

The Companies Act 2013

- ◆ Company Accounts
- ◆ Auditors
- ◆ Corporate Social Responsibility

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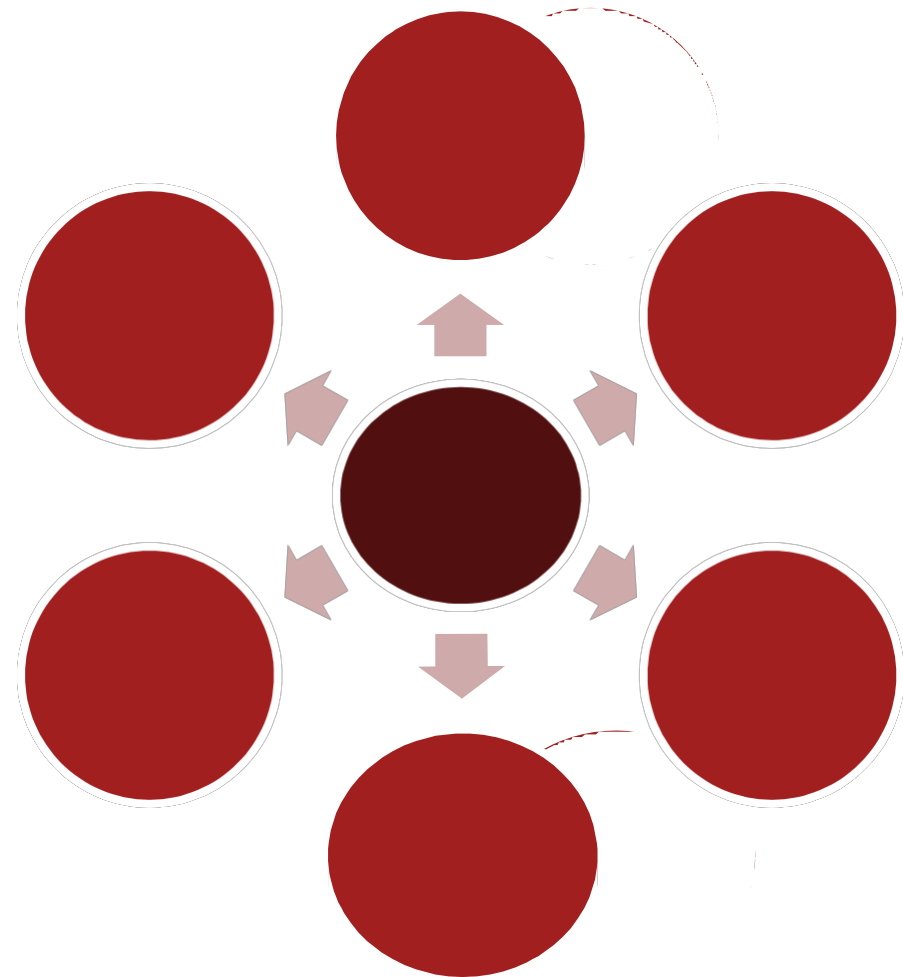
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Areas impacting Accounts, Audit, and RPT



Key areas impacting Accounts and Audit and other related areas:



Related Chapters	Related Section
Chapter IX: Accounts of Companies	Section: 128 to 138
Chapter X: Audit and Auditors	Section: 139 to 148
Chapter XII: Related party transaction	Section: 186 to 188

Quick update in Companies Act 2013

Applicability of Sections notified by MCA:

As a part of the phased implementation of the Companies Act, 2013 (New Act), out of a total of 470 sections, 100 sections were earlier notified by the Ministry of Corporate Affairs (MCA), including section 135 relating to Corporate Social Responsibility.

The MCA has now notified 183 new sections and some sub-sections of sections which were already notified vide notification dated September 12, 2013 and the remaining Schedules on March 26, 2014

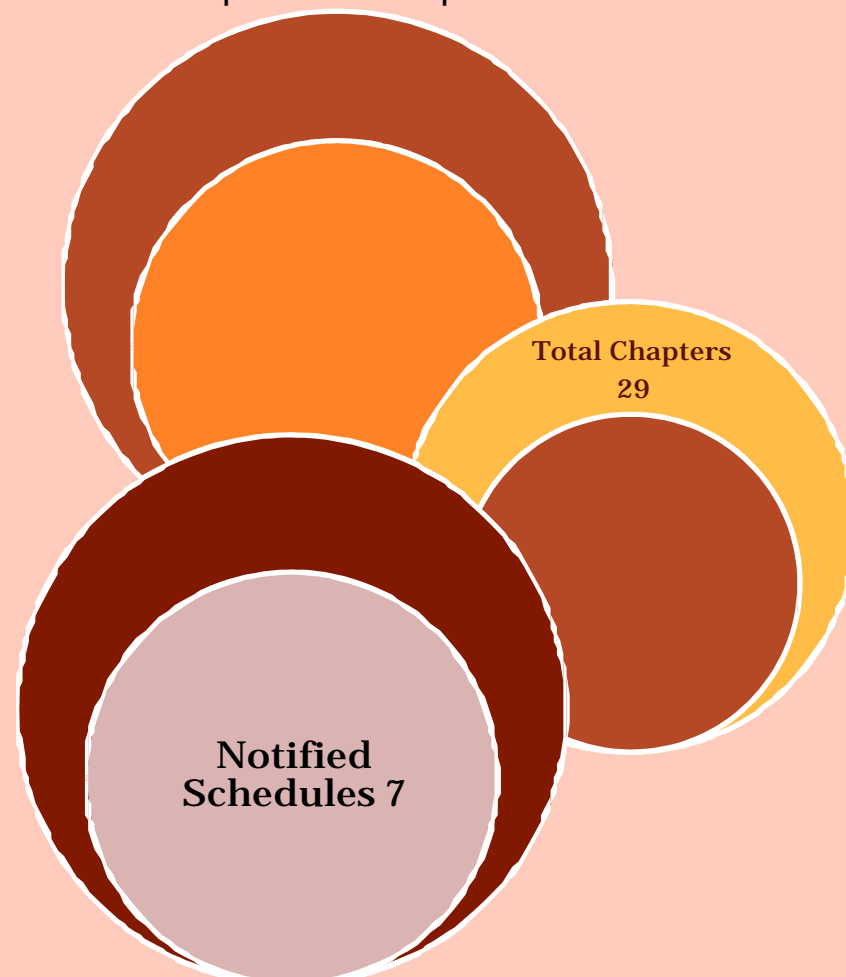
These section would be effective from April 1, 2014, as the same has been clarified by MCA on 4th April 2014 vide its General Circular, stating that the financial statements (and documents required to be attached thereto), Auditor's report and Board report in respect of financial year that commenced earlier than 1st April 2014 shall be governed by the relevant provisions / schedules / rules of the Companies Act 1956.

Out of the total 470 section, 187 section and certain sub-sections of notified sections are yet to be notified by the MCA.

Rules:

MCA, has also notified rules relating to 20 chapters, which will be effective from April 1, 2014.

Statistical snapshot of Companies Act 2013



* Please note that all the sections of notified chapter were not notified. Refer earlier circle to know list of notified sections

List of sections notified by MCA relating to Accounts

List of sections notified by MCA and corresponding sections of Companies Act 1956

Sections - New Act	Name of Section	Corresponding Section of Companies Act,1956
Chapter IX: Accounts of Companies – Notified Sections		
128	Books of account, etc., to be kept by company	Section 209 - Books of Accounts, etc., to be kept by Company
129	Financial statement	Section 210 - Annual accounts and balance-sheet
133	Central Government to prescribe accounting standards	Section 210A - Constitution of National Advisory Committee on Accounting Standards
134	Financial statement, Board's report	Section 217 - Board's report
135	Corporate Social Responsibility	New Provision
136	Right of member to copies of Audited financial statement	Section 219 - Right of member to copies of balance sheet and auditors' report
137	Copy of financial statement to be filed with Registrar	Section 220 - Three copies of balance-sheet, etc., to be filed with Registrar
138	Internal Audit	New Provision

Sections YET TO BE notified by MCA		
130	Re-opening of accounts on court's or Tribunal's Order	New Provision
131	Voluntary revision of financial statements or Board's Report	New Provision
132	Constitution of National Financial Reporting Agency	New Provision

List of sections notified by MCA relating to Audit and Auditors

List of sections notified by MCA and corresponding sections of Companies Act 1956

Sections - New Act	Name of Section	Corresponding Section of Companies Act,1956
Chapter X: Audit And Auditors		
139	Appointment of auditors	Section 224 - Appointment and remuneration of Auditors
140	Removal, resignation of auditor and giving of special notice (Except Second Proviso to sub-section 4 to 5)	[Section 224 (7) and] 225 - Provisions as to resolutions for appointing or removing auditors
141	Eligibility, qualifications and disqualifications of auditors	Section226 - Qualifications and disqualifications of Auditors
142	Remuneration of auditors	Section 224(8) - Appointment and remuneration of Auditors
143	Powers and duties of auditors and auditing standards	Section 227 - Powers and duties of auditors
144	Auditor not to render certain services	New Provision
145	Auditor to sign audit reports, etc.	Section 229 - Signature of audit report, etc.
146	Auditors to attend general Meeting	Section 231 - Right of auditor to attend general meeting
147	Punishment for contravention	Section 232 - Penalty for non-compliance with sections 225 to 231 Section 233 - Penalty for non-compliance by auditor with sections 227 and 229
148	Central Government to specify audit of items of cost in respect of certain Companies	Section 233B - Audit of cost accounts in certain cases

Key provisions given in Rules relating to Accounts

Key provisions given in Rules relating to Accounts

MCA has notified 'Companies (Accounts) Rules, 2014' relating chapter IX – Accounts of Companies, covering from Section 128 to Section 138 of the Companies Act 2013.

The key provisions of these rules has been explained below:

Maintenance of books	Financial statements, Board report etc.	Internal Audit
<ul style="list-style-type: none">◆ Detailed requirements with respect to maintenance of accounts in <u>electronic</u> mode has been given in Rules 3.◆ Back up of books maintained in electronic mode (including outside India) to be kept on servers in India on a periodic basis◆ Certain details regarding the service provider to be intimated to the Registrar Annually	<ul style="list-style-type: none">◆ Consolidated Financial Statement is to be prepared in accordance with Schedule III and the applicable accounting standards.◆ In addition to compliance with the accounting standards, Companies are now required to mandate certain additional disclosures given in Schedule III.◆ Board's Report to also include a separate section with respect to subsidiaries, associates and JVs	<p>Applicability:</p> <ul style="list-style-type: none">◆ Every listed company◆ Every unlisted company having:<ul style="list-style-type: none">• Paid up capital \geq 50 crores• Turnover \geq 200 crores• Outstanding loans / borrowing \geq 100 crores• Outstanding deposit \geq 25 cores◆ Every private company having:<ul style="list-style-type: none">• Paid up capital \geq 50 crores• Turnover \geq 200 crores• Outstanding loans / borrowing \geq 100 crores <p>A transition period of 6 months has been provided for compliance by existing companies</p>

Key provisions given in Rules relating to Audit and Auditor

MCA has notified 'Companies (Audit and Auditors) Rules, 2014' relating chapter X – Audit and Auditors, covering from Section 139 to Section 148 of the Companies Act 2013.

The key provisions of these rules has been explained below:

Applicability

The mandatory rotation of auditors is applicable only to specified companies. The **exhaustive list** of specified companies is as follows:

- ◆ Listed Companies.
- ◆ All **unlisted public companies** (having paid up shares capital > INR 10 Crore)
- ◆ All **private limited companies** (having paid up shares capital > INR 20 Crore)
- ◆ All other companies having paid up capital below threshold mentioned above, but having public borrowings from financial institutions, banks or public deposits of more than INR 50 Crore

Additional reporting requirements as per new rules

The rules mandates that the auditor's report should also include their **views and comments** on the following matters:

- ◆ Whether the company has disclosed the **impact**, if any, of **pending litigations** on its financial position in its financial statement.
- ◆ 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
- ◆ Whether there has been any **delay in transferring amounts**, required to be transferred, to the **Investor Education and Protection Fund** by the company.

Key provisions given in Rules relating to Audit and Auditor

Other points:

- ◆ The new rules provide a **three years transition period** for complying with the provisions pertaining to the auditor rotation in the Companies Act, 2013.
- ◆ In determining the tenure of the audit firm prior to 1 April 2014, tenure of the other firms operating under the **same network** of audit firms would also be considered. The rules clarify that term '**same network**' includes the firms operating or functioning, hitherto or in future, under the same brand, trade name or common control.
- ◆ If a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be **ineligible** to be appointed for a period of five years for that company.
- ◆ The rules clarify that for any criminal liability of any audit firm, liability other than fines would **devolve only on the concerned partner or partners**, who acted in a fraudulent manner or abetted or colluded in any fraud.

- ◆ Financial Statements
 - ./ Key changes in Definitions
 - ./ Key provisions impacting financial statement and CFS
 - ./ Others
- ◆ Books of accounts and revision
- ◆ Depreciation – Key highlights and amendment
- ◆ Related party transactions – Key changes
- ◆ NFRA and others





Financial Statements

Key changes in the definitions related with Financial Statements:

Particulars	Companies Act 2013	Companies Act 1956
Financial Statement 2 (40)	<p>Financial statement in relation to a company, includes—</p> <ul style="list-style-type: none"> i) a balance sheet as at the end of the financial year; ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year; iii) cash flow statement for the financial year; iv) <u>a statement of changes in equity, if applicable;</u> & v) <u>any explanatory note annexed to</u>, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv): <p>Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement;</p>	Not defined
Financial Year (FY) 2 (41)	<p>Financial year of a company / body corporate means the period ending on 31st March every year.</p> <p>In case a company has been (newly) incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, will be its first financial year.</p> <p>Exception – A company or body corporate, which is a holding company or a subsidiary of a company incorporated outside India and is required to follow a different FY for consolidation of its accounts outside India, with National Company Law Tribunal (NCLT) approval</p> <p>All existing companies will need to align their financial year with the new requirement within two years from the commencement of the new law.</p>	<p>Financial year means, in relation to any body corporate, <u>the period in respect of which any profit and loss account of the body corporate laid before it in annual general meeting</u> is made up, whether that period is a year or not.</p> <p>Exception: In case of Insurance companies, financial year shall mean the calendar year referred to in subsection (1) of section 11 of the Insurance Act, 1938 (4 of 1938)</p>

Financial Statements

Key provisions impacting Financial Statements:

Particulars	Companies Act 2013	Companies Act 1956
Signing of financial statements 134 (1)	<p>Financial Statements to be signed at least by:</p> <ul style="list-style-type: none"> • Chairperson of the company, if authorized by BOD; or • 2 Directors including MD, where there is one and CEO if he is a Director, • CFO and CS, (wherever they are appointed) <p>In case of One Person Company balance sheet and statement of profit and loss to be signed by 1 director only</p>	Balance sheet and statement of profit and loss to be signed by manager or secretary and by 2 Directors including MD where there is one.
Consolidated Financial statements 134 (1)	<p>A company has a subsidiary / associate / joint venture, CFS to be prepared and laid before an AGM in addition to standalone financial statements</p> <p>Schedule III – Financial Statements --◆  Schedule III</p> <p>General Instruction for CFS ---◆  CFS</p>	<p>No such concept.</p> <ul style="list-style-type: none"> • A company required to give specified information about the financials of a subsidiary - Section 212 report - as part of Director's report • Under the Listing Agreement of SEBI, Consolidated Financial Statement (CFS) is mandatory for listed company
Period for maintenance of Books of Accounts 128 (5)	Central Government may direct keeping books of accounts of a company to be maintained for a period more than 8 years where any investigation has been ordered.	Companies are required to preserve the Books of Account for a period of 8 years

Financial Statements

Key provisions impacting Consolidated Financial Statements – Sec 129:

Key provisions

- Company having one or more subsidiaries / associates / joint venture to prepare **Consolidated Financial Statement** ('CFS') in addition to standalone financials.
- Act requires **adoption and audit** of CFS in the same manner as stand-alone financial statements of the holding company
- The Company shall attach with its financial statement, a separate statement containing **salient features of financial statement of its Subsidiary**.
- Companies having subsidiaries outside India will need to submit the standalone financial statements of **subsidiary(ies) outside India to the ROC**

Impacts

- **Additional burden** on companies having global presence to:
 - a) Prepare CFS including all subsidiaries, associates and joint ventures (whether in India or outside) [Section 129 (3)]
 - b) Prepare a summary statement for all its subsidiaries, associates and joint ventures of the salient features of their respective financial statements [Proviso to Section 129 (3)]
 - c) Submit the standalone financial statements of subsidiary(ies) outside India to the ROC [Section 137 (1)]
- Additional efforts in preparation and audit of consolidated financial statement.
- Companies having parent company outside India is also required to prepare CFS in the format as specified in Schedule III to the Companies Act, 2013.
- Requirements of **section 212** of Companies Act, 1956 has been **dispensed with**.
- CFS prepared by the companies under IFRS is not recognized. Hence all the companies will mandatorily require to prepare CFS as per Accounting Standards.

Financial Statements

Circulation of financial statements to members – Sec 136:

Key provisions

Unlisted Company:

- A copy of the financial statements, CFS if any, auditor's report and every other document required by law to be annexed or attached to the financial statements, which are to be laid before a company in its general meeting, shall be sent to at least 21 days before the meeting to:
 - Every member of the company;
 - Every trustee for the debenture-holder of any debentures issued by the company; and
 - All other persons entitled to receive

Listed Company

- In addition to provisions applicable to an unlisted company, a listed company is required to:
 - Make these **documents available for inspection** at its registered office during working hours
 - To send a statement **containing salient features** of such documents in the prescribed form or copies of the documents, as the company may deem fit to shareholders unless they ask for full financial statements.
 - place its financial statement, CFS if any, and all other documents required to be attached thereto, on its **website**.
 - to provide a **copy of separate audited financial statements** in respect of each of its subsidiary, to any shareholder of the company who asks for it.

Penalty

- Any contravention will make the Company liable to penalty of Rs.25,000 and every officer who is in default with a penalty of Rs.5,000

Financial Statements

Filing of financial statements with ROC – Sec 137:

Key provisions

- Company to file its financials etc. within 30 days of its adoption at AGM
- If the financials etc. are not adopted at the AGM or at adjourned meeting even such **un-adopted financials** need to be filed with ROC within 30 days from the date of AGM
- ROC shall take such un-adopted financials on **record as provisional** till the financials are adopted in adjourned AGM for that purpose and filed within 30 days from the date of adjourned AGM
- **Even if AGM of the Company has not been held**, the financials etc. has to be filed within 30 days of the last date before which the AGM should have been held

Penal Provision

- If **Company** do not file the documents within time or extended time limit, the company is liable to pay a fine of Rs. 1,000 per day during which default continues subject to maximum Rs. 10,00,000; and
- MD and CFO, and in their absence, any other director in charge by the BOD with this responsibility, and in the absence of such director, all directors are punishable with
 - **imprisonment upto 6 months or**
 - **with fine of Rs. 1,00,000 to Rs. 5,00,000 or**
 - **with both of the above**

Books of accounts and revision (Sec 128 & 131)

Key provisions

- **General**

- ./ The Company may keep books of accounts and other relevant papers in **electronic mode** in such manner as prescribed in the rules to the Companies Act 2013.
- ./ In case of companies having branch offices in India or outside India, they are required to send **periodic returns** to registered office.

- **Voluntary revision:**

A Company shall not re-open its books of accounts unless an application is made by statutory authorities. However, now a company can **voluntarily revise** its financial statements or Board's report if it appears to the director of a company that the financial statement of the company or the Board's report does not comply with the provisions of section 129 (financial statements) and section 134 (financial statements and board reports) in respect of any of **three preceding financial years**, after obtaining approval from Tribunal.

- **Mandatory revision:**

A company can re-open its books of accounts or re-cast its financial statements on the below grounds:

- that the relevant earlier accounts were prepared in a **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 made statutory by regulatory authorities.

The provision of Company's Act 2013 concerning re-opening / revision of accounts are yet to be notified

Impacts

- Cognizance given to electronic mode - Electronic mode of maintaining books of accounts has been given cognizance.
- Reduction in compliance requirements / costs with respect to returns of branches - Requirement of returns to be sent by branches once in 3 months has been done away with and returns are required to be sent periodically.
- The provisions envisaged by the Act in respect of re-opening and voluntary revision of the financial statements and board report is yet to be acknowledged by SEBI in the Equity Listing Agreement and thus, pending similar amendment in the equity listing agreement the listed companies may face hardship.

Depreciation - Key highlights

Key Highlights of Schedule II

- Useful life of a tangible fixed asset has been restricted to the **useful life** (i.e., number of years) as against the depreciation rates specified by Schedule XIV in the 1956 Act.
- Significant increase in the rate of depreciation of commonly used assets as compared to Schedule XIV rates namely furniture and fittings, office equipment, desktops/ laptops, electrical installations, general plant and machinery other than continuous process plant, etc.
- The requirements of Part C would not be applicable for the companies in respect of which the useful life or residual value is notified by a **Regulatory Authority**.
- In case the useful life of the tangible fixed asset is longer than the useful life as per Part C of the Schedule or the residual value is more than 5% of the original cost of the asset, companies would be required to disclose the **justification** in their financial statements.
- Componentisation of tangible fixed assets has been recognized and 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.
- Transitional provisions included to state that if the remaining revised useful life is nil, the carrying value net of residual value should be recognised in the opening balance of retained earnings.
- Depreciation/amortisation of intangible assets would continue to be governed by the provisions of Accounting Standard 26 Intangible Assets (AS 26) except in case of Toll Roads where the amortisation amount would be prescribed by Schedule II (similar to Schedule XIV of the 1956 Act). Where a company arrives at the amortization amount of such intangible asset accordance with any other method as per AS 26, the same is required to be disclosed in the financial statements.

Depreciation - Amendments in Schedule II

The MCA has published an amendment to Schedule II of the Companies Act, 2013 (to be notified shortly).

Amendments	Impact
<ul style="list-style-type: none">◆ Companies are provided with the option of depreciating assets over their useful lives which could be different from the useful lives prescribed in Schedule II. Further, the determination of residual value could also deviate from the five per cent stated in Schedule II. ◆ If a company chooses to deviate from the limits indicated in Schedule II, it will be required to disclose a justification for the same in the financial statements. ◆ The notification has clarified that the amortisation of intangible assets created under toll road projects will be depreciated using a revenue based amortisation method. This change reverts back to the position under the erstwhile Companies Act.	<ul style="list-style-type: none">◆ This move by the MCA is in line with international best practices. ◆ The requirement to disclose justification for deviation will provide transparency to the users of financial statements. ◆ Revenue-based amortisation, will maintain status quo for companies having toll road projects.



Amended
Schedule II

Depreciation - CPP and BOT assets

Depreciation of CPP, BOT assets and plant used in double / triple shift working:

In the recent amendment to Schedule II to Companies Act, 2013 MCA has provided guidance related to above assets:

Continuous Process Plant	Plant working on Double/ Triple shift	BOT Assets
<ul style="list-style-type: none"> ◆ Useful life of Continuous Process Plant (CPP) has been increased to 25 years . ◆ In addition to above, amendment explains that a company can depreciate its CPP over a period shorter or longer than 25 years with proper justification. 	<ul style="list-style-type: none"> ◆ Under Schedule II, no separate rates / lives are prescribed for extra shift working. ◆ However, it mention that an asset used in double shift depreciation will increase by 50% and by 100% in case of triple shift working. 	<ul style="list-style-type: none"> ◆ As per amendment to Schedule II to the Companies Act, 2013 a Company was allowed to use revenue based amortisation for intangible assets created under BOT, BOOT or any other form of PPP route. ◆ For amortisation of other intangible assets, AS 26 needs to be applied.

Transitional Provision:

From the date Schedule II comes in effect, the carrying amount of asset as on that date:

- a. Will be depreciated over the remaining useful life of the asset as per this schedule
- b. After retaining the residual value, will be recognised in the opening balance of retained earnings where the remaining useful life of an asset is nil.

Related party transactions – Key provisions

Key provisions

- **Scope widened** to include leasing of property, appointment of agent for the sale or purchase, related party's appointment to any office or place of profit in company, its subsidiary or associate company .
- Contract or arrangement with related party can be entered into with the **prior approval of the company by special resolution.**
- 'Cash at prevailing market price' has now been substituted with '**Arm's length transaction**'.
- Related Party transactions to be **disclosed in the Director's Report** along with justification thereof.

Impacts

- Companies Act does not require approval of Central Government approval for related party transactions. It can be entered into by passing special resolution.
- Every contract or arrangements entered into with a related party will be referred to in the board's report to shareholders, along with justification for entering into such transactions.
- Key Managerial Person ('KMP') is a related party as per the definition. As per the new definition of KMP, **Chief Financial Officer** and **Company Secretary** are also included resulting into additional disclosure requirement.
- Proper mechanism for the calculation of '**Arm's length transaction**' has to be present.

Related party transactions – Key changes

Wider scope of Sec 188:

Particulars	Companies Act 2013	Companies Act 1956
Related party transaction (Section 188): Wide Scope	a) sale, purchase or supply of any goods or material; b) buying, selling or disposing of property of any kind; c) leasing of property of any kind; d) availing or rendering of any services ; e) appointment of any agents for purchase or sale of goods, materials, services or property; f) related party's appointment to any office or place of profit in the company, its subsidiary company associate company; or g) underwriting the subscription of any shares in or derivatives thereof;	a) sale, purchase or supply of any goods or materials; b) sale, purchase or supply of any services; c) underwriting the subscription of any shares, debentures of a company

- List of related party transactions widened
- Immovable property also brought under the ambit of related party transactions

Related party transactions – Key changes

Key changes in the definitions:

Particulars	Companies Act 2013	Companies Act 1956
Specified persons with whom contracts are covered Related party Sec 2 (76)	<p>“Related Party” with reference to company means:</p> <ol style="list-style-type: none"> i. Director or his relative; ii. KMP or his relative; iii. firm, in which a director, manager or his relative is a partner; iv. private company in which a director or manager is a member or director ; v. public company in which a director or manager is a director or holds along with his relatives, more than 2% of its paid-up share capital; vi. any body corporate whose BoD, managing director, or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager; vii. any person under whose advice, directions or instructions a director or manager is accustomed to act; viii.any company which is— <ol style="list-style-type: none"> i. a holding, subsidiary or an associate company of such company; or ii. a subsidiary of a holding company to which it is also a subsidiary ix. such other persons as may be prescribed* 	<ol style="list-style-type: none"> i. Director of the Company ii. Relative of such director iii. A firm in which such director or relative is a partner iv. Any other partner of such firm in which director or relative is a partner v. Private Company in which such director is a director or member

- The scope of related party is substantially expanded to ensure interest of shareholders.

* As per rules notified by MCA – “other prescribed persons “ means a director or KMP of the holding company or his relative as the related party.

NFRA and cognizance of accounting standards (Sec 132 & 133)

Key provisions

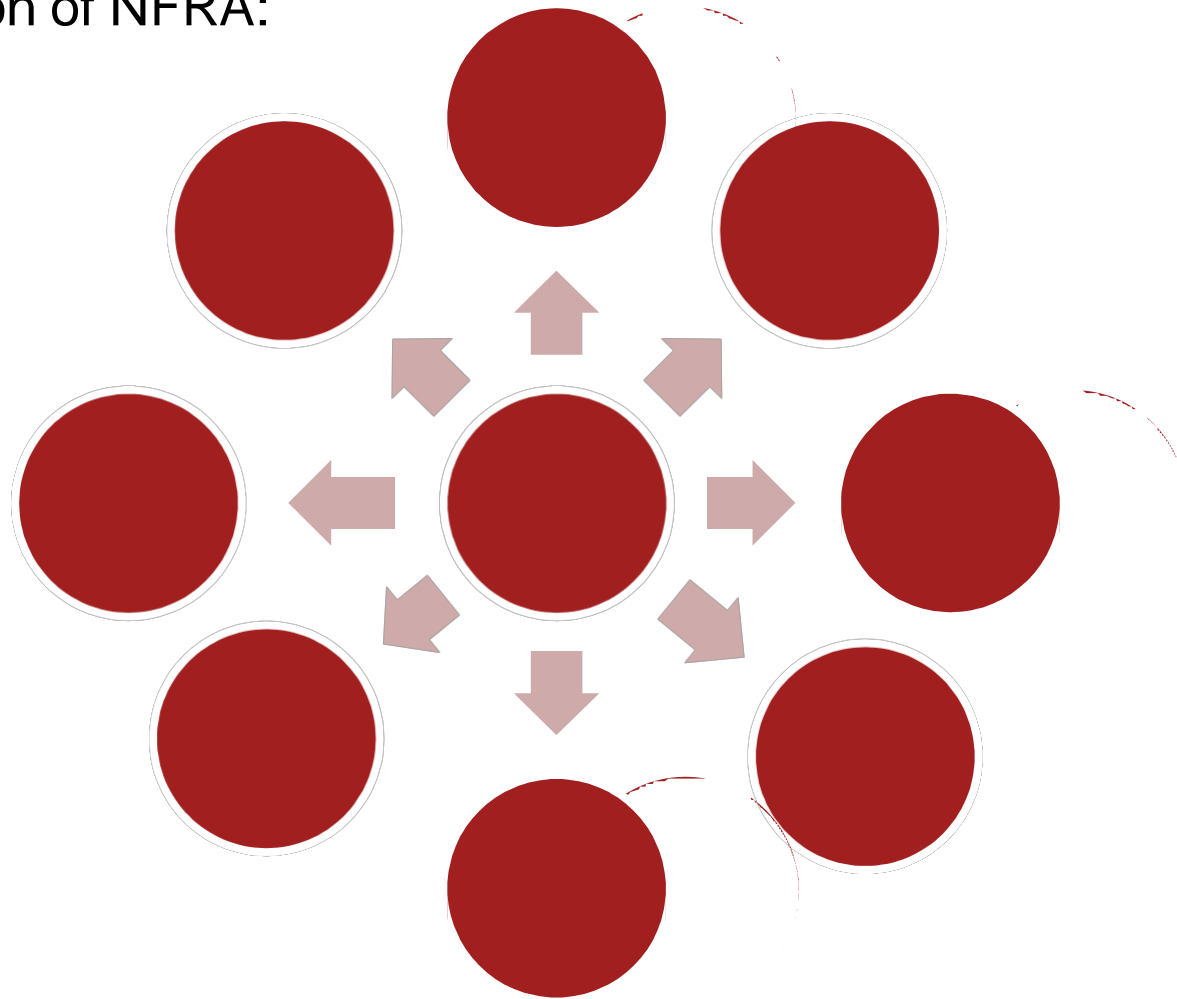
- The Central Government may, by notification, constitute a National Financial Reporting Authority ('NFRA') which recommends to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors.
- The definition of associate company as defined under section 2 (6) of the Companies Act, 2013 includes joint venture company. As per AS 23 "An associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor."
- For the purpose of section 2(6), significant influence means control of at least 20% of total share capital, or of business decisions under an agreement.

Impacts

- NFRA (the body replacing the NACAS) has been bestowed with significant powers not only for issuing the authoritative pronouncements on accounting standards, but also to regulate standards on auditing.
- Definitions of term 'associate' and 'significant influence' are not consistent with definitions in AS 18: Related party transaction and AS 23: Accounting for investment in associates in CFS
- It is to be noted that if a company has control with respect to business decisions of another company such other company would in fact tantamount to a subsidiary and not an associate company.

Draft NFRA Rules, 2013 - Composition

Composition of NFRA:



Draft NFRA Rules, 2013 - Structure

Structure of the Authority:



Draft NFRA Rules, 2013 – Function of Authority

Functions of the Authority (Major):

1. Standard Setting:

- Receive, consider and review the **recommendations** from the Committee on Accounting Standards and Committee on Auditing Standards.
- **Recommend the standards** to the Central Government for being considered and notified.

2. Monitoring, compliance review and overseeing quality of audit:

- **Receive reports** from the Accounting and Auditing Committees, and approve those reports issued on investigated companies.
- Forward reports to the Committee on Enforcement for further action along with its recommendations.

3. Enforcement

- **Receive reference** from the Central Government, Member – Accounting, Member – Auditing or suo motu **determine any investigation** to be undertaken by the Authority.
- **Forward such requirements** to the Committee on Enforcement.
- **Receive final investigation** report from the Committee on Enforcement and issue a notice in writing to the company or professional on whom action is proposed to be taken.
- Providing an **opportunity to be heard** to the company or professional.
- Take suitable action or pass order imposing penalty or **debarring the Professional or firm** concerned.

Other important topics

- **Utilisation securities premium:**

As per Companies Act, 2013, prescribed class of companies will not be allowed to use the securities premium for the following key purposes:

- issue of fully paid preference shares as bonus shares
- writing off preliminary expenses of the company
- writing off debentures and preference shares issue expenses
- providing for premium payable on redemption of preference shares / debentures

Central government introduces these restrictions over the use of securities premium to align the accounting requirement with Ind-AS. Since Ind-AS currently are not notified, the rule do not define companies which will be covered under the prescribed class.

However, it may be noted that ICAI has recently proposed a new roadmap for implementation of Ind-AS.

- **Free reserves:**

As per Companies Act, 2013, free reserves means 'such reserves which, as per the latest audited balance sheet of a company, are **available for distribution as dividend**; Provided that

- Any amount representing unrealised gains, **notional gains or revaluation** of assets, whether shown as a reserves or other otherwise or
- Any change in carrying amount of an asset or of a liability **recognise 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.

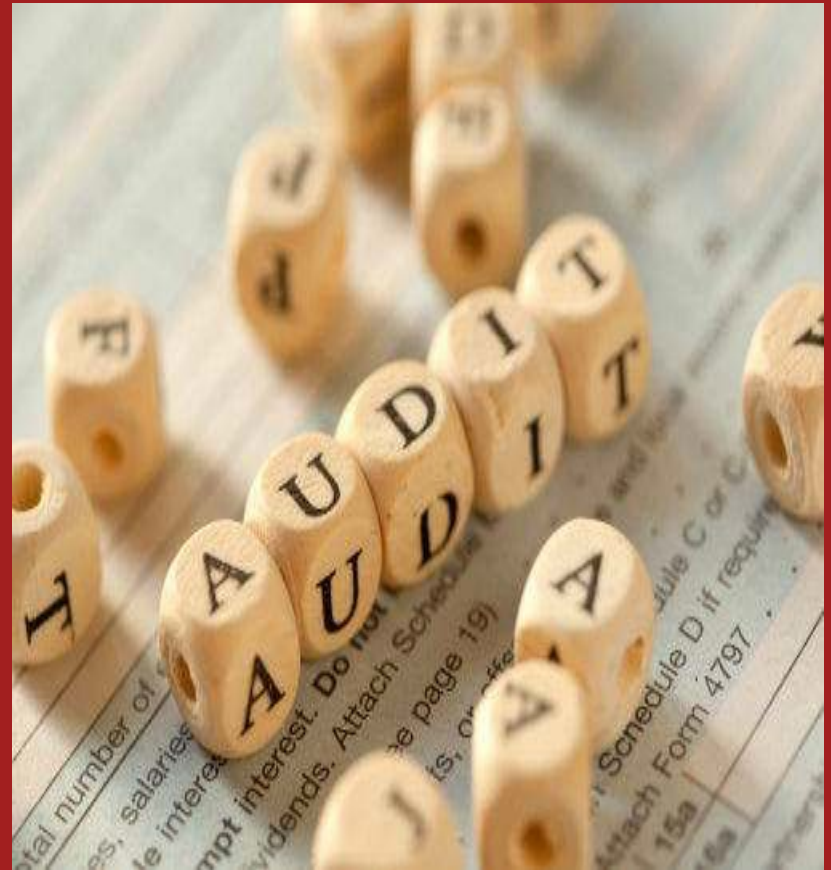
- **Debenture redemption reserve:**

As per Companies Act, 2013, where debentures are issued by a company, the company will create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such amount will not be utilised by the company except for the redemption of debentures.

◆ Auditors:

- Mandatory rotation
- Reporting in case of fraud
- Other provisions

◆ Internal Auditor



Auditors - Mandatory rotation (Sec 139)

Key provisions

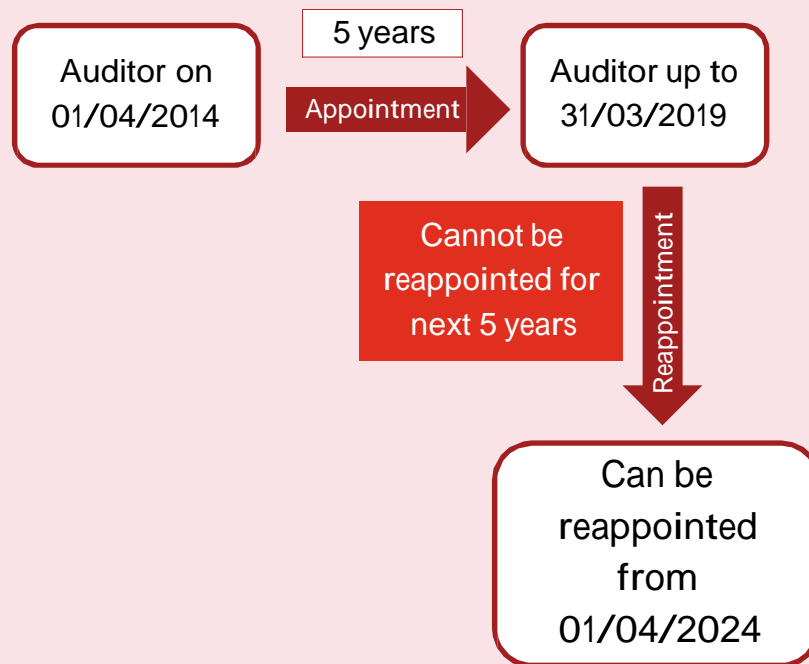
- Every company shall, at the **first annual general meeting**, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.
- **Compulsory rotation** of individual auditors in every five years and of audit firm every 10 years in the listed company & certain other class of companies.
- Every company needs to comply with this provision within a period of **3 years from commencement** of this Act.
- The members of a company may resolve for **rotation of audit partner** and his team and also for audit to be conducted by more than one auditor.

Impacts

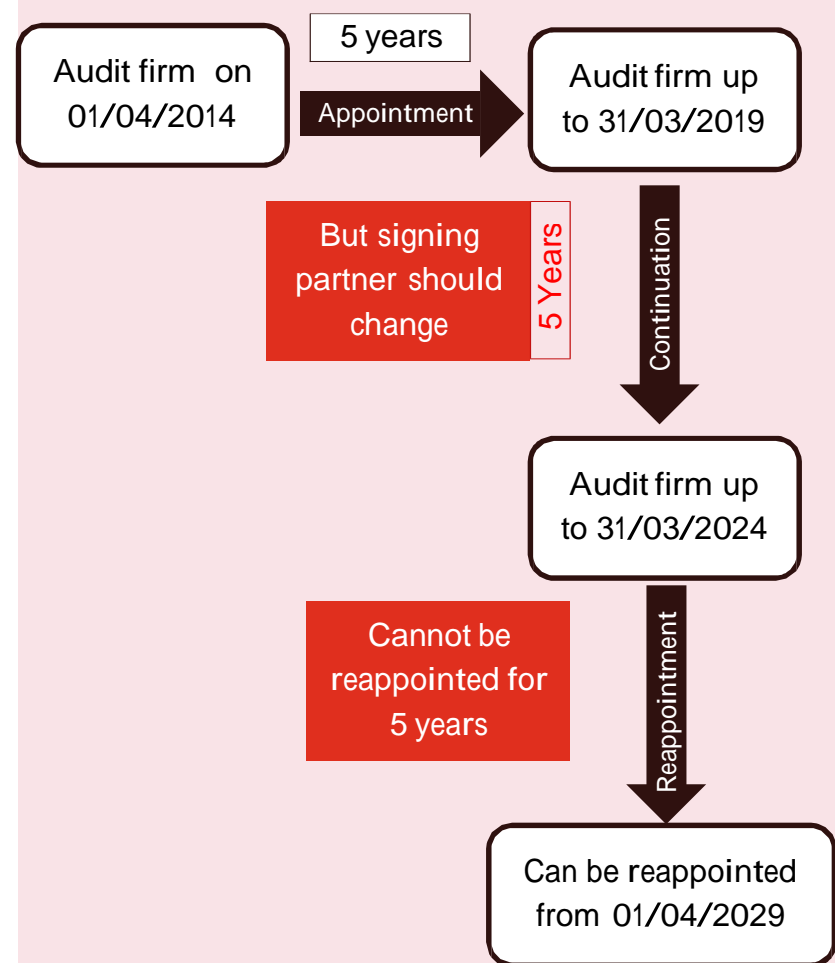
- Cost and complexity of audits - Companies will be forced to spend extra time and effort to manage the rotation process and bring the new auditor up to speed.
- In case of compulsory rotation of auditor which is mandatory for listed companies and other companies specified companies
- India is the first country to have auditor rotation applicable to private companies. Auditor rotation for public companies is currently mandatory in Italy, Brazil and Netherlands.
- The rotation will be applicable retrospectively. Hence, all the companies will have to change their auditors, if they have severed the company for over 10 years.

Auditors - Mandatory rotation (Sec 139)

Appointment of Individual Auditor:



Appointment of Audit firm:



Auditors – Reporting in case of fraud

Reporting of fraud by Auditor to Central Government

Particulars	Companies Act 2013	Companies Act 1956
Reporting of fraud by auditor to Central Government 143 (12)	Auditor is required to report directly to CG where he has reason to believe that an offence involving fraud is committed against the company by the officers or employees of the company	No such provision

- Responsibilities of auditors increased
- Audit processes to be revamped to be able to detect fraud

Proscribed services (Sec. 144)

Auditor cannot provide following services "directly or indirectly" to the company or its holding company or subsidiary company, namely:—

- 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;
- management services; and
- services prescribed under the Rules

Transition period: To comply with the restriction before the closure of the 1st FY after the date of commencement of 2013 Act

For proscribed services: "Directly or indirectly" shall include rendering of services by the auditor –

Where auditor is an individual - Either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or **whose name or trade mark or brand** is used by such individual

Where auditor is 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.

Key Provision

- **Disqualifications – Sec 141:**
- A person or a partner of a firm will not be eligible for appointment/reappointment, if such person or partner at the date of appointment, holds appointment as auditor of more than 20 companies. Private companies are included in the maximum cap of 20 Companies.
- A person or firm will not be eligible for appointment, if it, directly or indirectly, has **business relationship** (of such nature as may be prescribed) with the company, its subsidiary, its holding, or associate company or subsidiary of such holding company or associate company.
- A person will not be eligible for appointment if he himself, his relative or partner is **indebted to the company**, its subsidiary, holding or associate company, or subsidiary of such holding company in excess of rupees five lakh shall not be eligible for appointment.

Impacts

- The existing Act does not include private companies in the maximum limit of 20 companies per partner. However, the ICAI has fixed maximum limit that a person/ partner cannot audit more 30 companies, including private companies, per year. Under the new Companies Act, 2013, even private companies will be included in the maximum limit of 20 companies that may be audited by a partner. If the Companies Act, 2013 becomes enactment, it will prevail over the ICAI requirement.
- Additional restriction put in new Companies Act 2013 with respect to Business relationships which are entered into for a commercial purpose except commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm and commercial transactions which are in the ordinary course of business.

Auditors – Other provision

Requirements applicable to all companies:

First auditor

- First auditor to be appointed by the BOD within 30 days of incorporation of a company
- If the first auditor is not appointed by the BOD as above, the members to appoint the first auditor within 90 days at the EGM
- Tenure of the first auditor shall be upto the conclusion of first AGM

Additional conditions

- The company may resolve:
 - If audit firm is appointed, the audit partner and his team shall rotate at such intervals as may be resolved by members
 - that audit shall be conducted by more than 1 auditor (i.e. joint auditor)
- 1956 Act requires all the partners of the audit firm to be a qualified CA and practicing in India. New Act provides that:
 - Majority of partners practicing in India should be qualified CA;
 - If LLP is appointed as auditor, only partners who are CA shall be authorized to sign
- Procedure and manner of selection of auditor to be prescribed by the Rules
- Additional grounds for disqualifications for appointment as auditor may be provided

Internal Auditor

Particulars	Companies Act 2013	Companies Act 1956
Appointment of Internal Auditors Sec 138	Such class or classes of Companies as may prescribed need to compulsory appoint Internal Auditor to conduct the internal audit of functions and activities of the company.	No such provision
Qualification of Internal Auditor Sec 138	Internal Auditor shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the BOD	No such provision

- CARO contained provisions requiring auditor's comments on existence and efficacy of internal audit system in case of listed companies and / or companies having networth > Rs. 50 lakhs or average annual turnover > Rs. 5 crores for a period of 3 consecutive FY immediately preceding the FY concerned.
- Companies Act 2013 contains specific provision of appointment of internal auditor
- As per rules – prescribed class of companies –
 - ./ Every listed company
 - ./ Every unlisted company having:
 - Paid up capital > 50 crores
 - Turnover > 200 crores
 - Outstanding loans / borrowing > 100 crores
 - Outstanding deposit > 25 cores
 - ./ Every private company having:
 - Paid up capital > 50 crores
 - Turnover > 200 crores
 - Outstanding loans / borrowing > 100 crores
 - ./ A transition period of 6 months has been provided for compliance by existing companies

- ❖ Background
- ❖ Scope and Applicability
- ❖ CSR - Spending
- ❖ CSR Committee
- ❖ Board Responsibility
- ❖ Fines and Liability
- ❖ Companies (CSR Policy) Rules, 2014
- ❖ Revised Schedule VII – Activities
- ❖ Issues related with CSR Activities



Background

- MCA had proposed **Corporate Social Responsibility Voluntary Guidelines 2009**
- **CSR introduced in Companies Act 2013**
- **MCA Research on CSR listed the top 100 Companies (by Revenue) revealing how much each company will have to fork out on CSR when they will bound by law and their actual spending for the financial year 2012 (study by CSR identity.com together with Forbes India)**
- **The study also detailed the Guidelines on CSR for Public Enterprises and TOP PSU's Spending on CSR**
- **Ernst & Young estimates that the law would directly impact at least 2,500 companies, including the top 100 companies across several sectors, and generate an estimated US \$2 billion in CSR spending.**

CSR Scope and Applicability

Applicability from
Financial Year 2014-15

Net Worth \geq Rs 500 Cr

OR

Turnover \geq Rs 1000 Cr

OR

Net Profit \geq Rs 5 Cr



- The Companies Act, 2013 does not prescribe any penal provision if a company fails to spend amount on CSR activities.
- It is not clear whether a company will need to create provision in the financial statements toward unspent amount if it fails to spend 2% amount of the CSR activities in a particular year.

CSR - Spending

Amount to be Spent- in every financial year

- At least 2% of the average net profit (Before tax) during three immediately preceding financial years.
- Profit from **branches outside India** shall not be included
- **Exclude** dividend received from other companies in India complying with CSR provisions

Mode of Spending

- Corporate Social Responsibility **policy**
- List of **Activities** covered in Schedule VII (Amended)
- Preference to the **local area** and area around where Company operates
- **Tax treatment** of CSR spend will be in accordance with the IT Act as may be notified by CBDT
- CSR activities **only within India** are taken into consideration
- Activities which are not **exclusively** for the benefit of **employees** of the company or their family members shall be considered as CSR activity

CSR - Spending

Medium of spending

- Self
- Organization which is registered as a Trust or Section 8 Company, or Society or Foundation or any other form of entity operating within India, set up by the company itself
- Organization which is registered as a Trust or Section 8 Company, or Society or Foundation or any other form of entity operating within India, not set up by the company itself only if such organizations have an established track record of at least three years in carrying on activities in related areas.
- Companies may collaborate or pool resources with other companies to undertake CSR activities

CSR Committee

Composition

- Constitute a CSR Committee of the Board with min. 3 directors , out of which at least one director shall be an independent director
- The CSR Rules clarify that:
 - A Non-listed public company or a private company, which is not required to appoint an **Independent Director (ID)** as per the Companies Act 2013 / Rules, can have its CSR Committee with an ID.
 - A private company having only two directors on its board can constitute the CSR committee with the two **directors**.

Responsibility

- To formulate and recommend a **CSR policy** to the Board which shall indicate the activities to be undertaken by the company
- To recommend the **amount of expenditure** to be incurred on the activities
- To monitor the **CSR policy** of the company time to time

Board Responsibility

The Board shall,

- To approve the CSR policy & disclose content of the policy
- To place on the company's website
- To ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company
- To ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years- Preference to the local area
- If the company fails to spend such amount, the Board to specify reasons for not spending the amount in its report.

Fines and Liability

- Failure to explain or report is punishable by a fine on the company of not less than 50,000 rupees and up to 25 **lakh rupees** and
- Further, officers who default on the reporting provision could be subject to up to three years in prison and/or fines of not less than 50,000 rupees and as high as 5 **lakh rupees**

Companies (CSR Policy) Rules, 2014

On 27th February 2014, MCA has notified the provisions relating to CSR of the Companies Act, 2013 (Related Section 135 and Schedule VII of the Act). These provisions will be applicable with effect from 1st April, 2014.

The new Companies Act, 2013 mandates companies having a net worth of Rs 500 crore or more; or a turnover of Rs 1,000 crore or more; or a net profit of Rs 5 crore or more to spend of at least 2 % of their average net profit of past three years on CSR activities.

Salient provisions of notified CSR Rules:

- ◆ The concepts of shared value, social business projects are out. The rules have taken a **prescriptive** mode.
- ◆ CSR expenditure to be in line with the **amended Schedule VII** of the Companies Act 2013
- ◆ CSR expenditure to exclude those incurred in **normal course of business**
- ◆ Net profit to be after tax; **exclude dividends** from other Indian companies covered u/s 135 of the act and **profits generated outside India**
- ◆ **Foreign companies** (incorporated outside India and have place of business in India) are covered under CSR provisions
- ◆ **Indian branches and project offices** of foreign companies covered under CSR provision
- ◆ 3 years of non-applicability required to exit CSR compliance requirements
- ◆ **Group CSR projects** or joint CSR projects permitted
- ◆ Capacity building costs of own personnel or those of implementation agencies to qualify as CSR expenditure; **capped at 5%** of total CSR expenditure
- ◆ **Political contribution excluded from CSR expenditure**
- ◆ Private companies and certain unlisted public companies exempted from requirement for independent directors for CSR committee
- ◆ CSR policy and spending to be displayed on website.

Revised Schedule VII - Activities

Activities which may be included by companies in their Corporate Social Responsibility Policies

1. Eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water;
2. Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;
3. Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
4. Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water;
5. Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

Revised Schedule VII - Activities

Activities which may be included by companies in their Corporate Social Responsibility Policies

6. Measures for the benefit of armed forces veterans, war widows and their dependents;
7. Training to promote rural sports, nationally recognised sports, Paralympic sports and Olympic sports;
8. Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;
9. Contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;
10. Rural development projects.

Issues related with CSR Activities

Nature of the issue	Initial thoughts shared by ICAI	Comments
1. Identification and Measurement of CSR Spending – Computation of 2%		
a) Interest cost: If a company borrows funds to spend on CSR activities, would the interest cost be considered in determining the CSR spend.	None	Act or rules has not defined the nature of expenditure eligible for CSR spending. Accordingly, both capital and revenue expenditure related with CSR activities are eligible for CSR spending. Based on above, capital expenditure (related to fixed assets) incurred by the company on CSR activities are consider for measuring CSR spending and related interest cost would also become eligible for CSR spending.
b) Group structure: Several companies would have entities at group level that spend on CSR activities. Can an entity consider spending by designated entities in computing the CSR spend?	None	Yes, substance over form.
c) Branches: Should the profits earned by foreign of companies be considered in determining the eligible profits used to determine the CSR spend. The Rules states that profits considered for calculating the 2% spend should not include profits arising from branches outside India – how to deal with HO expenses?	None	In case of AS 17 – Segment reporting, branches unallocated corporate expenditure are shown separately from the operating segments of the company. Accordingly, HO expenditure should not be consider for computing branch profit.

Issues related with CSR Activities

Nature of the issue	Initial thoughts shared by ICAI	Comments
1. Identification and Measurement of CSR Spending – Computation of 2%		
d) Receipt of contribution for CSR: Some companies may receive grants for CSR spend. Should such amount be considered in determining the CSR spend?	None	No, as per section 135 of Companies act and rules, only actual cost incurred by the Company on CSR activities are eligible for computation of CSR spending.
e) Eligible expenses: Should entities include only direct expenses as CSR expenses or general administration expenses be also included. For example, overseas travel expenses of CSR team	None	Annexure 1 to CSR Rules has given the format of presentation in annual report on CSR initiatives covers both direct expenditure and overhead on CSR project eligible for CSR spending. Accordingly, indirect expenditure specifically attributable to CSR project are eligible for computation of CSR spending.

Issues related with CSR Activities

Nature of the issue	Initial thoughts shared by ICAI	Comments
<h2>2. Computation of CSR Amount</h2>		
<p>Dual purpose transactions</p> <p>Should an entity distinguish between employee engagement and CSR activities for the purpose of determining eligible amounts?</p> <p>Sometimes company provides certain facilities as mandated under a statute to its employees and such facilities are extended to the common public as well. Should this be treated as CSR expense?</p> <p>Examples:</p> <p>A company operating in a remote location may have a school which is used both by employees as well as locals in the neighborhood.</p> <p>A company having more than 500 employees is required to maintain a medical facility for its employees under the Factories Act. Such medical facility could be made available to locals as well.</p>	<p>Point to ponder - Various legislations require CSR (or quasi CSR) expenses to be incurred as there were no requirements similar to the Companies Act requirement to spend on CSR. Should these laws be amended? Should the amounts required to spent on such items be considered as CSR spend for Cos Act purposes</p>	<p>One of the most contemporary definitions of CSR given by World Bank Group, stating, “Corporate social responsibility is the commitment of businesses to contribute to sustainable economic development by working with employees, their families, the local community and society at large, to improve their lives in ways that are good for business and for development.”</p> <p>Further as per rules, activities which are not exclusively for the benefit of employees of the company or their family members shall be considered as CSR activity,</p> <p>Accordingly, the expenditure incurred by the company for the wellbeing of the employee as well society as a whole are eligible for computation of CSR spending.</p>

Issues related with CSR Activities

Nature of the issue	Initial thoughts shared by ICAI	Comments
<h3>3. Presentation in the financial statements</h3>		
<p>Should the CSR expense be shown as a separate line item on the face of the profit and loss statement or should it only be by way of note?</p> <p>If to be shown on the face of Profit and Loss Statement:</p> <ul style="list-style-type: none"> • How should CSR expenses be classified – should it be based on the nature of expense or should be as per project? • Companies Act requires companies to ‘spend’ the stipulated amount of CSR. This could mean that the amount must be actually spent and not accrued –The accounting for expenses is accrual basis so, amount to be disclosed in the profit or loss would be based on the accrual concept. Thus, there could be a difference between the two if the amount is to be shown on the face of the profit and loss. 	<ul style="list-style-type: none"> • CSR expenses should not be disclosed on the face of the profit and loss statement • CSR expenses should be classified based on the nature of the expense in various heads • CSR expense should be disclosed separately, head-wise, in the notes to accounts /Directors Report only? 	<p>Revised Schedule VI to the Companies Act 1956, has given the format of statement of profit and loss account. According to this format, expenditure are classified based on the nature of expenses and not based on function.</p> <p>Hence, expenditure incurred on CSR activities can-not be shown on the face of statement of profit and loss.</p> <p>However it will be shown under “Other expenses” with a detailed break up in notes to accounts with a separate line item on CSR spending.</p>

Issues related with CSR Activities

Nature of the issue	Initial thoughts shared by ICAI	Comments
<h2>4. Unspent Amount</h2>		
<p>Is a provision required for the unspent amount towards CSR for the year? Whether an entity will be required to create a provision would depend on whether a company is under a legal obligation to contribute towards CSR. Currently, section 135 merely states that the Board of Directors 'shall ensure that the company spends in every financial year.....'</p>	<p>As the Companies Act not make it mandatory to spend the CSR amount, no provision should be recognised as an obligation does not exist</p>	<p>As per the rules, there is a mandate for does creation of a budget/fund and not an obligation to incur expenditure on CSR. Further, neither there is any time limit for incurring the expenditure out of CSR fund nor any penalty is prescribed for non-incurrence of such expenditure.</p> <p>Hence, the company should not create any provision for unspent amount. However, it should <u>transfer the unspent amount to the CSR Reserve by appropriating the profit and loss.</u></p> <p>Also refer the attached "Expert advisory opinion" given by ICAI concluding the creation of reserve instead of provision for unspent amount.</p>

Issues related with CSR Activities

Nature of the issue	Initial thoughts shared by ICAI	Comments
<h2>5. Valuation of donation in kind</h2>		
<p>If an entity donates goods, will the cost of the inventory or its market price be considered for computation of the CSR spend?</p> <p>Ex. A pharmaceutical company donating medicine to flood affected regions.</p>	<ul style="list-style-type: none"> Accounting should be done on the basis of cost as is the case in the distribution of free goods – the cost will include indirect taxes, if any, required to be paid on such goods The charge should be recognised when the risk and rewards in the goods has passed following the rules provided in AS 9 	<p>Under Indian GAAP, we follow “Historic Cost Concept”. Accordingly actual cost incurred by the company would be consider for computation of CSR spending.</p>
<h2>6. Opportunity cost v/s actual cost</h2>		
<p>If a company deutes employees to undertake CSR activities, would the actual cost of the employees be considered as CSR spend or the cost based on ‘opportunity lost’ Further, should only the cost of employees hired specifically to conduct CSR activities be considered as CSR expenses or pro-rata cost of employees volunteering for CSR activities can also be considered.</p>	<ul style="list-style-type: none"> CSR amount should only include the actual cost of the employee It would be appropriate to consider pro-rata the cost of employees volunteering for CSR activities 	<p>Under Indian GAAP, we follow “Historic Cost Concept”. Accordingly actual cost incurred by the company would be consider for computation of CSR spending.</p>

Issues related with CSR Activities

Nature of the issue	Initial thoughts shared by ICAI	Comments
<h2>7. Capital versus revenue</h2>		
<p>a. Should the capital expenditure done for the purpose of CSR be capitalised in the books or expensed off in the same year?</p> <p>b. Company donates money to a trust to build certain facilities in Year 1, when the facility is used by the community at large. The donation is treated as CSR expenses. In Year 2, substantial portion of the facilities are being used by the employees. How should the transaction be accounted for?</p> <p>c. If an entity that capitalised an asset dedicated for CSR activities, sells it at a profit, should the amount of profit be netted from the amount eligible for CSR spend?</p> <p>AS 10 defines fixed assets as an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.</p>	<ul style="list-style-type: none"> • The assets constructed for CSR activities should be considered as Fixed Assets if other criteria is met • As per the CSR rules, any surplus/income from CSR activities needs to be ploughed back 	<p>a. Act or rules has not defined the nature of expenditure eligible for CSR spending. Accordingly, both capital and revenue expenditure related with CSR activities are eligible for CSR spending.</p> <p>b. Additionally, Accounting standard 18 deal with related party disclosures. Accordingly the company disclose the transactions between related parties in the financial statements. However, for the purpose of computation of CSR spending, the company is actually required to incur the cost towards these expenditure. Hence, in the absence of payment there won't be any accounting consequences.</p> <p>c. As per rules <u>any income / surplus arising out of CSR activities would not be consider for the computation of CSR spending of the company.</u></p> <p>Hence, the profit on sale of assets cannot be netted from amount eligible for CSR spend.</p>



Thank you!

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