Companies Act, 2013 – An Overview of Some Salient Requirements Relating to Auditor's Report

The Companies Act, 2013 is a significant shift from the erstwhile Companies Act, 1956 in several aspects related to Corporate Governance, Compliances and Auditor's power, duties and rights. The Government has tried to strengthen Corporate Governance as a whole and bring in more transparency. Statutory auditors, through their audit report, act as an important link-pin between the company and the various stakeholders and, hence, are essential pillars in the corporate governance framework. Section 143 of the Companies Act, 2013 contains several important provisions relating to information to be provided by the auditors through their audit report. Read on…

Section 143(1) of the Companies Act, 2013 contains certain matters to be inquired into by the statutory auditors. This section is more or less similar to Section 227(1A) of the Companies Act, 1956. It also requires the statutory auditors to inquire into certain matters stated in the section. The statutory auditor is, however, required to report on those matters only in case of any negative observation in respect of any of those matters.

The requirements relating to expression of true and fair view on the financial statements in the auditor's report are governed by Section 143(2) of the Act. Section 143(2) corresponds to Section 227(2) though with some evident differences.

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Section 143(3) of the Act contains additional matters on which the auditor has to make a report. Some of these matters are like statements of facts to be reported upon by the statutory auditors, meaning that the auditors have to report on these in all cases. On the other hand, some of the clauses contain requirements whereupon, as is implied from the language of the clauses, the statutory auditors would be required to report only if the conditions/situation envisaged in those clauses exists. **The following are the clauses on which the statutory auditors would need to report in all circumstances:**

Clause 143(3)(a)- Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements

Clause 143(3)(b)- Whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him.

Clause 143(3)(c)- Whether the report on the accounts of any branch office of the company audited under sub-Section (8) of Section 143, by a person other than the company's auditor has been sent to him under the proviso to that sub-Section and the manner in which he has dealt with it in preparing his report.

Clause 143(3)(d)- Whether the company's balance sheet, profit and loss account dealt with in the report are in agreement with the books of account and returns.

Clause 143(3)(e)- Whether, in his opinion, the financial statements comply with the accounting standards.

Clause 143(3)(g)- Whether any director is disqualified from being appointed as a director under sub-Section (2) of Section 164.

Clause 143(3)(i)- Whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.

Clause 143(3)(j)- Such other matters as may be prescribed. These matters are prescribed by the Companies (Audit and Auditors) Rules, 2014, namely:

a. Whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statements
b. Whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts.
c. Whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

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The following are the clauses whereupon the statutory auditors would be required to report only if there are matters reportable under these clauses:

Clause 143(3)(f)- The observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company.

Clause 143(3)(h)- Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.

The Institute of Chartered Accountants of India has issued the Guidance Note on Reporting under Section 143(f) and (h) of the Companies Act, 2013. The following paragraphs discuss the salient requirements of this Guidance Note.

Clause (f)- The observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company

The term "adverse effect on the functioning of the company" has not been defined anywhere in the Act. To avoid any confusion as to the responsibilities of the statutory auditors in this case, the Guidance Note clearly mentions that this expression should not be interpreted to mean that any event affecting the functioning of the company, observed by the auditor, should be reported upon even if it does not affect the financial statements. Accordingly, while reporting under this clause, the following matters (as included in the auditor's report in respect of the financial statements) need to be considered by the statutory auditors:

- A qualification/adverse/disclaimer opinion given in accordance with Standard on Auditing (SA) 705, *Modifications to the Opinion in the Independent Auditor's Report*
- If relevant, an emphasis of matter (EoM) given in the auditor's report in accordance with Standard on Auditing (SA) 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*
- Any negative observation/comment on any clause under Section 143(1), if the same leads to a modified opinion

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As per the Guidance Note, examples of such EoM paragraphs that deal with matters that may have an adverse effect on the functioning of the Company include:

- Those dealing with Going Concern issues
- Those matters that will significantly impact operations of the company due to their size and nature:

Thus, in other words, the following need not be considered by the auditor in reporting under this clause:

- Adverse events that have no effect on the financial statements. As an example of this situation, the Guidance Note mentions revocation of a license to manufacture one out of the many products during the year to which the financial statements relate, where such product that does not have any material contribution to the revenues of the company, etc
- Modifications of opinion/Emphasis of Matter paragraph in respect of matters not involving matters having "adverse effect"

Clause 143(3)(f) requires the statutory auditor to report any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.

In connection with reporting on this clause, the Guidance Note draws attention to the following important provisions of the Companies Act 2013:

- Section 2(13) which states that the books of account includes records for Receipts & expenditure, Sales and purchase of goods and services, assets and liabilities and Items of cost as referred to in section 148
- Section 128 which requires a company to prepare and keep books of account and other relevant books and papers and FS that give true and fair view
- Section 129(1) which provides that all financial statements should to comply with the Accounting Standards notified under Section 133 of the said Act.

The statutory auditor's duties in this regard have been clearly laid down by the aforesaid Guidance Note, viz.,

- The statutory auditors would need to make a report under this clause in the following situations:
  - If the auditor's report contains a modified opinion that could have consequential/ possible effects on books of account or matters connected therewith
  - If the auditor's report in respect of clause 143(3)(b) ie, "whether in his opinion, proper books of account as required by law have been kept by the company so far as it appears from his examination of those books and proper returns for the purposes of his audit have been received from the branches not visited by him", is in negative
  - If there is a material weakness in the internal financial controls that result in a modified opinion on the financial statements.
- The statutory auditors would not need to make a report under this clause in the following situations:
  - If the auditor's report contains an EoM paragraph then the matter covered by the EoM paragraph will not be considered. This is because the terms used in the Act are "qualification/reservation/adverse remark" and EoM *per se* is none of these
  - A material weakness under internal financial controls that does not result in modification of opinion on the financial statements.

In addition, the statutory auditors are also required to report on the Companies (Auditor's Report) Order, 2015 issued by the Central Government in terms of exercise of its power under ection 143(11) of the said Act. Since the eleven clauses included in this 2015 CARO are primarily similar to those in the CARO 2003, the Statement on CARO, 2003 issued by ICAI can be referred to by the statutory auditors for guidance on reporting on CARO 2015. ICAI has issued an announcement on the relevant paragraphs of the Statement *vis-a-vis* various clauses of CARO 2015. ■