



Companies Bill, 2013: Provisions on accounts and audit

Vinod Kothari Vinod Kothari & Company

1012 Krishna
224 AJC Bose Road
Kolkata – 700017
Phone 033-22811276/
22813742/ 22817715

601C, Neelkanth,
98, Marine Drive,
Mumbai-400002
Phone: 022-22817427

www.vinodkothari.com

Email: vinod@vinodkothari.com



Copyright

- ***The presentation is a property of Vinod Kothari & Company. No part of it can be copied, reproduced or distributed in any manner, without explicit prior permission.***
- ***In case of linking, please do give credit and full link***



About Us



- Vinod Kothari & Company, Company Secretaries in Practice
 - Based out of Kolkata, Mumbai
- We are a team of consultants, advisors & qualified professionals having recently completed 25 years of practice.

Our Organization's Credo:

Focus on capabilities; opportunities follow

Related Articles

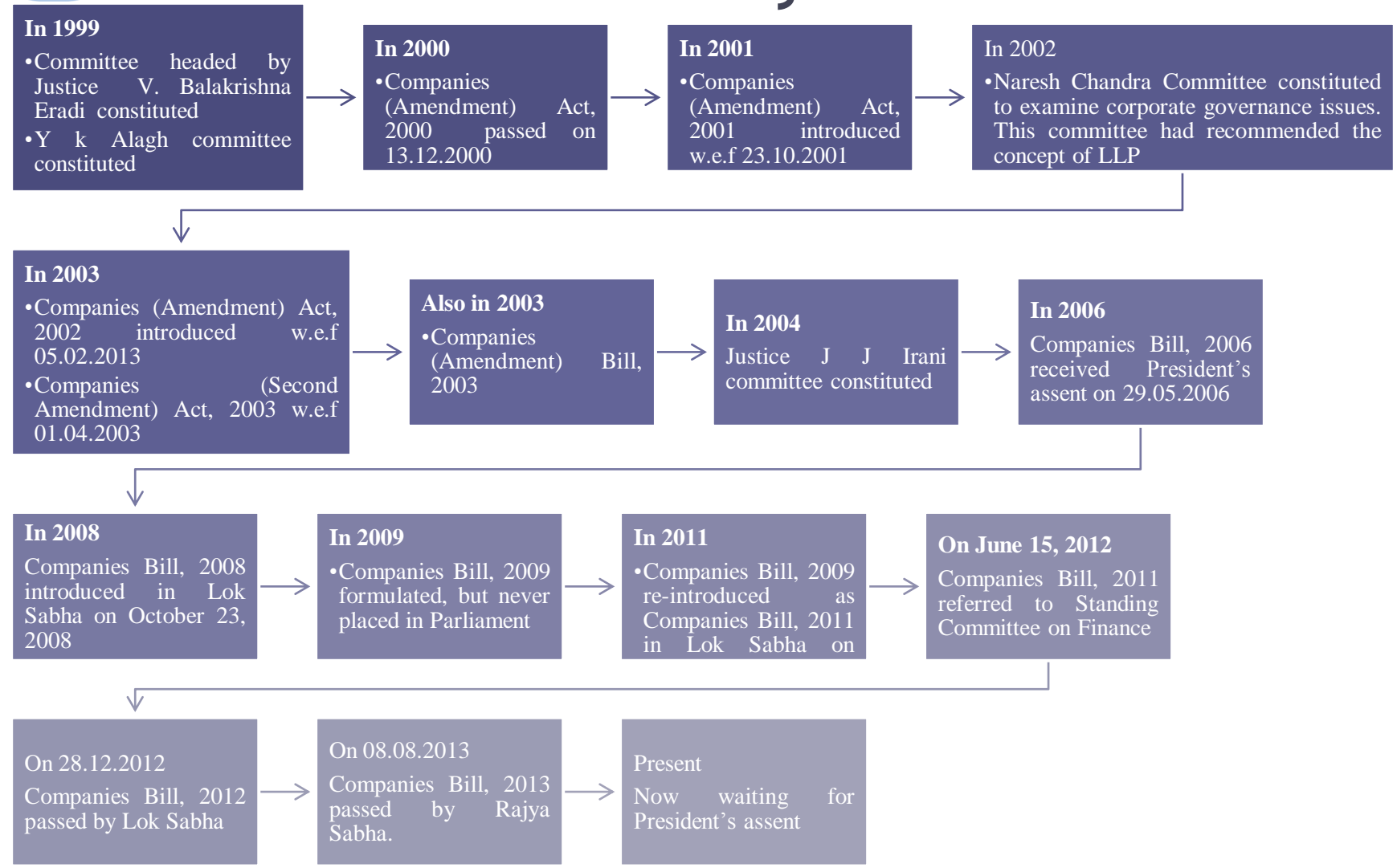
- Article on 'Companies Bill: From Rule of Law to the Law of Rules' at [https://india-financing.com/Companies_Bill_from_the_Rule_of_Law_to_the_Law_of_Rules%20\(1\).pdf](https://india-financing.com/Companies_Bill_from_the_Rule_of_Law_to_the_Law_of_Rules%20(1).pdf)
- Article on 'Corporate Social Responsibilities- One of the major highlights of Companies Bill, 2012' at https://india-financing.com/Companies_Bill_2012_Corporate_Social_Responsibilities.pdf
- There are lots of materials and articles on the Companies Bill 2013 here: <http://india-financing.com/component/content/article/281.html>
- Other articles on corporate laws at <https://india-financing.com/staff-publications-corporate-law.html>
- Our other staff publications at <https://india-financing.com/staff-publications.html>



Overview and Quick Comments



Companies Bill - history over last 13 years



Structure of the Bill

- Existing Act had some 658 sections and 14 Schedules
- New Bill has 470 sections and 7 schedules
- However, don't be misled to believe that the Act is any shorter or simpler
 - Huge amount of law has been moved into the rules
 - There are 416 occurrences of the word “prescribed”
 - This means a tremendous body of rule making
 - Several sections have been consolidated into single section
- In fact, there are lots of new provisions, new restrictions and approvals to be sought
 - 74 occurrences of “special resolution”
 - 15 occurrences of “approval of the Central Government”



However, opens lots of avenues for professionals

- NCLT and NCLAT both open for chartered accountants, cost accountants and company secretaries
- Registered valuers
 - Prescribed qualifications to be laid
- Company Liquidator
 - Panel to be maintained
- Conciliation Panel
 - Experts to be listed
- Panel of independent directors



Several new concepts

One person company

Dormant company

Class action

Freeze action

Mandatory corporate social responsibility

Mandatory retirement of auditors

Mandatory retirement of independent auditors

Pecuniary relationships completely ruled out in case of independent directors

A whole new set of provisions for private placements

National Financial Reporting Authority

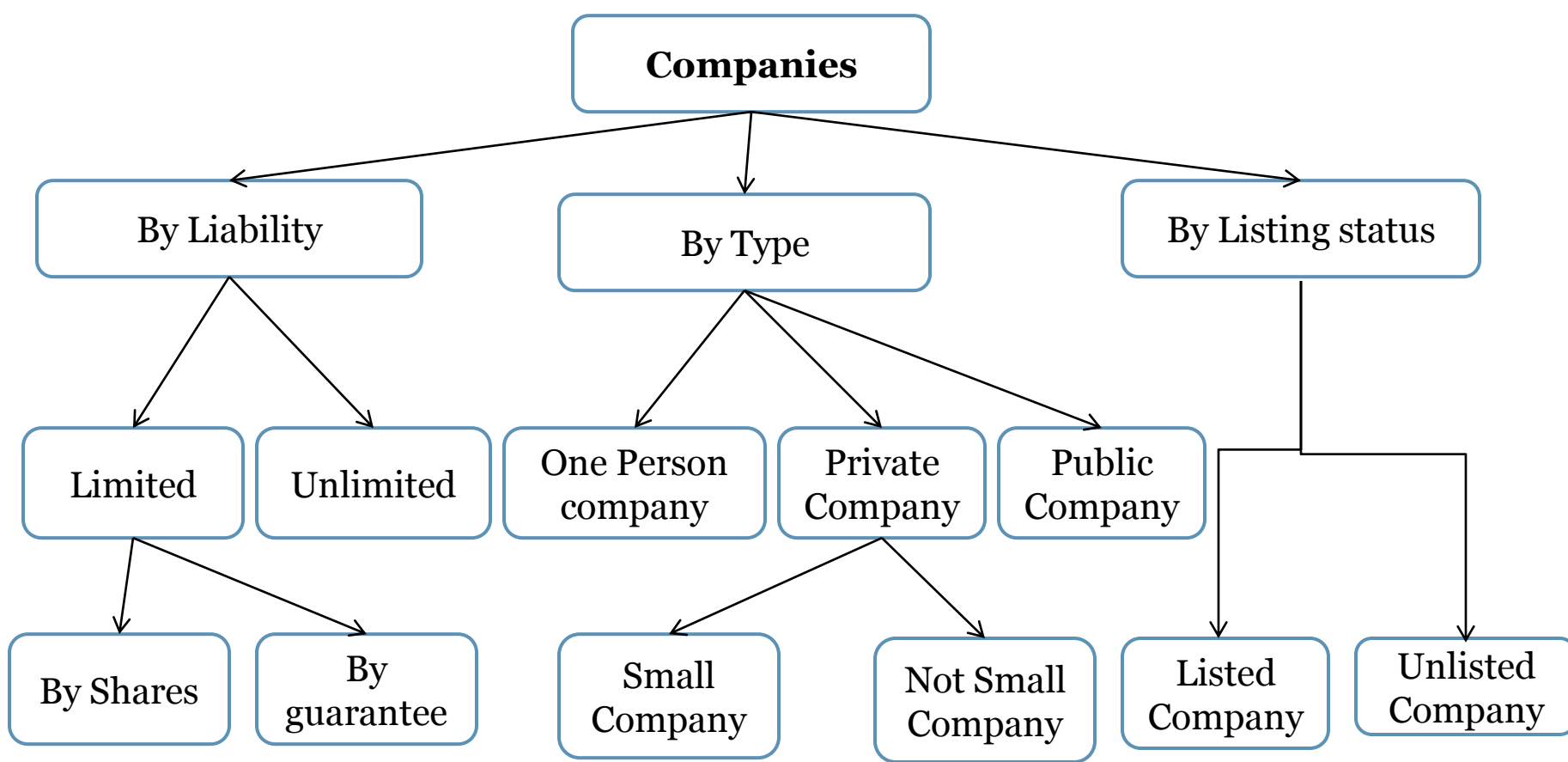
Non-judicial approval of mergers

Moratorium powers in case of sick companies

Troublesome Provisions

- Independent directors not to have any pecuniary relation at all
 - As the provision travels back in time, existing independent directorships to be affected
- Civil liabilities for auditors
 - Exposing auditors to massive claims
- Exemptions for private companies - *thin and meagre*
 - Of course, one will need to see the notifications

Types of Companies under the Bill



Types of Companies continued...

- One person company – one member
- Private company – upto 200 members
 - **Small companies**
 - Paid up capital Rs 50 lacs; turnover Rs 2 crores
 - In our view, both these conditions need to be complied with
 - Should not be a holding co or subsidiary co
 - **Other private companies**
 - Not being small companies
- Public companies
- Limited and unlimited companies
- Conversion from public to private companies will need sanction of NCLT



Accounting and Auditing related Provisions



Highlights of accounts and audit changes

- **Accounting**
 - Consolidation mandatory
 - Deviation from accounting standards recognised by law
 - Financial year mandatorily uniform
 - Statutory provision for restatement of accounts
- **Disciplinary**
 - Constitution of NAFRA and powers of NAFRA
 - Concurrent jurisdiction of NAFRA and NCLT in certain matters
- **Auditors**
 - Over-enthused to “hang” the auditor
 - Civil liability provision for the first time
- **CSR**
 - Legislated “social responsibility” expecting us to be responsible because the law says so



Accounting Terms

- **Financial year**
 - Mandatorily 31st March
 - Existing companies to align within 2 years
 - NCLT given powers to exempt in case of entities which are holding cos or subsidiary companies of foreign companies
- **Free reserves**
 - Defined to include such reserves as available for distribution
 - Credit balance in P/L a/c is not a reserve
 - Definition already tuned to requirements of IFRS on fair value accounting



Accounting Terms (contd.)

- **Net worth – sec 2 (57)s**

- This definition is dangerous, and perhaps has not been noted. The definition seems to say – only paid up capital, share premium and reserves created out of profit will be treated as net worth.
- Surprisingly, credit balance in P/L account has been left out.
 - Accumulated losses are, however, deducted
- In other words, companies will be left with no choice but to transfer profits from P/L account to “reserves”

- **Internal audit:**

- To be mandatory for such class of companies as CG may prescribe
 - If mandatory, existing internal auditors, if CA, CWA, can continue
 - Clause 144 prohibits statutory auditors to render internal audit
- Auditor may be CA, CWA or such other professional as the CG may lay down

Keeping of books of Accounts - (Clause 128)

- All companies to keep books of account and other relevant books and papers and financial statements for at least 8 financial year at its registered office
 - including that of its branch office or offices, if any
 - Also required to explain the transactions effected both at the registered office and its branches
 - Books can be kept on accrual basis and according to the double entry system of accounting
 - Such books can be maintained at any other place by giving intimation to RoC within 7 days of decision
- Records can be kept in electronic mode also *in the manner to be prescribed*
- On violation, the officers charged by the Board with the duty of complying with these provisions shall be punishable with:
 - Imprisonment which may extend to one year or
 - with fine not less than fifty thousand rupees but which may extend to five lakh rupees or
 - with both
 - Director in charge of finance, CFO, and “any other person charged by the board” brought in list of offenders
 - Punishment enhanced from 6 months to 1 year



Inspection of accounts by directors

- Sec 128 (3) corresponds to sec 209 (4):
 - Inspection by a director has made subject to such conditions as may be prescribed
 - No such conditions under existing law
- Proviso to sec 128 (3) provides for inspection in case of a subsidiary
 - This seems disconnected with the rest of the section as there is no requirement on the holding company to keep accounting records for the subsidiary
 - A possible interpretation can be – inspection in case of any subsidiary can be done only by a director authorised by the holding company
 - However, the law could not intend to take away the inspection rights of directors other than those appointed by the holding company
- Sec 128 (4) – new provision – creates an obligation on officers and employees to assist in inspection by directors



Financial statements - sec 129 (sec 210, 211, 212)

- Sec 129 requires companies to prepare “financial statements”, in form in Schedule III
 - Financial statements:
 - Balance sheet
 - Profit and loss account
 - Cash flow statement
 - Not required for OPC, small company and dormant co
 - Statement of changes in shareholders equity
 - Notes
 - SOCE – currently not practised in India as IAS 1 has not been adopted
 - Sec 129 (3) – consolidation also becomes mandatory for every company
 - This is in addition to statement containing salient features of the subsidiary (sec 212)
 - CG may provide for consolidation rules
 - “subsidiary” shall include a joint venture and associate
 - Obviously, consolidation rules will apply
 - Proportional consolidation in case of associates
 - Partial consolidation in case of joint ventures
 - Full consolidation in case of subsidiaries
 - Confusion – whether “subsidiary” has to be read as per accounting standards or as per company law
 - Definitions differ



Accounting standards - sec 129, 133

- Financial statements to be prepared as per accounting standards laid u/s 133
- Sec 129 (5)
 - Where financial statements do not comply with the standards, the statement to contain the reason and the impact
 - This goes in line with para 19 and 20 of IAS 1 permitting deviations from accounting standards
- Sec 133 – accounting standards to be notified by CG in consultation with NAFRA



Recasting of Accounts - sec 130 and 131

- For the first time, a statutory permission for recasting
 - Sec 130 permits recasting on order of Court or NCLT
 - Sec 131 permits recasting on order of NCLT
- Two types of recasting – mandatory/ voluntary
 - **Mandatory – sec 130**
 - Provision, allowing recasting only on application by certain authorities or “any concerned person”
 - But NCLT /court has to come to a finding that there was either a case of fraud or mismanagement, casting a doubt on the reliability of financial statements
 - NCLT to give notice to CG, IT, SEBI, other concerned authority
 - What authority is concerned will depend on the nature of the recast; however, CG and IT seem necessarily concerned
 - Apparently, “any concerned person” u/s 130 cannot include the company
 - Company separately covered by sec 131



Voluntary Recasting of Accounts - sec 131

- **Voluntary Recasting**
 - Highly confused language of sec 131 – this is what it means if we straighten it
 - **What** may be restated: accounts as well as board report
 - **Why:** non compliance with sec 129 or 134
 - **By whom:** directors
 - **For what period:** any of the 3 preceding financial years
 - **How:** application to NCLT
 - NCLT to consider CG and IT authorities in disposing of the application
 - Application to be filed only once in a financial year
 - Rules to be framed by the CG

Largest Write-Downs to Net Income by US companies
2012: JPMorgan Chase, \$459 million

2011: China Unicom (Hong Kong) Ltd., \$1.56 billion

2010: Telecom Italia, S.p.A., \$717 million

2009: USB AG, \$357 million

2008: TMST Inc., \$671 million

2007: General Electric, \$341 million

2006: Navistar International Corp., \$2.4 billion

2005: American International Group Inc., \$5.2 billion

2004: Fannie Mae, \$6.3 billion

2003: HealthSouth Corp., \$3.5 billion

2002: Tyco International Ltd., \$4.5 billion

National Financial Reporting Authority

Two new quasi-judicial bodies comes up – NAFRA, NAFRAA

- To oversee compliance of accounting and auditing standards
- To oversee quality of service of professionals associated with preparation of financial statements

It is a complete new quasi judicial body – complete with Appellate Authority, having powers of a civil court

Professional misconduct of chartered accountants also comes under NFRA

- Does this directly clash with the disciplinary powers of the ICAI?
- Section says, the powers of NFRA shall exclude the powers of the ICAI to investigate into the same misconduct



NFRA- Membership

- Maximum 15 members excluding a chairperson to be appointed by the CG
 - Members can be whole time and part time
 - Chairperson to possess expertise in accounting, auditing, finance or law
- Members and chairperson to not to be associated with any audit firm including any related consultancy firms
 - During their tenure and 2 years after ceasing to be a member of NFRA



Powers of NAFRA

- Sec 132 (4) grants powers to NAFRA
- Can initiate investigation suo-moto or on reference made by CG
 - Against corporates or any other person
 - Including firm of practicing chartered accountants or any member of the firm
 - If investigation already launched by NAFRA, no simultaneous proceeding by any other body, e.g, ICAI
- Shall have the powers of a civil court while trying specified suits
- If professional or other misconduct proved against chartered accountants (132 (4) (c))
 - Impose penalty of
 - Minimum 1 lac extendable to five times of fee received in case of individual CA
 - Minimum 10 lac extendable to ten times of fee received in case of firm
 - Debar from practice for a period of 10 years
- Meaning of professional misconduct same as in ICAI Act



National Financial Reporting Appellate Authority

- Course of appeals
 - NAFRA
 - NAFRAA
 - What next?
 - No further appeal provisions
 - There is apparently nothing in the law about exclusive jurisdiction
 - This means civil litigation against rulings of NAFRAA will be possible
- NAFRAA may have chairman plus 2 other members



Board report etc - sec 134 (sec 215, 217)

- **Signing of the financial statements:**
 - Chairperson or 2 directors (one of whom shall be MD or CEO, if CEO is a director)
 - CFO
 - Company secretary
 - Surprisingly, CEO who is not a director is left out
- **Attachments to financial statements (sec 134 (2) and (3):**
 - Extract of annual return as per sec 92 (3) – note sec 92 (3) says extract in a prescribed form shall form part of board report
 - No of meetings
 - DRS
 - Declaration by independent directors u/s 149 (6)
 - 149 (6) lays the conditions of independence; the declaration may be under 149 (7)
 - In case of cos covered by sec 178 (nomination and remuneration committee), company's policies on directors' appointment and remuneration
 - Explanation to auditors' qualifications
 - Good secretarial audit qualifications also require board explanations now
 - Particulars of loans/guarantees covered by sec 186 (intercorporate loans/investments)
 - Contracts/arrangements with related parties – sec 188
 - State of company's affairs
 - Material changes and commitments post balance sheet date
 - Energy technology absorption conservation, etc
 - Development and implementation of a risk management policy
 - CSR policy and initiatives – this seems applicable to all companies
 - In case of listed cos. And other specified companies, evaluation of board performance, committees and independent directors
 - Other matters as may be prescribed
 - All this is on top of the Management Analysis required under listing agreement



Directors' responsibility statement

- Shall contain statement on the following;
 - In preparation of financial statements, applicable accounting standards have been followed
 - Accounting policies selected are consistent and prudent, and judgement is prudent so as to give true and fair view
 - Proper and sufficient care in accounts, safeguarding assets, preventing and detecting fraud and error
 - Going concern basis
 - In case of listed cos., internal financial controls laid down
 - Internal financial controls related to prevent and detection of fraud and safeguarding of assets
 - Devised proper systems to ensure compliance with “all applicable laws” and that such systems are adequate and operating efficiently
 - Does the last clause say, all laws are being complied with?
 - Directors' report has to report on a system of ensuring compliance, and is itself not a report of compliance



Copies of annual report

- Sec 136 requires circulation of annual financial statements
 - Proviso once again contains reference to abridged financial statements
 - This should have become redundant with the generic permission for emailing of statements
- Listed companies will place financial statements on their website as well
- Proviso to sec 137 (1) requires filing of provisional accounts, if the accounts remain unadopted
 - 30 days of the AGM
 - In case there has been no AGM, sec 137 (2) applies:
 - A statement of facts and reasons for not holding meeting to be filed
- In case of OPCs, as there is no need for AGM, accounts are adopted by the member
- Failure to file makes the following liable to a fine
 - company
 - Managing director and CFO – fine and/or imprisonment
 - Where there is no MD or CFO, all directors



Audit and auditors



Auditors

- **Appointment of auditors – sec 139**
 - Currently, appointment is done every year
 - Under the new scheme, appointment is done once for 5 years
 - Ratification done every year
 - The law is casually confusing between “ratification” and “reappointment” taking these two expressions to mean the same
- In case of listed cos or cos of a specified class, mandatory retirement after 5 years in case of individual and 10 years in case of firms
 - no auditor/audit firm/ audit firms having common partners, shall take audit for a consecutive term of 5 years after 5 years have been completed
 - Cooling off period of 5 years
 - Condition not applicable to government companies where the auditors are to be appointed by C&AG – sec 139 (5)
 - In case of an audit firm restraint applies if there is a common partner
 - No restraint in case of a subsidiary or affiliate company
- Auditor’s consent to be filed by the company with the RoC within 15 days – 4th proviso to sec 139 (1)
 - Requirement shifted from auditor to the company
 - Time reduced from 30 days to 15 days
- Open question
 - Explanation says – appointment includes reappointment
 - Ratification of appointment is not a case of reappointment
 - Once we shift from annual appointment to quinquennial appointment, ratification should not be taken as a reappointment



Appointments in listed companies

- Listed and specified class of companies to not to appoint or re-appoint:
 - Individual for more than one term of five consecutive years
 - Will not be appointed for next 5 years in the same company
 - audit firm as auditor for more than two terms of five consecutive years
 - Will not be appointed for next 5 years in the same company
 - Restriction applies to any other audit firm having same or common partners
 - Existing companies to comply with the requirement within 3 years – second proviso to sec 139 (2)
 - What is the meaning of the proviso
 - Does this imply the term of 5 consecutive years is to be counted along with continuing appointment?
 - The proviso seems very critical
 - 139 (2) refers to appointment for “one term of five consecutive years”
 - Existing appointments are annual – hence, they are not for a term of 5 years
 - However, the second proviso loss its meaning altogether if the intent was not to cover existing appointments



Auditors (contd.)

- Lots of questions arise
 - Can auditors be appointed for less than 5 years?
 - Answer seems to be no
 - Can a company reappoint an auditor if the auditor resigned before completing the term of 5 years?
 - The law seems to be using the word “more than one term of five consecutive years”
 - However, first proviso to sub-section (2) seems to put a freeze of 5 years
- Sec 139 (10) – retiring auditor to continue if the AGM does not appoint an auditor
 - Sub-section is not made subject to 139 (2)
 - Neither does sub-section (2) have a non-obstante clause
 - However, sub-section (10) should be read subject to the embargo put in subsection (2)

Partner rotation; first auditor; casual vacancies

- Sec 139 (3) makes it optional for companies of all classes to provide for rotation of audit partner
- However, sec 139 (4) permits CG by rules to lay, for a class of companies, mandatory partner rotation
- first auditor to be appointed by Board within 30 days – same as sec 224 (5)
 - However, if the board fails, the company in EGM may appoint within 90 days (of failure or intimation by the board) appoint the first auditor
- Casual vacancy (non-CAG companies)
 - To be filled by the board within 30 days
 - However, if caused by resignation, to be resolved by members within 3 months of recommendation by board
 - No apparent time limit for making recommendation, but understandably, 30 days



Removal and resignations of auditors

- For not reappointing the retiring auditor, the law now requires special resolution, rather than ordinary resolution with a special notice
 - Not sure was this consciously done or crept out of oversight
 - For removal of auditor also, special resolution is sought now, in addition to CG approval
- Removal before expiry of tenure
 - Special resolution and prior approval of CG required
 - Auditors to be given a chance of being heard
- Resignations before completion of term
 - Every resigning auditor within 30 days of resignation to file a form with the registrar and the company
 - Stating reasons for resignation and “other relevant facts”
 - Failure to do so is a punishable offence – minimum Rs 50000, maximum Rs 5 lacs
- Special notice to appoint auditors other than retiring auditors
 - The rule for unlisted cos or companies not subject to a 5-year maximum term requirement is that every retiring auditor shall be reappointed
 - Special notice for appointing anyone other than retiring auditor applicable as before
 - Special notice – read with sec 115

Auditor's removal by NCLT

- Auditors' auditing offences subject to both NAFRA and NCLT
- Removal of auditor by NCLT
 - Sec 140 (5) provides powers of removal to remove auditor on reference by CG, suo motu, or "application by any person concerned"
 - Grounds:
 - Acted in fraudulent manner
 - Abetted in fraud
 - By or in relation to the company, or by any director or officer
 - Auditor so removed shall not hold any office as auditor of any company for 5 years
- Explanation I says – liability shall be of the firm and the committing/abetting partner
 - First, the section does not impose "liability" but disqualification
 - There are no punitive powers in the section
 - The explanation implies that other partners of the firm shall not suffer disqualification
 - However, this does not help, as the "liability" is anyway fixed on the firm
 - Explanation I read with sec 147 (5) seems to hold the partner and the firm both liable for offences



Internal Audit - 138

- Specified companies to appoint CA or cost accountant, or “such other professional as may be decided by the board” to be internal auditor
 - Qualifications of internal auditor are largely discretionary
 - Apparently there is no bar on the internal auditor being any employee/departments
- CG to prescribe the manner and frequency of internal audit
 - There is no power to lay down qualifications for internal auditor



Disqualifications of auditors

Following not to be appointed as auditors (sec 141 (3)):

- Body corporate other than LLPs
- Officer of employee of company
- person who is a partner, or who is in the employment, of an officer or employee of the company
- Person along with relative or partner
 - Holding any security or interest in company, its holding or associate company or a subsidiary
 - Relatives can hold security or interest for value not exceeding Rs 1,000
 - Indebted to company, its holding or associate company or a subsidiary for a sum to be specified
 - Has given guarantee or provided security for any third person indebted to company, its holding or associate company or a subsidiary
- Person or firm having direct or indirect business relationship with company, its holding or associate company or a subsidiary
- Relative of any director or KMP
- Person convicted by court for offence involving fraud
- Any person whose subsidiary, associate etc also involved in consulting and specialised services
- **Limit of 20**
 - Sec 141 (3) (g), worded rather clumsily, imposes an absolute limit of 20 audit per person
 - Persons in whole time employment cannot take any audit
 - Limit of 20 per person (in case of individuals) and 20 per partner in case of firms of auditors
 - Note that CG has a power to notify classes of companies as exempt from the law



Audit report and Auditing standards

- Sec 143 (2) makes audit report subject to audit standards
 - Sec 132 vests the power with NAFRA
- In other words, auditing standards get the mandatory force of the law – 143 (10) and 143 (2)
- Proviso to 143 (10) – until audit standards are notified, existing AAS of ICAI deemed to be audit standards
- Most of the contents of the audit report are the same, except
 - Observations and comments on financial transactions or matters which have adverse impact on the functioning of the company
 - This clause replaces sec 227 (3) (e)
 - There was no reference in the existing clause to financial transactions or matters
 - Auditors cannot be expected to comment on business judgement or propriety of transactions
 - However, if during the course of audit, they come across observations that are deleterious to the functioning of the company, they need to report the same
 - This a very wide reporting requirement
- CARO reporting
 - Does it stay?
 - Presumably yes, as the power to specify other reporting matters reserved – sec 143 (11)



Fraud Reporting

Fraud reporting

No, audit is not turning into forensic audit

But frauds against the company by any of its officers, or employees, are noticed by the auditor, the auditor shall report the same to the CG, within such time as may be laid by rules – sec 143 (12)



Meaning of fraud

- Sec 447 defines the term, otherwise used in scores of sections
 - Though the definition is limited to the section, but should be taken as generic meaning of the term
- **What is a fraud**
 - Act or omission
 - Concealment of any fact
 - Abuse of any position
- **Who does it:** Committed by any person or any other person with connivance in any manner
- **With what motive:** With intent to deceive or gain undue advantage from
 - Or injure the interests
- **Who are the victims:** Of the company, its shareholders or its creditors or any other person
- **Does the fraudster have to gain?** Whether or not there is a wrongful gain or wrongful loss



Obligations of cost auditor and secretarial auditor

- Little-noted provision in sec. 143 (14) extends all the provisions of sec 143, as may be applicable, to secretarial auditor and cost auditor
- Applying mutatis mutandis principle, following seem applicable to secretarial auditor
 - Right of access to books and vouchers – sec 143 (1)
 - Reporting to members or the board?
 - Sec 204 (1) requires the report to be annexed with the Board report
 - Board has to respond to qualifications
 - Understandably , therefore, it is a report to members
 - Reporting requirements of sec 143 do not apply to the secretarial auditor, as separate reporting contents laid by sec 143
 - Reasons for qualifications – 143 (4) – should apply
 - Sec 143 (9) makes audit standards mandatory – there is no corresponding requirement in case of secretarial audit standards
 - 143 (12) –reporting of fraud
 - Clearly applicable
- Punitive section – 143 (15) – minimum fine Rs 1 lac, maximum Rs 25 lacs
 - If there are reasons to believe that fraud exists, and we fail to report fraud
 - This offence is specifically linked to sec. 143 (12)
 - Generic offence of sec. 143 is dealt with by sec 147



Auditors & Non-audit Services

- **Auditors not to provide non-audit services – sec 144**
 - Positively
 - Only such services as are approved by the board or audit committee
 - That is, for every non-audit service, express board power or committee power required
 - Following services not to be provided
 - accounting and book keeping services;
 - internal audit;
 - design and implementation of any financial information system;
 - actuarial services;
 - investment advisory services;
 - investment banking services; 30
 - rendering of outsourced financial services;
 - management services; and
 - any other kind of services as may be prescribed
 - not to the company, holding company, or subsidiary
 - directly or indirectly
 - indirectly includes through relative, connected or associated person, or other entity over which individual has significant influence or control, or whose name or trade mark or brand is used by the individual
- Existing engagements:
 - Existing audit firms to ensure compliance before the commencement of the first financial year from the commencement of the law



Damage claims against auditors

Largest auditors Settlement since 2009

Auditors	Client	Amount (in mln US \$)	Country	Year
Ernst & Young	Akai Holdings	200	Hong Kong	2009
Ernst & Young	BCGE	120	Switzerland	2012
Ernst & Young	Sons Forest	117.60	Canada	2012
Ernst & Young	Sons of Gwalia	112.50	Australia	2009
Ernst & Young	Health South	109	United States	2009
KPMG	Westpoint Group	67.5	Australia	2011
PwC	Centro	66	Australia	2012



Auditors: Civil Liability

- **Criminal liability leads to civil liability**
 - **Sec 147 (3) connects with sec 147 (2)**
 - **That is, if offence of sec 147 (2) proved, civil liability also attaches**
- **Civil liability for auditors – Auditors, make your pockets deep!**
 - important provision for civil liability of auditor – sec 147 (3) says if the auditor is convicted u/s 147 (1) (offence of any of the provisions pertaining to audit), the auditor will be liable to compensate companies, statutory bodies and persons who have suffered loss
 - this will open floodgates of claims against auditors
- Who all may make compensatory claims:
 - Company
 - Statutory bodies or authorities
 - Or any other person
- For what : for loss arising out of misleading statement of facts or particulars in audit reports
- What are the pre conditions
 - There must have been a prosecution u/s 147 (2)
 - Who can prosecute
 - NAFRA's penal action is not sufficient for this section
 - Conviction has to be done by a criminal court/special court only
- Sec 147 (4) – central Govt to form a body for recovery of damages
- 147 (5)
 - Fastens liability to the partner as well as the firm
 - Jointly and severally
 - Clearly conflicting with the LLP Act – sec 27 (2) of the LLP Act confines the liability to the partners of the firm



How are damages fixed

- Who will fix damages:
 - Sec 147 (3) speaks of compensation by way of damages
 - However, no clue as to how are damages fixed
- As per established law, a claim for damages is a civil action, and therefore, civil court will have to award damages
 - Court under sec 2 (29) means High court
 - Section 245 (1) (g) allows class action suit to claim damages against auditors too
 - Requisite number of members/depositors need to make a class action claim
 - However, since class action is limited to members/depositors, creditors/lenders will have to resort to civil courts only
- Open question
 - Is section 245 (1) (g) independent of sec 147 (3)?
 - Language of both is almost similar
 - However, there is no precondition of prosecution u/s 245 (1) (g)
- In essence, after conviction u/s 147 (2), the aggrieved person(s) may make claim for damages

Auditors: Penalty for violation

- Severe penalty has been prescribed for:
 - Contravention of section 139, 144 and 145
 - twenty-five thousand rupees but which may extend to five lakh rupees
 - Lawmakers were over-enthused about auditor prosecution:
 - Offence of sec 139
 - Willful contravention with an intention to deceive the company or its shareholders or creditors or tax authorities – sec 147 (2)
 - Imprisonment which may extend to 1 year; **AND**
 - Fine of minimum Rs. 1 lac but may extend to Rs 25 lacs

Accounts and Audit

- **Consolidation** becomes mandatory for all companies
 - Strangely enough, consolidation has been provided for in case of associates and joint ventures
 - In case of associates, there is an equity method of accounting – which is not full scale consolidation
 - In case of JVs – consolidation is required only in case of certain JVs
 - Those that maintain separate books of account
 - In addition, the definition of “associate” as per the Act does not match with the definition as per accounting standards
 - Ideally, law should have provided for the AS to prevail



Corporate social responsibility



Corporate social responsibility - sec 135

- Surely, one of the most hyped provisions
- India seems to be the only country in the world that has imposed CSR as a part of the law



Corporate Social Responsibility (CSR)

- Section 135 deals with CSR – has 3 important elements
 - CSR Committee – frames the policy
 - CSR policy
 - CSR spending
- Note that the disclosure about CSR initiatives as part of the Board Report seems mandatory for all
- CSR committee versus board responsibility
 - Sec 135 (4) seems to say implementation of CSR policy is the responsibility of the board



when is CSR mandatory?

- CSR Committee
 - Every company with either of these 3
 - Net worth of Rs 500 crores or more
 - Turnover of Rs 1000 crores or more *during any financial year*
 - Net Profit of Rs 5 crores or more *during any financial year*
 - Lots of issues left gray – net profit is profit before tax or after tax?
 - It is profit before tax. Reference to sec 198 (5) makes this clear.
 - Referring to turnover and profits, the law says : “during any financial year” – surely enough, it cannot mean the running financial year. However, the law has not used “during preceding financial year” or during “any of the ** preceding financial years”
 - Clearly, the language is very very loose
 - However, as turnover and profits get known only upon preparation of financial statements, the requirement triggers in the next financial year
 - What is profit/turnover decline thereafter?
 - CSR Committee to have at least 3 directors, of which at least 1 independent
- CSR Policy to be framed by the Board and put on the website of companies
- CSR spending
 - At least 2% of average profits for last 3 financial years to be spent on CSR
- The law does not specify what activities will be counted towards CSR : some illustrations are given in Schedule VII



CSR activities

- Schedule VII may be taken as illustrative CSR activities but shows the intent of the lawmaker
- Activities relating to:—
 - (i) eradicating extreme hunger and poverty;
 - (ii) promotion of education;
 - (iii) promoting gender equality and empowering women;
 - (iv) reducing child mortality and improving maternal health;
 - (v) combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases;
 - (vi) ensuring environmental sustainability;
 - (vii) employment enhancing vocational skills;
 - (viii) social business projects;
 - (ix) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and
 - (x) such other matters as may be prescribed.
- Prof Mohammed Yunus (Creating a World without Poverty) defined social business as having following features
 - Financially self sustaining
 - Non-loss, non-dividend
 - Reinvesting its gain in advancement of the business itself



Some general questions on CSR

- Is it mandatory to do CSR spending:
 - The language of sec 135 (5) says – board of every company shall ensure that the company spends..”
 - Of course, the law does not come with a provision for parking unspent funds, or for accumulating unspent amount over next years
 - The board is required to explain reasons for not spending
 - However, that does not mean the spending requirement does not have the force of law
- Whether expenditure on staff, employees to be treated as CSR activities?
 - Bill provides to spend on social projects and expense on own employees cannot be treated as social services, hence, not allowed
- Can donation be given to group charitable organizations engaged in CSR?
 - Bill is silent. Can be given
 - May be a related party transaction if attracting the clause
- Can donation be given to outside charitable organizations with direction to spend in CSR?
 - Yes, can be given