सत्यमेव जयते

**Consultation Paper – September, 2021**

**on**

**Statutory Audit and Auditing Standards for Micro, Small and Medium Companies (MSMCs)**

**Last date for receipt of comments 10 November 2021**


राष्ट्रीय वित्तीय ररपोवटिंग प्राविकरण

National Financial Reporting Authority

7th – 8th Floor, Hindustan Times House

18-20, Kasturba Gandhi Marg, New Delhi -110001

https://nfra.gov.in

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

This document of 29 September 2021 “NFRA Consultation Paper on Statutory Audit and Auditing Standards for Micro, Small and Medium Companies (MSMCs)” is issued by National Financial Reporting Authority (NFRA) for comments by its stakeholders. The last date for receipt of the comments is 10 November 2021. The comments should be submitted in writing either by email (comments-tac.paper@nfra.gov.in) or by post.

**Page #**

## TABLE OF CONTENTS

## LIST OF ABBREVIATIONS and ACRONYMS

| | |
|---|---|
| ASs | Accounting Standards notified under the Companies (Accounting Standards) Rules 2021 |
| AFS | Annual Financial Statements |
| CARO | Companies' Auditors Report Order, 2020 issued by MCA |
| EU | European Union |
| GPFR | General Purpose Financial Reporting |
| GPFS | General Purpose Financial Statements |
| IAASB | International Auditing and Assurances Standards Board |
| IASB | International Accounting Standards Board of IFRS Foundation |
| ICAI | The Institute of Chartered Accountants of India |
| ICFR | Internal Controls over Financial Reporting |
| Ind ASs | Indian Accounting Standards substantially converged with IFRS Standards |
| MCA | Ministry of Corporate Affairs, Government of India |
| MSMCs | Micro, Small and Medium-size Companies |
| MSMEs | Micro, Small and Medium-size Enterprises |
| NBFCs | Non-Banking Finance Companies |
| NFRA | National Financial Reporting Authority |
| PIE | Public Interest Entity |
| SA | Standards of Auditing |
| SMC | Small and Medium-sized Company |
| UK | United Kingdom |
| US | United States of America |

## 1 EXECUTIVE SUMMARY AND LIST OF QUESTIONS TO RESPONDENTS

1.1 An important function of NFRA under 132(2)(a) of the Companies Act 2013 is to make recommendation to 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.

1.2 In view of the significant role played by companies in India in the economic growth and development of the Nation, it is essential that the regulatory environment is conducive to support, and not burden, the growth in business and economic activities of these entities. The regulations relating to financial reporting and auditing should not impose undue burdens and cost on the regulated entities, and the overall regulatory framework should be proportional to the size and type of the entities that are subject to such regulations.

1.3 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. Different regulations define Small and Medium companies differently depending upon the purpose and intention of the regulation. MSMC as a category used by NFRA in this Consultation Paper is mainly for research purposes keeping in mind that net worth threshold of Rs. 250 crores are a critical threshold differentiating AS and Ind AS companies. 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. A large proportion of these MSMCs are likely to belong to the Micro, Small and Medium -size Enterprises (MSME) sector, which sector plays a significant role in the economic growth and development of the Nation. NFRA now seeks stakeholder responses to issues thrown up by the data on MSMCs obtained by NFRA. These responses will be useful in evaluating the requirement of audit and minimum thresholds for MSMCs.

### 1.4 Questions related to Issues about the Auditing Areas of MSMCs

1.4.1 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?

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?

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 approach for estimating standard cost of audit computed by NFRA? If not, which areas/ assumptions need changes?

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

1.5 **Invitation to Comment**

1.5.1 NFRA invites comments on 4 specific questions listed in Section 4 of the Consultation Paper. In particular, the comments and responses would be useful if:

a) those specifically and precisely answer the questions listed;

b) the comments/suggestions are supported by a clear rationale; and

c) the comments/suggestions contain alternative options that can be evaluated by NFRA.

Last date for receiving the comments is **10 November 2021.**

| The comments can be provided as per the following contact details, and not later than **10 November 2021.** | |
|---|---|
| **Mode** | **Details** |
| Email | comments-tac.paper@nfra.gov.in |
| Postal | The Secretary,<br>National Financial Reporting Authority<br>7th-8th Floor, Hindustan Times House, 18-20,<br>Kasturba Gandhi Marg, New Delhi 110001. |

**1.6 Structure of the Consultation Paper**

**1.6.1** The Consultation Paper is organised as follows:

**Section 1**: Executive Summary and List of Questions to Respondents

**Section 2**: Introduction – Setting the Context

**Section 3**: NFRA's research on MSMCs and preliminary findings

**Section 4**: Issues related to audit of MSMCs

**Annexures and Appendices**

## 2 INTRODUCTION – SETTING THE CONTEXT

### 2.1 About NFRA

2.1.1 National Financial Reporting Authority ("NFRA" or "Authority"), was constituted as an independent regulator for accounting and auditing in India in October 2018. NFRA's Charter positions it as an organisation that should be known for Objectivity, Integrity, Impartiality, Independence, Fairness, and Transparency. In making any recommendations, NFRA attempts to keep in mind the implications of such recommendations on the Ease of Doing Business. Section 132(2)(a) of Companies Act, 2013 requires NFRA to 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.

### 2.2 History of Company Law in India

2.2.1 India has, since long, embraced the Corporate (Company) Structure for the organisations engaged in trade and commerce. The Company Structure came into existence with the enactment of Joint Stock Companies Act, 1857. Thereafter, the Companies Act was passed in the year 1866 which later got replaced by the Indian Companies Act, 1913. It underwent some major changes in 1930s and also in subsequent years, separate laws for Insurance, Banking and Electricity Companies were enacted. After independence, the Government appointed a Committee under the chairmanship of Shri H.C. Bhabha in the year 1950 to revise the Indian Companies Act of 1913. Based on the recommendations of the committee, the Companies Act, 1956 came into force on 1st April, 1956. The Indian Companies Act, 2013 replaced the Indian Companies Act, 1956 and is currently in force. It is pertinent to note that from the year 1857 till date, all these Companies Act enactments have recognised the mandatory requirement relating to Accounts and Audit of accounts of the companies in India. Further, all the Companies Act enactments from 1913 onwards have recognised the need for segregation of Companies into Private and Public for various regulatory purposes and mandated filing of annual financial statements (AFSs) of the Companies and Audit of such AFSs.

### 2.3 Audit Requirement in Present Indian Company Law

2.3.1 Chapter X Audit and Auditors (Section 139 to Section 148) of Companies Act, 2013 contains provisions related to audit of financial statements of companies. This chapter includes provisions, inter alia, regarding appointment, resignation, removal, rights and duties of the statutory auditors. 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. The manner and procedure for selection of auditors by the members shall be as prescribed and the matter relating to such appointment for ratification by members at every annual general meeting.

2.3.2 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 and requires that the report shall after taking into account the provisions of the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of the Act or any rules made thereunder or under any order made under sub-section (11)[1] and to the best of his information and knowledge, state that the said accounts and, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

2.3.3 Section 143(3) casts some additional reporting requirements on the auditor. One such requirement is that the auditor report shall state as to whether the company has adequate internal controls over financial reporting (ICFR) with reference to financial statements in place and the operating effectiveness of such controls.

2.3.4 Section 143(11) empowers the Central Government in consultation with NFRA, to specify vide an order, certain matters to be included in the Auditor's Report. Accordingly, the Companies (Auditor's Report) Order (CARO) has been issued. The CARO reporting origin dates back to 1975 and its scope was expanded in 1988 when the Central Government introduced Manufacturing and Other Companies (Auditors Report) Order, 1988 ('MAOCARO 1988') which was superseded by CARO 2003, CARO 2015, CARO 2016 and the current Companies (Auditor's Report) Order, 2020 ('CARO 2020' or 'the Order').

[1] The Central Government may, in consultation with the National Financial Reporting Authority, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.

2.3.5 **Auditing Standards applicable in India**[2]

Section 143(9) of Companies Act, 2013, requires that every auditor shall comply with auditing standards. Section 143(10) of Companies Act, 2013, states that the Central Government may prescribe the standards of auditing or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority, provided that until any auditing standards are notified, any standard or standards of auditing specified by the Institute of Chartered Accountants of India (ICAI) shall be deemed to be the auditing standards.

As of date, there is a single set of auditing standards issued by ICAI which is applicable for all type of companies viz. private, or public or large, medium or small.

## 2.4 Accounting Requirement in Present Indian Company Law

2.4.1 Chapter IX Account of Companies (Section 128 to Section 138) of Companies Act, 2013, contains provisions related to accounts of companies. Amongst other provisions, this Chapter includes requirements for maintenance of books of account; preparation of financial statement and adoption of the same by Board of Directors of the Companies. Section 129 of the Companies Act, 2013 lays down certain important requirements which are summarised below:

a) Section 129(1) of the Companies Act, 2013, requires that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.

b) Section 129(2) of the Companies Act, 2013, requires the Board of Directors of every company to lay at every annual general meeting of a company, such financial statements for the financial year.

c) Section 129(3) of the Companies Act, 2013, requires a Company which has one or more subsidiaries, to prepare a consolidated financial statement of the Company and of all the subsidiaries in the same form and manner as that of its own which shall also be laid before the annual general meeting of the Company in addition to financial statements provided under sub-section (2).

[2] In June 2021, the International Auditing and Assurance Standards Board (IAASB) has issued an EXPOSURE DRAFT, PROPOSED INTERNATIONAL STANDARDS ON AUDITING OF FINANCIAL STATEMENTS OF LESS COMPLEX ENTITIES and the comment period ends on 31 Jan, 2022. India's position on this reform project is not yet clear.

As per Section 2(40) of Companies Act, 2013, the financial statement in relation to a company, includes-

(i) a balance sheet as at the end of the financial year;

(ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

(iii) cash flow statement for the financial year;

(iv) a statement of changes in equity, if applicable; and

(v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv)[3]

### 2.4.2 Accounting Standards applicable in India

2.4.2.1 Section 133 of Companies Act, 2013, states that the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the ICAI, constituted under Section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

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

| Type | Particulars | Based on | MCA notification |
|---|---|---|---|
| 1 | Ind AS (Indian Accounting Standards) | IFRS based standards with carve outs | Companies (Indian Accounting Standards (IND AS)) Rules 2015 and amendments thereafter (Ind AS Rules 2015) |
| 2 | AS (Accounting Standards) | Traditional accounting standards applicable in India before notification of Ind AS | Companies (Accounting Standards) Rules, 2021 (AS Rules 2021)[4] |

Every company, other than a company to which Indian Accounting Standards as notified under Companies (Indian Accounting Standards) Rules, 2015 are applicable, shall comply with the Accounting Standards notified under Companies (Accounting Standards) Rules, 2021.

[3] Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement

[4] These Accounting Standards were originally notified in 2006 under Companies (Accounting Standards) Rules, 2006.

The Companies (Accounting Standards) Rules, 2021 define "Small and Medium Sized Company" (SMC) as a company:-

(i) whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; (ii) which is not a bank, financial institution or an insurance company; (iii) whose turnover (excluding other income) does not exceed two hundred and fifty crore rupees in the immediately preceding accounting year; (iv) which does not have borrowings (including public deposits) in excess of fifty crore rupees at any time during the immediately preceding accounting year; and (v) which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Such companies are eligible for some minimal exemptions from Accounting Standards.

### 2.5 Financial Reporting and General Purpose Financial Reporting (GPFR)

2.5.1 Financial Reporting generally means supply of financial information about an entity or reporting unit to the users or stakeholders, who could be an internal party or external party. In case of the former, it is commonly referred to as Management Reporting (or Accounting) and in case of latter it is known as External Financial Reporting. The more widely used and understood term is General Purpose Financial Reporting (GPFR) or General Purpose Financial Statements (GPFS).

2.5.2 The objective of GPFS[5] is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity. Those decisions involve decisions about:

(a) buying, selling or holding equity and debt instruments;

(b) providing or settling loans and other forms of credit; or

(c) exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

It may be noted that GPFS contain financial information that is useful and relevant to a wide set of external parties such as Regulators, Tax Authorities, Suppliers, Employees and the public at large. However, in recent times, the accounting standard-setting bodies whose standards form the primary bases for preparing GPFS, have consciously decided that the "Primary Users"[6] of

[5] Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS) issued by the Institute of Chartered Accountants of India (ICAI), 2020 -21

[6] Conceptual Framework for Financial Reporting issued by the International Accounting Standards Board (IASB) in March 2018 and Statement of Financial Accounting Concepts No. 8 issued by the Financial Accounting Standards Board (FASB), United States of America (US).

GPFS will be only those listed above in this para 2.5.2.What needs emphasis is that both such "Primary Users" and the information needs for the kind of decisions detailed above, are not likely to be found in a preponderant majority of MSMCs. Therefore, both Accounting and Auditing Standards, and the requirement of mandatory statutory audit, as applicable to other (i.e. non MSMCs or large) companies would be both unnecessary and unjustified on cost-benefit considerations.

**2.5.3 Contents and Characteristics of GPFS**

2.5.3.1 The GPFSs are intended to provide financial information about the reporting entity's economic resources, claims against the entity and changes in resources and claims. This information is provided in the form of a set of financial reports or statements as listed below:

(a)Statement of financial position or Balance Sheet which provides information about the entity's economic resources and the claims against the reporting entity.

(b)Statement of financial performance or Statement of Comprehensive Income which depicts the information about changes in entity's resources and claims due to transactions or events other than those with the owners or shareholders of the entity.

(c)Statement of Cash Flows which gives the information about the changes in the entity's cashflows during a particular period which is turn is intended to enable users to assess the entity's ability to generate future net cash inflows and to assess management's stewardship of the entity's economic resources.

(d)Notes to financial statements to aid the understanding of the financial information summarised in the above financial statements and enhance the value of that financial information.

2.5.3.2 In order for the financial information supplied through GPFS to be useful and meet the needs of the primary users of GPFS, the accounting standard-setters have laid down certain underlying ground rules or concepts in the form of Conceptual Framework[7] for Financial Reporting and one of the key components is about the qualitative characteristics of useful financial information. These qualitative characteristics have been broadly divided into following two groups.

[7] Ibid footnote 1 & 2

| **Fundamental qualitative characteristics** | **Enhancing qualitative characteristics** |
|---|---|
| Relevance* | Comparability |
| Materiality | Verifiability |
| Faithful representation* | Timeliness |
| | Understandability |

*These two aspects have been considered as two of the seven alignment principles to be considered in developing the IFRS for SMEs Standards.[8]

2.5.3.3 The providers as well as users of financial information incurs costs in generating and consuming the financial information supplied. The benefits of the financial information provided should justify the costs incurred by both the provider and users. Cost is considered to be a pervasive constraint in the financial information that can be provided through GPFS. Cost is, therefore, a critical aspect to consider for justifying the nature, complexity and extent of financial information that is required to be provided by the GPFS.

## 2.6 Profile at a Glance of companies registered in India

2.6.1 Based on the statistics published by the Ministry of Corporate Affairs, Government of India (MCA), the total number of active companies was in the range of 11,59,945 to 12,99,710 during the period 2018-2021. The preponderant share is of private limited and one person companies; 93.85%, 94.43%,94.66% and 94.93% of the total number of active companies were private limited companies and one person companies as of 31 March 2018, 31 March 2019, 31 March 2020 and 31 March 2021, respectively.

The below table gives the broad category-wise details of the total number of companies:

**Table 1: Total Population Size -Total number of Active Companies limited by Shares[9]**

| **Company Type** | **31 March 2018** | | **31 March 2019** | | **31 March 2020** | | **31 March 2021** | |
|---|---|---|---|---|---|---|---|---|
| | **Number** | **%** | **Number** | **%** | **Number** | **%** | **Number** | **%** |
| **Private Limited** | **10,88,657** | **93.85** | **10,85,178** | **94.43** | **11,28,300** | **94.66** | **12,33,768** | **94.93** |
| *Of which* | | | | | | | | |
| *Private Limited* | *10,71,944* | - | *10,62,418* | - | *11,00,235* | - | *11,97,244* | - |

[8] Comprehensive Review of IFRS for SMEs Standards, Request for Information- January 2020 of IASB.
[9] Source: Monthly Information Bulletin of Corporate Sector of MCA, GOI.

| Company Type | 31 March 2018 | | 31 March 2019 | | 31 March 2020 | | 31 March 2021 | |
|---|---|---|---|---|---|---|---|---|
| | Number | % | Number | % | Number | % | Number | % |
| *One Person Company* | *16,713* | - | *22,760* | - | *28,065* | - | *36,524* | - |
| **Public** | **71,288** | **6.15** | **63,989** | **5.57** | **63,592** | **5.34** | **65,942** | **5.07** |
| *Of which* | | | | | | | | |
| *Listed* | *7,239* | - | *6,915* | - | *6,802* | - | *6,740* | |
| *Unlisted* | *64,049* | - | *57,074* | - | *56,790* | - | *59,202* | |
| **Total** | **11,59,945** | **100** | **11,49,167** | **100** | **11,91,892** | **100** | **12,99,710** | **100** |

## 3 NFRA'S RESEARCH ON MSMCs AND PRELIMINARY FINDINGS

Key data parameters viz. payment to auditors, turnover, net worth, and indebtedness of companies with net worth below Rs. 250 crore were analysed by NFRA to understand the nature and size of such companies and the related public interest involved. The payment to auditors made by the Companies as reported in their filings is compared with the estimated standard cost of audit for a reasonably good quality audit, performed in compliance with the letter and spirit of the SAs. Further, the auditing requirement in India's tax laws, and the exemptions from the statutory audit requirement as existing in developed economies is provided in this consultation paper so that respondents can consider those aspects as well while giving their responses.

### 3.1 NFRA's Findings from MCA 21 Data

3.1.1 Of the total number of companies as per Table 1 in Para 2.6.1 above, only 52.48% (6,03,055 Companies) of the total number of active companies have filed their AFSs and MGT -7 for the financial year (FY) 2018-19[10] as of June 2021 (Refer Table 1.1 in Annexure 2 for details). Such a low percentage of 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. It may also be relevant to note that there are only 4,349 Listed Companies that have filed their AFSs & MGT-7 so far.

Of the total number of companies that have filed AFSs for the FY 2018-19, 97.09% (5,85,535 Companies) have submitted their financial statements prepared under Companies (Accounting Standards) Rules 2006 (AS Framework) and 2.91% (17,520 Companies) have submitted

[10] In view of the on-set of global pandemic COVID-19 in March 2020, there are likely to be delays in filings by the companies during FY 2019-20. Hence, the FY 2018-19 has been considered for analysis.

financial statements prepared under Companies (Indian Accounting Standards) Rules 2015 (Ind AS Framework) (Refer Table 1.2 in Annexure 2).

Out of the total companies which have made filings, 99.41% (5,99,487 Companies)[11] have reported Net Worth below ₹ 250 Crores (MSMCs for the purpose of this consultation paper).

3.1.2 The above data indicates the following key features of MSMCs:

(i) Payments to Auditors[12] ((Refer Table 1.6 in Annexure 2 and Annexure 3)

- There are a large number of Companies (1,81,392 Companies, nearly 30.26%) that have reported NIL Payments to Auditors. This perhaps could be data input error indicating lack of adequate accounting professionals with many of these companies.
- A large majority of Companies (2,48,218 Companies accounting for 41.41%) have reported small amounts of Payments to Auditors i.e., below ₹25 Thousand. Of these Companies, 40,708 Companies have reported extremely small amounts of payments to Auditors i.e., below ₹5 Thousand. The estimated standard cost to perform a reasonably good quality audit, in compliance with the letter and spirit of the SAs, for an MSMC, with Turnover below 50 Crores, is in the range of ₹1.50 lakhs to ₹ 8.43 lakhs (Refer Annexure 3). This estimated audit cost is several multiples higher as compared to the presently reported audit fee ranges i.e., a very large percentage of MSMCs have reported Payment to Auditors of less than ₹ 25 thousand.

(ii) Turnover (Refer Table 1.4 in Annexure 2):

- Of the total number of 5,99,487 MSMCs considered in NFRA's preliminary research, there are a large number of Companies (2,09,122 Companies accounting for 34.88%) that have reported Nil Turnover (in some cases, there could be data input errors in MCA21).
- Among the MSMCs that have reported Turnover, a large number of Companies (3,67,019) i.e., nearly 61.22% have very low turnover i.e., below ₹ 50 Crores.

(iii) Indebtedness (Refer Table 1.5 in Annexure 2)

- Of the total number of 5,99,487 MSMCs considered in NFRA's preliminary research, a significant number of Companies (2,66,832 Companies accounting for 44.51%) have reported NIL Indebtedness. Of these debt-free Companies, 1,12,043 Companies, nearly 41.99%, have also reported NIL Turnover.

[11] A small percentage of these companies (14,581 out of 5,99,487 companies) have made Ind AS filings perhaps due to voluntary adoption of Ind AS or for the reason of these companies being holding, subsidiary, associates or JVs of Ind AS companies.

[12] This includes fees to auditors for other services also as separate data for statutory audit fee is not available.

- Further, out of remaining companies having indebtedness, there are a large number of companies (3,15,803 Companies, nearly 52.68%) that have low Indebtedness i.e., below ₹ 25 Crores.

(iv) Net Worth Size (Refer Table 1.3 in Annexure 2):

- Of the total number of MSMCs, there are 4,76,536 Companies with cumulative positive Net Worth of ₹ 21,37,302 Crores and 1,22,951 Companies with cumulative negative Net Worth of ₹ 9,50,457 Crores.
- Among the MSMCs with positive Net Worth, there are a large number of Companies (4,57,170) i.e., nearly 95.93% that have very low Net Worth i.e., Net Worth below ₹ 25 Crores.

Needless to say, the above analysis clearly brings out that a preponderant majority of these companies is very small in size in terms of key financial parameters. Payment to auditors by such companies is miniscule and far below the minimum standard audit fees cost estimates.

**3.2 Limited Users of GPFSs of MSMCs**

As depicted in Table 1.2 in Annexure 2, 94.57% of MSMCs which have made filings for FY 2018-19 are Private Limited Companies or One Person Companies. A large majority of Companies has very low or NIL Indebtedness, which indicates low risk to the larger public interest. There is likely to be a very limited number of users of GPFSs of these Companies. The Primary Users of GPFSs of these companies would be Owners or Shareholders of these Private Limited Companies, who are unlikely to depend upon GPFSs for much of the financial information they need. Lenders, if any, such as banks have special requirements that are not within the purview of GPFSs.

**3.3 Auditing thresholds already available in**

**3.3.1 Indian Tax Laws**

The Indian Tax Authorities have substantially done away with the requirement of audit by Chartered Accountants up to certain threshold amounts. By the Finance Act, 2021, Income Tax audit has been dispensed with for businesses with turnover of up to Rs 10 crores, provided not more than 5 % of the total transactions are in cash. GST Audit has also been completely done away with.

In view of the above, the extent of public interest involved in the financial reporting of these Companies is most likely to be minimal.

### 3.3.2 Reporting on CARO and ICFR

| Nature of Company | CARO[13] | ICFR |
|---|---|---|
| One Person Company as per section 2(63) of the Companies Act, 2013 | Exempt – No reporting required | Exempt – No reporting required |
| Small Company as per section 2(85) of the Companies Act, 2013 | Exempt – No reporting required | Exempt – No reporting required |
| Private Limited Company as per section 2(68) of the Companies Act, 2013 | not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than ₹ 1 crores as on the balance sheet date and which does not have total borrowings exceeding ₹ 1 crores from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act (including revenue from discontinuing operations) exceeding ₹ 10 crores during the financial year as per the financial statements. | which has a turnover of less than 50 Crore as per the latest Audited Financial Statements or which has an aggregate borrowing from Banks or FIs or any Body Corporate at any point of time during the financial year less than Rs. 25 Crore |

[13] CARO is not applicable to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949); (ii) an insurance company as defined under the Insurance Act,1938 (4 of 1938); (iii) a company licensed to operate under section 8 of the Companies Act, 2013

### 3.3.3 Global jurisdictions

The auditing ecosystem of developed economies such as EU, UK, Singapore, Australia, USA and Japan allows for exemptions to certain classes of companies depending upon thresholds based on various parameters. The following is the country/ region wise summary. Full details of country-wise exemptions are given in Annexure 1.

(i) European Union (EU)

- The directive of EU states that the small undertakings should not be covered by the audit obligation, as audit can be a significant administrative burden for that category of undertakings. It also states that in many small undertakings the same persons are both shareholders and managers and, therefore, have limited need for third-party assurance on financial statements.
- The criteria for exemption set by EU is satisfaction of 2 out of 3 thresholds on basis of criteria viz. balance sheet total, net turnover and average number of employees during the financial year. The thresholds are categorised for micro, small and medium sized entities. Based on such directive, EU member countries have set their country specific thresholds.

(ii) United Kingdom

- Small companies are exempt from audit and the criteria for exemption is on basis of satisfying 2 out of 3 thresholds on basis of balance sheet total, turnover and number of employees. The thresholds are:-

| Criteria | Amount (in Pound) |
|---|---|
| Turnover | Not more than £ 10.2 million |
| Balance Sheet Total | Not more than £ 5.1 million |
| Number of employees | Not more than 50 |

- UK Companies Act also extends exemption to parent company provided the group headed by it qualifies as a small group (for which there are similar exemption thresholds).

(iii) Singapore

- Small companies are exempt from audit and the criteria for exemption is on basis of satisfying 2 out of 3 thresholds on basis of balance sheet total, turnover and number of employees. The thresholds are:-

| Criteria | Amount (in Singapore Dollar) |
|---|---|
| Revenue | Not more than $ 10 million |
| Total Assets | Not more than $ 10 million |
| Number of employees | Not more than 50 |

- Singapore Companies Act also extends exemption to parent company provided the group headed by it qualifies as a small group (for which there are similar exemption thresholds).

(iv) Australia

- Small companies are exempt from audit and the criteria for exemption is on basis of satisfying 2 out of 3 thresholds on basis of balance sheet total, turnover and number of employees. The thresholds are:-

| Criteria | Amount (in Australian Dollar) |
|---|---|
| Revenue | Not more than $ 25 million |
| Total Assets | Not more than $ 12.5 million |
| Number of employees | Not more than 50 |

- The exemption is also available to companies limited by guarantee provided revenue is less than Australia dollar 2,50,000.

(v) United States of America (USA)

- A company which is not issuer of securities and not listed on a US Stock Exchange, is regulated by Corporate Law of that particular state where it is incorporated. A majority of the states in USA have adopted the model law called 'Model Business Corporation Act' recommended by the American Bar Association. This model law does not prescribe any mandatory requirements for audit of financial statements of corporates. It states that if the annual financial statements are reported upon by a public accountant, his report must accompany them. If not, the statements must be accompanied by a declaration of the president or the person responsible for the corporation's accounting records stating that the financial statements are prepared on accepted accounting principles and if not, describing the basis of preparation.

(vi) Japan

- Under Japanese Act, 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; and

(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.

## 4 ISSUES RELATED TO AUDIT OF MSMCs

4.1 The above analysis clearly brings out the mismatch between the current payment made to auditors as reported by the companies and the estimated cost for conducting an audit in compliance with the letter and true spirit of SAs. The inference that is inescapable is that such audit as is being carried out is perhaps only a sham. In many small companies, the same persons are both owners and managers (as also pointed out by EU Directive mentioned in Annexure 1) and, therefore, have limited third-party users of GPFSs. A majority of these MSMCs is essentially family-owned enterprises formed as companies for the sake of limited liability, or to get bank loans, bus route permits, mining licences, and the like. They are effectively glorified proprietorships or partnerships. There is no public interest in foisting external audit on them. In any event, it is clear that such audit as is being carried out cannot boast of any quality at all. Banks or external investors, if any, can direct them to have an audit as a condition for giving them loans, but that can be a private matter. In the above circumstances, questions would naturally arise whether compulsory statutory audit of GPFSs is necessary, or even desirable in the case of the vast majority of companies who do not seem to be able to afford such an audit.

4.2 Exempting small companies from mandatory audit would result in furthering ease of doing business for MSMCs and reducing the compliance burden and costs on such enterprises. The audit requirement threshold exemption in tax laws of India also clearly point out the need for doing away with audit of MSMCs depending upon certain thresholds. Exemptions are also already available in CARO and ICFR Reporting depending upon certain thresholds as mentioned in Para 3.3.2. The same thought can be leveraged for overall approach towards statutory audits. Further, the criteria and basis for threshold exemptions for statutory audit, CARO and ICFR reporting can be considered for being streamlined.

4.3 NFRA requests views/comments of stakeholders on specific questions mentioned below in relation to the key issues mentioned above.

| Question No. | Particulars |
|---|---|
| 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?* |
| 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?* |
| 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? If not, which areas/ assumptions need changes?* |
| 4 | *Do you think the current exemption thresholds for CARO, ICFR and statutory audit applicability need to be standardised and made uniform? If no, why not and if yes, what would be the criteria and thresholds?* |

**Annexure 1**

**Audit Exemption Thresholds in Global Jurisdictions**

**A. European Union (EU) - Exemptions from Audit of Financial Statements of Companies**

In EU, the requirements relating to annual financial statements of Companies are prescribed in DIRECTIVE 2013/34/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013[14]. Article 34 in Chapter 8 of this Directive requires its member states to ensure that annual financial statements of public interest entities, medium-sized and large undertakings are audited by one or more statutory auditors or audit firms approved by Member States to carry out statutory audits on the basis of Directive 2006/43/EC.

Further, clause 43 of introductory part of the Directive states that Annual financial statements and consolidated financial statements should be audited. *However, this clause also states that the annual financial statements of small undertakings should not be covered by this audit obligation, as audit can be a significant administrative burden for that category of undertaking, while for many small undertakings the same persons are both shareholders and managers and, therefore, have limited need for third-party assurance on financial statements.*

Article 3 of the EU Directive defines Micro, Small and Medium-sized Undertakings as entities that do not exceed the limits of at least two of the three following criteria.

| **Particulars** | **Micro** | **Small** | | **Medium-sized** | |
|---|---|---|---|---|---|
| | **Individual** | **Individual** | **Group (Parent Co. Level)** | **Individual** | **Group (Parent Co. Level)** |
| Balance Sheet Total – Euro | 350,000 | 4,000,000* | 4,000,000* | 20,000,000 | 20,000,000 |
| Net Turnover- Euro | 700,000 | 8,000,000* | 8,000,000* | 40,000,000 | 40,000,000 |
| Average number of employees during the financial year | 10 | 50 | | 250 | 250 |

*Member States can increase these limits to Euro 6,000,000 and 12,000,000, for Balance Sheet Total and Net Turnover, respectively.

[14] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0034&from=EN

Table below provides an overview of the current audit exemption thresholds applicable in 27 EU Member States, Iceland, Norway, Switzerland, Turkey and United Kingdom[15].

Table 1 - Audit exemption thresholds in 27 EU Member States, Iceland, Norway, Switzerland, Turkey and United Kingdom in 2021[16]

| Country | Balance sheet total (EUR) | Net turnover (EUR) | Number of employees |
|---|---|---|---|
| Austria | 5.000.000 | 10.000.000 | 50 |
| Belgium[17] | 4.500.000 | 9.000.000 | 50 |
| Bulgaria | 1.000.000 | 2.000.000 | 50 |
| Croatia | 2.000.000 | 4.000.000 | 25 |
| Cyprus[18] | 0 | 0 | 0 |
| Czech Republic | 1.500.000 | 3.000.000 | 50 |
| Denmark a[19] | 537.000 | 1.075.000 | 12 |
| Denmark b[20] | 6.000.000 | 12.000.000 | 50 |
| Estonia a[21] | 800.000 | 1.600.000 | 24 |
| Estonia b[22] | 2.000.000 | 4.000.000 | 50 |
| Finland | 100.000 | 200.000 | 3 |
| France[23] | 4.000.000 | 8.000.000 | 50 |
| Germany | 6.000.000 | 12.000.000 | 50 |
| Greece | 4.000.000 | 8.000.000 | 50 |
| Hungary[24] | Not applicable | 833.333 | 50 |
| Iceland | 1.400.000 | 2.800.000 | 50 |
| Ireland | 6.000.000 | 12.000.000 | 50 |
| Italy[25] | 4.000.000 | 4.000.000 | 20 |
| Latvia | 800.000 | 1.600.000 | 50 |
| Lithuania | 1.800.000 | 3.500.000 | 50 |
| Luxembourg | 4.400.000 | 8.800.000 | 50 |

[16] Data obtained from Member bodies of Accountancy Europe. Figures in currencies other than EUR were converted to EUR at the time when the data were obtained
[17] Thresholds are determined on a consolidated basis for groups, which leads to mandatory statutory audit for smaller entities in the group although individually they fall under the thresholds
[18] There are considerations in Cyprus to introduce an option to opt for a review engagement under ISRE 2400 in lieu of an audit for very small companies
[19] Above these thresholds, there is a choice between extended review or audit
[20] Above these thresholds, statutory audit is mandatory
[21] Thresholds applicable for statutory review
[22] Thresholds applicable for statutory audit
[23] Only the companies that are above 2 of the 3 thresholds are now subject to statutory audit. There are 2 exceptions to that rule: 1) A company which is the head of a group where the group is above 2 of the 3 current thresholds is subject to statutory audit even though the group does not prepare consolidated financial statements; 2) The significant subsidiaries of such groups which are above 2 of the 3 following thresholds (EUR 2.000.000 for balance sheet, EUR 4.000.000 for turnover and 25 employees) are also subject to statutory audit
[24] The thresholds did not change since 2018, however there has been a depreciation of Hungarian Forint against the Euro. Therefore, the change in thresholds in EUR terms since 2018 is just a matter of exchange rate fluctuation. The threshold for net turnover in HUF is 300.000.000
[25] For non-PIEs, the Insolvency Law defines that the audit is mandatory after an entity has exceeded 1 of the 3 thresholds as per the Table 1 for 2 consecutive years. The audit is not mandatory when an entity has not exceeded any of the 3 thresholds for 3 consecutive years

[15] Source: https://www.accountancyeurope.eu/wp-content/uploads/Audit-exemption-thresholds-in-Europe.pdf

| Country | Balance sheet total (EUR) | Net turnover (EUR) | Number of employees |
|---|---|---|---|
| Malta[26] | 46.600 | 93.000 | 2 |
| Netherlands | 6.000.000 | 12.000.000 | 50 |
| Norway[27] | 2.500.000 | 625.000 | 10 |
| Poland[28] | 2.500.000 | 5.000.000 | 50 |
| Portugal[29] | 1.500.000 | 3.000.000 | 50 |
| Romania[30] | 3.350.000 | 6.650.000 | 50 |
| Slovakia | 2.000.000 | 4.000.000 | 30 |
| Slovenia | 4.000.000 | 8.000.000 | 50 |
| Spain | 2.850.000 | 5.700.000 | 50 |
| Sweden | 150.000 | 300.000 | 3 |
| Switzerland[31] | 18.203.000 | 36.405.000 | 250 |
| Turkey[32] | 4.070.000 | 8.140.000 | 175 |
| United Kingdom[33] | 6.541.000 | 13.082.000 | 50 |

[26] No audit exemption threshold for tax purposes
[27] Limited-liability companies exempt from statutory audit if all 3 limits are not exceeded
[28] Exemption does not apply if an entity prepares its financial statements under IFRS
[29] No audit exemption threshold for SAs (sociedades anónimas)
[30] The thresholds in Romanian Leus are RON 16.000.000 for balance sheet and 32.000.000 for net turnover
[31] The thresholds in Swiss Francs are CHF 20.000.000 for balance sheet and CHF 40.000.000 for turnover. Entities that do not exceed 2 of the 3 threshold criteria in 2 consecutive years are subject to a statutory limited examination (negative assurance or review engagement). Shareholders of entities with no more than 10 employees can decide to opt out of any audit or review obligation
[32] The thresholds in Turkish Liras are TRY 35.000.000 for balance sheet and 70.000.000 for net turnover. Note that in Turkey, audit is mandatory also for other entities such as those subject to the Banking Regulation, certain public entities, those that qualify as public institutions and other dedicated entities. For these entities (apart from banks which are always subject to audit), different (lower) sets of thresholds apply than those in Table 1
[33] The thresholds in British Pounds (£5.100.000 for balance sheet and £10.200.000 for turnover) were converted to EUR using an exchange rate set in the original legislation transposing the 2013 EU Accounting Directive
[34] For more details refer to Accountancy Europe's publication *Rediscovering the value of SME audit* (2018); available at https://www.accountancyeurope.eu/publications/rediscovering-value-sme-audit/
[35] The Swedish National Audit Office is an independent agency charged with the audit of government institutions and the oversight of the state finances through financial and performance-based audits of state agencies, state-owned companies and the Government of Sweden. It operates directly under the Swedish Parliament (Riksdag) and is independent of political or other stakeholder interests. More information is available at https://www.riksrevisionen.se/en/Start/About-us/

## B. United Kingdom (UK) - Exemptions from Audit of Financial Statements of Companies

According to Section 477 & 479 of the UK Companies Act 2006, certain category of Companies or Group of Companies are exempt from the requirements related to audit of accounts. Key prescriptions are summarized[16] below.

- *Section 477 Small companies: conditions for exemption from audit-*

(1) A company that qualifies as a small company in relation to a financial year is exempt from the requirements of this Act relating to the audit of accounts for that year.

[16] For more details, https://www.legislation.gov.uk/ukpga/2006/46/contents

(4) For the purposes of this section—
whether a company qualifies as a small company shall be determined in accordance with section 382(1) to (6),

- *Section 382 Companies qualifying as small: general-*

(1) A company qualifies as small in relation to its first financial year if the qualifying conditions are met in that year.
(3) The qualifying conditions are met by a company in a year in which it satisfies two or more of the following requirements—

| | |
|---|---|
| 1. Turnover | Not more than £10.2 million |
| 2. Balance sheet total | Not more than 5.1 million |
| 3. Number of employees | Not more than 50 |

- *Section 383 Companies qualifying as small: parent companies-*

(1) A parent company qualifies as a small company in relation to a financial year only if the group headed by it qualifies as a small group.
(2) A group qualifies as small in relation to the parent company's first financial year if the qualifying conditions are met in that year.
(4) The qualifying conditions are met by a group in a year in which it satisfies two or more of the following requirements—

| | |
|---|---|
| 1. Aggregate turnover | Not more than £10.2 million net (or £12.2 million gross) |
| 2. Aggregate balance sheet total | Not more than £5.1 million net (or £6.1 million gross) |
| 3. Aggregate number of employees | Not more than 50 |

- *Section 478 Companies excluded from small companies exemption-*

A company is not entitled to the exemption conferred by section 477 (small companies) if it was at any time within the financial year in question—
(a) a public company,
(b) a company that—
   (i) is an authorised insurance company, a banking company, an e-money issuer, MiFID investment firm or a UCITS management company,
   (ii) carries on insurance market activity, or

(iii) is a scheme funder of a Master Trust scheme within the meanings given by section 39(1) of the Pension Schemes Act 2017(interpretation of Part 1), or

(iv)a special register body as defined in section 117(1) of the Trade Union and Labour Relations (Consolidation) Act 1992 (c. 52) or an employers' association as defined in section 122 of that Act or Article 4 of the Industrial Relations (Northern Ireland) Order 1992 (S.I. 1992/807 (N.I. 5)).

- *Section 479 Availability of small companies exemption in case of group company*

(1) A company is not entitled to the exemption conferred by section 477 (small companies) in respect of a financial year during any part of which it was a group company unless—

(a) the group—

(i) qualifies as a small group in relation to that financial year, and

(ii) was not at any time in that year an ineligible group, or

(b) subsection (3) applies.

(3) A company is not excluded by subsection (1) if, throughout the whole of the period or periods during the financial year when it was a group company, it was both a subsidiary undertaking and dormant.

### C. Singapore - Exemptions from Audit of Financial Statements of Companies

According to Section 205C of the Singapore Companies Act, certain category of Companies or Group of Companies are exempt from the requirements related to audit of accounts. Key prescriptions are summarized[17] below.

- *Small company exempt from audit requirements*

Section 205C.—(1) Subject to subsections (3), (4) and (6), a company that is a small company in respect of a financial year shall be exempt from audit requirements for that financial year.

(2) Section 205B(4), (6) and (7) shall apply, with the necessary modifications, to a small company so exempt.

(3) Subsection (1) does not apply to a parent company unless the parent company —

(a) is a small company; and

(b) is part of a small group.

(4) Subsection (1) does not apply to a subsidiary company unless the subsidiary company —

(a) is a small company; and (b) is part of a small group.

(5) In this section, “small company” and “small group” have the same meanings as in the Thirteenth Schedule.

[17] For more details, https://sso.agc.gov.sg/Act/CoA1967

- *Thirteenth schedule - criteria for small company and small group*

2. A company is a small company from a financial year if —

(*a*) it is a private company throughout the financial year; and

(*b*) it satisfies any 2 of the following criteria for each of the 2 financial years immediately preceding the financial year:

(i) the revenue of the company for each financial year does not exceed $10 million;

(ii) the value of the company's total assets at the end of each financial year does not exceed $10 million;

(iii) it has at the end of each financial year not more than 50 employees.

7. A group is a small group from a financial year if the group satisfies any 2 of the following criteria for each of the 2 consecutive financial years immediately preceding the financial year:

(*a*) the consolidated revenue of the group for each financial year does not exceed $10 million;

(*b*) the value of the consolidated total assets of the group at the end of each financial year does not exceed $10 million;

(*c*) the group has at the end of each financial year an aggregate number of employees of not more than 50.

## D. Australia- Exemptions from Audit of Financial Statements of Companies

According to Section 301 Corporation Act 2001, certain category of Companies are exempt from the requirements related to audit of accounts. Key prescriptions are summarized[18] below.

- *Section 301 Audit of annual financial report*

Small proprietary companies

(2) A small proprietary company's financial report for a financial year does not have to be audited if:

(a) the report is prepared in response to a direction under section 293; and

(b) the direction did not ask for the financial report to be audited.

- *Section 293 Small proprietary company—shareholder direction*

(1) Shareholders with at least 5% of the votes in a small proprietary company may give the company a direction to:

(a) prepare a financial report and directors' report for a financial year; and

(b) send them to all shareholders.

[18] For more details, https://www.legislation.gov.uk/ukpga/2006/46/contents

- *Section 45A Proprietary companies Small proprietary company*

(2) A proprietary company is a small proprietary company for a financial year if it satisfies at least 2 of the following paragraphs:

(a) the consolidated revenue for the financial year of the company and the entities it controls (if any) is less than $25 million, or any other amount prescribed by the regulations for the purposes of this paragraph;

(b) the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is less than $12.5 million, or any other amount prescribed by the regulations for the purposes of this paragraph;

(c) the company and the entities it controls (if any) have fewer than 50, or any other number prescribed by the regulations for the purposes of this paragraph, employees at the end of the financial year.

- *Companies limited by guarantee*

(4) A small company limited by guarantee's financial report for a financial year does not have to be audited or reviewed if:

(a) the report is prepared in response to a member direction under section 294A; and

(b) the direction does not ask for the audit or review.

- *294A Small company limited by guarantee—member direction*

(1) Members with at least 5% of the votes in a small company limited by guarantee may give the company a direction to:

(a) prepare a financial report and directors' report for a financial year; and

(b) send them to members who have elected to receive them under section 316A.

Section 45B defines Small company limited by guarantee and quantitative threshold is revenue of less than $250,000.

## E. United States of America (US)- Exemptions from Audit of Financial Statements of Companies

In US, the governing law and regulations depend upon whether the Company is an issuer of securities on US Stock Exchanges and therefore governed by SEC, US. If not, the Company will be primarily governed by the Corporate Law of the State where it is incorporated. Majority of the States in US have adopted a model law called 'Model Business Corporation Act' prepared/recommended by The American Bar Association[19], which was reportedly revised recently in 2017. This model law does not prescribe any mandatory requirements for audit of financial statements of corporates. Following are the specimen texts of clauses relating to audit of financial statements.

[19] https://en.wikipedia.org/wiki/Model_Business_Corporation_Act

- *Model Business Corporation Act CHAPTER 16 RECORDS AND REPORTS*
  16.20. Financial statements for shareholders

  (a) A corporation shall furnish its shareholders annual financial statements, which may be consolidated or combined statements of the corporation and one or more of its subsidiaries, as appropriate, that include a balance sheet as of the end of the fiscal year, an income statement for that year, and a statement of changes in shareholders' equity for the year unless that information appears elsewhere in the financial statements. If financial statements are prepared for the corporation on the basis of generally accepted accounting principles, the annual financial statements must also be prepared on that basis.

  *(b) If the annual financial statements are reported upon by a public accountant*, his report must accompany them. If not, the statements must be accompanied by a statement of the president or the person responsible for the corporation's accounting records:

  (1) stating his reasonable belief whether the statements were prepared on the basis of generally accepted accounting principles and, if not, describing the basis of preparation; and

  (2) describing any respects in which the statements were not prepared on a basis of accounting consistent with the statements prepared for the preceding year.

- *Washington State Act*

*(3) If the annual financial statements are reported upon by a public accountant*, the accountant's report must accompany them. If not, the statements must be accompanied by accountant's a statement of the president or the person responsible for the corporation's accounting records:

(a) Stating the person's reasonable belief whether the statements were prepared on the basis of generally accepted accounting principles and, if not, describing the basis of preparation; and of and

(b) Describing any respects in which the statements were not prepared on a basis of accounting consistent with the basis used for statements prepared for the preceding year.

- *Florida State Act*

607.1620 Financial statements for shareholders.**--**

(1) Unless modified by resolution of the shareholders within 120 days of the close of each fiscal year, a corporation shall furnish its shareholders annual financial statements which may be consolidated or combined statements of the corporation and one or more of its subsidiaries, as appropriate, that include a balance sheet as of the end of the fiscal year, an income statement for that year, and a statement of cash flows for that year. If financial statements are prepared for the corporation on the basis of generally accepted accounting principles, the annual financial statements must also be prepared on that basis.

*(2) If the annual financial statements are reported upon by a public accountant*, his or her report must accompany them. If not, the statements must be accompanied by a statement of the president or the person responsible for the corporation's accounting records:

(a) Stating his or her reasonable belief whether the statements were prepared on the basis of generally accepted accounting principles and, if not, describing the basis of preparation; and

(b) Describing any respects in which the statements were not prepared on a basis of accounting consistent with the statements prepared for the preceding year.

## F. Japan

The exemptions available in Japan Companies Act can be accessed at below link:-

http://www.hp.jicpa.or.jp/english/accounting/system/archive01.html

**Annexure 2**

## Data Tables used by NFRA for its Research

1 Population size of Companies & Status of Filing of AFSs/MGT 7

Before identifying and analysing the certain key features of MSMCs, it is considered appropriate to identify the population size of the companies with net worth below ₹ 250 crores and the status of filing of Annual Financial Statements by these Companies. The data sources used for this purpose are as follows.

a) Population Size: This data is obtained from Monthly Information Bulletins published by Ministry of Corporate Affairs, Government of India (MCA).

b) Status of Filing of AFSs/MGT 7: This data is obtained from annual returns (viz. MGT 9) and AOC-4 filed with MCA and stored I the MCA's Corporate Data Management (CDM). Filings are for the financial year 2018-19[20] and cut-off date for filings is June 2021.

**Table 1.1. Summary Status of Filing of Annual Financial Statements/MGT-7 for FY 2018-19**

| Company Type | Total Active Companies | | AFS/MGT-7 Filing Data | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Total number of filings | | Companies with Net Worth below ₹ 250 crores | | Companies with Net Worth above ₹ 250 crores | |
| | Number of Companies | % | Number of Companies | % | Number of Companies | % | Number of Companies | % |
| **Private Limited *of which*** | 10,85,178 | 94.43% | 5,68,556 | 52.39% | 5,66,935 | 94.57% | 1,621 | 45.43% |
| *Private Limited* | *10,62,418* | - | 5,60,405 | | *5,58,784* | - | *1,621* | - |
| *One Person Company* | *22,760* | - | 8,151 | | *8,151* | - | - | - |

[20] In view of the on-set of global pandemic COVID-19 in March 2020, there are likely to be delays in filings by the companies during 2019-20. Hence, the previous filing year has been considered.

| **Company Type** | **Total Active Companies** | | **AFS/MGT-7 Filing Data** | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | **Total number of filings** | | **Companies with Net Worth below ₹ 250 crores** | | **Companies with Net Worth above ₹ 250 crores** | |
| | **Number of Companies** | **%** | **Number of Companies** | **%** | **Number of Companies** | **%** | **Number of Companies** | **%** |
| **Public Limited** ***Of which*** | 63,989 | 5.57% | 34,499 | 53.91% | 32,552 | 5.43% | 1,947 | 54.57% |
| *Listed* | *6,915* | - | 4,349 | | 3478 | - | *871* | |
| *Unlisted* | *57,074* | - | 30,150 | | *29,074* | - | *1,076* | |
| **Total** | **11,49,167** | **100%** | 6,03,055 | **52.48%** | **5,99,487** | **100%** | **3,568** | **100%** |

| Table 1.2 AFS/MGT 7 Filings by Type of Filings for 2018-19- Companies with A) Net Worth below ₹ 250 crores | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Company Type** | **Total number of filings** | | **Type of Filings** | | | | | |
| | | | **AOC 4 XBRL -Ind AS** | | **AOC 4 XBRL -AS** | | **AOC 4 -AS** | |
| | **Number of Companies** | **%** | **Number of Companies** | **%** | **Number of Companies** | **%** | **Number of Companies** | **%** |
| **Private Limited *Of which*** | 5,66,935 | 94.57% | 8,517 | 58.41% | 23,404 | 78.58% | 5,35,014 | 96.38% |
| *Private Limited* | *558784* | | 8,517 | | *23,401* | - | *5,26,866* | - |
| *One Person Company* | *8151* | | 0 | | *3* | - | *8,148* | - |
| **Public Limited *Of which*** | 32,552 | 5.43% | 6,064 | 41.59% | 6,379 | 21.42% | 20,109 | 3.62% |
| *Listed* | *3478* | | 2,491 | | *655* | | *332* | |
| *Unlisted* | *29074* | | 3,573 | | *5724* | | *19,777* | |
| **Total (A)** | **5,99,487** | **100%** | **14,581** | **100%** | **29,783** | **100%** | **5,55,123** | **100%** |
| **B) Net Worth above ₹ 250 crores** | | | | | | | | |
| **Company Type** | **Total number of filings** | | **Type of Filings** | | | | | |
| | | | **AOC 4 XBRL -Ind AS** | | **AOC 4 XBRL -AS** | | **AOC 4 -AS** | |
| | **Number of Companies** | **%** | **Number of Companies** | **%** | **Number of Companies** | **%** | **Number of Companies** | **%** |
| **Private Limited *Of which*** | 1,621 | 45.43% | 1,261 | 42.91% | 228 | 76.51% | 132 | 39.88% |
| *Private Limited* | *1,621* | - | *1,261* | | *228* | - | *132* | - |
| *One Person Company* | *0* | - | *0* | | *0* | - | *0* | - |

| **Company Type** | **Total number of filings** | | **Type of Filings** | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | **AOC 4 XBRL -Ind AS** | | **AOC 4 XBRL -AS** | | **AOC 4 -AS** | |
| | **Number of Companies** | **%** | **Number of Companies** | **%** | **Number of Companies** | **%** | **Number of Companies** | **%** |
| **Public Limited**<br>***Of which*** | 1,947 | 54.57% | 1,678 | 57.09% | 70 | 23.49% | 199 | 60.12% |
| *Listed* | *871* | - | *812* | | *5* | - | *54* | |
| *Unlisted* | *1,076* | - | *866* | | *65* | - | *145* | |
| **Total (B)** | **3,568** | **100%** | **2,939** | **100%** | **298** | **100%** | **331** | **100%** |
| **Grand Total (A+B)** | **6,03,055** | | **17,520** | | **30,081** | | **5,55,454** | |

| Net Worth Based Analysis | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Table 1.3 Companies with Net Worth below ₹ 250 crores (all amount in crores except no. of companies)** | | | | | | | | | | |
| | **No. of Companies** | | | | **Turnover Analysis** | | | **Indebtedness Analysis** | | |
| **Net Worth Range (₹ Crores)** | **Private** | **Public** | **Total No. of Companies** | **Total Net Worth (₹ Crores)** | **No. of companies with +ve Turnover** | **No. of companies with zero Turnover** | **Turnover range (Min &Max) (₹ Crores)** | **No. of companies with Indebtedness** | **No. of companies with Zero Indebtedness** | **Indebtedness Range (Min &Max) (₹ Crores)** |
| **Positive Net Worth** | | | | | | | | | | |
| >=200-<250 | 497 | 246 | 743 | 1,65,888 | 678 | 65 | 0 & 5,960 | 496 | 247 | 0 & 2,771 |
| >=100-<200 | 2,192 | 1086 | 3,278 | 4,58,021 | 2,928 | 350 | 0 & 16,780 | 2,272 | 1,006 | 0 & 18,413 |
| >=50-<100 | 4,383 | 1,514 | 5,897 | 4,12,461 | 5,031 | 866 | 0 & 19,538 | 3,801 | 2,096 | 0 & 8,525 |
| >=25-<50 | 7,501 | 1,947 | 9,448 | 3,32,026 | 7,878 | 1,570 | 0 & 14,081 | 6,208 | 3,240 | 0 & 8,236 |
| >=10-<25 | 18,032 | 3,233 | 21,265 | 3,31,823 | 17,193 | 4,072 | 0 & 21,260 | 13,743 | 7,522 | 0 & 9,959 |
| >=5-<10 | 22,274 | 2,675 | 24,949 | 1,76,764 | 19,893 | 5,056 | 0 & 10,468 | 16,158 | 8,791 | 0 & 1,779 |
| >=1-<5 | 79,570 | 5,992 | 85,562 | 2,03,538 | 66,039 | 19,523 | -0.03 & 64,265 | 54,987 | 30,575 | 0 & 6,540 |
| >=0.5-<1 | 39,584 | 1,868 | 41,452 | 29,880 | 31,016 | 10,436 | 0 & 5,145 | 25,571 | 15,881 | 0 & 1,507 |
| >=0.2-<0.5 | 49,762 | 1,997 | 51,759 | 17,132 | 37,977 | 13,782 | -0.47 & 4,242 | 30,165 | 21,594 | 0 & 1,600 |
| >=0-<0.2 | 2,25,471 | 6,712 | 2,32,183 | 9,770 | 1,32,787 | 99,396 | 0 & 5,223 | 91,043 | 1,41,140 | 0 & 4,833 |
| **Subtotal (A)** | **4,49,266** | **27,270** | **4,76,536** | **21,37,302** | **3,21,420** | **1,55,116** | **-** | **2,44,444** | **2,32,092** | **-** |
| **Negative Net Worth** | | | | | | | | | | |
| >=50000 & above | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| >=25000-<50000 | 0 | 4 | 4 | -1,41,290 | 4 | 0 | 2,720 & 54,900 | 4 | 0 | 113 & 72,700 |
| >=10000-<25000 | 0 | 11 | 11 | -1,53,176 | 11 | 0 | 11.8 & 17,300 | 11 | 0 | 55.2 & 29,600 |
| >=5000-<10000 | 4 | 10 | 14 | -1,02,959 | 9 | 5 | 0 & 23,900 | 12 | 2 | 0 &19,800 |

| | No. of Companies | | | | Turnover Analysis | | | Indebtedness Analysis | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Net Worth Range (₹ Crores)** | **Private** | **Public** | **Total No. of Companies** | **Total Net Worth (₹ Crores)** | **No. of companies with +ve Turnover** | **No. of companies with zero Turnover** | **Turnover range (Min &Max) (₹ Crores)** | **No. of companies with Indebtedness** | **No. of companies with Zero Indebtedness** | **Indebtedness Range (Min &Max) (₹ Crores)** |
| >=1000-<5000 | 25 | 72 | 97 | -2,05,983 | 80 | 17 | 0 & 21,500 | 94 | 3 | 0 & 28, 600 |
| >=250-<1000 | 112 | 154 | 266 | -1,25,867 | 193 | 73 | 0 & 9,110 | 251 | 15 | 0 & 9,330 |
| >=200-<250 | 41 | 26 | 67 | -14,916 | 42 | 25 | 0 & 2,240 | 65 | 2 | 0 & 5,590 |
| >=100-<200 | 186 | 137 | 323 | -45,557 | 232 | 91 | 0 & 1,770 | 299 | 24 | 0 & 3,750 |
| >=50-<100 | 340 | 193 | 533 | -37,743 | 358 | 175 | 0 & 12, 900 | 479 | 54 | 0 & 5,620 |
| >=25-<50 | 622 | 265 | 887 | -30,712 | 562 | 325 | 0 & 36,800 | 789 | 98 | 0 & 3,820 |
| >=10-<25 | 1,588 | 456 | 2,044 | -31,779 | 1,328 | 716 | 0 & 2,400 | 1,787 | 257 | 0 & 2,840 |
| >=5-<10 | 2,205 | 419 | 2,624 | -18,602 | 1,731 | 893 | 0 & 3,150 | 2,237 | 387 | 0 & 1,750 |
| >=1-<5 | 11,004 | 1,056 | 12,060 | -26,908 | 7,857 | 4,203 | 0 & 7, 960 | 10,228 | 1,832 | 0 & 2,230 |
| >=0.5-<1 | 8,340 | 464 | 8,804 | -6,280 | 5,826 | 2,978 | 0 & 287 | 7,308 | 1,496 | 0 & 567 |
| >=0.2-<0.5 | 14,881 | 582 | 15,463 | -4,983 | 10,050 | 5,413 | 0 & 540 | 12,366 | 3,097 | 0 & 678 |
| >=0-<0.2 | 78,321 | 1,433 | 79,754 | -3,702 | 40,665 | 39,089 | 0 & 249 | 52,282 | 27,472 | 0 & 1,610 |
| **Subtotal (B)** | **1,17,669** | **5,282** | **1,22,951** | **-9,50,457** | **68,948** | **54,003** | **-** | **88,212** | **34,739** | **-** |
| **Total** | **5,66,935** | **32,552** | **5,99,487** | **11,86,845** | **3,90,368** | **2,09,119** | **-** | **3,32,656** | **2,66,831** | **-** |

| Table 1.4 Turnover Analysis of Companies with Net Worth below ₹ 250 crores (all amount in crores except no. of companies) | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **No. of Companies** | | | | **Net Worth Analysis** | | | **Indebtedness Analysis** | | |
| **Turnover Range (₹ Crores)** | **Private** | **Public** | **Total No. of Companies** | **Total Turnover (₹ Crores)** | **No. of companies with +ve Net Worth** | **No. of companies with negative Net Worth** | **Net Worth range (Min &Max) (₹ Crores)** | **No. of companies with Indebtedness** | **No. of companies with zero Indebtedness** | **Indebtedness Range (Min &Max) (₹ Crores)** |
| >=25,000 & above | 1 | 4 | 5 | 2,13,295 | 1 | 4 | -48,720 & 3.83 | 5 | 0 | 8.97 & 72,709 |
| >=10,000-<25,000 | 10 | 17 | 27 | 4,12,707 | 14 | 13 | -19,831 & 191 | 24 | 3 | 0 & 20,494 |
| >=5,000-<10,000 | 11 | 17 | 28 | 2,01,554 | 19 | 9 | -11,476 & 211 | 25 | 3 | 0 & 16,131 |
| >=1,000-<5,000 | 254 | 159 | 413 | 7,23,512 | 340 | 73 | -35,300 &249 | 358 | 55 | 0 & 29,569 |
| >=800-<1,000 | 165 | 78 | 243 | 2,14,200 | 220 | 23 | -3,468 & 243 | 219 | 24 | 0 & 28,598 |
| >=500-<800 | 640 | 251 | 891 | 5,47,526 | 831 | 60 | -3,337 & 249 | 775 | 116 | 0 & 13,452 |
| >=200 - <500 | 3,321 | 1,083 | 4,404 | 13,29,059 | 4,170 | 234 | -6,556& 249 | 3782 | 622 | 0 & 9,959 |
| >=100 - <200 | 5,760 | 1,288 | 7,048 | 9,82,077 | 6,653 | 395 | -14,375 &249 | 6045 | 1,003 | 0 & 20,445 |
| >=50 - <100 | 8,790 | 1,497 | 10,287 | 7,22,440 | 9,663 | 624 | -9,716 & 249 | 8706 | 1,581 | 0 & 6,224 |
| >=25 - <50 | 14,212 | 1,615 | 15,827 | 5,59,003 | 14,864 | 963 | -1,053 & 247 | 13,354 | 2,473 | 0 & 6,540 |
| >=10 - <25 | 26,509 | 2,011 | 28,520 | 4,54,875 | 26,267 | 2,253 | -15,108 & 248 | 23,459 | 5,061 | 0 & 15,313 |
| >=5 - <10 | 25,756 | 1,529 | 27,285 | 1,95,221 | 24,678 | 2,607 | -3,050 & 248 | 21,350 | 5,935 | 0 & 6,833 |
| >=1 - <5 | 73,648 | 3,197 | 76,845 | 1,86,180 | 65,893 | 10,952 | -2,314 & 248 | 54,171 | 22,674 | 0 & 14,000 |
| >=0.5 - <1 | 34,359 | 1,339 | 35,698 | 26,072 | 28,613 | 7,085 | -942 & 242 | 21,842 | 13,856 | 0 & 3,357 |
| >=0.2 - <0.5 | 38,900 | 1,593 | 40,493 | 13,420 | 31,048 | 9,445 | -2,406 & 248 | 22,214 | 18,279 | 0 & 1,577 |
| >0 - <0.2 | 1,36,914 | 5,437 | 1,42,351 | 8,064 | 1,08,143 | 34,208 | -950 & 241 | 59,247 | 83,104 | 0 & 4,833 |
| <=0 | 1,97,685 | 11,437 | 2,09,122 | -1 | 1,55,119 | 54,003 | -9,369 & 249 | 97,080 | 1,12,042 | -0.72& 9,332 |
| **Total** | **5,66,935** | **32,552** | **5,99,487** | **67,89,203** | **4,76,536** | **1,22,951** | | **3,32,656** | **2,66,831** | |

**Table 1.5 Indebtedness Analysis of Companies with Net Worth below ₹ 250 crores (all amount in crores except no. of companies)**

| | No. of Companies | | | | Net Worth Analysis | | | Turnover Analysis | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Indebtedness Range (₹ Crores)** | **Private** | **Public** | **Total No. of Companies** | **Total Indebtedness** | **No. of companies with +ve Net Worth** | **No. of companies with negative Net Worth** | **Net Worth range (Min &Max) (₹ Crores)** | **No. of companies with +ve Turnover** | **No. of companies with zero & negative turnover** | **Turnover Range (Min &Max) (₹ Crores)** |
| >=25,000 & above | 0 | 5 | 5 | 64082 | 0 | 5 | -35,300 & -2,640 | 5 | 0 | 907 & 31,800 |
| >=10,000-<25,000 | 3 | 13 | 16 | 1,14,005 | 1 | 15 | -19,800 & 154 | 16 | 0 | 1.1 & 21,500 |
| >=5,000-<10,000 | 10 | 27 | 37 | 1,27,628 | 8 | 29 | -9,940 & 195 | 33 | 4 | 0 & 23,900 |
| >=1,000-<5,000 | 173 | 185 | 358 | 2,81,595 | 139 | 219 | -6,120 & 249 | 302 | 56 | 0 & 36,800 |
| >=800-<1,000 | 74 | 55 | 129 | 37,066 | 74 | 55 | -3,810 & 249 | 103 | 26 | 0 & 15,179 |
| >=500-<800 | 273 | 146 | 419 | 98,914 | 256 | 163 | -6,790 & 247 | 332 | 87 | 0 & 5,960 |
| >=200 - <500 | 1,060 | 502 | 1,562 | 3,43,633 | 1037 | 525 | -4,770 & 249 | 1,243 | 319 | 0 & 13,124 |
| >=100 - <200 | 1,695 | 676 | 2,371 | 5,39,871 | 1744 | 627 | -48,700 & 249 | 1,949 | 422 | 0 & 54,945 |
| >=50 - <100 | 3,300 | 1,003 | 4,303 | 6,86,302 | 3330 | 973 | -10,649 & 247 | 3,534 | 769 | 0 & 14,683 |
| >=25 - <50 | 6,251 | 1,401 | 7,652 | 7,38,248 | 6066 | 1586 | -1,850 & 249 | 6,307 | 1,345 | 0 & 9,466 |
| >=10 - <25 | 16,081 | 2,354 | 18,435 | 9,13,833 | 14514 | 3921 | -614 & 248 | 15,137 | 3,298 | 0 & 7,960 |
| >=5 - <10 | 20,165 | 1,950 | 22,115 | 5,99,014 | 17404 | 4711 | -424 & 246 | 18,004 | 4,111 | 0 & 64,265 |
| >=1 - <5 | 69,559 | 4,026 | 73,585 | 7,73,869 | 55671 | 17914 | -304 & 249 | 56,366 | 17,219 | 0 & 19,384 |
| >=0.5 - <1 | 35,007 | 1,554 | 36,561 | 1,61,512 | 26408 | 10153 | -544 & 245 | 26,671 | 9,890 | -0.956 & 3,614 |
| >=0.2 - <0.5 | 45,284 | 1,775 | 47,059 | 1,63,897 | 33440 | 13,619 | -121 & 239 | 33,294 | 13,765 | -0.476 & 10,468 |
| >0 - <0.2 | 1,14,310 | 3,738 | 1,18,048 | 1,79,524 | 84351 | 33,697 | -2,050 & 249 | 72,280 | 45,768 | 0 & 5,145 |
| <=0 | 2,53,690 | 13,142 | 2,66,832 | 9,66,210 | 232093 | 34,739 | -9,720 & 249 | 1,54,789 | 1,12,043 | -0.032 & 14,434 |
| **Total** | **5,66,935** | **32,552** | **5,99,487** | **67,89,203** | **4,76,536** | **1,22,951** | | **3,90,365** | **2,09,122** | |

| **Payments to Auditors Analysis** | | | |
|---|---|---|---|
| **Table 1.6 Payments to Auditors Analysis of Companies with Net Worth below ₹ 250 crores (all amount in actuals except no. of companies)** | | | |
| | **No. of Companies** | | |
| **Auditors Payments Range (₹ Actuals)** | **Private** | **Public** | **Total No. of Companies** |
| >=50,00,000 | 177 | 87 | 264 |
| >=10,00,000-<50,00,000 | 3,818 | 1,004 | 4,822 |
| >=5,00,000-<10,00,000 | 4,887 | 1,185 | 6,072 |
| >=1,00,000-<5,00,000 | 33,357 | 4,966 | 38,323 |
| >=50,000-<1,00,000 | 34,272 | 2,977 | 37,249 |
| >=25,000-<50,000 | 78,430 | 4,714 | 83,144 |
| >=10,000-<25,000 | 1,23,390 | 6,336 | 1,29,726 |
| >=5,000-<10,000 | 74,694 | 3,090 | 77,784 |
| >=1,000-<5,000 | 38,127 | 1,764 | 39,891 |
| >0-<1,000 | 754 | 63 | 817 |
| 0 | 1,75,025 | 6,367 | 1,81,392 |
| <0 | 1 | 2 | 3 |
| **Total** | **5,66,932** | **32,555** | **5,99,487** |

**Annexure 3**

**Estimated Cost of Audit using Standard Cost Model Approach**

1) Key Assumptions for estimating the standard audit cost.

a) Audit relates to statutory audit of GPFR of an SMC.

b) Audit is performed by either a Small or Medium Practitioner, (SMP CA) located in one of three categories of cities i.e., small cities, mid-tier cities and metro cities.

c) Audit is in accordance with the existing set of Standards on Auditing (SAs)[21] as required under the Companies Act, 2013.

d) GPFR are prepared in accordance with the revised set of ASs, which are largely aligned with high-quality Ind AS Framework relevant and useful for large PIEs.

2) Using the audit cost estimation approach described above, expected cost of audit across different size of MSMCs will be as follows.

[21] Recently in June 2021, International Assurance and Auditing Standards Board has issued exposure draft for public consultation of a set of standards called 'PROPOSED INTERNATIONAL STANDARD ON AUDITING OF FINANCIAL STATEMENTS OF LESS COMPLEX ENTITIES'. It is expected to be issued in Dec 2022. India's position on this reform project is not yet clear.

**Table 1.7: Estimated Cost of Audit**

| Turnover Range (in Rs. crores) | Estimated Audit Fees | | | Avg PBT per Company (in Rs. Lakhs)* | Avg. of Estimated Audit Fees as % to PBT# |
|---|---|---|---|---|---|
| | Small Firm - Small Town (in Rs. Lakhs) | Small Firm - Mid Tier City (in Rs. Lakhs) | Small Firm - Metro City (in Rs. Lakhs) | | |
| >=25,000-<50,000 | 37.09 | 62.43 | 106.19 | 2,144 | 4.95% |
| >=10,000-<25,000 | 33.95 | 57.15 | 97.22 | 22,132 | 0.44% |
| >=5,000-<10,000 | 22.07 | 37.15 | 63.20 | 10,969 | 0.58% |
| >=1000-<5000 | 13.80 | 23.23 | 39.51 | 4,798 | 0.82% |
| >=800-<1000 | 8.11 | 13.65 | 23.21 | 3,535 | 0.66% |
| >=500-<800 | 6.47 | 10.89 | 18.52 | 2,308 | 0.80% |
| >=200 - <500 | 4.03 | 6.78 | 11.53 | 1,560 | 0.74% |
| >=100 - <200 | 3.62 | 6.10 | 10.38 | 770 | 1.35% |
| >=50 - <100 | 3.26 | 5.49 | 9.34 | 398 | 2.34% |
| >=25 - <50 | 2.94 | 4.95 | 8.43 | 203 | 2.68% |
| >=10 - <25 | 2.64 | 4.44 | 7.56 | 105 | 4.65% |
| >=5 - <10 | 2.38 | 4.00 | 6.80 | 53 | 8.25% |
| >=1 - <5 | 2.14 | 3.60 | 6.13 | 25 | 15.86% |

| **Turnover Range (in Rs. crores)** | **Estimated Audit Fees** | | | **Avg PBT per Company (in Rs. Lakhs)*** | **Avg. of Estimated Audit Fees as % to PBT#** |
|---|---|---|---|---|---|
| | **Small Firm - Small Town (in Rs. Lakhs)** | **Small Firm - Mid Tier City (in Rs. Lakhs)** | **Small Firm - Metro City (in Rs. Lakhs)** | | |
| >=0.5 - <1 | 1.94 | 3.27 | 5.56 | 12 | 31.11% |
| >=0.2 - <0.5 | 1.75 | 2.95 | 5.02 | 8 | 39.32% |
| >0 - <0.2 | 1.50 | 2.68 | 4.57 | 5 | 58.53% |

*For Average PBT calculation, the data is based on 2,36,983 company filings. The companies with NIL turnover has been excluded and only the Companies which have positive PBT have been considered.

# Avg. of Estimated Audit Fees as % to PBT for companies with turnover upto ₹50 crores has been calculated on basis of avg. of estimated audit fees in small town, mid- tier city and metro city. The Avg. of Estimated Audit Fees as % to PBT for companies with turnover above ₹50 crores has been calculated on basis of estimated audit fees in metro city assuming companies with turnover above ₹50 crores are more likely to exist in metro cities.

3) Supporting details for the above cost estimation.

(Refer Appendix I)

**Supporting Details for Cost Estimation**
**Tab:- Costing Regular Audit**

| Particulars | Reference Tab |
|---|---|
| For cost per hour calculations | Tab Estimated Cost per hour |
| For estimated hours | Tab Estimated Hours |

| Particulars | Cost per hour of staff (Rs./hour) | Cost per hour of partner (Rs./hour) |
|---|---|---|
| Small Firm - Small Town | 241 | 686 |
| Small Firm - Mid Tier City | 468 | 1,145 |
| Small Firm - Metro City | 885 | 1,971 |

| | Small Firm - Small Town | | | | Small Firm - Mid Tier City | | | | Small Firm - Metro City | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Revenue (in crores)** | **Field Hours (Ref tab Estimated Hours)** | **Partner Hours @ 45% over and above field hours** | **Total Hours** | **Total Cost (in Rs.)** | **Field Hours (Ref tab Estimated Hours)** | **Partner Hours @ 40% over and above field hours** | **Total Hours** | **Total Cost (in Rs.)** | **Field Hours (Ref tab Estimated Hours)** | **Partner Hours @ 35% over and above field hours** | **Total Hours** | **Total Cost (in Rs.)** |
| >=25000 - <50000 | 6,743 | 3,034 | 9,777 | 37,08,633 | 6,743 | 2,697 | 9,440 | 62,42,573 | 6,743 | 2,360 | 9,103 | 1,06,18,800 |
| >=10000 - <25000 | 6,174 | 2,778 | 8,952 | 33,95,485 | 6,174 | 2,469 | 8,643 | 57,15,465 | 6,174 | 2,161 | 8,334 | 97,22,173 |
| >=5000 - <10000 | 4,013 | 1,806 | 5,819 | 22,07,153 | 4,013 | 1,605 | 5,618 | 37,15,200 | 4,013 | 1,405 | 5,418 | 63,19,665 |
| >=1000 - <5000 | 2,509 | 1,129 | 3,638 | 13,79,952 | 2,509 | 1,004 | 3,513 | 23,22,810 | 2,509 | 878 | 3,387 | 39,51,168 |
| >=800 - <1000 | 1,474 | 663 | 2,137 | 8,10,701 | 1,474 | 590 | 2,064 | 13,64,616 | 1,474 | 516 | 1,990 | 23,21,252 |
| >=500 - <800 | 1,176 | 529 | 1,705 | 6,46,801 | 1,176 | 470 | 1,646 | 10,88,731 | 1,176 | 412 | 1,588 | 18,51,963 |
| >=200 - <500 | 732 | 329 | 1,061 | 4,02,601 | 732 | 293 | 1,025 | 6,77,679 | 732 | 256 | 988 | 11,52,752 |
| >=100 - <200 | 659 | 297 | 956 | 3,62,451 | 659 | 264 | 923 | 6,10,096 | 659 | 231 | 890 | 10,37,792 |
| >=50 - <100 | 593 | 267 | 860 | 3,26,150 | 593 | 237 | 830 | 5,48,994 | 593 | 208 | 801 | 9,33,855 |
| >=25 - <50 | 535 | 241 | 776 | 2,94,250 | 535 | 214 | 749 | 4,95,298 | 535 | 187 | 722 | 8,42,517 |
| >=10 - <25 | 480 | 216 | 696 | 2,64,000 | 480 | 192 | 672 | 4,44,380 | 480 | 168 | 648 | 7,55,903 |
| >=5 - <10 | 432 | 194 | 626 | 2,37,600 | 432 | 173 | 605 | 3,99,942 | 432 | 151 | 583 | 6,80,313 |
| >=1 - <5 | 389 | 175 | 564 | 2,13,950 | 389 | 156 | 545 | 3,60,133 | 389 | 136 | 525 | 6,12,596 |
| >=0.5 - <1 | 353 | 159 | 512 | 1,94,150 | 353 | 141 | 494 | 3,26,804 | 353 | 124 | 477 | 5,55,904 |
| >=0.2 - <0.5 | 319 | 144 | 463 | 1,75,450 | 319 | 128 | 447 | 2,95,327 | 319 | 112 | 431 | 5,02,361 |
| >=0 - <0.2 | 290 | 116 | 406 | 1,49,551 | 290 | 116 | 406 | 2,68,479 | 290 | 102 | 392 | 4,56,691 |

**Supporting Details for Cost Estimation**
**Tab:- Estimated Cost per hour**

**Assumption**
9 hours per day with 22 working days in a month
Cost rate of partner has been determined on basis of his monthly salary and profit of the firm
Cost rate of staff has been determined on basis of his monthly salary and overheads of the firm

**No. of resources**

| | Small Firm - Small Town/ City | Small Firm - Mid Tier City | Small Firm - Metro City |
|---|---|---|---|
| Partner | 3 | 6 | 10 |
| Staff-Senior | 4 | 8 | 16 |
| Staff-AM | 1 | 2 | 4 |
| Staff-Manager | 0 | 2 | 4 |
| Article | 20 | 60 | 80 |

**Salary**

| | | | |
|---|---|---|---|
| Partner | 80,000 | 1,20,000 | 1,80,000 |
| Staff - Senior | 22,000 | 30,000 | 55,000 |
| Staff-AM | 30,000 | 40,000 | 70,000 |
| Staff-Manager | 40,000 | 70,000 | 1,00,000 |
| Article (Avg) | 1,500 | 2,000 | 2,500 |

**Rent**

| | | | |
|---|---|---|---|
| Area (sq feet) | | | |
| Per Partner | 100 | 100 | 100 |
| Per Staff | 50 | 50 | 50 |
| Total Area for Partner | 300 | 600 | 1,000 |
| Total Area for Staff (other thar | 250 | 600 | 1200 |
| Total Area for Article | 500 | 1500 | 2000 |
| Total | 1,050 | 2,700 | 4,200 |
| Per Square Ft Rent per month | 35 | 100 | 315 |
| Total Rent per month | 36,750 | 2,70,000 | 13,23,000 |

| Particulars | Small Firm - Small Town | Small Firm - Mid Tier City | Small Firm - Metro City |
|---|---|---|---|
| Salaries - Partner | 2,40,000 | 7,20,000 | 18,00,000 |
| Staff - Senior | 88,000 | 2,40,000 | 8,80,000 |
| Staff-AM | 30,000 | 80,000 | 2,80,000 |
| Staff-Manager | - | 1,40,000 | 4,00,000 |
| Salaries - Article | 30,000 | 1,20,000 | 2,00,000 |
| Rent | 36,750 | 2,70,000 | 13,23,000 |
| Electricity@20% of rent | 7,350 | 54,000 | 2,64,600 |
| Office Expense@25% of rent | 9,188 | 67,500 | 3,30,750 |
| Depreciation @ 10% of rent | 3,675 | 27,000 | 1,32,300 |
| Printing @ 10% of rent | 3,675 | 27,000 | 1,32,300 |
| Internet @ 10% of rent | 3,675 | 27,000 | 1,32,300 |
| Mobile | 1,500 | 3,000 | 8,000 |
| Travel @ 5% of Partner Salary | 12,000 | 36,000 | 90,000 |
| Software | 10,000 | 15,000 | 25,000 |
| Subscriptions @ 30% of Softw | 3,000 | 4,500 | 7,500 |
| **Total Cost per month** | **4,78,813** | **18,31,000** | **60,05,750** |
| **Profit @ 35%** | **1,67,584** | **6,40,850** | **21,02,013** |
| **Total** | **6,46,397** | **24,71,850** | **81,07,763** |

| | | | |
|---|---|---|---|
| Total partner Hours in a month | 594 | 1,188 | 1,980 |
| Cost per hour of partner | 686 | 1,145 | 1,971 |
| Total Staff hours in a month | 990 | 2,376 | 4,752 |
| Cost per hour of staff | 241 | 468 | 885 |

**Supporting Details for Cost Estimation**
**Tab:- Estimated Hours**

The below sheet gives budget (in terms of hours) depending upon size of the Company for audit.

"Illustrative Audit Planning Schedule" as per "Implementation Guide to Standard on Auditing (SA) 300, Planning an Audit of Financial Statements" issued by ICAI for putting worksteps required for an audit has been used for hours estimation.

| **Turnover (in Rs. Crores) (Horizontal)<br>Work Steps (Vertical)** | **>=25000 - <50000** | **>=10000 - <25000** | **>=5000 - <10000** | **>=1000 - <5000** | **>=800 - <1000** | **>=500 - <800** | **500** | **>=200 - <500** | **>=100 - <200** | **>=50 - <100** | **>=25 - <50** | **>=10 - <25** | **>=5 - <10** | **>=1 - <5** | **>=0.5 - <1** | **>=0.2 - <0.5** | **>=0 - <0.2** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Meetings** | | | | | | | | | | | | | | | | | |
| Meetings with management to understand entity's operations and significant developments, update progress | 83 | 76 | 69 | 43 | 25 | 20 | 14 | 13 | 12 | 11 | 10 | 9 | 8 | 7 | 6 | 5 | 5 |
| Deployment of engagement team and team meetings | 371 | 338 | 307 | 192 | 113 | 90 | 62 | 56 | 50 | 45 | 41 | 37 | 33 | 30 | 27 | 24 | 22 |
| Meetings with Those Charged with Governance – sharing audit strategy and conclusions | 145 | 132 | 120 | 75 | 44 | 35 | 24 | 22 | 20 | 18 | 16 | 14 | 13 | 12 | 11 | 10 | 9 |
| **Perform risk assessment** | | | | | | | | | | | | | | | | | |
| Perform preliminary analytics and other planning procedures | 211 | 192 | 120 | 75 | 44 | 35 | 24 | 22 | 20 | 18 | 16 | 14 | 13 | 12 | 11 | 10 | 9 |
| Identify and assess key risk | 173 | 157 | 98 | 61 | 36 | 29 | 20 | 18 | 16 | 14 | 13 | 12 | 11 | 10 | 9 | 8 | 7 |
| Determine audit strategy | 278 | 253 | 158 | 99 | 58 | 46 | 32 | 29 | 26 | 23 | 21 | 19 | 17 | 15 | 14 | 13 | 12 |
| Develop responses to risks through detailed audit plan | 540 | 491 | 307 | 192 | 113 | 90 | 62 | 56 | 50 | 45 | 41 | 37 | 33 | 30 | 27 | 24 | 22 |
| **Perform tests of controls** | | | | | | | | | | | | | | | | | |
| Identify key controls | 521 | 474 | 296 | 185 | 109 | 87 | 60 | 54 | 49 | 44 | 40 | 36 | 32 | 29 | 26 | 23 | 21 |
| Review work of others (Internal audit, Type 1/2 reports) | 102 | 93 | 58 | 36 | 21 | 17 | 12 | 11 | 10 | 9 | 8 | 7 | 6 | 5 | 5 | 5 | 5 |
| Perform tests as designed | 1,045 | 950 | 594 | 371 | 218 | 174 | 120 | 108 | 97 | 87 | 78 | 70 | 63 | 57 | 51 | 46 | 41 |
| Evaluate deficiencies and impact on substantive procedures | 211 | 192 | 120 | 75 | 44 | 35 | 24 | 22 | 20 | 18 | 16 | 14 | 13 | 12 | 11 | 10 | 9 |
| **Perform Substantive Procedures** | | | | | | | | | | | | | | | | | |
| Determine procedures responsive to key risks | 278 | 253 | 158 | 99 | 58 | 46 | 32 | 29 | 26 | 23 | 21 | 19 | 17 | 15 | 14 | 13 | 12 |
| Perform substantive analytical procedures or tests of details as planned and obtain sufficient appropriate audit evidence | 1,306 | 1,187 | 742 | 464 | 273 | 218 | 150 | 135 | 122 | 110 | 99 | 89 | 80 | 72 | 65 | 59 | 53 |
| Evaluate appropriateness and sufficiency of audit evidence | 437 | 397 | 248 | 155 | 91 | 73 | 50 | 45 | 41 | 37 | 33 | 30 | 27 | 24 | 22 | 20 | 18 |
| Execute changes to audit strategy and plan if circumstances require | 211 | 192 | 120 | 75 | 44 | 35 | 24 | 22 | 20 | 18 | 16 | 14 | 13 | 12 | 11 | 10 | 9 |
| **Conclusions** | | | | | | | | | | | | | | | | | |
| Perform final analytics and other closing procedures | 349 | 317 | 198 | 124 | 73 | 58 | 40 | 36 | 32 | 29 | 26 | 23 | 21 | 19 | 17 | 15 | 14 |
| Review by Engagement Partner and conclude on evidences obtained | | | | | | | | | | | | | | | | | |
| Consultations with Quality Review Partner | | | | | | | | | | | | | | | | | |
| Share draft results and discuss with management | 240 | 240 | 150 | 94 | 55 | 44 | 30 | 27 | 24 | 22 | 20 | 18 | 16 | 14 | 13 | 12 | 11 |
| Finalise and Issue opinion, discuss with Those Charged with Governance | 240 | 240 | 150 | 94 | 55 | 44 | 30 | 27 | 24 | 22 | 20 | 18 | 16 | 14 | 13 | 12 | 11 |
| **Total** | **6743** | **6174** | **4013** | **2509** | **1474** | **1176** | **810** | **732** | **659** | **593** | **535** | **480** | **432** | **389** | **353** | **319** | **290** |

The Engagement Partner hours and consultations with Quality Review Partner will depend upon firm location. This is based on the assumption that partner of small firm in small city will invest more time in reviews as compared to partner of small firm in metro city. For details of these hours refer "Costing Regular Audit" tab