopted different year end.

Key concepts:

Financial statements - section 2(40) & Section 129 (1):

- 'Financial Statements' include:
 - balance sheet,
 - profit and loss account/income and expenditure account,
 - cash flow statement,
 - statement of changes in equity and
 - Any explanatory note annexed to the above
- Financial statements shall be prepared as per Schedule III and shall give a true and fair view of the state of affairs of the company and shall comply with the accounting standards notified under Section 133.

Accounting and Auditing Standards - Section 2(2) & 2(7):

- Accounting Standards and Auditing Standards means the standards as recommended by ICAI in consultation with and after examination of the recommendations made by NFRA.

Key concepts:

Consolidated Financial statements- Section 129(3):

- Where a company has one or more subsidiaries or associate companies, it shall prepare a consolidated financial statement of the group. (As per Ind AS 110, CFS mandatory if there is a subsidiary)
- The consolidation of financial statements of the Group shall be made in accordance with the provisions of Schedule III of the Act and the applicable accounting standards.

Exception to CFS:

- Exception applies if it meets the following conditions:
 - (i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, do not object in writing to the company not presenting consolidated financial statements;
 - (ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and
 - (iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

Key concepts:

Associate company - section 2(6):

- Associate company means a company in which that other company has significant influence but which is not a subsidiary AND includes a joint venture company.
- “Significant influence” means control of at least 20% of total voting power, or of business decision under an agreement. However, as per Accounting Standard AS 23 (Ind AS 28) significant influence is defined as “the power to participate in financial and/or operating policy decisions of the investee but is not control or joint control of those policies”.

Control shall include - Section 2(27):

- To appoint majority of the directors or
- To control the management or policy decisions of the company through shareholding or management rights or shareholder agreements or voting agreements or any other manner.

As per Section 2(87), holding and subsidiary relationship relating to exercises and controls more than half of the total voting power directly or indirectly. (companies act 2017 amendment has aligned the definition as per AS 21).

As per Ind AS 110:

“An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.”

Key concepts:

Restatement of financial statements and boards report - section 130 & 131:

- Concept of restatement is new and is an internationally required practice.
- Further, SEBI has mandated for restatement in case of justified audit qualification
- The 2013 Act provides for the following:
 1. **Mandatory restatement**: in case of fraud and when a Court/ the Tribunal passes an order for restatement (Re-opening of books of accounts is limited to 8 financial years immediately preceding the current financial year)
 2. **Voluntary restatement**: - to comply with accounting standards with the approval of the tribunal
- Voluntary restatement of financial statements or directors report can be made in respect of any three preceding financial years.
- such revised financial statement or report of directors shall not be prepared more than once in any financial years.
- Further, detailed reasons for such revision will have to be disclosed

Rotation of auditors:

Mandatory rotation of auditors are applicable for

- Listed company or
- Public company having paid up share capital of Rs 10 crore or more or
- Private company having paid up share capital of Rs. 50 crore or more or
- All companies having borrowings from financial institutions, banks or public deposits of Rs. 50 crore or more

Time Frame for Rotation:

- ✓ An individual as auditor shall not be appointed or re-appointed for more than one term of five consecutive years and in the case of an audit firm not more than two terms of five consecutive years.
- ✓ The Auditor appointed in the AGM shall hold office from the conclusion of that AGM till the conclusion of the sixth AGM.
- ✓ Removal of Auditors before expiry of his term shall require special resolution and prior approval of central government.

Auditors disqualifications:

The 2013 Act includes the following additional disqualification:

- Business relationship disqualification: Any person who has a business relationship with the company/ its subsidiary/associate/its holding company/subsidiary or associate of its holding company; {commercial transactions which are in the ordinary course of business of the company at arm's length price}
- A person whose relative is a non-executive/ executive director or key managerial personnel of the company;
- A person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
- A person who is in full-time employment elsewhere;
- Any person whose appointment will result in the person being the auditor of more than 20 companies other than one person company, dormant company, small company and private company having paid-up share capital less than 100 crore; and
- a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company (non-audit services disqualifications).

Non-audit services:

An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee

Non-audit services:

- ✓ accounting and book keeping services;
- ✓ internal audit;
- ✓ design and implementation of any financial information system;
- ✓ actuarial services;
- ✓ investment advisory services;
- ✓ investment banking services;
- ✓ rendering of outsourced financial services; and
- ✓ management services.
- ✓ Other restricted services may be further prescribed.

Auditors' report (Sec.-245)

The following additional reporting requirement was introduced in 2013 Act and includes the following matters for auditor reporting

- Adequacy of the internal financial controls with reference to financial statements and the operating effectiveness of such controls [in a similar context with respect to directors report, internal financial control has been defined to mean the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information].
- Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.
- For unlisted entities the requirements related to reporting in internal financial controls apply only to auditors and not to the directors which is inconsistent with the company's / director's primary responsibility for implementing such controls

Auditors' report (Sec.-245)

IFC shall not be applicable :-

- i. which is a one person company or a small company; or
- ii. which has turnover less than Rs 50 crores as per latest audited financial and
- iii. which has aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial year less than Rs 25 crore."

Whistle blower – Fraud Reporting:

If an auditor has reason to believe that an offence of fraud has been committed against the Company by its officers and employees, the Auditor shall report the matter to the Central Government (threshold individually an amount of Rs 1 crore or more)

Procedure to be followed:

- ✓ the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days
- ✓ on receipt of such reply or observations, the auditor shall forward his report along with board's report to the Central Government within fifteen days from the date of receipt of such reply or observations;
- ✓ in case the auditor fails to get any reply from the Board or the AC within 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the AC
- ✓ the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same.

Internal and Secretarial Audit:

- Internal Audit is mandatory by Law to the following companies: (Section- 138)
 - All listed company or,
 - Public company: Having Paid up share capital Rs. 50 crore or more, Turnover Rs. 200 crores or more, outstanding borrowing from banks or public financial institutions Rs 100 crore or more, outstanding deposits of Rs 25 crore or more at any point of time during preceding financial year or,
 - Private company: Turnover Rs 200 crore or more, outstanding borrowing from banks or public financial institutions Rs 100 crore or more at any point of time during preceding financial year.
- Internal auditor may or may not be an employee of the Company and may be either an individual or a partnership firm or a body corporate.

Secretarial audit is mandatory for: (Section - 204)

- All listed company or
- Public company having paid up share capital of Rs 50 crore or more, or turnover of Rs 250 crore or more.

Corporate Social Responsibility (whether desirable for brand building):

Corporate Social Responsibility (CSR) Obligations have been introduced under section 135 of the Companies Bill, 2013. The companies will have to mandatorily spend 2% of their average net profits during the three immediately preceding financial years for CSR activities.

- **CSR Provisions in Companies Act 2013 applicable to every company including foreign company having;**
 1. Net worth of Rs. 500 Crore or more, or
 2. Turnover of Rs. 1,000 Crore or more or
 3. Net profit of Rs. 5 Crore or more during the immediately preceding financial year.
- CSR committee shall have 3 or more directors and shall have minimum 1 independent director which shall -
 - Formulate and recommend policy and choose activities out of schedule VII
 - Recommend amount of expenditure to be incurred and Monitor such policy
- Board approved policy - content to be disclosed in Board's report and on Company's website.

National Financial Reporting Authority (NFRA): (Section-132)

Yet to be notified except sub-section (3) and (11) notified w.e.f. 21/03/2018

Formation:

- NFRA shall consist of chairperson having expertise in accountancy, auditing, finance or law and to be appointed by the Central Government.
- Other members not exceeding 15 part time or full time.
- Chairperson, 3 full time and nine part time members shall not be associated with any audit or related consultancy firm during their tenure with NFRA and till 2 years after ceasing to hold such appointment.

Function:

- The Central Government may constitute a NFRA to provide for matters relating to accounting and auditing standards which shall:
 - ✓ make recommendation to CG for standard setting,
 - ✓ monitor and enforce compliance of such standard,
 - ✓ overseas the quality of service of professionals associated with ensuring compliance and suggest measures required for improvement in quality of service.

New Regulator-National Financial Reporting Authority (NFRA): (Section-132)

Power and duties:

- NFRA shall have the powers to investigate into matters of professional and other misconduct committed by member or firm of CAs.
- NFRA has the same powers as are vested in a civil court under the code of civil procedure
- Where professional or other misconduct is proved, NFRA has the power to impose penalty as follows:
 - In the case of individual: penalty of not less than Rs. 1 lakh, but which may extend to 5 times of fees received
 - In the case of firm: penalty of not less than Rs. 10 Lakh, but which may extend to 10 times of fees received.
 - Debarring the member or firm from practice for a minimum period of six months or for higher period not exceeding 10 years
- Appeal against NFRA order possible before the Appellate Authority.

New Regulator-Serious Fraud Investigation Office (SFIO): (Section-211 & 212)

Formation:

- The Central Government shall establish SFIO to investigate frauds relating to a company. Until SFIO is established under this Act, the SFIO set-up by the Central Government shall be deemed to be SFIO for this purpose.
- The CG refers matters to SFIO on receipt of report of Registrar, special resolution from the company, in public interest, on request of Central/ State Govt.
- SFIO shall be headed by a Director and consist of experts.

Function & power:

- If the director, Additional or Assistant director of SFIO has on the basis of material in possession reason to believe (to be recorded in writing) that any person has been guilty of an offence, he may arrest such person
- After such arrest, there is a limitation on granting bail.

New Regulator-National Company Law Tribunal (NCLT): (Chapter-27)

- NCLT has been replaced with Company Law Board.
- There are two classes of members to the National Company Law Tribunal; Judicial Members and Technical Members. The Tribunal shall be headed by the President.
- The President shall be a person who is or has been a Judge of a high Court for five years.
- Qualification of Judicial Member unless he or she is or has been a judge of high court, or district judge for at least 5 years or having 10 years of experience been an advocate.
- Qualification of Technical Member unless he has been member of Indian Corporate Law service, Indian Legal Service or has been in practice of CA, CS or Cost Accountant for at least 15 years.
- The Central Government shall by notification, constitute an National Company Law Appellate Tribunal, constituting of a Chairperson and not exceeding eleven members for hearing appeals against the orders of the Tribunal.

Class Action Suit (Sec.-245)

Background:

After Satyam Scam broke out in 2009, concept of Class action came to the spotlight in India. Satyam's ADR were listed in New York Stock Exchange, several class actions were filed against Satyam, MD and auditors. In the absence of any statutory provision under Indian Companies Act, 1956, no similar proceedings could be initiated by the Indian investors.

Who can file Class Action Suits?

Requisite number of Members, Depositors or any class of the above (not less than 100 members or such percentage of total members (10% of total number of members prescribed in draft rule) or such percentage of members having issued share capital of the company (10% of total issued share capital prescribed in draft rule).

Against whom a Class Action Suit can be filed?

- Against company, any of its directors, Auditor including Audit firm, any other expert or advisor.
- In the case of claim against audit firm, the liability shall be of the firm as well as of each partner who is involved.

Class Action Suit (Sec.-245)

When can a Class Action suit be filed?:

When applicants are of the opinion that the management or conduct of the affairs of the company are being carried in a manner prejudicial to the interest of the company or its member or depositors.

What action will be taken by NCLT?

- NCLT will issue a public notice with in 7 days of admission of the application in regional and English news paper.
- Consolidate all similar applications prevalent in any jurisdiction into a single application. NCLT will not allow two class action applications for the same cause of action.

Penalty:

- Company shall be punishable with fine which shall not be less than Rs 5 lakh but which may extend to Rs 25 lakh, and Every officer who is in default shall be punishable with imprisonment up to 3 years and with fine up to Rs. 1 lakh.
- If the application filed is found to be frivolous the applicant shall pay to the opposite party fine up to actual cost up to Rs. 1 lakh.



Thank You

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