“MANAGEMENT SERVICES”
under Section 144 of the
Companies Act, 2013

-By CA Mohit Bhuteria &
CA Priyanka Choraria

INTRODUCTION:

Section 144 provides that an auditor shall provide to the company only such services as are approved by the Board of Directors or the audit committee, as the case may be but shall not include the following services rendered “directly or indirectly” to the company or its holding company or subsidiary company, namely:—
(a) accounting and book keeping services;
(b) internal audit;
(c) design and implementation of any financial information system;
(d) actuarial services;
(e) investment advisory services;
(f) investment banking services;
(g) rendering of outsourced financial services;
(h) management services; and
(i) services as may be prescribed - till now no such services has been prescribed

In terms of Explanation to Section 144, the term “Directly or Indirectly” shall include rendering of services by the auditor,—

Where auditor is an individual— Either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual.

Where auditor is a firm— Either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners.

First proviso to Section 144 provides that an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of the Companies Act, 2013 shall comply with the above before the closure of the first financial year after the date of such commencement (that is the maximum time allowed for such a compliance ends on 31.3.2015).
Section 144(h) of the Companies Act, 2013 has restricted the statutory auditors to provide “management services” but has not explained the meaning and scope of this expression even till date.

Also, there are no materiality thresholds which have been prescribed for such services.

**LEGISLATIVE INTENT:**

The Standing Committee suggested the Ministry that Management services should be defined and services such as valuations, due diligence, special audit/investigation etc which could have bearing on the audit services may be prohibited.

Scope of terms 'investment advisory services' and 'management services' should be clarified so that there is no doubt as to whether a service falls under these or not. AICPA Code of Professional Conduct defines the terms 'investment advisory services'; 'investment banking services' and 'management services' which can be used. Some mechanism may be considered through which certain non audit services which are being provided by auditors traditionally consistent with their skills and expertise may be continued with adequate safeguards. It may be necessary to evaluate the significance of any threat created by provisions of non audit services. Clause may be amended to exclude services where there are no self-review threats from scope of this clause.

It further stated that if at all the Bill needs to cover non-audit services, the Bill itself should contain only minimum restrictions and further restrictions may be prescribed through Code of Ethics.

The Ministry was of the view that these provisions were included in the Companies Bill, 2009 as Clause 127 which were examined by Hon’ble Committee. Kind attention is drawn to recommendation at Para 34 and para 10.50 of report of Hon’ble Committee. The provisions proposed in the new Bill are in accordance with such recommendation. These provisions were included in the regulatory framework by various jurisdictions post 2002 scams of Enron/Worldcom etc to ensure independence of auditors. Implementation of such provisions internationally has successfully enhanced the standards of accountable and transparent financial reporting and auditing requirements.

Para 5(vi)(b) of the “Statement of Objects and Reasons” for the Companies Act, 2013, read as follows:

“Stricter and more accountable role for auditor being retained. Provisions relating to prohibiting auditor from performing non-audit services revised to ensure independence and accountability of auditor. Subject to the maximum prescribed number of companies, the members of a company may resolve that the auditor or audit firm of such company shall not become auditor in companies beyond the number as may be specified in such resolution”

**REGULATORY FRAMEWORK:**

**Guidance Note on Independence of Auditors:** Para 1.9 of the Guidance Note on Independence of Auditors state that the auditor should be straight-forward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its
actual effect, as being incompatible with integrity and objectivity. This is not self evident in the exercise of the reporting function but also applies to all other professional work. In determining whether a member in practice is or is not seen to be free of any interest which is incompatible with objectivity, the criterion should be whether a reasonable person, having knowledge of relevant facts and taking into account the conduct of the member and the member’s behaviour under the circumstances, could conclude that the member has placed himself in a Position where his objectivity would or could be impaired.

Para 2.1 of this Guidance Note further states that the Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. These are:

(1) **Self-interest threats**, which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include:
   (i) direct financial interest or materially significant indirect financial interest in a client,
   (ii) loan or guarantee to or from the concerned client,
   (iii) undue dependence on a client’s fees and, hence, concerns about losing the engagement,
   (iv) close business relationship with an audit client,
   (v) potential employment with the client, and
   (vi) contingent fees for the audit engagement.

(2) **Self-review threats**, which occur when during a review of any judgment or conclusion reached in a previous audit or non-audit engagement, or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are:
   (i) when an auditor having recently been a director or senior officer of the company, and
   (ii) when auditors perform services that are themselves subject matters of audit.

(3) **Advocacy threats**, which occur when the auditor promotes, or is perceived to promote, a client’s opinion to a point where people may believe that objectivity is getting compromised, e.g. when an auditor deals with shares or securities of the audited company, or becomes the client’s advocate in litigation and third party disputes.

(4) **Familiarity threats** are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client’s interests. This can occur in many ways:
   (i) close relative of the audit team working in a senior position in the client company,
   (ii) former partner of the audit firm being a director or senior employee of the client,
   (iii) long association between specific auditors and their specific client counterparts, and
   (iv) acceptance of significant gifts or hospitality from the client company, its directors or employees.

(5) **Intimidation threats**, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

Chartered Accountants Act, 1949: As per Section 2(2) of the Chartered Accountants Act, 1949, a member of the Institute shall be deemed to be in practice when individually or in partnership with chartered accountant(s) in practice, he in consideration of remuneration received or to be received:

(i) engages himself in the practice of accountancy; or

(ii) offers to perform or performs services involving
   • auditing; or
   • verification of financial transactions, books, records; or
Chartered Accountants Regulations, 1988: Regulation 190A states that a chartered accountant in practice cannot engage in any business or occupation other than the profession of accountancy and such other services as may be prescribed by the Council of ICAI. In the opinion of the Council of ICAI, the “other services” that may be rendered by a chartered accountant as described in Section 2(2)(iv) will include the entire range of management consultancy services, as described below:

(i) financial management planning and financial policy determination;
(ii) capital structure planning;
(iii) working capital management;
(iv) preparation of project reports and feasibility studies;
(v) preparing cash budgets and other budgets, cash flow statements, profitability statements etc.;
(vi) inventory management, price fixation and other management decision making;
(vii) personnel recruitment and selection;
(viii) management and operational audit;
(ix) advise regarding mergers and amalgamations;
(x) systems analysis and computer related services;
(xi) acting as advisor or consultant to an issue, including matters such as:
   • drafting of prospectus and memorandum containing salient features of prospectus;
   • drafting and filing of listing agreement and completing formalities with Stock Exchanges, ROC and SEBI;
   • preparation of publicity budget;
   • advice regarding selection of various agencies connected with issue such as Registrars to Issue, printers and advertising agencies;
   • advice on post issue activities;
(xii) investment counseling in respect of securities as defined in SCRA, 1956 and other financial instruments;
(xiii) acting as Registrar to an Issue and for transfer of shares/other securities;
(xiv) quality audit, environment audit, energy audit;
(xv) acting as Recovery Consultant in the Banking sector;
(xvi) insurance financial advisory services under IRDA, 1999, including insurance brokerage.

It is to be noted that the activities of broking, underwriting and portfolio management are not permitted.

Expert Advisory Committee of the ICAI: The Committee has opined that providing liaison services does not appear in the list of management consultancy and other services and therefore, statutory auditors cannot provide liaison services with export authorities unless such services are connected with certification or representation.

Management services vis-à-vis management consultancy services: Section 144(h) of the Companies Act, 2013 has used the words “managements services” while section 2(2)(iv) of the Chartered Accountants Act,
1949 read with Regulation 190A (supra) have used the words “management consultancy and other services”. In this regard, attention of the readers is invited to the provisions of Clause 11 of Part I of the First Schedule to the Chartered Accountants Act, 1949 which provides that a practicing member shall be deemed to be guilty of professional misconduct:

“Clause 11: If he engages in any business or occupation other than the profession of chartered accountants, unless permitted by the Council to so engage;”

Thus, it follows that the scope of section 144(h) of the Companies Act, 2013 cannot go beyond section 2(2)(iv) and Regulation 190A (supra), in light of the provisions contained in aforementioned Clause 11 of Part I of the First Schedule to the Chartered Accountants Act, 1949.

CONCLUSION:

Companies Act unlike the Income Tax Act, is not a fiscal statute and therefore, should not be construed strictly but purposively. As per general understanding, management services could mean any services as may be provided in relation to the management and/or administration of the company. Simply giving options/setting out alternatives, without making a recommendation should be permitted so long as these recommendations/options do not in any way relate to any decisions pertaining to the way the business of auditee company is being run and does not constitute management consulting. It seems that financial due diligence and tax services does not fall within the scope of prohibited services to the extent these are not management services.

The Act prohibits investment advisory and investment banking services but there is no prohibition for valuation services. However, if the valuation is for giving opinion on whether or not to invest in the company, to acquire the company, it may fall within management services. Accordingly, depending upon the purpose of valuation, merger valuation, RBI valuation, Business Valuation will not fall under the prohibited category, if the auditor does not provide any recommendation to management as to whether to proceed with a transaction and the services are purely advisory in nature. In a scenario where the management of a company requires the services provider to undertake a complete review of a particular business which entails the service provider analysing and specifically assessing the business and in pursuance thereto, the service provider provides recommendation to the management in relation to any restructuring which the management proposes to undertake, such a activity by the service provider may be considered as ‘management services’. Therefore, the judgement is very subjective and will depend upon facts & circumstances of each case.