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17th November, 2021

To,
The Secretary
National Financial Reporting Authority,
7th-8th Floor, Hindustan Times House, 18-20
Kasturba Gandhi Marg,
New Delhi 110001

Respected Sir,

**Sub: Consultation Paper issued by NFRA in September 2021
on Statutory Audit & Auditing Standards for Micro, Small and
Medium Companies (MSMCs)**

The Chamber of Tax Consultants (CTC), Mumbai, was established in 1926. CTC is one of the oldest (94 years old) voluntary non-profit making organizations in Mumbai formed with the object of educating and updating its members on Tax and other laws. It has robust membership strength of about 4000 professionals comprising of Advocates, Chartered Accountants and Tax Practitioners. It has from time to time made various representations to different Government Authorities drawing their attention to pressing issues.

National Financial Reporting Authority (“**The Authority/ NFRA**”) is an independent authority established under the Companies Act 2013, for the enforcement and establishment of accounting and auditing standards and oversight of the work of auditors.

The Authority has issued consultation paper on 29th September 2021 for granting exemption from statutory audit to Companies having net worth below Rs. 250 crores.

NFRA Observations:

1. The Consultation Paper has discussed following broad parameters amongst other things for exempting the Micro, Small and Medium Companies (MSMCs) having net worth below Rs.250 crores from the mandatory statutory audit under Companies Act 2013;

(i) Most of the Companies incorporated are Private Companies:

Consultation papers states that 94.93% of the Companies incorporated are One Person company or Private Company.

(ii) Low Percentage of compliances for Annual filing with MCA;

It is stated that 52.48% of the Companies have done their annual filing with MCA for FY 2018-19, a low percentage compliance with a critical statutory filing even after two years from the end of the reporting period indicates perhaps a lack of adequate accounting professionals with many of these companies,

(iii) Most of the companies have prepared their Accounts under AS Frame work:

Of the 52.48% of the filing done, 97.09% (i.e 50.95%) have submitted their financial statements prepared under Companies (Accounting standards) Rules 2006 (AS Frame Work) ,

(iv) Most of the companies who have filed their accounts have net worth below Rs. 250 cr.

out of the 52.48% of the filings made 99.41% (i.e 52.17%) of the companies have reported net worth below Rs.250 crore,

(V) Large company reported NIL payment to Auditors:

Large companies nearly 30.26% (i.e 15.88%) have reported NIL payments to Auditors indicating data input error due to lack of adequate accounting professionals with many of these companies

(vi) **Many Companies have NIL Turnover:**

34.67% of the companies have NIL turnover

(vii) **Limited Users of General Purpose Financial Statements (GPFs) of MSMCs:**

A large number of companies have very low or NIL indebtedness, which indicate low risk to large public interest. There is likely to be very limited number of users of GPFs of these companies. Stakeholders of Private Limited Companies are unlikely to depend upon GPFs for much of the financial information they need. Lenders, if any such as banks have special requirements that are not within the purview of GPFs.

(ix) **Auditing threshold already available in India tax Laws:**

Tax Audit has been dispensed with turnover of upto Rs.10 crores subject to certain conditions and GST audit has been completely done away with.

In the backdrop of the above consultation paper it is necessary to understand the Role of NFRA as defined under the Companies Act, 2013:

Role of NFRA

Section 132(2) of Companies Act, 2013 prescribes the broad role the NFRA is expected to play which are as follows:

(i) 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;

- (ii) monitor and enforce the compliance with accounting standards and auditing standards;
- (iii) 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
- (iv) perform such other functions relating to above as may be prescribed.

NFRA Rules 2018, more particularly, Rule 4 specifies the functions to be performed by NFRA.

Rule 4(1) states that, it shall protect the interests of investors, creditors and others associated with the companies or bodies corporate governed by it by establishing high quality standards of accounting and auditing and exercising effective oversight of accounting functions performed by the companies and bodies corporate and auditing functions performed by auditor.

Rule 4(2) provides that in particular the Authority shall:

- (i) maintain details of particulars of auditors appointed in the companies and bodies corporate covered by it
- (ii) recommend accounting standards and auditing standards for approval by the Central Government;
- (iii) monitor and enforce compliance with accounting standards and auditing standards;
- (iv) Oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measures for improvement in the quality of service;

- (v) promote awareness in relation to the compliance of accounting standards and auditing standards;
- (vi) co-operate with national and international organizations of independent audit regulators in establishing and overseeing adherence to accounting standards and auditing standards; and
- (vii) perform such other functions and duties as may be necessary or incidental to the aforesaid functions and duties.

2. Before we proceed to answer to the relevant questions raised by the Authority based on what has been discussed broadly in above paras it is necessary to understand the following points ;

- (i) It is not clear it is not clear that the consultation paper put up in public domain whether comes within the purview of the Authority.
- (ii) It appears that the Data used by NFRA is inadequate & incomplete, as also the Analysis done based on the preliminary incomplete data is primitive and is self serving in nature and appears to be lopsided.
- (iii) It appears that the entire formation of opinion or discussion in consultation paper is based on the data obtained from MCA website which states that only 52.48% the companies have done their annual filings with MCA for FY 2018-19 up to June 21 only. At the outset One needs to understand reasons for such low filings and accuracy of data.

It is also to be noted that companies are more concerned with compliance of Annual filing with MCA. There are possibilities of disclosure issues in the necessary predefined forms uploaded by the Companies, which needs to be analyzed or investigated before relying on the data. What really needs to be seen is the Audited Annual

Accounts of the Companies rather than the Annual Returns before drawing any conclusions. It is pertinent to note that it is the responsibility of the management of a company to file Annual return and follow compliances under Companies Act, and “accounting Professionals” have no role to play. Further it is to be noted that there are stringent penalties prescribed for non filing of Annual Accounts with the Ministry Of Corporate Affairs (MCA). So it is unlikely that such a large number of companies have missed on the said dead lines. Further Registrar Of Companies (ROC)/ MCA is very vigilant in initiating necessary action against such companies.

- (iv) In the consultation paper it has been stated that certain companies have NIL turnover. It may be noted that there are likely chances that such companies may be service oriented companies, Investment companies, companies having only renting of property and other such companies which may not have turnover. These companies may have other income or other operating Income, which needs to be considered. There are many companies which make strategic investments which are long term in nature and doesn't yield any income on regular basis. Also there are companies which have got long gestation period before it commences its operations. Hence there are multiple reasons for companies not having income.
- (v) It is to be noted that in cases where companies are non operational as mentioned in the consultation paper, the Registrar of Companies is vigilant and is striking off the name of such companies, as a result it loses its existence. The MCA has struck off 3 lakh plus companies in last few years. Thus the data in consultation paper seems to be in contradiction to the actions taken by Registrar of Companies.

- (vi) It has been mentioned that 30.26% have reported NIL payments to Auditors. It has also been mentioned that there could be data input error. It's a big error and hence authenticity of the data is questionable. Based on such erroneous data a far reaching conclusion can not be drawn.
- (vii) The rationale of net worth of Rs.250 crores considered by the Authority for treating private companies as MSMCs itself is not appropriate. Companies having net-worth of less than Rs.250 crores can also have asset base, Debts & liabilities and/ or turnover of over Rs.250 crores. Thus it could have higher asset base, liabilities and higher turnover, even exceeding Rs. 250 cr which on the contrary warrants conducting of statutory audit rather than granting an exemption from conducting statutory Audit.

Moreover net worth criteria considered for IND AS adoption may not be relevant for the purpose of exemption from mandatory statutory audit of such companies. Company with lesser net worth can have large turnover or debt and other public interest as reflected in this paper itself.

It is stated in the consultation paper that, out of total 603,055 companies that have made filings with MCA, 99.41% companies (i.e 599487 companies) have reported net worth below Rs. 250 Cr that means only 3537 companies are subject to audit. This will virtually rule out statutory audit of Companies, is that the intention of the Paper?

- (viii) Audit fees as a Cost can't be the only factor to be considered for preparation of financial statements. The benefits which the audited financial statements gives to lenders / tax authorities / vendors /investors etc apart from the fiscal discipline it brings, as also

potential of fund raise etc. have not been considered. Audited GPFS gives more credibility than the unaudited GPFS. There are various qualitative factors which gives credence to the GPFS and such criteria's can not be compared with the cost.

(ix) Application of Accounting Standards is mandatory and therefore its of paramount importance that the Accounting Standards are complied with. Due to audit being mandatory, there is discipline amongst the companies in terms of compliance of Accounting Standards. Also Auditing Standards being mandatory for Auditor of company, Auditor has to mandatorily do certain audit procedures such as external confirmation, risk assessment, assessment of controls etc. This indirectly forces companies to have financial discipline. Therefore there is huge benefit of audit and it gives more credibility to GPFS.

(x) From the consultation paper itself, it is noted that in other developed countries of the world, only small Companies are exempt and not MSMCs as defined in this Paper. In the developed countries criteria that have been adopted for determining smaller companies are based on Turnover, Balance sheet total , Number of employees etc and that to having very low threshold limit than the threshold of Rs.250 cr based on the net-worth of the companies have been considered in this paper .

Also the moot question is that even the lower thresholds considered in developed countries, can the same be considered even for India? The whole regulatory, ethical & compliance ecosystem and background are different in developed Countries as compared to India.

The fact that even the criteria and thresholds used in the developed world countries are not considered in this Paper despite being discussed,

- (xi) Audit was prescribed way back in 1857, i.e. almost 164 years back, hence there is definitely a sound rationale for introduction of Audit. Statutory audit mitigates risk of other stakeholders while dealing with Corporate entity having limited liability like other than promoter shareholders , bankers , regulators , vendors etc
- (xii) It has to be noted that many such companies having net worth of Rs.250 crores may have potential to raise funds either from domestic markets or from abroad. So once corporate structure has been adopted, following up of the accounting standards and principles become imperative to make GPFs more reliable, comparable and credible. If a company which has not done audit for numbers of years decides to raise funds from Banks / capital markets etc then getting a audit done afresh for many years would be difficult, if not impossible. Specially how would the true & fair view of opening balances of assets, liabilities & reserves be established in an unaudited company assuming no audit done for many years.
- (xiii) For the purpose of Income Tax Act , there is increase in threshold limit for the purpose of conducting tax Audit upto Rs.10 cr and Audit under GST Act has been done away with. Please note that Audit under income Tax Act and GST Act is more in the nature of compliance of the provisions of the respective laws. The whole purpose here is whether items of Income and Expenditure has been rightly offered/claimed in the return of Income for the purpose of income Tax Act. Further under GST Act, companies are required to do exhaustive reconciliation of its sales and purchases on a month to month basis. It has to reconcile its data with the vendors. The whole purpose is to

ensure that GST has been correctly levied, input credit has been rightly claimed and sales have been properly shown. Since exhaustive process has been laid out in GST returns, GST audit was done away with in order to reduce compliance burden. It has a very limited application as the Government is the major stakeholder. The same can not be compared with the statutory audit which is more concerned with reliability and transparency of GPFSSs. Here there are many stakeholders apart from promoters viz. creditors, lenders, banks, Govt, foreign Companies etc. who rely on the GPFSSs. In fact they only rely on audited financial statements.

- (xiv) The rationale that doing away with audit will lead to “Ease of doing business” is flawed, as audit was never a part of the World bank “Ease of Doing Business” survey and findings.

Ease of doing business should not be compromised by granting exemption to MSMCs from mandatory statutory audits. Also not doing an audit would on the contrary lead to challenges in doing business vis a vis difficulties in getting loans, less reliability of tax authorities on the Books of the entity . Lower reliance of vendors in doing business with such entity.

3. Rationale for Audit regardless of size of the Company

The choice of form of business enterprise is given to every entrepreneur. Those opting for the CORPORATE structure do so knowing the benefits of Limited Liability as well as the ease of changing owners through transfer of shares and the ease of accessing capital through secured borrowings as well as various investors (not restricted to access to equity markets only). Hence when an entrepreneur selects the corporate structure as against an LLP or a partnership he signs up for the associated compliances - knowing

quite well the benefits that he gets from the corporate structure. In a corporate form even the compliance costs of ROC filings and other compliance costs are higher than non corporate entities which the promoters of the Companies are fully aware of.

Also there are legislative provisions which allow smaller companies that no longer need the benefits of the corporate form of business to convert themselves to LLPs and opting for lesser compliance.

The corporate structure necessarily calls for a distinction between owners and management and the stake holders are many – including lenders, investors and tax authorities, customers inviting tenders too – all of whom use General Purpose Financial Statements (GPFS). Such GPFS are also used by various Researchers and form the basis of data input for numerous projects dealing with economic or financial development. Hence an audit of these GPFS is merited. One cannot imagine the situation where the GPFS were unaudited and their credibility would be in question –as explained in this representation as well.

A larger investment is required in accounting systems. The intent of any legislation would surely not be to exempt companies from maintenance of accounting records and implementing financial control systems and if these are to be maintained then, keeping in mind complexity of accounting, the need to get them audited is almost as imperative. And we do not see any case for exempting entities of any threshold whatsoever from maintenance of books and control systems.

Argument against: today government is keen to encourage businesses have companies rather than other forms – but

corporatization comes at a larger compliance cost and hence the number of new corporates is not increasing as much. Hence if we exempt them from an audit we will be able to encourage corporatization.

Answer to that: If you want to encourage corporatization and you feel audit is a bottleneck then what will be needed is exempting them from record keeping of any kind or keeping a very rudimentary form of records – and that is a risk which one cannot take because the stakeholders in a company are larger. Complete freedom to keep accounting records or not or to keep in whatever way one wants with no checks and balances by any independent authority could create havoc – the very fact that investors and lenders have been insisting on corporatization is because there is a merit in filing of results in public domain and third party verification through Audits.

A view cannot be taken based on statistics which seem to suggest that many companies have not filed audited statements or that the auditors do not charge audit fees.

Any statistics which indicate a large number of cases with no audit fee would only mean that the data is not accurate. Also failure to file audited accounts may be not because audits were not done – the responsibility to file these is of the management. Unless there is an assurance that not only will there be no audit but also no need to file any returns, statements, reports or to even maintain books of accounts, this would be a very incomplete measure.

One needs to decide whether we can as an economy afford a situation of such a level of deregulation?

Counter argument: anyone who perceives need for an audit will get one done anyways – for banking, investor, lending purpose. Or for tax

if required. Why should law mandate compulsory audit for those who have no external stakeholders?

Answer: we have seen in the past that there is an overall credibility that a corporate sector carries in any country – and that is typically determined by the level of mandated regulation. Self regulation is almost often not looked at as the best form of regulation and particularly in countries where there have been documented frauds etc. India is an inbound investment destination and we need to attract capital from lenders and investors – and unless there is a framework in place which mandates regulation and which therefore speaks for the integrity of data provided, we would become a weak destination for such inbound investment, at-least from credible investment sources and we would attract investment from unregulated sources which could have huge economic ramification.

We do not want to a truncated audit to be sanctioned as it would take away the purpose. A CARO exemption is anyways provided for SMSC.

One cannot ignore the benefits of financial discipline that maintenance of accounts and audit thereof brings to a business.

One cannot do away with a provision merely because one feels it is not performed adequately – the former must be judged on merits of need and the latter can be strengthened if at all so needed.

Ease of doing business should be not in the form of lethargic record keeping – there are various other impediments which need to be cleared and business will be easy. The reporting bane is not from audit – corporate or Business India rues the amount of reporting mandated by tax laws – each asking for data in a different form and

format – there is no issue with book keeping and audit as even the businessman realises the need for the same and the credibility it imparts to his operations.

Also India is in a development stage of start ups and one cannot overemphasize the need for start ups to be guided into correct record keeping and the same can be done best by mandating an audit by a third party professional – the need otherwise to present results in a self serving form cannot be overemphasized.

Hence it is suggested that the current system of audit for companies be kept as it is – knowing that any company that is too small in size would always have the option to move to a structure that requires lesser compliance and hence the sanctity of the corporate structure must be preserved.

4. In the back drop of what has been stated above we answer the questions raised by the Authority as under:

Question No. 1 – *“Do you think that Micro, Small and Medium Companies (MSMCs) depending upon some criteria and threshold should be exempted from the mandatory statutory audit under Companies Act, 2013? If not, why not and if yes, what would be the criteria and thresholds for exemption?”*

Answer:

In our view, granting exemption to MSMCs from Mandatory Statutory Audit under Companies Act 2013 would not be a good idea. As explained in detail hereinabove in the Preamble, we further propound

our reasoning stated above for not granting exemption from statutory audit to MSMCs.

One needs to understand that Company is independent from the Owners/promoters. Management is always responsible to various stakeholders. There is always underlying presumption that GPFs are reliable, comparable and transparent. Hence audit plays very vital role in accomplishing the objective. *One has to go beyond the cobweb of statistical analysis to understand the theme behind the same.*

Further company also needs to follow various compliances under companies Act and various other laws hence it is necessary for it to get its accounts audited under companies Act. It helps the company to maintain proper records, follow all checks and balances in system to ensure that the GPFs are reliable, transparent and comparable. If such exemptions are granted, there are likely chances that above purpose would be defeated.

Chartered Accountants have expertise and knowledge to guide the MSMCs to follow Companies Accounting Standards. Also Standard Auditing Practices which Auditor follows brings discipline in companies. Accounting Standards would make the accounts more comparable and universally acceptable which otherwise would not be possible and there is definitely overall financial and accounting discipline in the Company due to Standard Auditing practices which Auditor follows .

We further list down herein below some of the drawbacks of granting an exemption from mandatory statutory Audit to MSMCs;

i) if companies are exempted from audit , management would tend to manipulate and fudge accounts and transactions with related parties will be without any check

- (ii) There will be indiscipline in maintenance of accounts .Also in the smaller entities not everyone has professional staff and non professionals may not be able to handle complex accounting entries.
- (iii) Because of audit, there is a procedure of obtaining external confirmations from debtors, banks, lenders, borrowers, etc. and this brings in discipline in management.
- (iv) Revised Schedule III of the Companies Act is quite complex and in absence of audit the details and disclosures under schedule III would always be questionable
- (v) How would the independent directors derive confidence from the financial statements which are not audited

Exemption from Statutory Audit is already available to Partnership firm and Sole proprietary concern. So it is advisable for small companies to convert to similar structure where audit is either exempted or is not compulsory.

Question No. 2- *“Do you think there is a requirement for a separate set of auditing standards for MSMCs as it exists for accounting standards? If no, why not and if yes, what should be the basis for the same”?*

Answer:

The current auditing standards are in line with international standards. Without prejudice to above, one can think in that direction for auditing standards keeping in mind that reliability of accounts and transparency should not get affected. However, the ICAI has already come out with a different Auditing Standard for Less Complex Entities & internationally IAASB has come out with a Exposure Draft for a

Separate Standard on Less Complex Entity which is expected to be issued in 2022

Question No. 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 18 approach for estimating standard cost of audit computed by NFRA? If not, which areas/assumptions need changes?”*

Answer:

There can not be any standard parameter to bench mark the fees for Conducting the Audit. It depends upon various Qualitative Parameters such as time involved, Knowledge base, Skill set, experience of the Partners and team members, Research activities carried on, international exposure, skilled manpower, technology based infrastructure, compulsory training, etc. The cost would be different for different person and depends on various qualitative parameters. Hence the estimated costs as arrived at by NFRA are not appropriate. So it would be inappropriate to standardize audit fees. ICAI has already recommended the scale of fees to be charged by its members. Anyways, all the auditing practitioners/ firms definitely have their own standards to measure the cost and must be definitely factoring all those aspects as considered by the Authority. It should be left to the audit firms to decide their audit fees in free economy or open market.

Question No. 4- *“Do you think the current exemption thresholds for CARO, ICFR and statutory audit applicability need to be standardized and made uniform? If no, why not and if yes, what would be the criteria and thresholds?”*

Answer:

We do not think the current exemption thresholds for CARO, ICFR and statutory audit applicability need to be standardized and made uniform. One has to understand the purpose & functionality of each the same.

Objective for issue if Companies Auditors Report Order (CARO) as stated by MCA, is that there are certain particular issues which are important to be reported with the financial statements for certain entities as a part of their audit reports. The auditor of such prescribed entities is required to report on the points as mentioned in CARO such as fixed assets, Inventories, loans given or taken by companies, timely payment of statutory dues etc after performing procedures for verification of the same. While doing so, care has been taken to ensure that certain categories of companies and smaller companies have been kept out of the same. It has specified following limits for applicability of the same to private companies

- (i) Whose gross receipts or revenue (including revenue from discontinuing operations) is less than or equal to Rs 10 crore in the financial year
- (ii) Whose paid up share capital plus reserves is less than or equal to Rs 1 crore as on Balance Sheet date.
- (iii) Is not a holding or subsidiary of a public company
- (iv) Whose borrowings is less than or equal to Rs 1 crore.

Similarly in case of Internal Control Over financial Reporting (ICFR) is a *Internal Control over Financial Reporting (ICFR)* is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

It provides an accurate and fair reflection of transactions and dispositions of the assets of the company. IFC/ICFR is applicable without any minimum threshold for listed companies and public unlisted companies. In case of private companies, IFC/ICFR is applicable wherein Turnover is more than Rupees 50 crores or outstanding loan & borrowings from bank are more than Rupees 25 crores. Hence criteria's are different in both cases.

Without prejudice to above even if one feels that both the threshold criteria to be made uniform in that case it should be made applicable to such companies having turnover of at least Rs.50 crore and having a borrowing of at least Rs.25 crore or more . Other Criteria's be kept at the same level.

Lastly we conclude by stating that audit is as important function of any enterprise, irrespective of its scale and size, as keeping the financial records. It makes the GPFSS more reliable, comparable, transparent and universally acceptable.

Yours Sincerely,

For THE CHAMBER OF TAX CONSULTANTS

Sd/-
Ketan Vajani
President

Sd/-
Mahendra Sanghvi
Chairman
Law & Representation Committee

Sd/-
Apurva Shah
Co-Chairman