Provisions Relating To Accounts And Audit

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Topics covered

- Provisions relating to Accounts
- Depreciation under Schedule II
- Corporate Social Responsibility
- Rotation of Auditors
- Prohibited Services

Accounts

Areas covered

- Certain definitions / concepts modified
- Consolidation made mandatory with certain exceptions
- Re-opening of accounts
- Revision of financial statements
- Other provisions relating to Accounts
- Internal Audit
- Contents of Board Report

Financial Year (FY)

- Period ending 31st March every year
- Only exception - a company or body corporate, which is a holding or subsidiary of a company incorporated outside India and is required to follow different FY for consolidation of its accounts outside India – with NCLT approval
- Companies incorporated on or after 1st January in a year – period ending on 31st March of the following year
- Existing companies – allowed transition period of 2 years
- Extension of FY no longer permissible –

Books of account

- Books of account defined
- Book and paper definition modified
- New definition also includes minutes and registers maintained
- Maintenance of records in electronic form permitted

  Rule 3 of the Companies (Accounts) Rules 2014 prescribes manner of keeping the books of account in electronic mode

Financial statements (FS)

- Defined to include
  - Balance sheet
  - Profit and Loss account / Income and Expenditure account
  - Cash flow statement
  - Statement of changes in equity, if applicable and
  - Any explanatory notes annexed to or forming part of the above
- In case of One Person Company / Small Company and Dormant Company

  \- financial statements exclude cash flow statement

Consolidated Financial Statements (CFS)

- Company having one or more subsidiaries required to prepare CFS
- Subsidiaries includes associate company and joint venture
- Intermediate subsidiaries may not present CFS in certain cases
- Manner of consolidation of accounts – Rule 6 of the Companies (Accounts) Rules, 2014
- Companies required to attach statement containing salient features of the financial statements of its subsidiaries - Rule 5 of the Companies (Accounts) Rules, 2014 – Form AOC-1

Re-opening of accounts (Not Notified)

- Re-opening of accounts (only on application by the Central Government or other Regulatory Body or Authority) on order by Court/Tribunal to the effect that
  - Earlier accounts were prepared in a fraudulent manner or
  - Company's affairs were mismanaged casting a doubt on reliability of financial statements
- Representations of the aforesaid body/authority concerned need to be considered before passing such order

Voluntary Revision (Not Notified)

- Voluntary revision of financial statements/ board report permitted for any of the 3 preceding financial years
  - Detailed reasons required to be disclosed in the board report
  - Company needs to obtain specific approval from Tribunal for restatement
- Representations of the Central Government and Income-Tax Authorities need to be considered by Tribunal before passing such order

Other provisions relating to accounts

- FS and CFS to be sent to members / debenture trustees not less than 21 days before the date of general meeting – manner of circulation prescribed by Rule 11
- In case of listed companies - <u>unless shareholders ask for full financial statements</u> – sufficient compliance of the above if
  - Copies made available for inspection at registered office for inspection 21 days before the date of meeting
  - A statement of salient features (in form AOC-1) is sent to members 21 days before the date of meeting

Other provisions relating to accounts – contd.

- Audited accounts of all subsidiaries required to be
  - Placed on website, if any and
  - Copies to be provided to each shareholder <u>on request</u>
- The FS including CFS to be signed by
  - Chairperson of the company where he is authorized by the Board **<u>or</u>** two directors out of which one shall be MD **and**
  - Chief Executive Officer, if he is director of the company
  - Chief Financial Officer
  - Company Secretary

Internal Audit

Entities	Applicability
Listed Companies	All
Unlisted Public Companies	(a) Paid up Capital of Rs. 50 crore or more ** (b) Turnover Rs. 200 crore or more ** (c) Outstanding loans or borrowings from bank/ public financial institution - Rs. 100 crore or more**** (d) Outstanding deposits Rs. 25 crore or more****
Private Companies	(a) Turnover Rs. 200 crore or more ** (b) Outstanding loan or borrowings from bank/ public financial institutions Rs. 100 crore or more ****
** During the preceding financial year ***** At any point during the preceding financial year	

Additional requirements in Board Report

- Extract of annual return in Form MGT-9
- Number of meetings of the Board
- Under Directors Responsibility Statement-additional disclosure relating t
  devising of system to ensure compliance with applicable laws and that such system was adequate and working effectively
- Explanation or comments on every qualification, reservation or adverse remark or disclaimer by auditor including by secretarial auditor

Board Report – contd.

- Particulars of loans, guarantees or investments u/s. 186
- Particulars of contracts with related parties referred to in section 188(1) – Form AOC-2
- A statement on risk management policy
- Details of policy on CSR
- Financial highlights
- Change in the business, if any

Board Report – contd.

- Details of directors **<u>or</u>** KMPs who were appointed or have resigned
- Names of the companies which became or ceased to be its subsidiaries, joint ventures or associate companies
- Details relating to deposits (including those not in compliance with Chapter V)
- Details of significant and material orders passed by the regulators or courts or tribunals impacting going concern status and company's operations in future
- Details in respect of adequacy of internal financial controls with reference to FS

Depreciation

Basic Concepts

- Depreciation
- Depreciable amount
- Useful Life
- Residual Value
- Classification of assets
- Component accounting

Useful Life & Residual Value

- Useful Life prescribed for tangible assets only
- Where useful life and residual value determined by Regulatory Authority
- Adopting useful life and residual value different from that prescribed
- Factors to be considered while determining useful life
- Factors to be considered while determining residual value

Classification of assets

Under Schedule XIV (Companies Act 1956)	Under Schedule II (Companies Act 2013)
Buildings (other than factory buildings)	Other than factory buildings – RCC Frame Structure Other than factory buildings – Other than RCC Frame Structure
Factory buildings (included wells and tube wells) Fences not specifically covered	Factory buildings Fences, wells, tube wells
Purely temporary structures	Others (including temporary structures)
Bridges and Culverts formed part of buildings (other than factory buildings)	Bridges, Culverts, Bunders
Roads formed part of buildings (other than factory buildings)	Roads

Classification of assets

Under Schedule XIV (Companies Act 1956)	**Under Schedule II (Companies Act 2013)**
Plant and Machinery	Classification altered substantially
Separate rate of depreciation prescribed for certain specific items of plant and machinery	Separately useful life prescribed for certain specific items of plant and machinery used in certain industries
Motor vehicles and cycles (with separate depreciation rate), office equipment, laboratory equipment, electrical installation and equipment, hydraulic works, pipelines and sluices, railway sidings, ropeway structures – were not classified as assets and thus formed part of general plant and machinery	These assets are now classified separately with distinct useful life prescribed for each of them.
Ocean going ships – classified under 3 heads	Classified more detail now under 12 heads
Ships plying on inland waters – classified under 2 heads	No change

Transitional Provisions

- From the date the Schedule comes into effect
  - Carrying amount of the asset shall be depreciated over the remaining useful life
  - Where remaining useful life is Nil – after retaining residual value – carrying amount may either be charged to profit and loss or opening balance of retained earnings

Other Issues

- Extra Shift Depreciation
- Depreciation on low value assets
- Continuous process plant
- Depreciation on revalued assets
- Disclosure requirements

Component Accounting

- New concept
- Applicability postponed by one year – now applicable from FY 15-16
- Issues in Component accounting
  - Identification of components
  - Allocation of costs
  - Computing depreciation
- Impact of Component accounting

Corporate Social Responsibility (CSR)

Applicability

- Applicable with effect from 1st April 2014
- Every company, during any financial year, having
  - Net worth of Rs. 500 crore or more OR
  - Turnover of Rs. 1000 crore or more OR
  - Net profit of Rs. 5 crore or more
- Needs to constitute a CSR Committee
- Any financial year implies any of the three preceding financial years

Definitions

- Financial Year
- Net Profit
- Average Net profit
- Net Worth
- Turnover

Computation of net profit

- Net profit as per profit and loss account as reduced by
  - Profit arising from overseas branches
  - Dividend received from an Indian company to whom CSR provisions apply
- Net profit for any financial year for which accounts were prepared under Companies Act 1956 not required to be recalculated
- Net profit in case of foreign company – as per profit and loss prepared u/s. 381(1)(b) r.w. section 198
- For computing average net profits – Whether loss in any of the three years to be ignored

CSR Expenditure

- Quantum of expenditure – 2% of average net profits during preceding three years
- CSR activities to be undertaken in India only
- Amount to be spent pursuant to CSR Policy – towards activities specified in Schedule VII
- CSR expenditure – whether appropriation or charge on profit & loss
- In case the Company fails to spend – Directors to specify the reasons for not spending

CSR Expenditure – contd.

Expenditure qualifying as CSR expenditure

- Expenditure by foreign holding company – subject to certain conditions
- CSR activities can be undertaken through a registered trust or registere society
- Contribution towards corpus – subject to certain conditions
- Expenditure on capacity building - Salaries of staff (on pro rata basis) and CSR volunteers including administrative overheads – ceiling of 5%

CSR Expenditure – contd.

- Expenditure not qualifying as CSR expenditure:
  - Advertisement / sponsorship / one off events
  - Expenditure in fulfillment of statutory obligations
  - Expenditure on activities undertaken in the normal course of business
  - Activities for the exclusive benefit of employees
  - Contributions to political parties

Accounting aspects of CSR Expenditure

- Whether unspent amount needs to be provided for?
- Excess amount spent – whether can be carried forward
- Capital expenditure incurred as part of CSR expenditure
- Goods manufactured by Company / services rendered as part of CSR expenditure
- Grant received against CSR expenditure
- Surplus arising from CSR activities

Taxation aspects of CSR Expenditure

- CSR Expenditure not allowable as deduction under section 37 of the Income Tax Act 1961
- Donation to Swachh Bharat Fund / Clean Ganga Fund – not eligible u/s 80G to the extent treated as CSR expenditure
- Amount of employee & other costs - in excess of 5% - whether allowable
- Whether adjustment required under MAT ?

Rotation of Auditors

Applicability

Entities	Coverage
Listed Companies	All
Unlisted Public companies	Having paid up share capital of Rs. 10 crore or more
All private companies	Having paid up share capital of Rs. 20 crore or more
Unlisted public companies and private companies not covered above	Having public borrowings from financial institutions, banks or public deposits of Rs. 50 crore or more

Rotation of Auditors

- Manner and procedure for rotation – Rule 10.6
- In case of individual – one term of 5 years
- In case of firm of auditors – two terms of 5 consecutive years
- Cooling off period – in both cases – 5 years
- Audit firms having common partner or partners as on the date of appointment cannot be appointed for 5 years

Rotation of auditors – contd.

- Existing companies to comply with these provisions within 3 years of enactment
- Incoming auditor not eligible if such auditor or audit firm is associated with outgoing auditor or firm
  - Under same network
  - Operates under same trade mark or brand

Rotation of auditors – contd.

- Mode of rotation when joint auditors are appointed

- Issues
  - Whether the restriction applies only on the date of appointment or for the entire cooling period of 5 years?
  - Can partner of a firm be appointed in individual capacity?
  - How will provision relating to joint auditor not retiring in same year be complied in the first year of application of section?

Rotation of Auditors-Illustration for Individual auditor

No. of consecutive years for which an individual auditor has been functioning as auditor in the same company	Maximum no. of consecutive years for which he may be appointed in the same company	Aggregate period which the auditor would complete in the same company in view of column 1 and 2
5 years (or more than 5 years)	3 years	8 years or more
4 years	3 years	7 years
3 years	3 years	6 years
2 years	3 years	5 years
1 year	4 years	5 years

Rotation of Auditors-Illustration for Audit Firm

No. of consecutive years for which the auditor firm has been functioning as auditor in the same company	Maximum no. of consecutive years for which it may be appointed in the same company	Aggregate period which the auditor firm would complete in the same company in view of column 1 and 2
10 years (or more than 10 years)	3 years	13 years or more
9 years	3 years	12 years
8 years	3 years	11 years
7 years	3 years	10 years
6 years	4 years	10 years
5 years	5 years	10 years
4 years	6 years	10 years
3 years	7 years	10 years
2 years	8 years	10 years
1 year	9 years	10 years

Prohibited Services

Prohibited Services

- An auditor not to render directly or indirectly any of the following services :—
  - Accounting and book keeping services
  - Internal audit
  - Design and implementation of any financial info. System
  - Actuarial services
  - Investment advisory services
  - Investment banking services
  - Rendering of outsourced financial services
  - Management services
  - Any other kind of services as may be prescribed

- Restriction applies to company – its holding company – its subsidiary company

Prohibited Services

- Apart from audit – auditor can provide only those services as are approved by the AC/BOD
- Auditor prohibited, directly or indirectly, from rendering certain specified services
- Auditors rendering such services at present to comply before the closure of first financial year.

Thank You