NFRA Consultation Paper on Statutory Audit and Auditing Standards for Micro, Small and Medium Companies (MSMCs)—dt 29.09.2021

1. NFRA - Background

As per section 132 of the Companies Act, 2013 (the Act), the Central Government may, by notification, constitute a **National Financial Reporting Authority (NFRA)** to provide for matters relating to accounting and auditing standards under this Act.

NFRA is an independent regulator to oversee the auditing profession and accounting standards in India under the Companies Act 2013. It came into existence in October 2018.

NFRA has wide powers and Section 132(2)(a) of the Act states that NFRA shall :

(a) Make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be;
(b) Monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed;
(c) Oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed; and
(d) Perform such other functions relating to clauses (a), (b) and (c) as may be prescribed.

2. NFRA Consultation Paper on Statutory Audit and Auditing Standards for Micro, Small and Medium Companies (MSMCs)"

On 29 September 2021 NFRA has issued ***"NFRA Consultation Paper on Statutory Audit and Auditing Standards for Micro, Small and Medium Companies (MSMCs)"*** for comments by its stakeholders. The last date for receipt of the comments was 10 November 2021.

It was considered that overall regulatory framework should be proportional to the size and type of the entities that are subject to such regulations. In order to understand issues related to compliance with the regulatory framework specifically by smaller size companies, NFRA has done a preliminary analysis on the key financial parameters of the companies registered in India which have made MCA-21 filings.

The focus of the analysis is ***companies with Net worth below Rs. 250 crores. These companies are referred to as Micro, Small and Medium companies (MSMCs)*** for the purpose of this Consultation Paper. The data on MSMCs analysed by NFRA includes key features of their financial statements, and the primary users of the ***General Purpose of Financial Statements (GPFS)*** of such Companies.

3. NFRA invited comments on following four specific questions

1. Do you think MSMCs depending upon some criteria and threshold should be exempted from the mandatory statutory audit under Companies Act, 2013?
2. Do you think there is a requirement for a separate set of auditing standards for MSMCs as it exists for accounting standards?
3. The cost of conducting an audit as per the prescribed standards is an important input for the responses to Questions 1 and 2. Do you agree with the approach for estimating standard cost of audit computed by NFRA?
4. Do you think the current exemption thresholds for CARO, ICFR and statutory audit applicability need to be standardized and made uniform?

4. Journey of the Companies Act in India

- **The Joint Stock Companies Act, 1857**
- **The Companies Act,1866**
- **The Indian Companies Act, 1913**
- **The Companies Act, 1956 (under Chairmanship of Shri H.C.Bhabha)**
- **The Companies Act, 2013**

5. Provisions of Audit under the Companies Act, 2013

The requirement of statutory audit is mandatory for all companies, without any exception. Section 139(1) prescribes that every Company shall appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

Section 143(2) casts a duty on the auditor to make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under the Act to be laid before the company in general meeting.

6. The CARO Reporting

CARO 1976 → **MAOCARO, 1988** → **CARO, 2003** → **CARO, 2015** → **CARO, 2016** → **CARO, 2020**

7. Accounting Standard & Ind AS --(AS) /(SA) & Ind AS

In the year 1977, Institute of Chartered Accountants of India (ICAI) had, constituted the Accounting Standards Board (ASB) to formulate the accounting standards to be used in the preparation and presentation of general-purpose financial statements. ASB of ICAI is responsible for setting accounting standards (AS).

The Ind AS are converged with the International Financial Reporting Standards (IFRS). IND AS is applicable to

- Every Listed Company.
- Every Unlisted Companies with Net worth greater than or equal to Rs. 250 crore but less than Rs. 500 crore in previous four FY

As on date Ministry of Corporate Affairs (MCA) has notified 41 Ind AS.

Currently, there are two sets of accounting standards notified in India.

a. AS (Accounting Standards) Traditional accounting standards applicable in India before notification of Ind AS Companies (Accounting Standards) Rules, 2021
b. Ind AS (Indian Accounting Standards) IFRS based standards with carve outs Companies.

8. Statistics & Data

NFRA has researched companies having net worth below Rs.250 Crores on key data parameters of ***payment to auditors, turnover , indebtedness & public interest involved.***

The parameters of payment to auditors are compared with the standard cost of audit with good quality audit in compliance with letter and spirit of the accounting standards.

It is also compared with the exemption from the statutory audit requirements existing in developed countries like UK, Singapore, Australia, USA and Japan.

9. Global practice

In European Union , UK , Singapore and Australia:
It is considered as significant administrative burden. Criteria for small company is satisfaction of 2 of 3 criteria that is balance sheet total, net turnover and average number of employees during the FY. The amount of the thresholds are different in all these countries ranging turnover or revenue from not more than 10 million to 25 million, assets not more than 5 million to 12.5 million and number of employees not more than 50.

In USA: Only listed company are regulated by US Stock Exchange and unlisted companies are regulated as per State law which needs declaration from president or person responsible for the corporation's accounting records stating that the financial statements are prepared on accepted accounting principles , if not describing the basis of preparation.

In Japan: Only certain large companies must be audited by an independent CPA. The requirements are as follows:

(i) Large companies: Capital stock of ¥500 million or more, or liabilities of ¥20 billion or more, as of the latest fiscal year-end;
(ii) Companies which adopt a "Company with Committees" corporate governance system; &
(iii) Other companies which appoint an accounting auditors on a voluntary basis.
The above requirements are subject to certain PIEs covered under The Financial Instrument and Exchange Act.

Companies registered in India:

Company Type	31 March, 2021	
	Number	Percentage (%)
Private Limited of which- (A)	**12,33,768**	**94.93**
Private Limited	11,97,244	92.12
One Person Company	36,524	2.81
Public of which – (B)	**65,942**	**5.07**
Listed	6,740	0.52
Unlisted	59,202	4.56
Total (A) + (B)	**12,99,710**	**100**

Payments to Auditors:

Sr. No.	No. of MSMCs	Payment to Auditors	Percentage (%)
1	1,81,392	NIL	30.26
2	40,708	< Rs.5,000	16.40
3	207,510	<Rs.25000/-	25.01

Turnover:

Sr. No.	No. of MSMCs	Turnover	Percentage (%)
1	2,09,122	NIL	34.88
2	3,67,019	< Rs. 50 Crores	61.2

Indebtedness:

Sr. No.	No. of MSMCs	Indebtedness	Percentage (%)
1	2,66,832	NIL	44.51
2	1,12,043	NIL Turnover (Debt-Free)	41.99

Net Worth Size:

Sr. No.	No. of Companies	Cumulative Net Worth (in Rupees)
1	4,76,536	Positive 21,37,302 Crores
2	1,22,951	Negative 9,50,457 Crores

10. Issues related to Audit as per NFRA

a. Payment to Auditor & Quality of Audit and it's a sham
b. Cost of compliances & *Ease of Doing Business (Cost of compliance is never a parameter for Ease of Doing Business)
c. Low public interest as essentially family owned enterprises but formed as Limited Liability Company for taking bank loan, bus route permits, mining licenses etc (a big question on not having public interest directly or indirectly)
d. Private Audit can be done by Banks and External Investors

   * 11 Indicators for Ease of Doing Business are (1)Starting a Business (2) Dealing with Construction Permits (3) Getting Electricity (4) Registering Property (5) Getting Credit (6) Protecting Minority Investors (7) Paying Taxes (8) Trading across Borders (9) Enforcing Contracts (10) Resolving Insolvency and (11) Dealing with Construction permits.

11. Views of CAs, MSMCs, other Professionals

Many businessmen do not find the fees under the audit too high or a burden and are worried that the removal of such audits might cast doubts on their business' representation and certification in the eyes of banks, investors, vendors, rating agencies and even by the regulators.

The credibility of businesses is indeed one subject that might come under scrutiny if the mandatory audit is done away with as the data through the audit serves as a certificate of reliability of accounting information.

Some experts are of the view that the exemption limit should be based on a company's turnover instead of net worth so that the exemption would actually help smaller companies and not weaken the regulatory oversight of bigger ones. There is no need to have a new definition of MSMCs linked with the Net Worth (below Rs.250 Crores). Suggestion is that only small enterprise with turnover less than Rs.50 Crores and having no Bank loans or third party borrowings may be exempted from statutory Audit.

In fact bring LLP and traditional Partnership Firms which has turnover beyond threshold limit and have borrowings from Bank should be under the net of statutory audit. NFRA may suggest tools to improvise reporting instead of done away with Audit for almost 95% to 97% of companies in India.

There could be one Integrated Report covering number of other Audits but Audit cannot be done away with for the benefit of the Society, Business and Governance and lastly for the Professionals.

Some experts are of the view that audits are not necessary as all information of transactions is recorded in bank statements and GST returns.

Experts have view that Audit brings value addition in reporting of financials and discipline in business. All limited liability company has more credibility due to the data available on public domain and certified by professionals with qualification or remarks.

The Digitization, Ecosystem, Governance does not give level playing field to compare India with Developed countries, where majority companies are professionally managed and in India majority are family owned.

If there is trust deficit in Audit Report MCA may tighten the norms but for that reason is it wise to do away with the Audit itself.

As per NFRA statement, the Institute of Chartered Accountants of India (ICAI) has furnished an approach paper for revising the existing Accounting Standards of companies that are not needed to obey the Indian Accounting Standards (Ind AS). The paper furnished to the NFRA asked for texts of 18 improved accounting Standards (AS) out of the sum of 32 improved AS which is urged to be noted at the finish of the AS revision report.

12. Some Questions

1. Is Audit a Burden? Is Audit not one of the Pillar of Governance bringing Accountability, Credibility and Responsibility?
2. Which other source of information will be credible?
3. Payment of fees is never a concern for Ease of Doing Business.
4. Suggest steps to improvise quality of Audit Report.
5. How to address requirement of each stakeholders which is varied
6. Whether a separate format for small companies may be devised?
7. If necessary, a separate Accounting Standard may be framed for small companies?
8. NFRA consultation paper (Para 4.1) states that Banks or external investors, if any, can direct to have audit for giving them loans, but that can be private matter. When MSME is a company with limited liability, how anything can be private and not disclosed on public domain raising questions on transparency?

13. Possible Outcome

Views of ICAI & NFRA are incongruous on this subject matter. MCA has not yet decided to either revise Accounting Standards or remove statutory audit for MSMCs. If MCA goes with the views of NFRA then MSMEs may not be required to conduct the compulsory statutory audit anymore.

Can this prove to be good news for small and medium-sized companies looking for ease of doing business as currently, all companies, big or small are required to conduct a compulsory audit as per Indian laws? The views of MSMCs are that they are not burdened and credible data is made available by them to their stakeholders.

Can this not prove to be a blunder or disaster considering the Frauds being reported more frequently and there is less degree of integrity, honesty and transparency in the governance and reporting system and the entire ecosystem?

Can we have roads without traffic signals where light or heavy vehicles are passing ? Without any discipline, self- governance and culture of compliance, will it not create chaos and accidents?

Disclaimer: Views are all personal. This brief article is just for sharing of views and not considered as solicitation of any business or services.

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