Workshop on Companies Act, 2013

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Background:

- The Companies Act, 2013, contains 470 Sections, 29 Chapters, 7 schedules.
- Of the total sections, 283 sections are notified/in force.
- The new Act ushers the requirements of Corporate Governance and permeates the same to unlisted companies.
- It also takes congisance of growing importance of technology and recognises electronic mode of transacting for the purposes of various provisions.
- To a greater extent, it gives autonomy to the corporates, and imposes a regime of self-regulation.
- The Act attempts to simplify the processes, *inter alia,* doing away with Central Government approval in many places, the nomenclature used for the forms is an acronym of the title of that Chapter, etc.

<u>Internal Financial Controls – Key Provisions</u>

- The Companies Act, 2013 (the "2013 Act") has stated specific responsibilities on the board of listed companies towards the company's internal financial controls and, *inter alia,* requires the board to state that they have laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.
- Statutory auditors are also required to report on the adequacy and operating effectiveness of the company's internal financial control system.
- The reporting by the auditors is voluntary for the year ending 31 March 2015 and mandatory for financial years beginning on or after 1 April 2015.
- Section 134(5)(e) of the 2013 Act requires the board of listed companies to assume responsibility of laying down "internal financial controls" and ensuring that such controls are not only adequate but are also operating effectively.
- As per the explanation provided to this clause, the term "internal financial controls" means 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.
- The Code for Independent Directors provided in Schedule IV to the 2013 Act also emphasizes that the independent directors have to satisfy themselves on the strength of financial controls, thereby placing specific responsibility on independent directors.
- As per section 177 of the 2013 Act, the Audit Committee is required to evaluate the internal financial controls and risk management systems in the company.
- Rule 8(1) of the Companies (Accounts) Rules, 2014 states the matters to be included in the board's report.

- This Rule states that the board's report shall be prepared based on the stand alone financial statements of the company. It further states that with respect to the subsidiaries, associates and joint ventures, the board report shall contain a separate section reporting the performance and the financial position for each such entity.
- Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 requires the board report of all companies to state the details in respect of adequacy of internal financial controls with reference to the financial Statements.

Key provisions as per Listing Agreement

- As per sub-clause IV.D of Clause 49 of the Equity Listing Agreement (the "ELA"), the role of the Audit Committee of companies whose equity shares are listed, includes evaluation of internal financial controls and risk management systems.
- Further, sub-clause IX.C of Clause 49 requires the CEO and CFO of such companies, to certify to the board of directors (the "board") that they accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting.

Internal Financial Controls

- Internal Financial Controls means "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."

There are many frameworks that provide guidance to entities for developing and establishing their internal control systems. Some common international frameworks are:

- Internal Control - Integrated Framework issued by Committee of the Sponsoring Organisations of the Treadway Commission (COSO Framework).
- Guidance on Assessing Control published by the Canadian Institute of Chartered Accountants (CoCo)
- "Internal Control: Guidance for Directors on the Combined Code", published by the Institute of Chartered Accountants in England & Wales (known as the Turnbull Report)

Objectives of internal control frameworks:

- **Operations Objectives** - These pertain to effectiveness and efficiency of the entity's operations, including operational and financial performance goals, and safeguarding assets against loss.
- **Reporting Objectives -** These pertain to internal and external financial and non-financial reporting and may encompass reliability, timeliness, transparency, or other terms as set forth by regulators, recognised standard setters, or the entity's policies.

- **Compliance Objectives** - These pertain to adherence to laws and regulations to which the entity is subject.

Components of Internal Control

The five components of internal control, that are essential in any control environment, as they relate to a financial statement audit. The following are the components of internal audit:

Control Environment

- The control environment sets the tone of an organization, influencing the control consciousness of its people.
- It is the foundation for all other components of internal control, providing discipline and structure.
- Control environment factors include the integrity, ethical values and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the board of directors.

Entity's Risk Management Process

- For financial reporting purposes, the entity's risk assessment process includes how management identifies business risks relevant to the preparation of financial statements in accordance with the entity's applicable financial reporting framework, estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to respond to and manage them and the results thereof.

Control Activities:

Control activities that may be relevant to an audit may be categorised as policies and procedures that pertain to the following:

- Performance reviews
- Information processing
- Physical Controls:

Information Systems:

- An information system consists of infrastructure (physical and hardware components), software, people, procedures, and data. Many information systems make extensive use of information technology (IT).

Monitoring

- Internal control systems need to be monitored--a process that assesses the quality of the system's performance over time.
- This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two.

- Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties.
- The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures.

Borrowings

Board of Directors of a Company can exercise the following powers only with the consent of the company by a special resolution:

- to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business
- Provided that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.

- "Temporary loans" means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature
- Every special resolution passed by the company in general meeting in relation to the exercise of the powers shall specify the total amount up to which monies may be borrowed by the Board of Directors.

- As per Section 2(64), paid-up share capital or share capital paid-up means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called
- As per Sec. 2(43) 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 reserve or otherwise, or
  - any change in carrying amount of an asset or of a liability recognised 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

Deposits

"Deposit" includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India

Deposits includes any receipt of money by way of deposit or loan in any other form, by a company, but does not include any amount received from:

- Central or State Government
- Foreign Governments, foreign or international banks
- As a loan or facility from any banking company
- As a loan or financial assistance from Public Financial Institutions notified by Central Government.
- Amount received against issue or commercial papers or any instruments issued as per RBI guidelines
- Amount received by a company from any other company
- Amount received and held towards subscription to any securities including share application money or advance towards allotment of securities pending allotment. However, if securities are not allotted or amount or amounts refunded within 60 days of receipt of application money or advance, such amount shall be treated as deposit.
- A person who is a director and has given declaration.
- Issue of debentures compulsorily convertible into shares within 5 years.
- An employee not exceeding his annual salary
- Any non-interest bearing amount received or held in trust
- In ordinary course of business of the company (advance for supply of goods, security deposit)
- Amount bought in by the promoters of Company by way of unsecured loan pursuant to lending by bank or financial institution.
- Any amount accepted by a Nidhi Company in accordance with provisions of Sec.406 of the Act.
- any amount received in the course of, or for the purposes of, the business of the company,-

  (a) as an advance for the supply of goods or provision of services, provided that such advance is appropriated against supply of goods or provision of services within a period of 365 days from the date of acceptance of such advance:
  Provided that in case of any advance which is subject matter of any legal proceedings before any court of law, the said time limit of 365 days shall not apply:
  (b) as advance, accounted, received in connection with consideration for property under an agreement or arrangement, provided that such advance is adjusted against the property in accordance with the terms of agreement or arrangement;
  (c) as security deposit for the performance of the contract for supply of goods or provision of services;
  (d) as advance received under long term projects for supply of capital goods except those covered under item (b) above:

  Provided that if the amount received under items (a), (b) and (d) above becomes refundable due to the reasons that the company accepting the money does not have necessary permission or approval, then the amount received shall be deemed to be a deposit under these rules. The amount referred to in the first proviso shall be deemed to be deposits on the expiry of fifteen days from the date they become due for refund.

- any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to fulfillment of the following conditions, namely:-
  - the loan is brought in pursuance of the stipulation imposed by the lending institutions on the promoters to contribute such finance;
  - the loan is provided by the promoters themselves or by their relatives or by both; and
  - the exemption under this sub-clause shall be available only till the loans of financial institution or bank are repaid and not thereafter;

Reporting on Fraud

"Fraud" in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.

"Wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled.

"Wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled.

Procedure

- Auditor shall forward his report to the Board /Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observations within 45 days
- On receipt of such reply or observations the auditor shall forward his report and the reply or observations of the Board / Audit Committee along with his comments to the Central Government within 15 days of receipt of such reply or observations;
- In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive any reply or observations within the stipulated time.
- The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed post followed by an email in confirmation of the same.
- This report shall be on the letter-head of the auditor containing postal address, e-mail address and contact number and be signed by the auditor with his seal and shall indicate his Membership Number. The report shall be in the form of a statement as specified in Form ADT-4.
- No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter above if it is done in good faith.

***************************THANK YOU*****************************