THE COMPANIES ACT, 2013- SIGNIFICANT CHANGES IN RESPECT OF ACCOUNTS, FINANCIAL STATEMENTS, RELATED PARTY TRANSACTIONS

1. Financial year - Section 2 (41) (Corresponding Section 2 (17))

It is mandatory for all the companies / body corporate to follow single financial year, i.e. April-March. Further, transition period of two years is provided for existing companies to re-align their financial year. The Company can follow different financial year if:

- Company is incorporated on or after 1st day of January. In such case financial year shall be upto 31st day of March of the following year.
- Company is a subsidiary or a holding of a foreign company. In such case it can follow a different financial year with the approval of Tribunal.

2. Books of account - Section 128 (Corresponding Section 209)

- Company may keep books of account or other relevant papers in electronic mode in such manner as per the rules prescribed. Further, punishment for failure to comply with the provisions relating to keeping of books of account has been increased.
- Books of account need to be retained for a period of 8 years. However, in case investigation under the Act is ordered, books of account have to be kept for a longer period as may be directed.

3. Financial statements - Section 2 (40) (New definition), Section 129 (Corresponding Section 210, 211, 212)

- Financial statements is now defined and it comprises of balance sheet, profit and loss account, cash flow statement, statement of changes in equity (if applicable) and any explanatory note annexed to and forming part of financial statements. However, financial statements of One Person Company, Small Company and Dormant Company may not include cash flow statement.
  - Accordingly SMC (Small and Medium Company) as per Companies Accounting Standard Rules, 2006 having a turnover upto Rs. 50 crores which were earlier exempted from preparing Cash Flow Statement (CFS) are now required to prepare cash flow statement. However as mentioned above, small companies as defined will be exempt from preparation of CFS.
- Financial statements shall be prepared as per the format provided in Schedule III for different class or classes of Companies. These formats are similar to existing Revised Schedule VI. Instructions for preparation of consolidated financial statements have been added.

- Mandatory Consolidation
    - In case the Company has subsidiaries, consolidated financial statements of all subsidiaries and the holding Company shall be prepared and placed before the Company in Annual General Meeting.
    - For the purpose of consolidation of financial statements "Subsidiary" includes associate company and joint venture. Accordingly, now Companies not having any subsidiary but only associate company /joint venture would also have to prepare consolidated financial statements.
    - Further, definition of subsidiaries prescribes that control of more than 50% of the total share capital (i.e. including preference shares) is required as against control of more than 50% of equity share capital under the Companies Act, 1956. Consequently, investment in only preference shares may also require consolidation. This could lead to several challenges and issues.
    - Associate Company is defined as a Company in which the other Company has significant influence i.e. control of (a) at least 20% of total share capital, or (b) of business decisions under an agreement. This definition is different as compared to Accounting Standard 23, which refers to only participation in financial and/ or operating policies and not control over those policies.

4. Signing of financial statements – Section 134 (Corresponding Section 215, 216, 217)

Financial statements of the Company are now required to be signed by following:

- Either (i) Two directors (out of which one shall be MD) or (ii) Chairperson if authorized by board
- CEO (if he / she is director),
- CFO (if appointed)
- Company Secretary (if appointed)

5. Central Government to prescribe Accounting Standards – Section 133 (Corresponding Section 211)

Company has to comply with the Accounting Standards prescribed by Central Government in consultation with and after examination of recommendations made by the National Financial Reporting Authority (NFRA). Since NFRA has not been constituted it has been clarified that existing Accounting Standards will continue to apply. This section has been notified and effective from 12th September, 2013.

6. **Re-opening of accounts on court or tribunal's order - Section 130 (New Provision)**

- Re-opening of accounts can be done on an application made to the court or tribunal by Central Government, Income Tax, SEBI, any other regulatory body or any person and order has been made by the court or tribunal concluding that:
  - Accounts are prepared in a fraudulent manner, or
  - Affairs of the Company were mismanaged during that period.
- Accounts so revised shall be final.
- There is no time limit prescribed for re-opening of accounts.

7. **Voluntary revision of financial statements - Section 131 (New Provision)**

- Company may prepare revised financial statements, if Board is of the opinion that financial statements do not comply with provisions of Section 129 (financial statements) and Section 134 (financial statements and board report). For this, Company has to obtain the approval of tribunal. Other salient features are as under:
  - Revision of accounts is allowed only for 3 preceding financial years
  - Revision will be made for all the subsequent periods
  - Company cannot revise accounts more than once in a financial year
  - Detailed reason for revision shall be disclosed in board's report in the relevant financial year in which revision is made
  - If revised financial statements are audited by a different auditor, then consent letter from original auditor is required to be obtained and if Company is not able to obtain the consent letter then reason for the same needs to be mentioned.

8. **Depreciation - Schedule II (Corresponding Schedule XIV)**

- Depreciation has to be calculated as per Schedule II which prescribes useful life for each class of the asset instead of rate of depreciation prescribed in Schedule XIV of the Companies Act, 1956. Depreciation is to be calculated by dividing original cost less residual value with useful life. Consequently, written down value method is done away with.
- Useful life greater than life as prescribed by Schedule II is permitted only in the case of prescribed class of companies.
- Some additional items are included along with their useful lives, such as:
  - Building (Other than Factory building) with RCC based frame structure and other than RCC based frame structure – 60 years and 30 years respectively

- Carpeted roads with RCC based and other than RCC based frame structure and non-carpeted roads – 10 years, 5 years and 3 years respectively
- Servers and desktops/laptops – 6 years and 3 years respectively
- In respect of plant and machinery, industry wise useful life is covered for industries like steel, pharma, civil construction, etc.

- In case, cost of the part of an asset is significant to the total cost of an asset and useful life is different than the remaining asset, useful life of such significant part shall be determined separately.

- Depreciable amount includes cost of an asset or other amount substituted for its cost less residual value. Thus additional depreciation charged on revaluation of asset is also charged to the profit and loss account and corresponding amount would be transferred from revaluation reserve to general reserve. This would affect the results in case of companies which have opted for revaluation of assets and may affect the amount available for distribution of dividend.

- Significant increase in the rate of depreciation of commonly used assets as compared to Schedule XIV rates under Companies Act, 1956

Nature of asset – Illustrative	**Companies Act, 2013**		**Companies Act, 1956**	**Increase**	**% change**
	Useful life	**Deemed rate**			
General Plant and Machinery other than continuous process plant	15	6.33%	4.75%	1.58%	33.33%
General furniture and fittings	10	9.50%	6.33%	3.17%	50.08%
Office equipment	5	19.00%	4.75%	14.25%	300.00%
Desktops, laptops, etc.	3	31.67%	16.21%	15.46%	95.35%
Electrical Installations and Equipment	10	9.50%	4.75%	4.75%	100.00%

Note 1: deemed rate is after considering 5% of residual value.

Above would reduce the amount available for distribution of dividend.

- From the date of applicability of Schedule II, carrying amount of asset (net of residual value) shall be depreciated over remaining useful life of asset as per the Schedule and if the useful life is nil, carrying value (net of residual value) shall be charged to opening balance of retained earnings.

- If asset is used for double shift, amount of depreciation is increased by 50% and if it is used for triple shift then depreciation is to be increased by 100% as per existing requirement.

- Intangible assets need to be amortized as per Accounting Standard 26 (Intangible assets). Further, assets costing Rs. 5,000 or less are also to be depreciated based on useful life.

9. Declaration of dividend - Section 123 (Corresponding Section 205)

- Before declaring dividend, profits of the Company shall be arrived at after providing depreciation as per Schedule II instead of other alternatives provided under Companies Act, 1956.

- In case of inadequacy or absence of profits, final dividend rate should not exceed average dividend declared during 3 preceding financial years (earlier 5 years) and needs to comply with conditions prescribed in the rules.

- Restrictions on declaration of Interim dividend have been placed which provide that declaration of dividend shall be out of the profit and loss account balance and out of the profits for that financial year. In case of loss in the previous quarter, interim dividend rate not to exceed average dividends declared during 3 preceding financial years (previously average of 5 years).

- Free reserves for the purpose of declaration of dividend specifically exclude unrealized/notional gains. However, clarification with regard to unrealized/notional gains is required.

- Company at its discretion can decide % of profits to be transferred to reserves for declaring the dividend instead of transferring a fixed % of profits to reserves. Further, such transfer is not mandatory.

- For declaration of dividend, Company has to comply with the provision of Section 73 (prohibition on acceptance of deposits from public) and Section 74 (repayment of deposits, etc., accepted before commencement of this Act).

- Earlier, Company had to transfer unclaimed and unpaid dividend to the Investor Education and Protection Fund (IEPF). Now along with dividend, shares on which dividend has not been paid also needs to be transferred to IEPF. Further, Company has to post information relating to unclaimed dividend within 90 days of transfer on its website.

10. Related party transactions - Section 188 (Corresponding Section 297, 299, 314)

- Type of relationships covered:

  Relationships included under Companies Act, 1956 as well as Companies Act, 2013:

  - a director or his relative
  - a firm, in which a director or his relative is a partner
  - a private company, in which a director or manager is a member or director

Additional relationships under Companies Act, 2013:

- a firm, in which a manager or his relative is a partner
- a Key Managerial Personnel (KMP) or his relative
- a public company in which a director or a manager is a director or holds along with his relatives, more than 2 % of its paid-up share capital
- any body corporate whose board of directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager (other than a person who is acting merely in a professional capacity)
- any person on whose advice, directions or instructions a director or manager is accustomed to act (other than a person who is acting merely in a professional capacity)
- any Company which is a holding, a subsidiary or an associate company of such Company or a subsidiary of a holding company to which it is also a subsidiary
- any person appointed in senior management in the Company or its holding, subsidiary or associate company i.e. personnel of the Company who are members of the core management team excluding board of directors, comprising all members of management one level below the executive directors, including functional heads
- a director or KMP of the holding, subsidiary or the associate company of such Company or its relative

- Definition of related party has been widened as compared to relationships covered under section 297/299 of the Companies Act, 1956. It is also wider in scope as compared to Accounting Standard 18.
- Type of related party transactions covered:
    - Sale, purchase or supply of any goods or materials;
    - Buying, selling or otherwise disposing of and leasing of property of any kind;
    - Availing or rendering of any services;
    - Appointment of any agent for purchase or sale of goods, materials, services or property;
    - Appointment of any related party to any office or place of profit in the company or its subsidiary company or associate company;
    - Contract for underwriting the subscription of securities or derivatives thereof.

- Company has to obtain the approval of Board of directors / shareholders as per the criteria prescribed below:

Criteria	Approval required
A) If transactions are in ordinary course of business and at arm's length price	No approval is required
B) If transactions are not in ordinary course of business and not at arm's length price;	
• Companies not having (a) paid up capital of Rs. 1 crore or more or (b) transaction value higher of (i) more than 5% of turnover for the year or (ii) 20% of net worth as at last year	Approval of board of directors
• Companies having (a) paid up capital of Rs. 1 crore or more or (b) transaction value exceeds 5% of turnover for the year or 20% of net worth as at last year	Approval of shareholders (special resolution is required)

Note: above limits are as per Draft Rules.

- Approval of Central Government has been now dispensed with.
- No interested member or director can vote on resolution approving related party transaction and hence there could be a possibility of deadlock in certain situations.
- Related party transactions (entered into under section 188(1) are required to be referred to in Directors report giving justification for entering into such transactions.

11. National Financial Reporting Authority (NFRA) – Section 132 (Corresponding Section 210A)

- Role played by National Advisory Committee on Accounting Standards (NACAS) will now be played by NFRA, which has much wider roles and powers.
- The functions of NFRA includes to make recommendation to Central Government on formulation and laying down of accounting and auditing policies and standards, monitor and enforce compliance therewith and oversee the quality of service of relevant professions. The role of NACAS was limited to making recommendations on formulation and laying down of Accounting Standards.
- NFRA has been vested with the special power to investigate either by suo moto or on a reference made to it by the Central Government for such class of body corporates or person into the matters of professional or other misconduct committed by any members of chartered accountants, cost accountants and if found guilty penalties will be imposed.

- NFRA has power to undertake investigation or conduct quality review of audit of prescribed class of companies also.
- Further, NFRA has been vested with the powers similar to a civil court.

Disclaimer:

This document has been prepared as a service to the clients. We recommend you to seek professional advice before taking any action on the specific issues.

In case of any clarification, you may reach us at **nashah@nashah.com**