Implications of the Provisions of Companies Act 2013 on Audits, Auditors and Audit Profession

Dr. Manoj S. Kamat[1], Dr. Manasvi Kamat[2]

[1]Associate Professor in Commerce, VVM's Shree Damodar College of Commerce & Economics, Mrago-Goa, Dharbandora
[2]Associate Professors in Economics, Goa Multi-Faculty College, Dharbandora-Goa

ABSTRACT

The Companies enactment of 2013 has the potential to be a historic milestone as it aims to improve corporate governance, simplify regulations, enhance the interests of minority investors and for the first time legislates the role of whistle-blowers. Sections 128 to 133 and 138 to 148 of new act 2013 deals with accounts, auditors and the audit profession. This paper under covers the key changes in the above provisions in the 2013 Act, having specific implications on the company audit and auditors compared to corresponding provisions in the Companies Act 1956. The key changes in the provisions relating to Audit and the Auditors along with its implications on the corporate sector are analysed from the academic and practical viewpoint.

Keywords: Companies Act 2013, Companies Act 1956, Audit, Auditor, Audit Profession, Key Changes, Implications

1. Introduction:

The Companies Act, 2013 enacted on 29 August 2013 on accord of Hon'ble President's assent replaces the nearly 60-year-old Companies Act, 1956 (1956 Act). The 2013 Act provides an opportunity to catch up and make our corporate regulations more contemporary, as also potentially to make our corporate regulatory framework a model to emulate for other economies with similar characteristics. The 2013 Act is more of a rule-based legislation containing only 470 sections, which means that the substantial part of the legislation are in the form of rules. There are over 180 sections in the 2013 Act where major rules have still to be prescribed to facilitate the ease of implementation in a phased approach followed by the Ministry of Corporate Affairs (MCA). Accordingly 282 sections have been notified and are in force from 1st April 2014. Final Rules for 21 chapters have also been released by the MCA, and the rules for the remaining chapters continue to be in draft stage.

Sections 128 to 133 and 138 to 148 of new act 2013 deals with accounts, auditors and the audit profession. In the light of the above the objective of the present paper is an attempt to undercover the number of provisions from the 2013 Act which have specific implications on the company audit and auditors. In this paper, we analyse the key changes with respect to provisions related to Company Audits and the Auditor and have also identified certain implications and challenges associated with the implementation of these specific provision, the companies ought to consider.

2. Impact of Companies Act 2013:

The existing Companies Act was enacted in 1956 with the object to consolidate the law relating to corporate sector and to regulate its activities. This Act is in force for the last over 56 years and has been amended several times. In view of changes in national and international economic environment and growth of our economy, the Government has decided to replace the Companies Act, 1956, by a new legislation. Originally Companies Bill, 2009 was introduced in the Lok Sabha in August, 2009 and was referred to Parliamentary Standing Committee. The Government received several suggestions from various stakeholders. After due consideration of various recommendations, a fresh Companies Bill, 2011 was introduced in the Lok Sabha and again referred to the Parliamentary Standing Committee. Lok Sabha has passed this Bill as Companies Bill, 2012 on 18th December, 2012. The Rajya Sabha has also passed the Bill in August, 2013. The President has given his assent on 29th august, 2013. Thus the Companies Act, 2013, has now been enacted and has come into force from the date to be notified by the Government.

The new enactment of 2013 has the potential to be a historic milestone as it aims to improve corporate governance, simplify regulations, enhance the interests of minority investors and for the first time legislates the role of whistle-blowers. The full impact of the New Companies Act is not yet clear, as many matters will be covered by rules or circulars, which will be issued from time to time.

III. Audit, Auditors and the Companies Act 2013:

Out of 470 Sections in the Companies Amendment Act 2013, 98 Sections have come into force with effect from 12- 09-2013 by a notification issued by the Government. The impact of the new pronouncement on the Audits and Auditors cannot not be underestimated and companies and other stakeholders should start examining its impact and swift action. This becomes more imperative as we are getting close to 1 million registered companies in India. A strong and specific understanding of this company legislation is therefore imperative and the efficacy of this the new enactment will depend on how well it is understood and implemented.

Sections 128 to 133 and 138 to 148 of this Act deal with Accounts, Audit and Auditors. In this paper, we analyse some of these key provisions relating accounts, audit and auditors visa-vie the Companies Act 1956 and have also identified certain action steps and challenges associated with the implementation of these provisions for the companies to consider. These provisions will have far reaching implications for the Audit Profession. In this paper some important provisions contained in the Companies Act, 2013 related to Audits and the Auditor are discussed, along with the potential implications.

The key changes in the provisions relating to Audit and the Auditors along with its implications on the corporate sector is analysed in 10 sections and presented in the following order; appointment and tenure of auditors; the eligibility, qualifications and disqualifications; removal and resignation; rotation of auditors; non-audit and restricted services, restriction on number of audits, the audit reporting responsibility, whistle blowing and fraud reporting, specialised audits and branch auditors. The analysis of these provisions with respect to key changes and their implications follows as under:

III.1 Appointment and the Tenure of Auditor:

Overview and Key Changes:
As per Companies Act 1956 the auditor is appointed on an annual basis and holds office only till the conclusion of the next AGM. The provisions of new section 139 dealing with appointment of auditors can be briefly stated as under:

After incorporation of a company, the first auditors (Individual or Firm of CA) should be appointed by the Board of Directors within 30 days. If the Board does not make such appointment, an extraordinary general meeting of members will have to be called within 90 days for appointment of auditors. The first auditors shall hold office up to the conclusion of first AGM. The auditor so appointed will hold its office till the conclusion of the sixth AGM. Though the auditor is appointed for 5 years, the matters related to such appointments will be placed for ratification at each AGM. If no auditor is appointed/ re-appointed at the AGM, the existing auditor will continue to be the auditor of the company. Before appointment, the auditors will have to give their consent in writing along with a certificate in accordance with the prescribed conditions. The auditor has also to give a certificate that the criterion for his appointment given in new section 141 is satisfied. After such appointment, the company will have to file a notice with ROC within 15 days and also inform the auditors. The Rules 10.1 and 10.2 provide for the procedure for selection of Auditors and conditions of their appointment.

An auditor/ audit firm is eligible for reappointment after expiry of five years since completion of the previous tenure. An audit firm having common partner (s) with another firm which has completed its term is not eligible for re-appointment for a period of five years from the completion of the other firm's term

As per the 2013 Act, before the expiry of the term of appointment, the company may remove the auditors (subject to special resolution and prior approval from Central Government ('CG') and the auditors, as well, have the right to resign. Further, the Tribunal either *suomoto* or on an application made to it by CG or by any person concerned, if it is satisfied that the auditor has acted in a fraudulent manner or abetted or colluded in any fraud by the company or in relation to the company/its directors/officers; may direct the company to change its auditors. The auditor, against whom such an order is issued, shall not be eligible to be appointed as auditor of any company for five years, together with other penal actions.

Currently, the listing agreement requires that the Audit Committee constituted by a listed company should make recommendation to the board for appointment/ reappointment/ replacement of statutory auditors. For non-listed entities, no such requirement is applicable. Under the Bill, all companies, which are required to constitute an Audit Committee, will need to appoint an auditor after taking into account the recommendations of such committee.

Implications of the above Changes:

a. The above amendments relating to appointment of auditor would require companies to consider long-term perspective while appointing an auditor. The provision of five year appointment may result in effectively protecting the tenure of the auditor for five years by including stringent provisions on removal of auditors. While rotation affects the long-term continuity of the company-auditor relationship, the five-year appointment, brings in stability for a limited period. However, the ratification provision results into annual confirmation of the appointment and effectively may not provide the tenure protection in reality.

b. The Tribunal's authority to suo-moto change the auditor and consequent ineligibility of such auditor, to act as an auditor for any company is quite punitive and could be disruptive to the audit profession. This could result in disproportionate punishment for a minor intentional / unintentional act and could potentially shut down large accounting firms overnight.

c. The prescribed class of non-listed companies, which are required to constitute Audit Committee, will also need to consider recommendations of the Committee for appointing auditors. Listed companies and companies belonging to prescribed class of companies will not appoint or re-appoint the auditor for more than 2 terms for 5 consecutive years if the auditor appointed is a firm, more than 1 term of 5 years is the appointed auditor is an individual. Secondly the auditor, who has completed his term, will not be eligible for re-appointment as auditor in the same company for 5 years from completion of the term.

d. The above restriction will also apply to the audit firm, which has common partner(s) with the outgoing audit firm at the time of appointment and thirdly every company, covered by these requirements, will need to comply with the above requirements within three years from the date of commencement of new law.

III.2 Eligibility, Qualifications and Disqualifications of Auditor:

Overview and Key Changes:

Section 141 in the 2013 act deals with eligibility, qualifications and disqualifications of Auditors and is similar to the existing section 226 with the following modifications. It may be noted that under the 1956 Act, a Chartered Accountant (CA) holding a Certificate of Practice or a firm of CAs (only) can be appointed as auditor(s) of a company. The 2013 Act, in addition, proposes that a firm wherein a majority of the partners practicing in India are qualified for appointment, may be appointed to be an auditor of a company. The new act permits a Limited Liability Partnership (LLP) to appointed as an auditor of a company.

A firm of Chartered Accountants can be appointed as auditors of a company only if majority of its partners are partners practicing in India. A LLP can be appointed as auditors of a company. However, in such a case only those partners of LLP who are chartered accountants in practice can be authorised to act and sign on behalf of the LLP.

It is provided that no Individual or Firm of chartered accountants can be appointed as auditors of a company if the Individual, his partner or partner of the firm or any relative of such persons hold any shares in the company, its holding or subsidiary or associate company. However, a relative of such persons can hold shares of the F.V of Rs. 1,000/- or such higher amount prescribed by the rules. Draft Rule 10.7(2) increases this limit from Rs. 1,000/- to Rs.1 Lakh. Similarly, the limit for indebtedness to the Company, its subsidiary etc. is also fixed by Rule 10.7(3) at Rs. 1 Lakh. A person whose relative is a director or is in employment of the company as a director or key managerial personnel cannot be appointed as auditor. A person who is associated with any entity which is engaged in consulting and specialized services as specified in the new section 144 cannot be appointed as auditor. Rule 10.7 provides for circumstances under which an Auditor will be disqualified.

In addition, the Companies Act contains a general requirement that a person will not qualify for appointment as auditor of a auditor of a company if he is disqualified, by virtue of one or more of the above disqualifications, for appointment as an auditor of any other body corporate which is that company's subsidiary or holding company, or a subsidiary of that company's holding company, or would be so disqualified if the body corporate was a company.

The amendments relating eligibility and disqualifications are presented in tabular form below:

No.	Topic	Companies Act	Companies Bill
Eligibility for appointment			
1.	Individual	Only if the person is a chartered accountant	Similar requirement.
2.	Firm	All the partners practicing in India should be qualified for appointment.	Majority partners practicing in India should be qualified for appointment.
3.	LLP	Not eligible for appointment	Eligible for appointment if it meets criteria similar to the firm.
Disqualifications for the appointment Both under the Companies Act and the Companies Bill, the following persons are not eligible for appointment as an auditor of the company: (a) A body corporate (b) An officer or employee of the company (c) A person who is a partner, or who is in the employment, of an officer or employee of the company.			
1.	Holding of security	A person holding security in the company is not eligible for appointment.	A person will not be eligible for appointment if he himself, his relative (term not fully defined) or partner holds any security or interest in the company, its subsidiary, holding or associate company or subsidiary of such holding company. However, the relative may be allowed to hold security or interest in the company with face value not exceeding ₹1 thousand or the amount as may be prescribed.
2.	Indebtedness/ guarantee/security	A person who is indebted to the company for an amount exceeding ₹1 thousand, or who has given any guarantee or provided any security in connection with third person's indebtedness to the company for an amount exceeding ₹1 thousand is not eligible for appointment.	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 such amount as may be prescribed. A similar disqualification has also been provided in case of guarantee given or security provided in connection with indebtedness of third person.
3.	Business relationship	No restrictions.	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.
4.	Relative's employment	No restrictions.	A person, whose relative is a director or is in the employment of the company as a director or key managerial personnel (KMP), will not be eligible for appointment.
5.	Full-time employment	A person who is in full time employment elsewhere is not eligible for appointment.	Similar requirement exists under the Companies Bill also.
6.	Limit on maximum number of companies	No company or its board will appoint/ reappoint a person or firm as its auditor, if such person or firm, at the date of appointment, hold appointment as auditor of more than 20 companies. However, private companies are not included in the maximum cap of 20 companies.	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.
7.	Fraud	No restriction.	A person will not be eligible for appointment, if he has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.
8.	Provision of services other than audit service	Discussed elsewhere in this publication	Discussed elsewhere in this publication (refer section titled "Independence / prohibited services")

The additional disqualifications prescribed are: *a.* Any person who has a 'business relationship' with the company/ its subsidiary/associate/its holding company/subsidiary or associate of its holding company (business relationship disqualification); *b.* A person whose relative is a non-executive/ executive director or KMP of the company; *c.* A person who has been convicted by a court for an offence involving fraud and a period of ten years has not elapsed from such conviction; *d.* A person being full-time employee elsewhere; *e.* A person whose appointment will make him the auditor of more than 20 companies; *f.* Any person whose subsidiary or associate or any other form of entity is engaged in providing non-audit services as on the date of appointment and *g.* Any person who is holding interest greater than Rs 1 lakh face value or indebted for greater than Rs 5 lakh to the company.
As per final Rules, the term 'business relationships' is defined to construe any transaction entered into for a commercial purpose except for the professional services permitted for auditors under the Act and the CA Act and in the ordinary course of business at arm's length price.

Implications of the above Changes:
a. The introduction of LLP as an auditor and ability to work along with partners who are not CAs is a welcome change and in line with international practices. This will also pave the way for multidisciplinary partnership firms. Auditor needs to submit eligibility certificate before proposal of the appointment is taken up. The company needs to file a form with the government within 15 days of appointment of auditors.
b. The new companies act prescribes significant additional restrictions on appointment of auditor. Existing auditor's relationships need to be re-evaluated considering the several disqualifications included. Some of the disqualifications seem to be quite punitive and may be difficult to implement. This will require both the company as well as auditor to track these aspects closely and exercise strict measures to avoid potential issues. *For example*, a person will not be eligible for appointment if his relative or partner is indebted to the company, its subsidiary, holding or associate company, or subsidiary of such holding company etc. or holds securities of those companies. If the government prescribes a long list of relations and any of these relatives inadvertently enter into a disqualifying transaction with the company, its subsidiary, holding or associate company, etc., it may require the auditor to vacate his/her office immediately.
c. The term 'business relationship' defined through Rules brings some clarity to the application of the provisions. However, determination of 'ordinary course of business' and 'arm's length price' would also bring some challenges in evaluating and establishing the same. Further, no cooling off/ transition period has been provided by the 2013 Act. Further, it seems that the non-audit services may be provided in the year of the appointment without affecting eligibility provided the engagement is terminated prior to the date of the appointment.
d. In the context of disqualification, certain provisions refer to a person as well as firm; while other provisions refer to person as well as his relative. For example, point 3 in the above table prohibits an auditor, whether person or a firm, from entering into a business relationship. However, there is no such restriction on relatives. Also, this clause does not restrict partners from having business relation with the company. In contras new provisions prohibits person, his relative and partner from having indebtedness; however, there is no such restriction on the firm. This is likely to give rise to the following key issues:

i. Whether restrictions, which refer to "person" only, are applicable to individual auditor and not the firm or its partners?
ii. Whether the restrictions applicable to firm will also apply to partners in the firm? and if yes, will that restriction apply only to the partner auditing the company or all partners in the firm ?
iii. Since the restriction on business relationship refer only person and firm it seems that the same is not likely to apply to relatives of the person.

e. The existing Act does not include private companies in the maximum limit of 20 companies per partner. However, the audit more 30 companies, including private companies, per year. Under the new Bill, even private companies will be included in the maximum limit of 20 companies that may be audited by a partner.

III.3 Removal and Resignation of Auditors
Overview and Key Changes:
The new section 140 in 2013 Act provides for Removal, Resignation *etc.* of Auditors. The procedure given in this section is more or less similar to the existing procedure in section 225 in the 1956 Act with the following difference:

The Rules 10.5 and 10.6 provide for procedure for removal and resignation of an Auditor. Under new section 140 of the companies Act 2013 require an approval from the Central Government to remove an auditor from his office before expiry of his term similarly the companies will need to comply with the onerous requirement of taking an approval from the Central Government to remove the auditor during this term. Also they will need to pass a special resolution at the general meeting.

If an auditor resigns from his office, he is required to file, within 30 days, a statement in the prescribed form with the company and ROC. In the case of a Government company, this form is also required to be filed with C& AG. In this statement the auditor has give reasons and other facts relevant for his resignation. For failure to comply with this requirement, the auditor is punishable with a minimum fine of Rs. 50,000/- which may extend upto Rs. 5 lakh.

Implications of the above Changes:

a. The intention of the regulator seems to be to bring more transparency and accountability both for companies and auditors. Though there is no change in the requirement for the Central Government approval to remove an auditor before expiry of the term, the auditor will be appointed for a term of five consecutive years under the new law. Hence, the company will not be able to change its auditors for 5 years, without getting the Central Government approval.
b. If the auditor is found to have, directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by the company or any of its officers, the Tribunal can, on its own or on an application by the company, Central Government or any concerned person, direct the company to change the auditors. In the case of such an application by the Central Government for change of Auditors, the Tribunal can, within 15 days, pass an order that the auditor shall not function as such and the Central Government will be able to appoint another auditor.
c. The auditor who is removed by the Tribunal cannot be appointed as an auditor of that company for 5 years. Further, under the new section 447 the auditor who is guilty of fraud will be punishable with imprisonment for a minimum term of six months which may extent to 10 years and shall also be liable to pay a minimum fine of an amount involved in the fraud which may extend to 3 times the said amount. If the fraud involves public interest the minimum period of imprisonment will be 3 years.

III.4 Rotation of Auditors:

Overview and Key Changes

The ICAI had successfully objected to the introduction of the system of Rotation of Auditors for the last six decades. Several commissions and Parliamentary Committees had agreed that rotation of auditors is not in the interest of the Accounting Profession and the corporate sector. In spite of this, provision for rotation of auditors has now been introduced 139 in the New Act. The system of Rotation of Auditors has been introduced in the case of Auditors of listed companies and other class of companies (specified companies) as may be prescribed by rules. This is provided in new section 139(2) as under:

If the auditor is an Individual, he cannot be auditor of such a company for more than 5 consecutive years. If a firm/LLP is auditor, it cannot be auditor of such a company for more than two terms of 5 consecutive years (*i.e.* 10 years). In the case of an Individual who has been auditor for one term of 5 years, he cannot be reappointed by the company for the next 5 years. In the case of a firm/LLP who has been auditors of such a company for 10 years cannot be reappointed by the company for the next 5 years. It may be noted that any firm/LLP which has one or more partners who are also partners in the outgoing audit firm/LLP cannot be appointed as auditors during this 5 year period.

As per the Companies Act, 2013, every existing listed or specified company will have to comply with the above provisions relating to Rotation of Auditors within 3 years from such commencement. From the wording of second proviso to Section 139(2) it is not clear whether, for the purpose of Rotation, the period prior to the New Act coming into force should be counted for calculating the period of 10 years. Rule 10.4(4)(i) states that for the purpose of Rotation the period for which the Auditor has been holding office as Auditor prior to the commencement of the New Act shall be taken into account in calculating the period of 5 or 10 consecutive years. Thus, if an Auditor (Individual) was Auditor of any specified Company for 5 consecutive years or a Firm has been Auditors of such a Company for 10 consecutive years prior to the New Act coming into force, such Auditors will be subject to the new provisions for rotation and the provisions relating to rotation will also apply to Branch Auditors.

It may be noted that Rule 10.1 to 10.4 provide for procedure for Rotation of Auditors. It may also be noted that Rule 10.3 provides that the above provisions for Appointment and Rotation of Auditors will apply, besides listed Companies, to all public and private companies, other than one-person Company or small Companies.

Implications of the above Changes:

a. The RBI requires all banks, including banking companies, to rotate auditors every four years. The IRDA requires all insurance company auditors to be rotated after every 5 years. After the completion of the term, two years cooling off period is required. However the mandatory rotation is a new concept under the new companies act and is expected to change the Indian audit market structure significantly as several large companies have retained their auditors for more than 10 years.

b. Mandatory rotation could possibly result in both positive and negative influences on the quality of the financial reporting processes and on overall audit quality. Not many jurisdictions have established mandatory auditor rotation requirements, accordingly its feasibility and practicability is debatable because the extent of information about its potential impact is not readily available. Further the international practice so far is of mandatory partner rotation only. While European Union has very recently issued requirements for mandatory firm rotation, the same are applicable to only very large companies and the rotation period could be up to 20 years.

c. As a result of rotation, the learning curve experience available to previous auditors will not be available to the new auditors, who may have to understand the business of the company, its systems and processes, from scratch. Therefore, cost of audit is likely to increase both for companies and the audit firm. While the potential benefit of mandatory rotation is enhanced auditor objectivity, it will also likely have an effect on overall cost, conduct and timing. A sudden introduction of such a requirement may disrupt the audit market and the industry as a whole. The implications could be far reaching and cannot be commented at this point in time.

III.5 Non-Audit and Prohibited Services:

Overview and Key Changes

Whether non-audit services can be rendered to an audit client is normally determined by applying the Code of Ethics and the Guidance Note on Independence of Auditors issued by the ICAI. Unlike 1956 Act, the 2013 Act contains specific provisions that prohibit auditors of a company to render non-audit services to an audit client (or its holding company or its subsidiary company). Under the Companies Act 2013, an auditor will be allowed to provide only such other services to the company as are approved by its board or audit committee.

However, the auditor is not allowed to render the following services either directly or indirectly to the company, its holding or subsidiary company: Prohibited non-audit services include: 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; and management services with a rider that other restricted services may be further prescribed.

In case of audit firm, the above restrictions also apply to rendering of services by; audit firm itself, all of its partners, its parent, subsidiary or associate entity, any other entity in which the firm or its partner has significant influence/control, or whose name/trademark/ brand is used by the firm or any of its partners.

Implications of the above Changes:

a. The list of prohibited services is quite wide and also vaguely worded. This results in restricting the ability of an audit firm to provide most non-audit services. Whilst the provision of some non-audit services to audit clients can pose a risk, the objectivity of auditors is not compromised by providing non audit services to audit clients or their holding companies provided that auditors comply with independence standards. Certain non-audit services, for example, services that pose a risk of self-review do impair independence; however there are several non-audit services that do not affect independence. The list provided under the 2013 Act is subject to wide interpretation and may limit auditors in providing valid non-audit services which do not pose any risk of independence. It should be noted that the list appears to be more restrictive than international practices.

b. Such restrictions are generally applied to all 'downward affiliates' of the company, as those entities could be considered as being subject to audit (in the context of the parent company's financial statements); however, these restrictions have been extended to the holding company as well. Traditionally, companies have engaged auditors to provide a range of non-audit services. This is because an auditor, due to its continuous engagement with the company, is in a better position to provide these services. The new companies act does not make any distinction based on the size/materiality of the company being audited. Hence, the restrictions are likely to apply equally in all cases. This is at variance from independence requirement being followed in other parts of the world, including the US.

c. It is clear that the above restrictions will prohibit an auditor from rendering certain prescribed non audit services to the company and its holding or subsidiary company in India. What is not clear is whether the above restriction will apply to rendering of non-audit services by the auditor or its network subsidiary located outside of India. It can be believed that the requirements of the new act cannot be extended to a jurisdiction beyond India. Hence, providing non-audit services to the auditee's holding company or subsidiary located outside of India either by the auditor or its network firm will not be prohibited.

d. Thus the requirements as per the new amendments appear to be quite onerous and indeed would appear to prohibit an audit firm from providing a wide range of services, even when those are non-material. The risks associated with the audits increases significantly, and have a severe impact on the cost of professional indemnity insurance and hence cost of audits.

III.6 Restriction on No. of Audits:

Overview and Key Changes:

The 1956 Act and the Institute of Chartered Accountants of India restricted the number of companies in which a person/firm can be appointed as auditor. As per the new enactment an individual cannot be appointed as auditor for more than 30 companies. Further, an individual cannot be appointed as auditor for more than 20 public companies and of which not more than 10 companies should have a paid up share capital of more than Rs 25 lakh. In case of a firm, such ceiling is determined for every partner of the firm.

Implications of the above Changes:

a. The 2013 Act restricts the number of audits to 20 companies for an individual/ partner but does not provide any restrictions based on nature/size of the companies. Now private companies will also be considered for calculating the limit of 20 audits per partner.

III.7 Audit Reporting Responsibility:

Overview and Key Changes

In addition to the 1956 Act reporting requirements, the 2013 Act mandates that the audit report should include the following additional matters, compared to the current requirements for reporting: Whether the company has adequate internal financial control system in place and on the operating effectiveness of such controls. Currently, the requirement under the CARO to report on internal control matters is limited. It requires an auditor to comment on whether the company has an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services.

The auditor now is also expected to comment on the adequacy of the internal financial controls system and the operating effectiveness of such controls, and in a similar context with respect to directors report, internal financial control has been defined to mean the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. . Also, such observations/comments will be now be read in the AGM and can be inspected by any member. Earlier, the Companies Act 1956 required the observations or comments of the auditors with any adverse effect on the functioning of the company to be given in bold/italic in the audit report.

As per the final rules, additional comments need to be provided by the auditors in their report for: disclosure of the effect of pending litigations; provision for material foreseeable losses as required under any law or accounting standards on long-term contracts, including derivatives; and delay in depositing money into the Investor Education and Protection Fund.

Implications of the above Changes:
a. The auditors are subjected to wider and onerous responsibility of providing a comfort on internal controls and on operational effectiveness of the conduct of the business, in addition to the true and fair opinion on financial statements.
b. There seems be a focus to bring in global best practices in terms of reporting by auditors on the effectiveness of internal control over financial reporting and maintenance of accounting records. However, the terms or language highlighted in these requirements, are subjective and open to wide interpretations. This may adversely affect the scope of the audit and can pose significant implementation challenges.
c. Further, for unlisted entities the requirements related to reporting in internal financial controls apply only to auditors and not to the directors which is inconsistent with the company's / director's primary responsibility for implementing such controls.
d. Scope of audit inquiries/testing may no longer be restricted to financial information and may include more qualitative operational assessments as well. There may be significant costs associated with implementation of acceptable internal financial reporting controls.

III.8 Whistle Blowing and Fraud Reporting:

Overview and Key Changes
The 2013 Act provides that the auditor should immediately inform the Central Government within such time and in such manner as may be prescribed, if he has reason to believe that an offence involving fraud is being committed or has been committed against the company by its officers or employees. As per final Rules the auditors now have to report about the fraud to the Central Government if sufficient evidence, within 60 days. The initial report is to be given to Board/Audit Committee for their comments and the time limit for responses set at 45 days. It is also requires that within 15 days of receipt of comments or expiry of 45 days (in case comments not received), the report is to be sent to the Central Government. This responsibility to report fraud applies equally to secretarial and cost auditors.

Implications of the above Changes:
a. The term “Fraud”, as defined under the 2013 Act, and is so very wide that perhaps encompasses every act of omission or commission. The current language of the Act and the Rules suggest covering all sorts of frauds which lays excessive responsibility on the auditors. It will be interesting to understand how these requirements will work considering that auditors are also the gatekeepers of the accounting and internal controls of the company.
b. Further, there is no materiality limit set under the 2013 Act for reporting to the Central Government. The 2013 Act also require an auditor to report even trivial matters, making it an ineffective exercise.
c. The 2013 Act only requires reporting fraud by the officers or employees on the company. However, the fraud committed by others on the company and frauds reported by the company on these or others is currently not required to be reported. Further it is apprehended that the **d.** The fraud reporting by the auditors irrespective of the materiality and actions taken by the management would result into confusion and onerous obligation.

III.9 Specialized Audits:

Overview and Key Changes:
As per the new companies act, the Internal audit has been mandated for listed and prescribed classes of companies. As per Final Rule, Internal Audit is made mandatory for listed companies and unlisted public companies with paid up share capital of Rs 50 crore or more or turnover of Rs 200 crore or more or outstanding loans or borrowings exceeding Rs 100 crore or outstanding deposits of Rs 25 crore or more at any point of time during the last financial year, for private companies with turnover of Rs 200 crore or more or outstanding loans or borrowings exceeding Rs 100 crore at any point of time during the last financial year. The new companies act also mandates cost audit for specified class of companies. Section 148 in the new act provides for appointment of Cost Auditors by Board of Directors of Companies engaged in the business of manufacture of such goods as may be notified by the Government. This section is more or less similar to existing section 233B with some modifications. The procedure for appointment and reporting by the Cost Auditor is similar to the existing procedure. As per the Rules, the companies required to include cost records in their books of account in accordance with specified draft Rule shall be required to get such cost records audited by a cost auditor. It may be noted that the above penalty provisions contained in new section 147 are applicable to the company as well as the Cost Auditor in the same manner as stated above.

Secretarial audit has also been mandated for listed and prescribed classes of companies. As per final Rules, secretarial audit is made mandatory for every public company with a paid up capital of Rs 50 crore or more or turnover of Rs 250 crore or more.

Implications of the above Changes:
a. Mandatory internal audit requirement will strengthen the system of internal controls in the wake of recent corporate fraud.
b. Further strengthening the requirements of the cost audit, covering more companies under its ambit will further discipline manufacturing industries, which in turn would expand its benefits to larger groups of people.
c. Mandatory secretarial audit report would be a good measure to ensure compliance with legal requirements as any adverse comment in the report could have significant impact from a regulatory perspective.

III.10 Branch Auditor:

Overview and Key Changes:
Section 143(8) of the new act 2013 provides for appointment of Branch auditors and is similar to section 228 in the 1956 Act. The earlier act provided that in case the statutory auditor is not able to conduct the audit of the branch, members can appoint branch auditors at AGM or authorise the Board of Directors to make such appointment. The new act provides that the Branch Auditors will have to be appointed by the members in AGM as provided in new section 139. It is also provided in section 143 that if an auditor, during the course of audit, has reason to believe that an offence involving fraud is being committed by the officers/employees against the company; the auditor will have to report to the Central Government in the prescribed manner. If the auditor fails to comply with this reporting requirement, without reasonable cause, he shall be punishable with minimum fine of Rs. 1 lakh which may extend to Rs. 25 lakh.

Implications of the above Changes:
a. From the above it is now evident that the Branch Auditors will have to be appointed for a consecutive period of 5 years. Similarly, it appears that the Branch Auditors will also be subject to the system of Rotation of Auditors u/s. 139(2) in the audit of a listed company or a specified company as stated to above. While doing so, the auditors will also have to comply with the Auditing Standards while conducting Audit of any company as provided in new section 143(10).

IV. Summary and Conclusions:

The provisions in sections 128 to 133 and 138 to 148 relating to accounts and audit contained in the Companies Act, 2013 will have far reaching impact on the audit of companies and their auditors. It appears that these provisions are being made with a view to curb the present day tendency on the part of some companies to manipulate accounts with a view to benefit those in management or with a view to reduce tax. Some of these provisions are very harsh and they are likely to affect the development of the corporate sector and the profession of auditing as such. In the above sections, the key changes in the specific provisions in the 2013 Act, having implications on the company audit and auditors compared to corresponding provisions in the Companies Act 1956 are assessed. The key changes in the provisions relating to Audit and the Auditors along with its implications on the corporate sector are analysed from the academic and practical viewpoint.

The New Act will curtail the autonomy of the Institute of Chartered Accountants of India to issue Accounting Standards and Auditing Standards. These standards will now be notified by the Government in consultation with NFRA. This is a new national authority to be appointed by the Government with very wide powers. This National Authority will be able to take disciplinary action against erring auditors and award punishment to them. Therefore, the autonomy of ICAI to take disciplinary action against its members will be curtailed to this extent. It also appears that the Central Government is now looking to transfer the important function of regulating the accounting and audit profession to other Government controlled Agencies.

Considering the responsibilities being placed on the auditors it appears that small and medium size audit firms will find it difficult to continue in audit practice. No such audit firm will be able to undertake such responsibilities with threat of litigation in the event of unintended and genuine mistakes. The provisions relating to restrictions on number of years one can continue to remain auditor of a company and restriction on rendering other services will also impact the ability of such small and medium size firms to continue in audit practice. It is hoped that the provisions for removal of auditors, awarding punishment and other harsh provisions will be implemented by the Government and other authorities in a reasonable, sympathetic and fair manner.

References:

Abbott, L. J., Park, Y., & Parker, S. (2000). The effects of audit committee activity and independence on corporate fraud. *Managerial Finance*, *26*(11), 55-68.

Act, Companies. (2013). New Rules of The game'. *A Deloitte and ASSOCHAM Report*.

Cameran, M., Francis, J. R., Marra, A., & Pettinicchio, A. (2013). Are there adverse consequences of mandatory auditor rotation? Evidence from the Italian experience. *Auditing: A Journal of Practice & Theory*, *34*(1), 1-24.

Carcello, J. V., Hermanson, D. R., & Ye, Z. (2011). Corporate governance research in accounting and auditing: Insights, practice implications, and future research directions. *Auditing: A Journal of Practice & Theory*, *30*(3), 1-31.

Goto, G. (2013). The outline for the Companies Act reform in Japan and its implications.

Ramaiya, A. (2013). *Guide to the companies Act*. A. P. Datar, S. Sarkar, & V. Kothari (Eds.).
