The Companies 2013
Impact on the profession

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Background

- The Companies Act, 2013 has been enacted and it received the assent of President of India on August 29, 2013
- This Act contains 470 Sections, 29 Chapters, 7 schedules.
- A substantial portion of the Act, will be by way of Rules, which have been issued in draft form. In more than 330 areas, the Rules will clarify the requirements.
- The Act will come in force as and when notified. As of now only 98 sections have been notified.
- It lays significant emphasis on e-governance and corporate governance measures

Key Provisions: Accounting and Financial Reporting

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Accounting Standards

The Central Government may prescribe standards of accounting or any as recommended by ICAI in consultation and after examination by National Financial Reporting Authority (NFRA).

As per the draft rules, for the purposes of sec. 133, the standards of accounting as prescribed under the Companies Act, 1956 shall be deemed to be the accounting standards until accounting standards are prescribed by the Central Government under section 133.

Key Provisions: Accounting and Financial Reporting (contd.)

Depreciation (Schedule II of the Act)

- Depreciation on tangible assets based on estimated useful life.
  - Focus has been shifted from ‘rates’ to ‘useful life’.
  - Useful life of an asset is the period over which the asset is expected to be available for use by the entity or number of production or similar units expected to be obtained from the assets.
- Componentisation of assets has been mandated.
  - Separate capitalisation and depreciation of a part of an asset if its cost is significant to the total cost of the asset and its estimated life is different from the remaining asset
- Significant revision in the rate of depreciation of commonly used assets as compared to Schedule XIV rates of the Companies Act, 1956
- Depreciation amount to be determined after reducing expected residual value (generally not more than 5% of the original cost of the asset).
- Depreciation / amortisation of intangible assets shall be as per the Accounting Standards.

Key Provisions: Accounting and Financial Reporting (contd.)

Comparison of Key Depreciation rates and the impact thereon

Nature of Asset	Companies Act, 2013		Companies Act, 1956	Increase	% Change
	Useful Life	Deemed rate			
General Plant and Machinery other than continuous process plant	15	6.33%	4.75%	1.58%	33.33%
Continuous process plant	8	11.88%	5.28%	6.60%	124.91%
General furniture and fittings	10	9.50%	6.33%	3.17%	50.08%
Office Equipment	5	19.00%	4.75%	14.25%	300.00%
Desktops, laptops etc	3	31.67%	16.21%	15.46%	95.35%
Electrical installations	10	9.50%	4.75%	4.75%	100.00%

Key Provisions: Accounting and Financial Reporting (contd.)

Depreciation (Contd.)

- Transitional Provisions
  - Carrying value (net of residual value) is to be depreciated, over the remaining revised useful life of the asset.
  - If the remaining useful life is nil, the carrying value, is to be charged to the opening balance of retained earnings.
- Incremental depreciation relating to surplus on revaluation of assets is to be charged to Profit & Loss Account

Key Provisions: Accounting and Financial Reporting (contd.)

Utilisation of Securities Premium Account

For classes of Companies to be prescribed in the Rules, utilisation of Securities Premium for the following purposes will be require such Company to ensure that the prescribed Accounting Standards have been complied

- Issue of bonus shares
- Writing off the expenses of or the commission paid on any issue of equity shares
- Buy back of shares or other securities

Key Provisions: Accounting and Financial Reporting (contd.)

Consolidated Financial Statements (CFS):

- Companies having one or more subsidiaries, shall also prepare CFS and the same shall be laid before the Annual General Meeting of the Company along with standalone financial statements.
- A separate statement containing salient features of the financial statement of subsidiaries to be attached to the holding Company's financial statements.
- 'Subsidiary' includes 'associate company' and 'joint venture' (Associate means a Company other than a subsidiary company and joint venture company in which the other Company has a significant influence)

As per draft rules:

The CFS of the company shall be made in accordance with the Accounting Standards, subject however, to the requirement that if under such Accounting Standards, consolidation is not required for the reason that the company has its immediate parent outside India, then such companies will also be required to prepare CFS in the manner and format as specified under Schedule III to the Act.

Key Provisions: Accounting and Financial Reporting (contd.)

Revision of Financial Statements or Board's Report:

- **Voluntary Revision:**
  - The Company may, if it appears to the directors that the Financial Statements or Board's Report are not in compliance with the provisions of the Act, may prepare revised financial statement or a revised Board's Report with the approval of Tribunal.

- **Mandatory reopening or recasting:**
  - A Company can reopen its books of accounts and recast its financial statements if:
    - The relevant accounts were prepared in fraudulent manner or
    - Affairs of the Company were mismanaged during the relevant period casting a doubt on the reliability of the financial statements
  - On an application by Central Government, IT authorities, SEBI or any regulatory body and an order being made by Court or Tribunal.

Key Provisions: Accounting and Financial Reporting (contd.)

Related party transactions (Sec.188)

Except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as may be prescribed, no company shall enter into any contract or arrangement with a related party with respect to—

- sale, purchase or supply of any goods or materials
- selling or otherwise disposing of, or buying, property of any kind
- leasing of property of any kind
- availing or rendering of any services
- appointment of any agent for purchase or sale of goods, materials, services or property
- such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company and
- underwriting the subscription of any securities or derivatives thereof, of the company

Key Provisions: Accounting and Financial Reporting (contd.)

Related party transactions (Sec.188) (contd.)

- In the case of a company having a paid-up share capital (`1 crore as per the draft rules) of not less than such amount, or transactions not exceeding such sums, as may be prescribed, shall be entered into except with the prior approval of the company by a special resolution.
- No member who is a related party, shall vote on such special resolution.
- The aforesaid provisions shall not apply to any transactions in ordinary course which are on arms length basis.

The provisions of this section may create administrative inconvenience to the companies in terms of compliance vis a vis business transactions.

Further, the ambit and definition of relative and related party is very wide, which would create practical difficulties for the companies.

Key provisions: Auditors’ Role and Responsibilities

Tenure of Auditor Appointment

Rotation of Auditors

Individual as auditor → Not more than 1 term of 5 consecutive years

Firm as auditor → Not more than 2 terms of 5 consecutive years

Cooling off period → After completion of term not eligible for reappointment for 5 years from completion of such term

Restriction applicable to all the Companies except One person Companies and Small Companies

Manner of Appointment

Audit committee

↓

Board

↓

Members at general meeting

As per draft Rules

The period for calculation of 5 consecutive years / 10 consecutive years shall be reckoned ***retrospectively***

Transition period – 3 years

Eligibility for Appointment

As per draft Rules

- In case of companies which have an Audit Committee, the audit committee shall recommend the name of individual/firm as auditor to the Board.
- The audit committee or the Board, as the case may be, shall also consider the completed and pending proceedings against the auditor before the ICAI or the NFRA or Tribunal or any Court of law.
- In case of other companies, the Board shall consider and recommend the name of individual/firm as auditor to members in AGM.
- If the board is not satisfied with the recommendation of the audit committee, it may send back the recommendation to the audit committee for reconsideration with their reasons.
- The term “business relationship” shall construe any transaction entered into for a commercial purpose except those which are in the nature of professional services as permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act and the rules and the regulations made under such Act.

Powers of Auditors

- Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor

- The auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its financial statements with that of its subsidiaries

Reporting Requirements

Matters to be stated in Auditor’s Report inter alia include:

(e) whether, in his opinion, the financial statements comply with the accounting standards

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company

(g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith

(i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls

(j) such other matters as may be prescribed.

Internal Controls over Financial reporting - Common Myths

We have a good SLA with service providers. We don't need to evaluate their controls

Meeting CARO requirement is sufficient

We don't need to revisit processes and controls.

There is no need to document processes and controls

We don't need to link risks with controls.

Testing of controls and remediation of deficiencies is the responsibility of auditors

We don't need a process for ICFR certification to Board / AC. We know people are doing their jobs

Scope and plan

Assess and define

Identify and document

Test and remediate

Monitor, certify and assert

Materiality is for financials. It doesn't really impact control considerations

Why do we need to look at cost / benefit for controls? Everything is essential

Automation through ERP – Controls are automatically in place

We don't need an oversight body to oversee all changes in processes / controls

We understand controls. There is no need for training and development of our people

Reporting Requirements

Matters to be stated in Auditor's Report

The auditor shall also report on

- Whether the company has disclosed the effect, if any, of pending litigations on its financial position in its financial statement
- Whether the company has made provision for foreseeable losses, if any, on long term contracts including derivative contracts
- Whether there has been delay in depositing money into the Investor Education and Protection Fund by the company
- CARO will have to be notified under an Order.

Reporting on Fraud

Fraud (explanation to Sec.447)

"Fraud" in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss

Reporting by Auditors (Sec.143(12))

If an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government

Reporting on Fraud

Penal provisions in case of non-compliance (Sec.143(15))

In case of non compliance with the provision relating to reporting on fraud by the auditor, he shall be punishable with a fine of `1 lakh which may extend up to ` 25 Lakhs

As per the draft rules

- If the auditor has sufficient reasons/information to believe that an offence involving fraud which is likely to affect the Company is being committed, he shall report the matter within 30 days of his knowledge or information with a copy to Audit Committee and Board.
- For fraud reporting, materiality has been defined to mean:
  - Frauds that are happening frequently or
  - Frauds where the amount involved is less than 5% of net profits or 2% of turnover for preceding financial year.
- Audit Committee or Board shall reply to the auditors in writing about the steps taken by the Company in addressing the issues of fraud, including systemic issues.

Scope of Services

Auditors are not allowed to provide following non - audit services either directly or indirectly to the company, its holding or subsidiary	
A	accounting and book keeping services
B	internal audit
C	design and implementation of any financial information system
D	actuarial services
E	investment advisory services
F	investment banking services
G	rendering of outsourced financial services
H	management services and
I	any other kind of services as may be prescribed

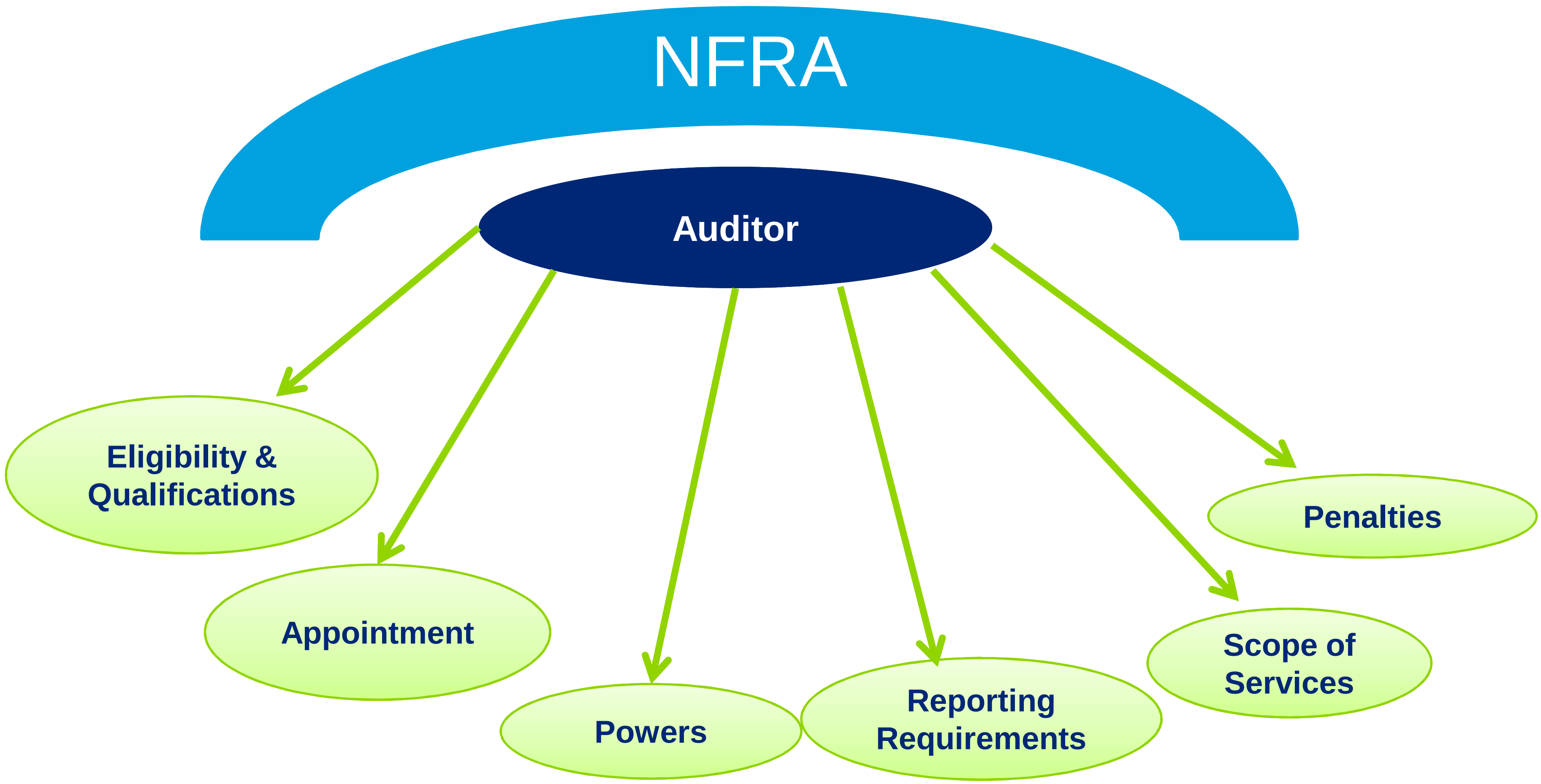
Scope of Services (Contd.)

The term “directly or indirectly” shall include rendering of services by the auditor:

In case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners

Transition period: To comply before closure of first year after the date of commencement of the Act.

Oversight Body for Auditors



National Financial Reporting Authority

Functions of NFRA

- Make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be
- Monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed
- Oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measures required for improvement in quality of service and such other related matters as may be prescribed and
- Perform such other functions as may be prescribed.

It has the power to investigate, suo moto or on reference made by Central Government in matters of professional or other misconduct by CA or firm.

No other institute or body shall initiate or continue any proceedings in matters where NFRA has initiated an investigation.

National Financial Reporting Authority (Contd.)

The authority shall undertake investigation or conduct quality control review of

- Listed Companies
- Companies with
  - networth >= Rs 500 Crores
  - Paid up capital >= Rs 500 crores
  - Annual Turnover >= Rs 1000 crores
- Companies having securities listed overseas

As per draft rules

Authority shall undertake investigation against auditors / audit firms who undertake audit of companies (including through the network or brand) whether directly or indirectly

- Audit of 200 or more companies in a year
- Audit of more than 20 Listed Companies
- Companies with
  - networth >= ` 500 Crores
  - Paid up capital >= ` 500 crores
  - Annual Turnover >= ` 1000 crores
- Companies having securities listed overseas

Penalties for Contravention

- If an auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than `25,000 but which may extend to ` 5 lakh
- If an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than ` 1 lakh but which may extend to ` 25 Lakh
- Where an auditor has been convicted he shall be liable to—

  (i) refund the remuneration received by him to the company and

  (*ii*) pay for damages to the company, statutory bodies or authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.

Penalties for Contravention (Contd.)

- In case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

Class Action Suits

Such number of member or members, depositor or depositors or any class of them, as the case may be may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal seeking inter alia the following orders:

- to claim damages or compensation or demand any other suitable action from or against—
  - (i) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part
  - (ii) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct or
  - (*iii*) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part

Happy to Take any Questions !