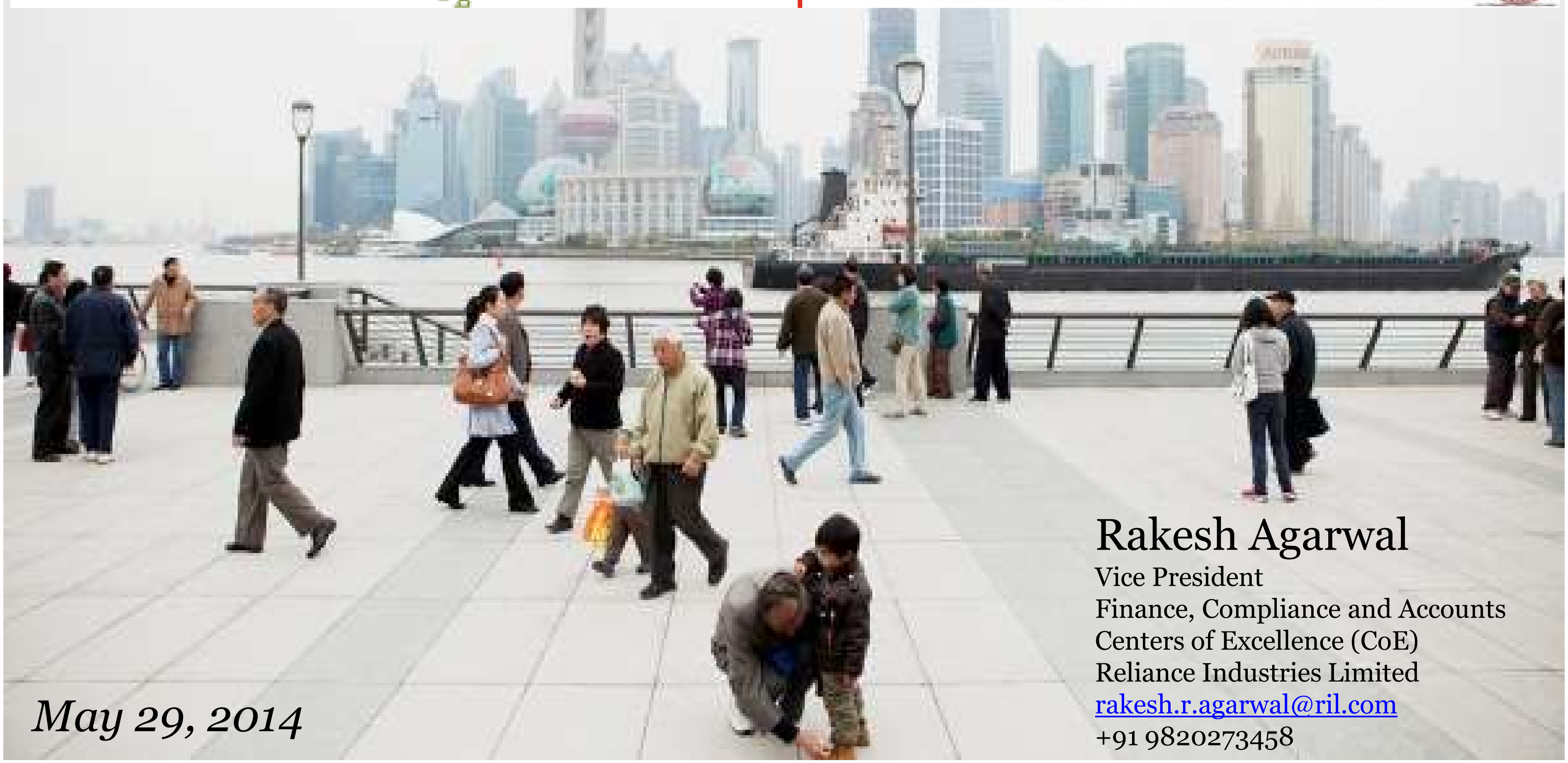
Companies Act 2013 and Financial Statements



Rakesh Agarwal
Vice President
Finance, Compliance and Accounts
Centers of Excellence (CoE)
Reliance Industries Limited
rakesh.r.agarwal@ril.com
+91 9820273458

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Areas impacting Accounts, Audit, Dividend and RPT

Key areas impacting Accounts and Audit and other related areas:

Related Chapters	Related Section
Chapter VIII: Declaration of dividend	Section: 123 to 127
Chapter IX: Accounts of Companies	Section: 128 to 138
Chapter X: Audit and Auditors	Section: 139 to 148
Chapter XII: Related party transaction	Section: 186 to 188

Company Accounts

- Financial Statements
  - ✓ Consolidation procedure
  - ✓ Key changes in Definitions
  - ✓ Key provisions impacting Consolidated Financial Statement

- Books of accounts and revision

Financial Statements – Consolidation procedure

Balance Sheet of Parent (A Ltd) and Subsidiary (B Ltd)

Particulars	A Ltd	B Ltd	CFS
EQUITY AND LIABILITIES			
Share Capital	600,000	4,00,000	6,00,000
Reserves and Surplus	1,60,000 +	80,000 =	2,40,000
	7,60,000	**4,80,000**	**8,40,000**
Non-Current Liabilities			
Long Term Borrowings	2,30,000 +	1,85,000 =	4,15,000
Deferred Tax Liability	70,000	35,000	1,05,000
	3,00,000	**2,20,000**	**5,20,000**
Current Liabilities			
Short Term Borrowings	120000	70000	1,90,000
Trade Payables	280000	15000	2,95,000
TOTAL	**14,60,000**	**7,85,000**	**18,45,000**
ASSETS			
Tangible Fixed Assets	3,40,000	3,20,000	6,60,000
Intangible Fixed Assets	1,05,000	90,000	1,95,000
Investment in B Ltd.	4,00,000	-	-
	8,45,000	**4,10,000**	**8,55,000**
Current Assets			
Inventories	2,35,000	1,85,000	4,20,000
Trade Receivables	2,60,000	1,70,000	4,30,000
Cash and Bank Balances	1,20,000	20,000	1,40,000
TOTAL	**14,60,000**	**7,85,000**	**18,45,000**

Elimination of investments

Statement of Profit and Loss of Parent (A Ltd) and Subsidiary (B Ltd)

Particulars	A Ltd	B Ltd	CFS
INCOME			
Revenue from Operations	9,85,000 +	7,38,000 =	17,23,000
Other Income	80,000 +	23,000 =	1,03,000
Total Revenue	**10,65,000**	**7,61,000**	**18,26,000**
EXPENDITURE			
Cost of Materials Consumed	510,000	3,80,000	8,90,000
Employee Benefits Expense	1,80,000	98,000	2,78,000
Finance Costs	96,000	68,000	1,64,000
Depreciation and Amortisation Expense	1,26,000	1,28,000	2,54,000
Other Expenses	47,000	23,000	70,000
Total Expenses	**9,59,000**	**6,97,000**	**16,56,000**
Profit Before Tax	1,06,000	64,000	1,70,000
Tax Expenses	52,000	32,000	84,000
Profit for the year	54,000	32,000	86,000

Notes:

- *Consolidation is done by line-by-line addition of respect assets and liabilities and income and expenses*
- *Inter-company profits if any is eliminated from stock*
- *Inter-company receivables and payables are eliminated*

Financial Statements

Key changes in the definitions related with Financial Statements:

Particulars	Companies Act 2013	Companies Act 1956
Financial Statement 2 (40)	Financial statement in relation to a company, includes— i) a **balance sheet** as at the end of the financial year; ii) a **profit and loss account**, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year; iii) **cash flow** statement for the financial year; **<u>iv) a statement of changes in equity, if applicable;</u> &** v) <u>any explanatory note annexed</u> to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv): Provided that the financial statement, with respect to One Person Company, small company and dormant company, **may not include the cash flow statement**;	Not defined
Financial Year (FY) 2 (41)	Financial year of a company / body corporate means the period ending on **31st March every year**. In case a company has been **<u>(newly) incorporated</u>** on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, will be its first financial year. Exception – A company or body corporate, which is a holding company or a subsidiary of a company incorporated outside India and is required to follow a different FY for consolidation of its accounts outside India, with National Company Law Tribunal (NCLT) approval All existing companies will **need to align** their financial year with the new requirement within two years from the commencement of the new law.	Financial year means, in relation to any body corporate, <u>the period in respect of which any profit and loss account of the body corporate laid before it in annual general meeting</u> is made up, whether that period is a year or not. Exception: In case of Insurance companies, financial year shall mean the calendar year referred to in subsection (1) of section 11 of the Insurance Act, 1938 (4 of 1938)

Financial Statements

Key provisions impacting Financial Statements:

Particulars	Companies Act 2013	Companies Act 1956
Signing of financial statements 134 (1)	Financial Statements to be **signed at least by**: • Chairperson of the company, if authorized by BOD; or • 2 Directors including MD, where there is one and CEO if he is a Director, • **CFO and CS**, (wherever they are appointed) In case of One Person Company balance sheet and statement of profit and loss to be signed by 1 director only	Balance sheet and statement of profit and loss to be signed by manager or secretary and by 2 Directors including MD where there is one.
Consolidated Financial statements 134 (1)	A company has a subsidiary / associate / joint venture, **CFS to be prepared and laid before an AGM in addition** to standalone financial statements Schedule III – Financial Statements --→ Schedule III General Instruction for CFS ---→ CFS	No such concept. • A company required to give specified information about the financials of a subsidiary - Section 212 report - as part of Director's report • Under the Listing Agreement of SEBI, Consolidated Financial Statement (CFS) is mandatory for listed company
Period for maintenance of Books of Accounts 128 (5)	Central Government may direct keeping books of accounts of a company to be maintained for a period **more than 8 years** where any investigation has been ordered.	Companies are required to preserve the Books of Account for a period of 8 years

Financial Statements

Key provisions impacting Consolidated Financial Statements – Sec 129:

Key provisions

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

Impacts

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

Financial Statements

Circulation of financial statements to members – Sec 136:

Key provisions

Unlisted Company:

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

Listed Company

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

Penalty

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

Financial Statements

Filing of financial statements with ROC – Sec 137:

Key provisions

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

Penal Provision

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

Books of accounts and revision *(Sec 128 & 131)*

Key provisions

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

- **Voluntary revision:**
  A Company shall not re-open its books of accounts unless an application is made by statutory authorities. However, now a company can **voluntarily revise** its financial statements or Board's report if it appears to the director of a company that the financial statement of the company or the Board's report does not comply with the provisions of section 129 (financial statements) and section134 (financial statements and board reports) in respect of **any of three preceding financial years**, after obtaining approval from Tribunal.

- **Mandatory revision:**
  A company can re-open its books of accounts or re-cast its financial statements on the below grounds:
  - that the relevant earlier accounts were prepared in a **fraudulent manne**r; or
  - affairs of the company were **mismanaged** during the relevant period casting a doubt on the reliability of the financial statements

  on an application made statutory by regulatory authorities.

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

Impacts

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

Recent updates from MCA

- Update in Companies Act 2013
- Depreciation - Key highlights
- Amendments in Schedule II
- Depreciation of CPP and BOT assets

Update in Companies Act 2013

Applicability of Sections notified by MCA:

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

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

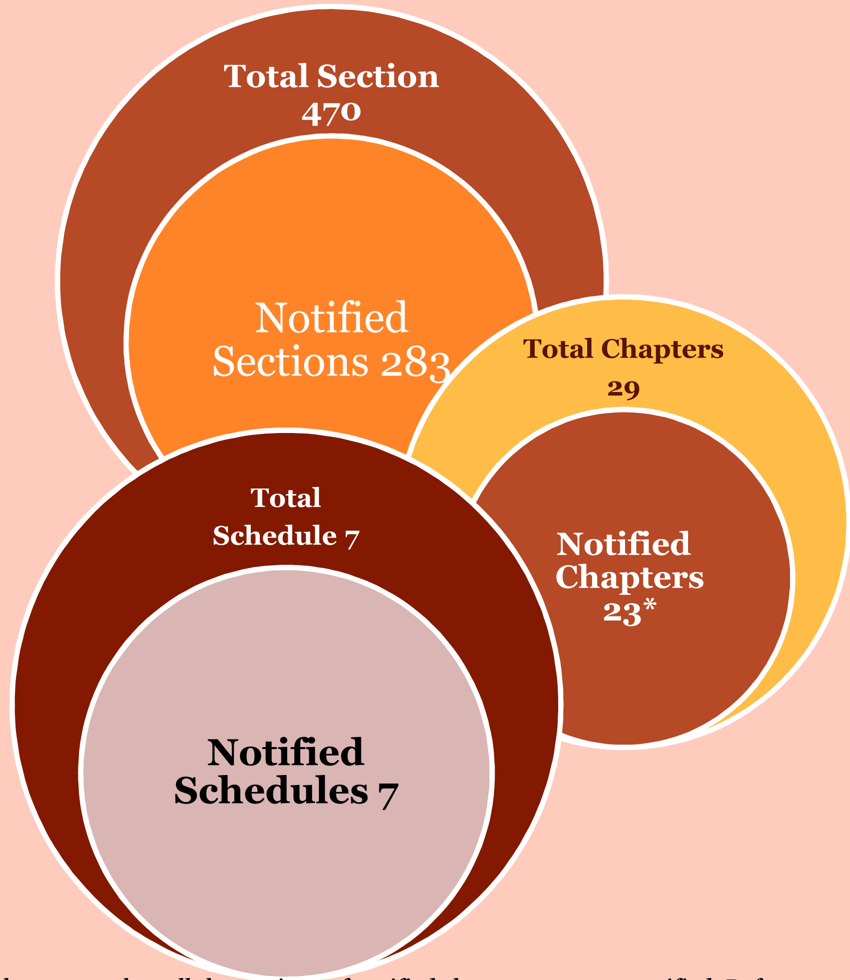
These section would be effective from April 1, 2014, as the same has been clarified by MCA on 4th April 2014 vide its General Circular, stating that the financial statements (and documents required to be attached thereto), Auditor's report and Board report in respect of financial year that commenced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

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

Rules:

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

Statistical snapshot of Companies Act 2013



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

Update in Companies Act 2013 - Rules relating to Accounts

Key provisions given in Rules relating to Accounts

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

The key provisions of these rules has been explained below:

Maintenance of books

- Detailed requirements with respect to **maintenance of accounts** in electronic mode has been given in Rules 3.
- Back up of books maintained in electronic mode (including outside India) to be kept on **servers in India** on a periodic basis
- Certain details regarding the service provider to be intimated to the Registrar Annually

Financial statements, Board report etc.

- Consolidated Financial Statement is to be prepared in accordance with **Schedule III** and the applicable accounting standards.
- In addition to compliance with the accounting standards, Companies are now required to mandate certain additional disclosures given in Schedule III.
- Board's Report to also include a separate section with respect to subsidiaries, associates and JVs

Internal Audit

Applicability:

- Every listed company
- Every unlisted company having:
  - Paid up capital $\geq$ 50 crores
  - Turnover $\geq$ 200 crores
  - Outstanding loans / borrowing $\geq$ 100 crores
  - Outstanding deposit $\geq$ 25 cores
- Every private company having:
  - Paid up capital $\geq$ 50 crores
  - Turnover $\geq$ 200 crores
  - Outstanding loans / borrowing $\geq$ 100 crores

A **transition period** of 6 months has been provided for compliance by existing companies

Depreciation - Key highlights

Key Highlights of Schedule II

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

Depreciation - Amendments in Schedule II

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

Amendments	Impact
➢ Companies are provided with the option of depreciating assets over their useful lives which could be different from the useful lives prescribed in Schedule II. Further, the determination of residual value could also deviate from the five per cent stated in Schedule II.	➢ This move by the MCA is in line with international best practices.
➢ If a company chooses to deviate from the limits indicated in Schedule II, it will be required to disclose a justification for the same in the financial statements.	➢ The requirement to disclose justification for deviation will provide transparency to the users of financial statements.
➢ The notification has clarified that the amortisation of intangible assets created under toll road projects will be depreciated using a revenue based amortisation method. This change reverts back to the position under the erstwhile Companies Act.	➢ Revenue-based amortisation, will maintain status quo for companies having toll road projects.

Amended Schedule II

Depreciation - CPP and BOT assets

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

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

Continuous Process Plant

- Useful life of Continuous Process Plant (CPP) has been increased to 25 years .
- In addition to above, amendment explains that a company can depreciate its CPP over a period shorter or longer than 25 years with proper justification.

Plant working on Double/ Triple shift

- Under Schedule II, no separate rates / lives are prescribed for extra shift working.
- However, it mention that an asset used in double shift depreciation will increase by 50% and by 100% in case of triple shift working.

BOT Assets

- As per amendment to Schedule II to the Companies Act, 2013 a Company was allowed to use revenue based amortisation for intangible assets created under BOT, BOOT or any other form of PPP route.
- For amortisation of other intangible assets, AS 26 needs to be applied.

Transitional Provision:

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

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

Others topics

- Related party transactions:

  Key provisions & Key changes in definitions

- Compromises, arrangements and amalgamations

- Other important topics

Related party transactions – Key provisions

Key provisions

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

Impacts

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

Related party transactions – Key changes

Wider scope of Sec 188:

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

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

Related party transactions – Key changes

Key changes in the definitions:

Particulars	Companies Act 2013	Companies Act 1956
Specified persons with whom contracts are covered Related party Sec 2 (76)	"Related Party" with reference to company means: **i. Director** or his relative; **ii. KMP** or his relative; **iii. firm**, in which a director, manager or his relative is a partner; **iv. private company** in which a director or manager is a member or director ; **v. public company** in which a director or manager is a director or holds along with his relatives, more than 2% of its paid-up share capital; **vi. any body corporate whose BoD**, managing director, or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager; **vii. any person under whose** advice, directions or instructions a director or manager is accustomed to act; **viii. any company** which is— i. a holding, subsidiary or an associate company of such company; or ii. a subsidiary of a holding company to which it is also a subsidiary **ix. such other persons as may be prescribed***	i. Director of the Company ii. Relative of such director iii. A firm in which such director or relative is a partner iv. Any other partner of such firm in which director or relative is a partner v. Private Company in which such director is a director or member

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

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

Compromises, arrangements and amalgamations

- The Companies Act, 2013 features some new provisions in the area of mergers and acquisitions, apart from making certain changes from the existing provisions. While the changes are aimed at simplifying and rationalising the procedures involved, the new provisions are also aimed at ensuring higher accountability for the company and majority shareholders and increasing flexibility for corporates.

- These changes are quite constructive and could go a long way in streamlining the manner in which mergers and other corporate scheme of arrangements are structured and implemented in India. These are:
  - **Streamlining requirements:** The section dealing with compromises and arrangements, deals comprehensively with all forms of compromises as well as arrangements, and extends to the reduction of share capital, buy-back, takeovers and corporate debt restructuring as well.

  - **Mergers or division of companies:** There are certain additional documents mandated to be circulated for the meeting to be held of creditors or a class of members

  - **Certifying the accounting treatment**: Currently, under the Companies Act 1956, there is <u>no mandate requiring companies to ensure compliance with accounting standards</u> or generally accepted accounting principles while proposing the accounting treatment in a scheme. However, listed companies are required to ensure such compliance as the Equity Listing Agreement mandates such companies to obtain an auditor's certificate regarding appropriateness of the accounting treatment proposed in the scheme of arrangement. **Companies Act 2013 requires all companies undertaking any compromise or arrangement to obtain an auditor's certificate**. This requirement will help in streamlining the varied practices as well as ensuring appropriate accounting treatment.

  - **Simplifying procedures:** The current procedural requirements in case of a merger and acquisition in any form are quite cumbersome and complex. There are no exemptions even in the case of mergers between a company and its wholly owned subsidiaries. The Companies Act 2013 now introduces simplification of procedures in two areas, firstly, for holding wholly owned subsidiaries and secondly, for arrangements between small companies

Other important topics

- **Utilisation securities premium:**

  As per Companies Act, 2013, prescribed class of companies will not be allowed to use the securities premium for the following key purposes:
  - issue of fully paid preference shares as bonus shares
  - writing off preliminary expenses of the company
  - writing off debentures and preference shares issue expenses
  - providing for premium payable on redemption of preference shares / debentures

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

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

- **Free reserves:**

  As per Companies Act, 2013, free reserves means 'such reserves which, as per the latest audited balance sheet of a company, are **available for distribution as dividend**; Provided that
  - Any amount representing unrealized gains, notional gains or revaluation of assets, whether shown as a reserves or other otherwise or
  - Any change in carrying amount of an asset or of a liability recognise in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value
    Shall not be treated as free reserves.

- **Debenture redemption reserve:**

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

Rakesh Agarwal
Vice President,
Finance, Compliance and Accounts
Centers of Excellence (CoE)
Reliance Industries Limited
rakesh.r.agarwal@ril.com
+91 9820273458