

Management Services and the Auditors

1. Introduction

[Section 141\(3\)\(i\) of the Companies Act, 2013](#) states any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services as restricted for statutory auditors in [section 144](#), shall be disqualified for appointment as auditor of a company.

1.1. Restricted services for statutory auditors: An auditor shall provide to the company only such services as are approved by the Board of Directors or the audit committee, as the case may be. However, as per [section 144](#) auditors cannot provide following services “*directly or indirectly*” to the company or its holding company or subsidiary company, namely:—

- (a) Accounting and book keeping services;
- (b) Internal audit;
- (c) Design and implementation of any financial information system;
- (d) Actuarial services;
- (e) Investment advisory services;
- (f) Investment banking services;
- (g) Rendering of outsourced financial services;
- (h) Management services; and
- (i) Services prescribed under the Rules

1.2. Meaning of “directly or indirectly interested” by the auditors: “Directly or indirectly” shall include rendering of services by the auditor,—

Where auditor is an individual – Either himself or through his *relative* or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual.

Where auditor is a firm – Either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners.

Relatives [Section 2(77)]: Relative, with reference to any person, means anyone who is related to another, if—(i) they are members of a Hindu Undivided Family ;(ii) they are husband and wife; or

(iii) One person is related to the other in such manner as may be prescribed. As per the provisions of Rule 4 of the [Companies \(Specification of Definitions Details\) Rules, 2014](#) a person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely: —

- (1) Father: Provided that the term “Father” includes step-father.
- (2) Mother: Provided that the term “Mother” includes the step-mother.

- (3) Son: Provided that the term “Son” includes the step-son.
- (4) Son’s wife.
- (5) Daughter.
- (6) Daughter’s husband.
- (7) Brother: Provided that the term “Brother” includes the step-brother;
- (8) Sister: Provided that the term “Sister” includes the step-sister.

1.3. Time allowed to leave the restricted services by the auditors: An auditor or audit firm who or which has been performing any non-audit services on or before the commencement of the Companies Act, 2013 shall comply with the above before the closure of the first financial year after the date of such commencement (that is the maximum time allowed for such a compliance ends on 31.3.2015).

2. Management Services – an analysis:

[Section 144\(h\) of the Companies Act, 2013](#) has restricted the statutory auditors to provide “*management services*” but has not explained the meaning and scope of this expression even till date. The delay in clarification could probably result in non-compliance with [section 144\(h\) of the Companies Act 2013](#) as many auditors may be providing these services even after 31.3.2015.

In the present write up an attempt has been made to analyse the position of the Law in this regard to come to a logical conclusion pending the issuance of some authoritative clarification from MCA and/ or The Institute of Chartered Accountants of India (ICAI).

2.1. Audit accountability under Companies Act, 2013: Para 5(vi) (b) of the “Statement of Objects and Reasons” for the Companies Act, 2013, read as follows:

“Stricter and more accountable role for auditor being retained. Provisions relating to prohibiting auditor from performing non-audit services revised to ensure independence and accountability of auditor. Subject to the maximum prescribed number of companies, the members of a company may resolve that the auditor or audit firm of such company shall not become auditor in companies beyond the number as may be specified in such resolution”

The above theme is enshrined in [Section 144 of the Companies Act, 2013](#) on the same lines as borrowed from Section 201 of the Sarbanes Oxley Act, 2002 [SOX] given below:

“Sec. 201. Services outside the scope of practice of auditors.

(a) PROHIBITED ACTIVITIES. — Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1) is amended by adding at the end the following:

“(g) PROHIBITED ACTIVITIES.— , it shall be unlawful for a registered public accounting firm (and any associated person of that firm, to the extent determined appropriate by the Securities Exchange Commission) that performs for any issuer any audit required..... , to provide to that issuer, contemporaneously with the audit, any non-audit service, including—

“(1) bookkeeping or other services related to the accounting records or financial statements of the audit client;

“(2) Financial information systems design and implementation;

“(3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

“(4) Actuarial services;

“(5) Internal audit outsourcing services;

“(6) Management functions or human resources;

“(7) Broker or dealer, investment adviser, or investment banking services;

“(8) legal services and expert services unrelated to the audit; and

“(9) Any other service that the Board determines, by regulation, is impermissible.”

The following ingredients can be scooped from the above discussion:

(a) The prime motive of introducing the provisions under [section 144](#) is to ensure the enhanced independence and accountability of the auditors;

(b) The non-audit services (forming the subject matter of above discussion) are those services which are primarily the responsibility of the management itself and has no threaded connection with audit and assurance services (*for instance*, those services performed by the auditor which are themselves not the subject matter of audit)

3. Independence of Auditors: Para 1.9 of the Guidance Note on Independence of Auditors state that the auditor should be straight-forward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any Interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity. This is not self evident in the exercise of the reporting function but also applies to all other professional work. In determining whether a member in practice is or is not seen to be free of any interest which is incompatible with objectivity, the criterion should be whether a reasonable person, having knowledge of relevant facts and taking into account the conduct of the member and the member's behaviour under the circumstances, could conclude that the member has placed himself in a Position where his objectivity would or could be impaired.

Para 2.1 of this Guidance Note further states that the Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. These are:

(1) Self-interest threats, which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include:

- (i) direct financial interest or materially significant indirect financial interest in a client,
- (ii) loan or guarantee to or from the concerned client,
- (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement,
- (iv) close business relationship with an audit client,
- (v) potential employment with the client, and
- (vi) Contingent fees for the audit engagement.

(2) Self-review threats, which occur when during a review of any judgment or conclusion reached in a previous audit or non-audit engagement, or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are:

- (i) when an auditor having recently been a director or senior officer of the company, and
- (ii) When auditors perform services that are themselves subject matters of audit.

(3) Advocacy threats, which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes.

(4) Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways:

- (i) close relative of the audit team working in a senior position in the client company,
- (ii) former partner of the audit firm being a director or senior employee of the client,
- (iii) long association between specific auditors and their specific client counterparts, and
- (iv) Acceptance of significant gifts or hospitality from the client company, its directors or employees.

(5) Intimidation threats, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

4. Management – meaning thereof: In accordance with Para 6 of SA 260 on “Communication of Matters to Those Charged with Governance” issued by the Institute of Chartered Accountants of India (ICAI), “management” refers to the *person(s) with executive responsibility for the conduct of the entity’s operations*. For some entities, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner manager. Management is responsible for the preparation of the financial statements, overseen by those charged with governance, and in some cases management is also responsible for approving the entity’s financial statements (in other cases those charged with governance have this responsibility).

5. Management Consultancy Services: As per Section 2(2), a member of the Institute shall be *deemed to be in practice* when individually or in partnership with chartered accountant(s) in practice, he in consideration of remuneration received or to be received:

- (i) engages himself in the practice of accountancy; or
- (ii) offers to perform or performs services involving
 - Auditing; or
 - Verification of financial transactions, books, records; or
 - Preparation, verification or certification of financial accounting statements and related statements or holds himself out to the public as an accountant;
- (iii) renders professional services or assistance in or about matters relating to accounting procedure or the recording, presentation, or certification of financial facts or data; or
- (iv) Renders such other services as in the opinion of the Council may be rendered by Chartered Accountant in practice.

Regulation 190A of the Chartered Accountants Regulations, 1988, states that a chartered accountant in practice cannot engage in any business or occupation other than the profession of accountancy and such other services as may be prescribed by the Council of ICAI. In the opinion of the Council of ICAI, the “other services” that may be rendered by a chartered accountant as described in Section 2(2) (IV) will *include* the entire range of *management consultancy services*, as described below:

- (i) financial management planning and financial policy determination;
- (ii) capital structure planning;
- (iii) working capital management;
- (iv) preparation of project reports and feasibility studies;
- (v) preparing cash budgets and other budgets, cash flow statements, profitability statements etc.;
- (vi) inventory management, price fixation and other management decision making;

- (vii) personnel recruitment and selection;
- (viii) management and operational audit;
- (ix) advice regarding mergers and amalgamations;
- (x) systems analysis and computer related services;
- (xi) acting as advisor or consultant to an issue, including matters such as:
 - Drafting of prospectus and memorandum containing salient features of prospectus;
 - Drafting and filing of listing agreement and completing formalities with Stock Exchanges, ROC and SEBI;
 - preparation of publicity budget;
 - Advice regarding selection of various agencies connected with issue such as Registrars to Issue, printers and advertising agencies;
 - Advice on post issue activities;
- (xii) investment counselling in respect of securities as defined in SCRA, 1956 and other financial instruments;
- (xiii) acting as Registrar to an Issue and for transfer of shares/other securities;
- (xiv) quality audit, environment audit, energy audit;
- (xv) acting as Recovery Consultant in the Banking sector;
- (xvi) Insurance financial advisory services under IRDA, 1999, including insurance brokerage.

It is to be noted that the activities of *brokering, underwriting and portfolio management are not permitted*.

6. Management Services – interpretation: The expression “management services” as used in [section 144\(h\) of the Companies Act, 2013](#) thus should be interpreted on the basis of the above mentioned in-principle discussions and should be supplemented by the following further interpretational guidance:

6.1. Preamble or statement of object and reasons can be used for interpretation of the provisions: A preamble to a statute is a preliminary statement of the objects and reasons (*supra*) which have made the passing of the statute desirable, and its position is immediately after the title. It may also be used to introduce a particular section or a chapter. The policy and purpose of a given measure may be deduced from the title of the Act and the preamble thereof [*In re Kerala Education Bill 1957 AIR 1958 SC 956*]. Preamble is a key to open the mind of the Legislature but it cannot be used to control or qualify the precise and unambiguous language of the enactment. It is only when there is doubt as to the meaning of a provision that recourse may be had to the preamble to ascertain the reasons for the enactment and, hence, the intention of the Parliament [*Tribhuban Parkash v. Union of India AIR 1970 SC 540*].

6.2. External aids – References to statutes *pari materia* – Interpretation of a provision with reference to provisions of another enactment is permissible when the two Acts are in *pari materia* – (*Board of Muslim Wakfs v. Radha Kishan AIR 1979 SC 289* and *Sanjiv V. Kundva v. CIT [1981] 127 ITR 354 (Kar.)* and Also *Balchandra Anant Rao Rakvi v. Ramchandra Tukaram [2001] 8 SCC 616*). Thus, in the absence of a statutory definition, it would be open to look for the meaning by reference to definitions in the sister legislation and failing that to adopt the meaning in common parlance. Statutes are considered to be in *pari materia* to pertain to the same subject-matter, when they relate to the same person or thing, or to the same class of persons or things, or have the same purpose or object. Assistance in ascertaining the meaning of an enactment may be obtained by comparing its language with that used in earlier statutes relating to the same subject. Light is thrown on the meaning of a phrase in a statute by reference to a specific phrase in an earlier statute dealing with the same subject-matter. Subsequent statute by the same Legislature can be pressed in aid for the purpose of interpreting, in the event of any doubt, the provisions in earlier statute. Similarly, the earlier statute can be made use of for the purpose of construing, in the event of ambiguity, if any, the provisions of the later statute. [*Sirsluk Ltd. v. Textile*]

Committee [1989] 1 CLA SC 216 and Century Spinning Mfg. Co. Ltd. v. Textile Committee [1989] 1 CLA SC 216].

6.3. Interpretation to be made in a manner that suppresses the mischief and provides the remedy:

In *R.M.D. Chamarbaugwalla v. Union of India* AIR 1957 SC 628, Venkatarama Ayyar, J, stated the rule of interpretation of a statute thus (p. 631) :

“Now, when a question arises as to the interpretation to be put on an enactment, what the court has to do is to ascertain ‘the intent of them that makes it’, and that must of course be gathered from the words actually used in the statute. That, however, does not mean that the decision should rest on a literal interpretation of the words used in disregard of all other materials. ‘The literal construction then’, says *Maxwell on the Interpretation of Statutes*, 10th edn., p. 19, ‘has, in general, but *prima facie* preference. To arrive at the real meaning, it is always necessary to get an exact conception of the aim, scope and object of the whole Act; to consider, according to Lord Coke: (1) What was the law before the Act was passed; (2) What was the mischief or defect for which the law had not provided; (3) What remedy Parliament has appointed; and (4) The reason of the remedy. The reference here is To *Heydon’s* case [1584] 3 Co. Rep. 7a; 76 ER 637 (A-1). These are principles well-settled, and were applied by this court in *Bengal Immunity Co. Ltd. v. State of Bihar* [1955] 6 STC 446 (SC); [1955] 2 SCR 603 at p. 633; AIR 1955 SC 661 at pp. 674-675. To decide the true scope of the present Act, therefore, we must have regard to all such factors as can legitimately be taken into account in ascertaining the intention of the Legislature, such as the history of the legislation and the purpose thereof, the mischief which it intended to suppress and the other provisions of the statute.

Management services vis-à-vis management consultancy services: The readers should note that [section 144\(h\) of the Companies Act, 2013](#) has used the words “managements services” while section 2(2)(iv) of the Chartered Accountants Act, 1949 read with Regulation 190A (*supra*) have used the words “management consultancy services”. In this regard, attention of the readers is invited to the provisions of Clause 11 of Part I of the First Schedule to the Chartered Accountants Act, 1949 which provides that a practicing member shall be deemed to be guilty of professional misconduct.....:

“Clause 11: If he engages in any business or occupation other than the profession of chartered accountants, unless permitted by the Council to so engage;

Provided that nothing contained therein shall disentitle a chartered accountant from being a director of a company (Not being managing director or a whole time director), unless he or any of his partners is interested in such company as an auditor.”

Thus, it follows that the scope of [section 144\(h\) of the Companies Act, 2013](#) cannot go beyond section 2(2) (IV) and Regulation 190A (*supra*), in light of the provisions contained in aforementioned Clause 11 of Part I of the First Schedule to the Chartered Accountants Act, 1949.

Consider the following tabular discussion for the company ABC Limited:

Nature of Service(s) provided by CA ‘X’ to ABC Limited	Whether Permitted Service/ Management Consultancy Services under Reg. 190A read with Section 2(2)(i) to (iv) above	[1]Whether Management Services under Section 144(h)	Can CA ‘X’ be appointed/ continued as a statutory auditor of ABC Limited	Can CA ‘X’ be appointed/ continued as a statutory auditor of PQR Limited (not connected with ABC Limited)
Project Reports/ CMA Data	Yes	Yes	No	Yes

Depositing tax on behalf of the client	Yes	Yes[may even be categorized as outsourced financial services]	No	Yes
Filing of ITR/ VAT/ TDS/ Service Tax Returns	Yes	No	Yes	Yes
Tax Audit	Yes	No	Yes	Yes
Portfolio Management Services/ Brokering Services/ Underwriting Services	No[this will result in professional misconduct under Chartered Accountants Act, 1949, since such a service is not permitted by the Chartered Accountants Act, 1949]	Yes	No	Yes[assumed that CA 'X' is not removed from register of members pursuant to the professional misconduct]

7. Conclusion

Thus, whether a particular service falls within management service under [section 144\(h\) of the Companies Act, 2013](#) and hence is restricted, should be assessed on the following considerations:

1. Whether the service is within the purview of management services read with Regulation 190A (*supra*);
2. Whether by rendering such a service the auditor is *not* performing any managerial function or *not* making any managerial decisions;
3. Whether the auditor is merely reviewing and reporting on the work done by the audit client or by a third-party specialist employed by the audit client because, in such a situation the “third party or the audit client is the source of the financial information subject to the review or audit” and “the auditor will not be reviewing or auditing his or her own work.

If the answers to above three considerations are in affirmative (on *cumulative basis*) then in author's view such a service is not restricted under [section 144\(h\) of the Companies Act, 2013](#). For instance:

S. No.	Nature of Service	Whether restricted under Section 144(h)
1.	Filing VAT/ Service Tax Returns	No, because such a service merely is a facilitation service for a client whereby information about sales/ services etc. are being furnished to the department and such filing is not a source of the financial information subject to the review or audit
2.	Filing IT/ TDS Returns	No, because such a service merely is a facilitation service for a client whereby information about income chargeable to tax etc. are being furnished to the department and such filing is not a source of the financial information subject to the review or audit
3.	Filing ROC forms which are not to be certified by any professional	No, because such a service merely is a facilitation service for a client whereby information about various corporate events, transactions, etc. are being furnished to ROC for seeking various approvals, for updating such events, etc. and such filing is not A source of the financial information subject to the review or audit. In other words, these forms are the object documents

4.	Issuing opinions on Tax, FEMA or other issues	Yes, because such a service <i>may</i> result in such an opinion being subsumed as a source Of the financial information subject to the review or audit.
5.	Preparing CMA data, etc	Yes, because such a service would result in information which would be considered as a source of the financial information subject to the review or audit while applying (e.g.) Analytical procedures during audit examination.
6.	Representation services	Depends upon facts and circumstances of each case. For instance, representing an income tax case before Tribunal <i>may</i> impact assessment of contingent liabilities under AS 29.
7.	Computation and depositing tax on behalf of the client	Yes, because such a transaction will be a source of the financial information subject to The review or audit.
8.	Computation or depositing tax on behalf of the client	(i) Computation of tax on behalf of the client – yes because it will be a source of the financial information subject to the review or audit.(ii) Depositing of tax on behalf of the client – <i>might not</i> be management service but can be categorized as outsourced Financial service u/s 144(g) .
9.	Transfer Pricing Study	Yes, because the auditor is performing managerial function or making any managerial decisions and such a study is also a source of the financial information subject to the Review or audit.
10.	Share Valuation services	Yes, because the auditor is performing managerial function or making any managerial decisions and such a valuation is also a source of the financial information subject to the Review or audit.
11.	Personnel recruitment and selection	Yes, because the auditor is performing managerial function or making any managerial decisions and such a service also gets subsumed as a source of the financial Information subject to the review or audit.

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