



Bombay Chartered Accountants' Society

Harnessing Talent and Providing Quality Service

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Date: -December 21, 2020

Shri R. Sridharan
Chairperson
National Financial Reporting Authority
7th-8th Floor, Hindustan Times House
18-20 Kasturba Gandhi Marg,
New Delhi - 110 001

Subject: - BCAS Representation on Section 144(h) of the Companies Act, 2013.

Respected Sir,

The Bombay Chartered Accountants' Society (BCAS) is a Public Charitable Trust formed on July 06, 1949, with an objective to disseminate knowledge primarily to Chartered Accountants in Practice and in Industry. It also disseminates knowledge to other Legal Professionals and public at large. At present, BCAS has 9000+ Chartered Accountant members and more than 42,000 social media followers spread across the globe. As part of its activities, BCAS also carries out research on the topics which are immensely important for the Professionals in practice. We act as catalyst to bring out better and more effective Government policies & laws in order to have clean & efficient administration and governance. Based on the intensive research, we make Representations to Statutory Bodies thereby helping to bring out the best governance.

Please find a detailed Representation on the meaning, interpretation and subsequent consequences of the term "Management Services" as provided in Section 144(h) of the Companies Act, 2013, for your kind consideration, needful action/issuing clarification and/or suggesting suitable options in this regard. This Representation has been prepared by a team of experienced Chartered Accountants with the help of meticulous research on the subject matter.

Thanking You

Yours Sincerely
For Bombay Chartered Accountants' Society

CA Suhas Paranjpe
President

CC to: -

1. Honourable Finance Minister
2. Honourable Minister of Finance for State
3. Honourable Minister for Corporate Affairs
4. The Secretary, NFRA
5. The President - Institute of Chartered Accountants of India

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Representation to NFRA¹

Management Services

1. The term “Management Services” as appearing in section 144(h) of the Companies Act, 2013 (the Act) has been discussed at length in both the AQRRs² issued by NFRA till date. The main reason for such discussion is on account of the fact that the term Management Services has not been defined in the Act, rules framed thereunder or by MCA³ in its circulars or notifications or by ICAI⁴ in its technical materials, code of ethics or by way of guidance to its members.
2. The submissions made by DHS⁵ and BSR⁶ to NFRA relating to interpretation of the term Management Services during the course of inquiry against them and reasons given by NFRA for not considering such submissions, as appearing in AQRRs, are reproduced in the annexure to this note.

NFRA has stated that, in absence of any definition, the words used in the statute must be understood in their normal or dictionary sense and be given their literal and direct meaning and has defined the term Management Services as under:

“Management Services” has to be taken as services (performed by the statutory auditor) for the management, either (a) in the form of doing actions/functions that would otherwise have to be done/undertaken by the management; or (b) providing any kind of support (inclusive of analysis, research, advice etc.) that is required by management for the performance of those actions/functions.

All activities carried out by a company are pursuant to actions / functions of the management of that company. As a result of the above definition, advising the management on any activity of a company would get classified as management services to that company. In other words, all services other than attestation services i.e. all non-audit services would get classified as Management Services.

3. DHS has *inter alia* argued that the intention of the legislature was to permit some management consultancy / similar services by the auditor to auditee and was not to prohibit “any other kind of consultancy services”. NFRA has not appreciated this submission in defining the said term.

¹ National Financial Reporting Authority

² Audit Quality Review Reports

³ Ministry of Corporate Affairs

⁴ Institute of Chartered Accountants of India

⁵ Deloitte Haskins & Sells LLP – Joint Auditor of IL&FS Financial Services Ltd for the financial year 2017-18

⁶ BSR & Associates LLP – Joint Auditor of IL&FS Financial Services Ltd for the financial year 2017-18

Before defining the meaning of Management Services, NFRA has concluded⁷ that:

In such situations, the settled principles of statutory construction require that the words used in the statute must be understood in their normal or dictionary sense and be given their literal and direct meaning.

In the absence of definition in the statute, it is presumed that NFRA has gone by the dictionary meaning of the said term. However, NFRA has not quoted any source of the said definition. Further, the definition adopted by the NFRA is also not based on meaning adopted by any Indian or international professional body. Therefore, it appears that NFRA has attempted to deduce legislatures' intention while defining the said term. If that was the case, then we submit that:

- a If the intention of the legislature was to prohibit all non-audit services by specifying Management Services, then there was no need for the legislature to list out various services in section 144 of the Act, which are in addition to Management Services.
 - b In fact, u/s 144 of the Act, the legislature has further delegated powers to prescribe additional services as prohibited services. If the intention of legislature was not to permit any non-audit services, there was no need to delegate powers to prescribe "permitted" services at the time of enactment as prohibited services at a later date.
4. DHS also stated that they have relied on meaning given by IESBA⁸ in their Code of Ethics. NFRA didn't agree to this submission also. Apparently, the stand taken by NFRA is completely contrast with the stand taken by ICAI. Like many other professional bodies across the globe, the foundation of Code of Ethics laid down by ICAI for its members, is the Code of Ethics of IESBA⁹. There should have been strong and compelling reasons for shifting the stand (more so when it has to be applied retrospectively) from the standards adopted all these years by the governing body of the auditing profession.

It must be appreciated that the Indian Parliament has enacted the Chartered Accountant Act in 1949 *to make provision for the **regulation of the profession of chartered accountants and for that purpose to establish an Institute of Chartered Accountants.*** As per section 132(1) of the Act, NFRA has been constituted to provide for **matters relating to accounting and auditing standards**. In addition, as per section 132(2) of the Act, NFRA shall oversee the quality of service of the professions associated with **ensuring compliance with such standards** and also overseeing the quality of service and suggesting measures for improvement. From the above, it is evident that one of the primary functions of ICAI is to make regulation of the profession. NFRA's primary role is with respect to matters

⁷ Paragraph 2.2.14 of AAQR (DHS)

⁸ International Ethics Standards Board for Accountants

⁹ Earlier editions of Code of Ethics of ICAI were based on International Federation of Accountants (IFAC). IESBA is established by IFAC. IESBA is also subject to the oversight of the Public Interest Oversight Board.

relating to accounting and auditing standards and overseeing quality of services. It is evident from the above that ICAI's action has backing of statute and it cannot be undermined without having justification / due process. NFRA has not enunciated any such reason except what has been underlined in the extract from AQRR attached herewith as annexure A.

5. Tax representation, Tax Advisory and related services generally constitute the single largest non-audit services being rendered by auditor to the auditee. On perusal of AAQR in case of DHS, it is not clear whether NFRA has held "Tax representation work" as "Management Services". On page 139 / 140¹⁰ of AQRR – under Final Conclusion column relating to their observations on Engagement Letters for non-audit services, NFRA has concluded that tax representation work / tax advisory work results into self-review threat and also requires approval of the ACM u/s 144 of the Act. In other words, they have not considered such services as "Prohibited Services" u/s 144 of the Act. It may be noted that in the DAQRR, it was stated that such services are violative of SQC1 / SA 200. However, in the final conclusion in AQRR, there is no such mention, and basis of dropping such adverse observation is not provided in the AQRR.

However, on page nos. 146 to 149 of AQRR of DHS, against tax advisory services, it has been stated that such services are prohibited services. In this case, it is presumed that such comments might be due to nature of various services rendered by DHS in connection with transfer pricing and therefore, such comments may not be *per se* against "tax representation or advisory services".

In case of BSR, NFRA has considered all non-audit services as prohibited services without providing any reasoning for each of such non-audit services. Since all non-audit services are considered as prohibited services, by implication, NFRA has concluded that tax representation, tax advisory and related services as part of prohibited services.

It would have been more appropriate if NFRA would have communicated its stand unequivocally and avoided the confusion created in the minds of the practitioners at large.

6. NFRA has also concluded that Management Consultancy Services would be encompassed with the broader category of Management Services¹¹. This conclusion is without the authoritative backing in as much as Management Services have not been defined anywhere. The definition of Management Services brought out by NFRA in paragraph 2.2.3(d) of AQRR of BSR is NFRA's interpretation and is first such attempt, which appears to be without any due process.

¹⁰ printed page numbers (and not pdf file page numbers)

¹¹ Paragraph 2.2.3 (e) of AQRR (BSR)

7. We would also like to draw attention to Report of the Companies Law Committee of MCA which was published in the month of February 2016, On page 50, in para 10.16, the Committee has noted as under:

Auditor not to render certain services

*10.16 Section 144 prohibits rendering of certain non-audit services directly or indirectly to the auditee company or its holding company or subsidiary company. Clarity was sought on the term 'management services' used in Section 144(h). It was also suggested that restrictions under Section 144(h) and (i) should apply to listed companies and public interest entities only. A view was also given that such services could be allowed subject to certain percentage of audit fees being received by the auditor. **In this regard, ICAI had undertaken an exercise to list out such management services.** The Committee felt that the nature of the suggestions and issues being raised are broadly aimed at opening a window for the auditor to have a relationship other than that of an auditor and auditee, and thus may impinge on the independence of the auditor. It, therefore, recommended no change in the provision, or for providing any exemption to any class of companies. However, it was recommended that ICAI, after consulting the Ministry of Corporate Affairs, should come up with a guidance note for auditors.*

From the above, it is clear that there was never a total ban on all non-audit services. In fact, it was felt that there was a need to provide guidance to the Auditors and hence, it was directed to ICAI's to provide such guidance in consultation with MCA. We understand that ICAI has forwarded its interpretation of the term Management Services to MCA and it is "pending" with MCA.

8. Based on what is stated above, it is submitted that:
- a. it would be inappropriate, without following due process, to define the term Management Services after 8 years of enactment of the statute and make it applicable retrospectively, especially when the need to explain the term was recognized by the Committee constituted by MCA;
 - b. categorically no view has been expressed on Tax representation, tax advisory and related services, that auditor may be asked to render by the auditee;
 - c. The Code of Ethics issued by ICAI, which has been made mandatory with effect from July 1, 2020 (i.e. after the date of AQRR in case of DHS), even now permits various services that an auditor can render (subject to mitigation of audit risks) as specified in Volume II of the Code. This Code defines "Management Consultancy and other Services" and provides indicative list of permitted and non-permitted services. In addition, it clarifies that "Representation or Advice concerning tax matters" is not Management Consultancy and other Services. The Code of Ethics have been issued by

following due process of law. It may be noted that Volume II of the Code is *based on domestic provisions governing the Chartered Accountants*¹². It is thus evident that the views of two regulators are contrary in this aspect.

9. Even assuming that NFRA has correctly captured the intention of the legislature in defining the term Management Services, it causes serious injustice to the audit profession if the entire blame and consequences are thrust upon the audit profession as the entire corporate world (including Independent Directors) have interpreted the term differently for almost over past 7 to 8 years than what is interpreted by NFRA.
10. In conclusion, it is represented that MCA and ICAI should conclude the process recommended by the Company Law Committee constituted pursuant to statement made by the Honorable Minister in the Rajya Sabha by providing guidance to the auditors and in turn to the entire corporate world. Needless to mention, the outcome of the above process should be made applicable prospectively. It should be appreciated that the Chartered Accountants are not only law-abiding citizens but also play a major role in ensuring that the Corporate world follows the law in letter and spirit.

¹² As stated in Forward to 12th Edn. of Code of Ethics of ICAI

Annexure A

- The submissions¹³ made by DHS with respect to meaning of Management Services in response to inspection conducted by NFRA are as under:
 - a *The intent of the legislature was not to prohibit provision of “any other kind of consultancy services”; as a corollary, the intention of the legislature was that some management consultancy/similar services were permissible (which also aligns with ICAI guidelines on permissible services for auditors).*
 - b *The suggestion to define “management services” using AICPA Code of Ethics of Professional Conduct was rejected by the Standing Committee Report of 2012 stating that the guidance on management services is internationally followed and therefore, there is no need for further explanation/guidance on “management services”.*
 - c *Based on the above, it is clear that the intention of the legislature for “management services was to follow internationally followed practices that were prevalent at the time of enacting the Companies Act, 2013. Accordingly, in the absence of any definition of “management services”, we have followed “management services” to mean as services **that comprise or include management responsibilities** as defined in IESBA Code of Ethics, 2010 and as amended from time to time”.*
- NFRA didn't agree to any of the submissions made by DHS and concluded¹⁴ as under:
 - a *Admittedly, the term “management services” has not been defined in the Companies Act, 2013. In such situations, the settled principles of statutory construction require that the words used in the statute must be understood in their normal or dictionary sense and be given their literal and direct meaning. While doing so, the context in which the words are used will clearly be important. At the same time, the principles of interpretation would require that no extraneous matter should be brought in as part of the interpretation. Similarly, all the words used in the statute would have to be given their full meaning and no part of the statute can be rendered otiose.*
 - b *Using these principles, it is clear that the context, which is one of prohibition of provision of non-audit services by the auditor of a company, would mean that “management services” should be interpreted only as services that can be, or potentially can be, provided by the auditor to the management of the company. Given the context, it would be entirely repugnant thereto to interpret the term “management services” as “services performed or rendered by management”. If this were to be the interpretation, the question would then arise as to the person/entity for whom management is performing or rendering any services. The argument of the Audit Firm*

¹³ Paragraph 2.2.13 of AQRR (DHS)

¹⁴ Paragraph 2.2.14 of AQRR (DHS)

that the term “management services” implies the equivalent of “management responsibilities” is unacceptable since “management responsibilities” would mean actions to be done/functions to be undertaken BY management and not services rendered TO management, which is what is required by the context in which the term appears. “Management responsibilities” have to be discharged ONLY by management and cannot be done by others. All others, including auditors, can help management in discharging such responsibilities by providing them services of various kinds.

- c Hence, the definition of “management services”, read in the context in which the term has been used in the statute, *can be only understood to mean “services performed by the statutory auditor” for the management, either (a) in the form of doing actions/functions that would otherwise have to be done/undertaken by the management; or (b) providing any kind of support (inclusive of analysis, research, advice etc.) that is required by the management for the performance of those actions/functions.*
- d As explained above, it is completely impermissible in all accepted norms of statutory construction to import concepts, meanings, and definitions from extraneous sources in a situation where a plain reading of the words of the statute does not indicate that this is either permissible or has necessarily to be done.
- e As far as the contention of the Audit Firm that the intention of the legislature was not to prohibit provision of “any other kind of consultancy services” and that, it was indeed, on the contrary, to permit such provision, it is seen that the Audit Firm has based this argument on the Report of the Parliamentary Standing Committee on Finance, 2012. On an examination of the source documents (namely the Parliamentary Standing Committee on Finance Report of 2010 on the Companies Bill, 2009, and the Report of 2012 on the Companies Bill, 2011), it is clear that not only is the understanding by the Audit Firm of the Committee’s recommendations completely wrong, but that the Audit Firm has also seriously misrepresented the recommendations of the Committee.
- f The Audit Firm has said that a suggestion was received by the Standing Committee, 2012, to define “management services” using AICPA Code of Professional Conduct. It has also been stated that the quotation (on page 31 of the response dated 4th November, 2019, to the DAQRR) is the Committee’s rejection of this suggestion stating that the guidelines on management services is internationally followed and that, therefore, there is no need for further explanation/guidance on “management services”.
- g The Standing Committee Report, 2012 [Para 84 of Chapter IV of Part I of the Report (Suggestions on the Companies Bill, 2011)], clearly shows that the suggestion regarding the AICPA definition was one of 7 suggestions relating to Section 144, all of which were clubbed together and considered. These suggestions were all intended to

curb/restrict/relax the proposed prohibitions. In fact, the suggestion at Sl. No.(vii) of the list was that if at all the Bill needs to cover any non-audit services, the Bill itself should contain only minimum restrictions and further restrictions may be prescribed through the Code of Ethics.

- h It is seen that the quote on page 31 of the response that is attributed by the Audit Firm to the Committee is, in fact, only a truncated part of the comments of the Ministry. The Audit Firm is, therefore, clearly guilty of deliberate misrepresentation, both by attributing the quotation to the Committee, and also providing only a truncated portion of the comments of the Ministry so as to present a completely misleading picture.*
- i In fact, the Ministry, in its comments, had referred to the provisions of Clause 127 of the Companies Bill, 2009, which was examined by the Committee and recommendations on which are at Para 34 and Para 10.50 in its 2010 Report thereon. The Ministry had suggested that the provisions in the new Bill (namely Companies Bill, 2012, which has now become Companies Act, 2013) were in accordance with the recommendations of the Standing Committee Report, 2010.*
- j It is seen that Para 34 of the Standing Committee's Report, 2010 (page 31 of the pdf file) listed out suggestions received by the Committee about the need to make provisions relating to audit and auditors more stringent. The suggestions included (a) prohibition of rendering of non-audit services both "directly as well as indirectly", and suitably defining the term "directly or indirectly" in the Bill itself; (b) the prohibition should apply not only to the audit client company but also for its holding company, subsidiary company, and associate company; and (c) through a residual clause, prohibit the provision of "any kind of consultancy services" to take care of any non-audit services not covered in already provided clauses. Para 10.50 of the Report recommended that the Ministry should consider extending the scope of Clause 127 to cover specified services rendered to subsidiary companies as well.*
- k In its comments to the Standing Committee 2012, the Ministry had referred to all this background, and the fact that the recommendations of the Standing Committee 2010, had been accepted virtually in toto. It is in this context that the Ministry, drawing attention also to international practices, had emphasized the need for such prohibition for auditors in India as well and urged a rejection of any suggestions for curbing/restricting/relaxing such prohibitions.*
- l It is seen, therefore, that the conclusions drawn by the Audit Firm, ostensibly relying on the Report of the Parliamentary Committee, are completely unfounded and are an attempt at deliberate misrepresentation. Given the basic framework and principles governing statutory interpretation explained above, NFRA would have been fully within its right to ignore the extraneous matter such as statutes in other countries, Codes of*

Ethics prescribed by International Bodies etc., as well as the Reports of the Committees quoted by the Audit Firm in a situation where the plain meaning of the words used in the statute is clear and does not require any such additional aids to interpretation.

Nevertheless, NFRA has considered in detail the arguments of the Audit Firm in order to both demonstrate their complete lack of merit as well as to highlight their attempts at deliberate misrepresentation of the material relied upon.

After re-examining the matter in the light of the responses of the Audit Firm to the DAQRR¹⁵, NFRA reiterates and confirms its stand, for the reasons explained above, on the scope of the term “management services”.

- The submission¹⁶ of BSR with respect to meaning of Management Services are as under:
 - a *All the non-audit services provided by BSR or BSR & Co are in the nature of professional services which are permitted to be rendered by an auditor / Audit Firm under the Chartered Accountants Act, 1949 and the non-audit services provided by BSR or BSR & Co in the relevant period were provided to IFIN’s Fellow subsidiaries or Associate Company of IFIN respectively and are not prohibited under Sec 144 of the Companies Act, 2013 as they do not come under the scope of Sec 144.*
 - b *None of the services listed in Annexure of non-audit services of the Affidavit rendered by KPMG Entities in the Relevant Period to IFIN, or the holding or subsidiary companies of IFIN, falls within any category of “prohibited services” which are listed in Section 144.*

As per, the ICAI Code of Ethics 2019

“A firm or a network firm shall not assume a management responsibility for an audit client. Further, under Section 144 of the Companies Act, 2013, where applicable, the restriction also applies to the holding company and subsidiary company of such audit client.” “Providing advice and recommendations to assist the management of an audit client in discharging its responsibilities is not assuming a management responsibility.”

Therefore, the understanding of ICAI seems to be that management services prohibited under Section 144 are those that involve assumption of management responsibility.

Based on information provided by the KPMG Entities, BSR understands that the services which were provided by the KPMG Entities to IFIN or its holding company or its subsidiary company in the Relevant period are as follows:

- *Conducting pre-employment background checks on existing employees and applicants being considered for appointment.*

¹⁵ Draft Audit Quality Review Report

¹⁶ Paragraph 2.2.13 of AQRR (BSR)

- *Conducting a current state assessment of the IFIN's Business Continuity Management process and providing observations and recommendations basis leading practices.*
- *Carrying out an independent post facto review to check compliance with the client's investment and divestments processes for certain transactions identified by the client.*
- *Providing training to employees on key aspects of KYC Direction by RBI and applicable sections of Prevention of Money Laundering Act, 2002.*

As is clear from the descriptions above, such services did not involve assumption of any management responsibility or exercise of any management function or decision-making on behalf of management. In each case, a deliverable or recommendation was provided to the client to enable management, within the client, to take any judgment or decisions that were the proper responsibility of management.

- NFRA didn't agree¹⁷ to any of the submission by BSR and concluded as under:
 - a *Admittedly, the term "management services" has not been defined in the Companies Act, 2013. In such situations, the settled principles of statutory construction require that the words used in the statute must be understood in their normal or dictionary sense and be given their literal and direct meaning. While doing so, the context in which the words are used will clearly be important. At the same time, the principles of interpretation would require that no extraneous matter should be brought in as part of the interpretation. Similarly, all the words used in the statute would have to be given their full meaning and no part of the statute can be rendered otiose.*
 - b *Using these principles, it is clear that the context, which is one of prohibition of provision of non-audit services by the auditor of a company, would mean that "management services" should be interpreted only as services that can be, or potentially can be, provided by the auditor to the management of the company. Hence, the definition of "management services", read in the context in which the term has been used in the statute, can be only understood to mean "services performed by the statutory auditor" for the management, either in the form of doing actions/functions that would otherwise have to be done/undertaken by the management; or (b) providing any kind of support (inclusive of analysis, research, advice etc.) that is required by the management for the performance of those actions/functions.*
 - c *The Audit Firm's reference to the ICAI Code of Ethics 2019, is not in order, since it did not apply to the relevant period. Nevertheless, considering the facts detailed above, the*

¹⁷ Paragraph 2.2.14 of AAQR (BSR)

understanding drawn by the Audit Firm from this Code is clearly incorrect and inapplicable. The argument of the Audit Firm that the term “management services” is the same as “management responsibilities” is unacceptable. If it were indeed the intention of the legislature to prohibit the provision of “management responsibilities” by the statutory auditor, the term “management responsibilities” would have been directly used instead. It is not anybody’s case that there was no widespread ongoing debate about the provision of non audit services, and that the concept of “management responsibilities” was not examined threadbare. If after all this debate, the legislature, in its wisdom, has chosen to use the term “management services”, it must have done so for good reason.

- d This choice appears to have been made given the obvious absurdity that would accompany the use of “management responsibilities” because “management responsibilities” mean actions to be done/functions to be undertaken / responsibilities to be discharged by management, and not services rendered to management, which is what is required by the context in which the term appears. “Management responsibilities” have to be discharged only by management and cannot be done so by others. All others, including auditors, can only help management in discharging such responsibilities by providing them services of various kinds. The Audit Firm cannot derive any support by quoting the Code of Ethics 2019 to say that “Providing advice and recommendations to assist the management of an audit client in discharging its responsibilities is not assuming a management responsibility.” That is not NFRA’s argument either. However, “Providing advice and recommendations to assist the management of an audit client in discharging its responsibilities” is clearly provision of a “management service”. Therefore, NFRA’s concludes that*
- *The KPMG entities would be covered by the categories of “parent” and “associate” entity as per explanation (ii) to Sec 144 of the Act;*
 - *BSR entities make use of the KPMG Brand name/trade Mark for the audit and non-audit services provided by them;*
 - *the non-audit services provided by BSR Entities and KPMG entities both come within the purview of the prohibited services, including management services, covered under Section 144 of the Companies Act, 2013.*