



Role of ICAI - Companies Act 2013

**Role of ICAI
Challenges
Opportunities**

Change

- “Some changes look negative on the surface but you will soon realize that space is being created in your life for something new to emerge.”
 - Eckhart Tolle

Role of ICAI

Matters under consideration of ICAI for representation to MCA-1

- Mandatory rotation should not be retrospective S 139 and Rule 6
- Relatives should only include dependents S 141 and Rule 10
- Limit of 20 cos per auditor should not apply to private cos and clarification required regarding branches /CFS S 141(3)g
- Internal financial control system should be limited to those related to financial statements (as done for Board) S 143

Matters under consideration of ICAI for representation to MCA-2

- Additional reporting like pending litigation, foreseeable losses for Long term contracts and derivatives etc should be dispensed with (rule 11 – chapter X)
- Reporting of fraud- should not be open ended as it is now (§ 143(12))
- Prohibited services for auditors-clarification required (§ 144)
- Entire firm being debarred by NFRA should be reconsidered (§ 132(4))
- Auditor should not be responsible to ‘any other person’. (§ 147(3)(ii))

S 132 – NFRA (S 210A)

- NACAS becomes NFRA
- Reach extends to audit standards and overview of audit profession also
- NFRA has powers to investigate professional or other misconduct
 - Suo moto or on reference by CG
 - ICAI can't initiate/ continue any proceedings where NFRAS initiates action
 - Misconduct of CFO/Co. officials also covered
- NFRA has powers of civil court

S 132 NFRA contd.

- Penalty action if member (CA) proved guilty
 - Penalty not < Rs 1Lakh upto 5 times fees received for individual
 - Penalty not < Rs 10 lakhs upto 10 times fees received for firms
 - Fees for how many years?
 - Debarring member or firm min. 6 months max. 10 years
- Appeal to Appellate authority possible

Challenges

Consolidated Financial Statements

- Any company having subsidiary / associate / JV needs to prepare consolidated financial statement also
 - Seems like, even if a company has only an associate / JV and no subsidiary, need for preparing CFS
 - Even an intermediate company in a group structure needs to prepare CFS
 - Requirement to consider total capital to decide on whether a company is a subsidiary is going to pose problems of
 - Consolidating line by line entities where equity stake is small
 - Just because there is large preference capital holding
 - Could reflect a very large minority interest adjustment!!

Conflict between AS and Companies Act

- Control
 - to include the right to appoint majority of the directors or
 - to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner;
- Subsidiary
 - Definition of 'Subsidiary' (S. 2(87)) – (Already notified except restriction on layers of subsidiaries)
 - Control of more than $\frac{1}{2}$ of the total share capital as opposed to nominal value of equity share capital
 - Total Share Capital = paid-up equity share capital + convertible preference share capital
 - Control over composition of board of directors along with a subsidiary

Related Parties

| Aspect | Under Companies Bill | Under AS 18 |
|--|---|--|
| Officers | Director or his relative KMP or his relative | KMP and his relatives |
| Firm | Director, Manager or his relative is a partner | Enterprises over which individuals with significant influence in this company and / or KMPs have significant influence |
| Private company | Director or Manager is a member or director | |
| Public company | Director or Manager is a director or holds along with relatives more than 2% of paid up capital | |
| Body Corporate | Accustomed to act as per advice, directors or instructions of Director or Manager | |
| Any person | On whose advice, directions or instructions, Manager / Director is accustomed to act | Having an interest in voting power with significant influence over the enterprise And, their relatives |
| Group | Holding, Subsidiary, Associate, Co-subsidiary and Joint Ventures (as Associate includes joint ventures) | Holding, Subsidiary, Co-Subsidiary; Associates and Joint Ventures |
| Officers of Holding company | Director or his relative KMP or his relative | |
| <p>RED – AS 18 limited only where there was significant influence; now, extended to cover whether there is significant influence or not</p> <p>BLUE – Other differences between AS 18 and Companies Act 2013</p> | | |

Auditor's Relatives...

- The scope of disqualification has been made very wide
- How could in today's nuclear families, an auditor gets to know about the financial dealings of his brothers / sisters / Son in law etc.?
- All it requires for an estranged spouse is to buy some shares or have some dealings with audit clients...

Cap on Number of Audits

- Audit limit capped at 20 audits...
- This does not exclude even OPC, Dormant Companies and Private Companies!
- This is going to pose significant challenges to the profession – especially those auditors who are working limited client groups...

Common Financial Year

- **Financial year**

- Uniformly Mar 31
- A holding/ subsidiary of foreign co. can follow different FY with permission of Tribunal
 - Two years time for conversion to Mar 31

- **Result:**

- More work for companies and auditors due to peaking up

Revision of Accounts

- **Reopening/recasting of accounts – Court/Tribunal order (130)/ Voluntary (131):**
- Who can apply?
 - CG
 - IT authorities
 - SEBI
 - Any other statutory/regulatory authority
 - Board/Company- S 131
- To
 - Court /Tribunal – S 130
 - Tribunal – S 131

Revision of Accounts

- **Reopening contd.**
 - Conditions for reopening S 130
 - Accounts prepared in fraudulent manner
 - Affairs of the company was mismanaged during the relevant period casting a doubt on reliability of FS
 - Conditions S 131
 - FS or Board report not in compliance with S 129 / S 134

Revision of Accounts

○ Questions that arise:

- How many years can be reopened not clear in S 130
- For application by authorities nothing provided for opportunity of being heard to Company! S 130
- Finality is provided in S 130 not in S 131!
- S 131 revisions every year possible!
- Revision of CFS possible?
- Notice to same authorities only viz CG, IT, SEBI, other statutory regulatory body S 130
- Notice to CG, IT S 131
- Reopening/recasting only on order by court/Tribunal S 130 / Tribunal S 131
- Accounts so recast shall be final S 130

Revision of Accounts

- S 131 – revision of FS/Board report
 - Revision for any of the 3 preceding FY
 - Not more than once in a FY
 - Detailed reasons to be disclosed in Board report
 - Where already filed with ROC revision to be confined to correction to the extent of non compliance with S 129/S 134 and consequential corrections
 - CG to frame rules including functions of company auditor
- Recently SEBI issued circular which empowers it to order revision of FS –thus there are 3 ways

Fraud Reporting...

- Reporting fraud to CG:
 - Applies to main auditor as well as branch auditor
 - Presently only in respect of money laundering there is a requirement to report to CG (Implementation of S 51A of Unlawful activities (Prevention) Act 1969 ICAI circ. dated 22 Apr 2010)
 - Now if an 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 report it to CG
 - No duty of auditor regarded as contravened if such reporting done in good faith

S 2 (43) –free reserves

- (i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- (ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value,
 - shall not be treated as free reserves;
 - The underlined parts are going to pose lot of challenges!

Free reserves- to take care

- S 123 –no dividend to be declared from reserves other than free reserves.
- New declaration of dividends out of reserves rules (chapter VIII) clearly states amount drawn from accumulated profits shall first be utilised to set off losses incurred in the financial year in which dividend is declared.
- Hence the previous option of declaration out of 'surplus' in P&L is no longer there.

Free reserves- to take care

- S 180 on restrictions on powers of Board
 - Borrowing moneys exceeding paid up share capital and free reserves – here free reserves would mean only those available for distribution as dividend and after reducing unrealised gains and surplus on measurements of assets and liabilities at fair value.

Fraud Reporting

- Time:
 - Within 60 days
- In
 - Form ADI 4
- How?
 - Auditor to forward report to Board/AC of Co. seeking reply within 45 days
 - Forward his report and reply with his comments to CG within 15 days of receipt of reply
 - If no reply, auditor to forward his report to CG with a note containing details of report forwarded to Board or AC
- To
 - Secretary, MCA
- By
 - Registered post ack due or speed post followed by email
- Branch auditor to have same duty related to the concerned branch audited (Rule 12)

Commenting on Internal Financial Controls...

- Definition of “Internal Financial Controls” is wide and far reaching
 - Overarching requirements beyond SoX
- Very large responsibility on the auditors
 - Especially in private and small companies
- Even Directors are to cover this only in the case of listed entities
 - But, auditors are required to comment in case of all companies!
- Not required anywhere in the world! SA also does not require this!
 - CARO covered only two processes on which comments were required

Other Services by Auditors

- Requires Board or audit committee approval
- Many services are banned:
 - Accounting; Internal audit; Design and implementation of Financial info system; Actuarial services; Investment advisory ;Outsourced financial services; Management services*;
Others as prescribed
 - Existing work- To comply with before closure of first FY
 - Forensic audit does not seem prohibited?
- ICAI rule of fees for other services would still apply?
- Applies to auditor, firm, partners, parent, subsidiary/ associate/ any other entity where firm/partner has significant influence/ control or common trade mark/ brand
 - * ICAI has stated what are permitted Management services
- **This is, however, an opportunity for other audit firms to get involved in rendering non audit services**

Auditor Resignation

- Auditor to file a statement indicating reasons for resignation within 30 days
- Resigning auditor to file form ADT-3 with ROC
- Fine not filing- Rs 50k to Rs 5 lakhs!
- **Even resignation is not easy!**

Penal provisions

- Penalties /prison time go up sky high!
- Refund of remuneration/ paying damages etc contemplated
- Liability extends to concerned partner/ partners who have acted in a fraudulent manner or abetted or as the case may be colluded in the fraud (R 9).
 - Will it cover, for instance, an engagement quality control reviewer who may not have the full facts?
- Joint and several liability to firm/partners
- Action by NFRA/ Tribunal provided for
- Class action suits arrive in India
- Will an LLP help at all?
- Will audit be a very onerous and thankless job?
 - TIME ALONE WILL TELL US!

§ 447 (new)

- § 447 defines fraud and hence is very important from auditor's view point.
- “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;
- “wrongful gain” means the gain by unlawful means of property to which the person gaining is not legally entitled;
- “wrongful loss” means the loss by unlawful means of property to which the person losing is legally entitled.

Opportunities

On the whole, this Act has opened up more opportunities for professional work, though Statutory Auditors have been brought under a lot of restrictions!!

Audit Rotation

- Rotation has been mandated for large entities
- This throws open opportunities to more audit firms....

Fixed Assets and Depreciation

- Companies are going to be looking at advisory and support for
 - Revising depreciation, esp. where they were following Schedule XIV rates
 - Componentization
 - Effect of revaluation

Internal Audit

- Mandated for
 - Listed cos
 - All companies with TO Rs 200 cr or more or o/s loans and borrowings from Banks/FI Rs 100cr or more
 - Unlisted public cos with Share capital Rs 50cr or more or Public deposits Rs 25 cr or more
- Shall appoint a
 - CA /cost accountant / other professionals in practice or not; can be firm of internal auditors;
 - Employee or not
- AC or Board in consultation with IA to formulate scope, functioning, periodicity and methodology of IA

Internal Financial Controls

- A large engagement opportunity to the profession
- All companies need to have a system which is also documented so that the Board and auditors can place reliance on the system and its testing for effective operations...

Related Party Transactions...

- Identification of RTP
- Evaluation of arm's length basis for the RTP transactions
- Throws open a new area of practice for firms...

Valuation Services

- The Act mandates valuation services to be rendered by registered valuers...
- Members getting registered as valuers once the process for the same is effective could throw open opportunities...

Independent Directors

- Need for independent directors is bound to grow...
- As Chartered Accountants provide a pool of financial experts to be on the Board of companies...

CSR

- ◉ Another great opportunity for the profession
- ◉ Advisory on CSR activities to be taken up and selection of agencies through which the activities could be undertaken
- ◉ Monitoring and audit of CSR spends...