Significant Implications: Accounts and Audit

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Part I

Changed Face of
“Significant Financial Transactions“
under Companies Act, 2013

Turn

Whether “realisable amount to be made” should be the correct interpretation

- **“Turnover"** means the aggregate value of the realisation of amount made

1. from the sale, supply or distribution of **goods**; or
2. on account of **services** rendered; or
3. **both**,

by the company during a financial year

Cash flow statement made mandatory except for Small Companies, OPCs and Dormant Companies

- Under section 2(40)(iii) of the 2013 Act, **Cash flow statement shall form part of the financial statements for all companies;**
- **Exception:** Cash Flow Statement not mandatory for:

1. One Person Companies [Section 2(62)],
2. Small Companies [Section 2(85)], and
3. Dormant Companies [Section 455];

- Section 143(2) of the 2013 Act also requires the **auditor's report to state** whether in his opinion the financial statements give a **true and fair view** of the **cash flow for the year**

Section 2(85) vs. CASR, 2006

- **Section 2(85):** "***small company***" means a company, ***other than a public company***,—
  (*i*) **paid-up share capital ≤ Rs. 50 Lakhs** or such higher amount as may be prescribed which shall not be more than Rs. 5 crores; or
  (*ii*) **turnover (as per last P & L Account) ≤ Rs. 2 crores** or such higher amount as may be prescribed which shall not be more than Rs. 20 crores

- **CASR, 2006:** ***"Small and medium sized company"*** means, a company—
  ".............(*iii*) whose **turnover (excluding other income) ≤ Rs.50 crores** in the immediately preceding accounting year;
  (*iv*) which have **borrowings (including public deposits) ≤ Rs. 10 crores** at any time during the immediately preceding accounting year……………."

Case Study

- ABC Limited (2014-2015):

1. Paid up capital Rs. 2 Crores;
2. Borrowings Rs. 8 Crores;

Whether Cash Flow Statement is required

- XYZ Limited (2014-2015):

1. Paid up capital Rs. 40 Lakhs;
2. Borrowings Rs. 11 Crores;

Whether Cash Flow Statement is required

Statement of Changes in Equity made mandatory if applicable

- According to section 2(40)(iv) of the 2013 Act, the financial statements shall **also include:**

1. a **statement of changes in equity [SOCIE],**
2. if applicable

Howe (India) Private Limited

Statement of Changes in Equity

	No. of shares	Share capital	Share premium	Retained earnings	Other components of equity: Foreign currency translation reserve	Other components of equity: Cash flow hedging reserve	Other components of equity: Other reserve	Equity attributable to the equity holders of the Company	Total equity
As at April 1, 2010	**14,427**	**1,442,700**	**6,321,474**	**26,973,819**	**-**	**-**	**6,216,075**	**40,954,068**	**40,954,068**
Proposed Dividend declared for the current year				2,102,893					
Cash dividend paid (including dividend tax thereon) for the previous year				(2,102,893)				(2,102,893)	**(2,102,893)**
Addtions to General Reserves				2,000,000				2,000,000	**2,000,000**
Profit for the year				19,343,943				19,343,943	**19,343,943**
Transfer to General Reserves				(2,000,000)				(2,000,000)	**(2,000,000)**
Other comprehensive income					-	-	-	-	**-**
As at March 31, 2011	**14,427**	**1,442,700**	**6,321,474**	**46,317,762**	**-**	**-**	**6,216,075**	**58,195,118**	**58,195,118**

Consolidated financial statements made mandatory [Section 129]

- Where a company has one or more subsidiaries, it shall:

1. **prepare a CFS of the company and all the subsidiaries** in the same form and manner as that of its own; and
2. **lay the CFS also before the AGM** of the company along with the laying of its financial statement

- The term "**subsidiary**" for above purposes **shall include:**
  1. **associate company [Section 2(6)], and**
  2. **joint venture**

Consolidated financial statements made mandatory….contd.

- The company shall also **attach** along with its financial statement, **a separate statement containing the salient features of the financial statement of its subsidiary(s)** in prescribed form [Form AOC 1 as per Rule 5 of Accounts Rules, 2014];
- The **provisions of this Act applicable to** the **preparation, adoption** and **audit** of **financial statements of a holding company shall, *mutatis mutandis*, apply to CFS** also;
- The **auditor of a holding company shall also have the right of access to the records of all its subsidiaries** insofar as it relates to the consolidation of its financial statement with that of its subsidiaries.[Section 143(1)];
- Section 143(1) seems to imply that **auditor of holding company shall also be auditor of CFS**.

Depreciation

- Schedule II of the Companies Act, 2013 provides the **useful life as against the minimum rates of depreciation** prescribed in Schedule XIV of the Companies Act, 1956;
- For **Intangible assets**, there is no specific provision in the Schedule XIV of the Companies Act, 1956;
- Now, **for intangible assets, the provisions of the Accounting Standards would be applicable**;
- **Component Accounting made mandatory:** Where **cost of a part of the asset is significant to total cost** of the asset and **useful life of that part is different from the useful life of the remaining asset**, useful life of that significant part shall be determined separately

Revaluation Reserve vis-à-vis Depreciation

The **depreciable amount** of an asset is:

- **the cost of an asset; or**
- **other amount substituted for cost**,
- ***less*** its residual value [Part A of Schedule II].

Some Issues under Schedule II

- Useful life;
- Residual Value;
- Depreciation Methods – whether altogether absent;
- Low value items;
- Transitional Provisions;
- Disclosure Requirements

Useful Life, Residual Value and Depreciation Methods

- **Part 'A' of Schedule II:**
- Depreciation is the systematic allocation of the depreciable amount of an asset over its **useful life [≤ life under Part 'C', unless justified];**
- The depreciable amount of an asset is the cost of an asset or other amount substituted for cost, less its **residual value [≤ 5% of Original Cost, unless justified];**
- The useful life of an asset is the period over which an asset is expected to be available for use by an entity, or the **number of production or similar units expected to be obtained** from the asset by the entity

Low value items

- **Note 4 of Schedule II:**
- Where cost of a part of the asset is **significant** to total cost of the asset and useful life of that part is different from the useful life of the remaining asset, useful life of that significant part shall be determined separately

Transitional Provisions

Note 7 of Schedule II: From the date this Schedule comes into effect, the carrying amount of the asset as on that date—

- **<u>shall</u>** be depreciated over the remaining useful life of the asset as per this Schedule;
- after retaining the residual value,
- **<u>shall</u>** be recognised in the opening balance of retained earnings where the remaining useful life of an asset is *nil*

Disclosure Requirements

Note 3 of Schedule II: The following information shall also be disclosed in the accounts, namely:—

- **depreciation methods** used; and
- the **useful lives** of the assets for computing depreciation, <u>**if they are different**</u> from the life specified in the Schedule

Part II

Auditor's Obligations and Liabilities

Services which auditor should not provide to the auditee company

- Statutory auditor shall not ***directly or indirectly*** provide any of the prescribed **"other services“** to the:

1. auditee-company; or
2. its holding company; or
3. subsidiary company [Section 144]

Services which auditor should not provide to the auditee company….contd.

- **Prescribed Other Services**:
  1. accounting and book keeping services;
  2. internal audit;
  3. design and implementation of any financial information system;
  4. actuarial services;
  5. investment advisory services;
  6. investment banking services;
  7. rendering of outsourced financial services;
  8. management services; and
  9. **any other kind of services as may be prescribed**.

Requirement of highlighting certain comments in audit report in thick type or italics omitted

- Section 143(3)(f) **omits requirement to highlight comments in thick type or italics**;
- Section 143(3)(f) redrafts the requirement to provide that auditor's report shall **state the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;**
- Section 143(i) of the 2013 Act requires the auditor's report to **state whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls**

Additional Reporting Requirements under Audit & Auditors Rules, 2014

- **Rule 11 requires reporting of following additional matters** in the Auditors' Report**:**

1. whether the company has disclosed the **impact, if any, of pending litigations on its financial position** in its financial statement;
2. whether the company has made **provision, as required under any law or accounting standards, for material foreseeable losses**, if any, on long term contracts including derivative contracts;
3. whether there has been any **delay in transferring amounts**, required to be transferred, **to the IEPF** (Investor Education and Protection Fund) by the company

Auditor's duty to AGM

- Section 146 provides that the **auditor <u>shall</u> attend any general meeting:**
  1. by himself, or
  2. through his authorised representative who is qualified to be an auditor
- Such **attendance is compulsory unless otherwise exempted by the company**

Auditor's liabilities

Section 147(2) provides as under:

- If an **auditor of a company contravenes** any of the provisions relating to:
  - appointment of auditors (section 139),
  - **contents of audit report** (section 143),
  - **compliance with auditing standards** (section 143),
  - **rendering prohibited services** (section 144), and
  - signing of audit report (section 145),
- the auditor shall be punishable with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5,00,000

Auditor's liabilities….contd.

- If an **auditor has contravened such provisions knowingly or wilfully** with the intention to deceive:

1. the company, or
2. its shareholders; or
3. creditors; or
4. **tax authorities**,

   he shall be punishable with:

1. **imprisonment** for a term which may extend to one year; and
2. **with fine** which shall not be less than Rs. 1,00,000 lakh but which may extend to Rs. 25,00,000 [proviso to section 147(2)]

Auditor's liabilities….contd.

- Section 147(3) provides that where an auditor has been convicted of an offence as above, he **shall be liable to**-

1. **Refund the remuneration** received by him to the company; and
2. **Pay for damages:**

- ❑ to the company,
- ❑ to the statutory bodies or authorities,
- ❑ ***to any other persons***

for loss arising out of incorrect or misleading statements of particulars made in his audit report

Part III

CARO, 2003 and Auditors

Companies Act, 2013 Obligations vis-à-vis CARO, 2003

1. Prevention, detection and reporting of **frauds** by the auditor;
2. Mandatory obligations regarding **internal audit**;
3. Reporting on **internal controls** by the auditors;

Prevention, detection and reporting of frauds by the auditor

- **Clause 4(xxi) of CARO** requires auditors to report: ***"whether any fraud <u>on or by</u> the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated"***
- **Section 143(12) of the 2013 Act** states that: ***if an auditor of a <u>company</u>, 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 <u>against the company by officers or employees of the company</u>, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed***

Internal Audit

- **Clause 4 (vii) of CARO, 2003** requires auditors to report: ***"in the case of:***

1. ***listed companies; and/or***
2. ***other companies having:***
   - ***a paid-up capital and reserves > Rs.50 lakhs as at the commencement of the financial year concerned, or***
   - ***an average annual turnover > Rs. 5 crores for a period of three consecutive financial years immediately preceding the financial year concerned,***

- ***whether the company has an internal audit system commensurate with its size and nature of its business"***

Internal Audit [Section 138]

- **Such class or description of companies as may be prescribed shall appoint an internal auditor** to conduct internal audit of books of account of the company.
- Internal auditor shall be:

1. a Chartered Accountant [may or may not be in practice], or
2. a Cost Accountant, or
3. such other professional as may be decided by the **Board**.

- **CG may make rules** **[Rule 13 of Accounts Rules, 2014]** to prescribe the manner and the intervals in which internal audit shall be conducted and reported to the Board;
- **Scope of Internal Audit:** To be formulated by Audit Committee/ BOD, in consultation with Internal Auditor

Internal Audit [Section 138]....Contd.

- Companies required to appoint an internal auditor or a firm of internal auditors (may or may not be company's employee):—

1. every **listed company;**
2. every **unlisted public company** having:
   - Paid up share capital $\geq$ Rs. 50 crores, during preceding F.Y.;
   - Turnover $\geq$ Rs. 200 crores, during preceding F.Y.;
   - O/s loans or borrowings from Banks/ P.F.I. $\geq$ Rs. 100 crores, at any point of time during preceding F.Y.;
   - O/s Deposits $\geq$ Rs. 25 crores, at any point of time during preceding F.Y.
3. every **private company**:
   - Turnover $\geq$ Rs. 200 crores, during preceding F.Y.;
   - O/s loans or borrowings from Banks/ P.F.I. $\geq$ Rs. 100 crores, at any point of time during preceding F.Y.

Transitional Provisions: Comply with these requirement within 6 months from the commencement of this Section

Internal Controls

- **Clause 4 (iv) of CARO, 2003** requires auditors to report: ***"is there an adequate <u>internal control system</u> commensurate with the size of the company and the nature of its business, for the <u>purchase of inventory and fixed assets and for the sale of goods and services</u>. Whether there is a continuing failure to correct major weaknesses in internal control system"***
- **Section 143(3)(i) of 2013 Act** requires auditor to report: ***"whether the company has adequate <u>internal financial controls system</u> in place and the operating effectiveness of such controls"***

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