ASSURANCE INSIGHTS

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We are pleased to present the February issue of SKP Assurance Insights – our newsletter that aims at providing insights into company law, accounting and assurance related developments in India.

This month's issue focuses on the importance and key challenges related to huge datasets, the role of the internal auditor in data analysis and best practices to be adopted to progress from data analytics to audit analytics.

From data analytics we then shift to the challenges faced in the sphere of attest functions. The payment of bonus has proven to be a double edged sword for employers. It results in a cash outflows as well as a compliance burden where there is very little or no interpretative guidance. In the wake of recent amendments, the need for interpretative guidance has increased manifold. Also, certain retrospective applications in payment of bonus have resulted in added challenges for employers.

Lastly, under corporate updates, we cover the latest development in regulatory policy.

We hope you find our newsletter useful and look forward to your feedback. You can write to us at skpgrp.info@skpgroup.com.

Warm regards,

The SKP Team

In this issue

Payment of Bonus Act

Introduction

A mere mention of the word “bonus” can bring a smile to an employee . But the burden of cost and legislative compliances that the payment of bonus carries with it, has always spelt double trouble for employers. The payment of bonus is governed by the Payment of Bonus Act, 1965 (henceforth referred to as ‘the Act’). Certain crucial criteria’s of the Act were recently amended to make way for The Payment of Bonus Amendment Act, 2015 (henceforth referred to as the ‘the Amendment Act’). The Amendment Act, on account of these changes, can be viewed as an employee friendly legislation but at the same time it has posed substantial interpretational and legislative complications for employers to decipher.

The changes pronounced in the Amendment Act are retrospective in nature and the lack of clarification from the Ministry of Labour on these changes has made deciphering the Amendment Act a problem for employers. A retrospective application of any employee welfare legislation is complicated for employers and makes doing business difficult than it already is. The Amendment Act brings about no change in the applicability criteria of the Act which makes this legislation challenging for smaller companies and start-ups. This month’s insight is a capsule re-fresher on the Bonus Legislations that have a wide reaching impact across sectors and industries.

Applicability

The Act applies to every factory or establishment that employs 20 or more workers. Here, emphasis must be laid on the fact that the state governments are empowered to make the payment of bonus applicable to any factory or establishment that employs more than 10 workers. An example of such is the state of Maharashtra where the state levied bonus applicability has prevailed since 1983. The Maharashtra state government has made the payment of bonus applicable to any establishment that employs 10 or more workers. However, the Act cannot be made applicable to a factory or establishment that employs below 10 workers. It must be noted that establishments covered under the Act shall continue to pay bonus even if the number of employees falls below 10 at a later date.

Employee Eligibility: Revisions

For an employee to be eligible to receive bonus, the following conditions must be satisfied:

a. The employee must have worked in the establishment for a period not less than 30 days; and
b. The salary or wages paid to the employee must not exceed INR 21,000 per month.

The erstwhile limit of INR 10,000 has been changed to INR 21,000 under the Payment of Bonus Amendment Act, 2015.

The Amendment Act shall cover a larger number of employees who under the erstwhile Act were not mandatorily eligible for a bonus.

Salary: A maze of multiple interpretations

Challenges in interpreting the definition

Salary has been defined in Section 2(21) of the Act. The term salary expressly excludes remuneration for overtime work. Items such as allowances, bonuses and perquisites too are excluded from what would comprise of as salary for the purposes of payment of bonus. Here, employers may opine that the definition of salary, with its long list of seven specified exclusions, is subject to multiple interpretations, making it ambiguous. A conservative interpretation of the applicability provisions suggest that salary shall mean the basic salary plus dearness allowance. On the other hand, an aggressive interpretation of the definition of salary may lead to all items of salary being included for the purposes of calculation of bonus, except the seven exceptions.

It has conceptually agreed that any allowance that helps to cope up with the increased cost of living is considered as a dearness allowance. Employers may choose alternate terms, for example special allowance, to refer to such allowances for the purposes of their payroll processing. In such cases, it is in the spirit of the Act to consider the said allowance as a part of the salary for the purposes of applicability. This can be numerically illustrated as follows:

- Basic Salary of Employee Mr. A = INR 19,900 per month
- Special Allowance (paid to help cope with the increased cost of living) = INR 15,500 per month

A rigid interpretation of the Act shall result in it being applicable by virtue of the basic salary being less than INR 21,000 per month.

But if special allowances are conceptually identified as dearness allowances, the salary of Mr. A shall be INR 19,900 + INR 15,500 = INR 35,400 per month, thus exempting the company from paying him any legally mandated bonus.

When it comes to the payment of bonus, it has been agreed that such payments are inherently performance related. Employers in order to express their appreciation, may bring about an increase in the quantum of certain special allowances that are enjoyed by employees. This enables employees to enjoy higher salaries without changing their existing basic salary package. However, it will be a microscopic debate if the employer were asked to demarcate the following increments in allowances:

a. Increments to reward performance; and

b. Increments to help cope with increased cost of living.

Employees performing comparatively better than their counterparts may enjoy a higher performance bonus, an example of this can be found in the cases of sales and marketing executives. A numerical illustration has been given below on how payment of bonus becomes a compliance burden despite the employer's best intentions.

Company A is the manufacturer of reverse osmosis water purifiers. The company sees the National Capital Region (NCR) as a lucrative market, owing to the water salinity in that region. Mr. X and Mr. Y are sales executives at the same designation. Their salary package is given below:

- Basic salary: INR 10,000 per month
- Dearness allowance: INR 5,000 per month
- Performance bonus: INR 1,000 per unit sold

Mr. Y, an underperforming employee is unable to sell any units of the purifier, thus keeping his monthly take away salary at INR 15,000.

On the other hand Mr. X is highly motivated and is an efficient employee who manages to sell 100 units of the purifier. Hence, the take away salary for Mr. X was INR 115,000.

Despite the contrast in the level of performance, the employer shall be mandated by the Act to pay bonus to both the employees. The regulations and framework for the payment of bonus are not based on employee's efficiency and performance ability. Hence, even in the case of an under performing employees, the employer will have pay a minimum bonus as per the Act. However, if an employee is found to incite or participate in riots, fraud or sabotage, he shall be ineligible for bonus.

Monthly-Quarterly bonus payment - lack of clarity

Employers would like clarification on whether bonuses should be paid on a monthly or quarterly basis. The payment of monthly or quarterly bonus enables:

a. Employees to have a higher in hand monthly salary; and

b. The company to dispense of its liability of payment of bonus on a convenient monthly/quarterly basis.

It must be noted that there is no express disallowance for the payment of bonus on a monthly/quarterly basis.

The other two fold argument that goes against the payment of monthly/quarterly bonuses is:

a. Companies cannot calculate the percentage of bonus to be paid at the beginning of the financial year.

b. Any amount paid on a monthly basis shall form a part of salary, thus not being classified as bonus.

Allocable surplus, minimum bonus and maximum bonus

The Amendment

Section 12 of the Act prescribes that the bonus to be paid must be in proportion to the salary/wages of the employee. As per the Amendment Act, with effect from 1 April 2014 the following limits shall be adhered to:

Limit	Bonus
If the salary exceeds INR 7,000 per month	The bonus will be calculated assuming salary to be INR 7,000
If the salary does not exceed INR 7,000	The bonus will be payable taking the entire actual salary as a base.

The erstwhile limit of INR 3,500 has been changed to INR 7,000 under the Payment of Bonus Amendment Act, 2015

It must be noted that each state is empowered under the Minimum Wages Act, 1948 to prescribe minimum wages, which can be revised twice in a year. Hence, establishments operating in more than one state have to be wary of the challenge of adhering to different limit of minimum wages across state jurisdictions.

Allocable surplus

Under the Act, bonus is directly linked with profits. Allocable surplus acts as the yardstick in the payment of minimum or maximum bonus. A snapshot for arriving on allocable surplus is given below:

Step	Action	Provisions of the Act
1	Calculate gross profit	Section 4 of the Act
2	Arrive on available surplus	Section 5 of the Act
3	Arrive on allocable surplus	Section 2(4) of the Act

Minimum bonus

According to Section 10 of the Act, every eligible employee is entitled to receive an amount as minimum bonus which shall be higher than:

a. 8.33% of salary or wages earned during the accounting year; or

b. INR 100.

Maximum bonus (Section 11)

Condition	Limit as per the Act
If the Allocable surplus is greater than minimum bonus	Bonus shall be a maximum of 20% of the salary or wage, restricted to the amount of allocable surplus

a. The limit on maximum bonus prescribed by the Act is 20% of the salary/wage. However, the act does not spell this out explicitly.

b. Employers may argue that the limit of 20% is the maximum limit. However employer's at their own discretion may pay a bonus at any rate below 20%, say 15% or 18% in the absence of any strict specification.

c. However, as per the current interpretation of the law, if a practice is giving 20% of the salary is being paid as maximum bonus, the practice may be viewed by most employers as regressive.

Challenges and grey areas

The amendments with respect to employee eligibility and minimum bonus limits are retrospectively applicable from 1 April 2014. As of 13 June 2016, the Bombay High Court has stayed the retrospective operation of the Amendment Act. The Bombay High Court is not the only Court to have stayed this unfriendly retrospective pronouncement. Between January 2016 and April 2016, the High Court benches of Kerala, Karnataka, Madhya Pradesh, Allahabad, Gujrat and Punjab and Haryana too have brought about a stay on this retrospective operation. A brief summary of the challenges that may arise on the retrospective operation of the Amendment Act and other challenges that exist in the payment of bonus are discussed below:

a. In India, accountancy is spread over a period from April to March. As per the Act, an employer's are mandated to give the bonus within eight months of the closure of the accounting year. The challenges here are:

i. Most employers may have concluded the finalisation of the allocable surplus applicable to them for Financial Year (FY) 2014-15.

ii. Eligible employees with salaries below INR 10,000 may have already received the bonus for FY 2014-15. The payment of bonus on a retrospective basis to employees who fall in the bracket of INR 10,000 – INR 21,000 in FY 2014-15.

iii. Employees may have received the usual double revision in minimum wages. The Ministry of Labour has not defined a base for the retrospective bonus calculations in these cases.

iv. In case of minimum wages, there continues to be an unaddressed area of doubt arising due to two separate legislations (centre and state) prescribing different limits on the same subject matter.

b. There is a larger batch of employees to whom bonuses will have to be distributed due to increase in the limit from INR 10,000 to INR 21,000. This will impose a cost cum compliance burden on the employers. A retrospective re-calculation and distribution of bonus based on salary/wage structure that was effective in previous accounting periods will have to be dealt with for all present eligible employees.

c. Employee attrition will be a cumbersome task to deal with. Tracing employees who have left the organisation for the purpose of payment of revised bonus applicable to the impact period will be a time-consuming task for all organizations. In the absence of any specific guidelines on untraceable employees, employers may consider transferring unclaimed bonus to the **Labour welfare fund** managed by the state government.

d. There are disagreements in industry on whether allowances such as house rent allowance and various special allowances are a part of salary. The eligibility of employees for receiving bonus depends on the assumptions made by their employer.

e. Micro, Small and Medium Enterprises (MSMEs) and loss making companies will find it very challenging to abide by the Amendment Act. The primary focus of any business should be its core operations. Added compliances like these shall increase the burden on these companies.

i. Loss making start-ups have been granted a cushion of five years where they are not required to pay a bonus to their employees. However, from the sixth year, such companies will have to start paying a minimum bonus despite their loss making status.

ii. It may be viewed that to bring about ease of doing business in India, such companies should be granted a holiday from these cumbersome compliances. In cases where holidays cannot be granted, MSMEs and smaller start-ups should be granted a higher number of employees on whom the Act shall be applicable.

In Retrospect

Certain archaic prescriptions of the Act are reflective of the era of socio-communist philosophies that India's economy had adopted.

Retrospective application of any legislation is a major hurdle for businesses. Not only does it require re-work, but it also results in re-statement of vital results. Foreign companies will view such rulings as a hurdle in doing business. One of the primary agendas of the current government was to bring about ease of doing business. However, the revised limit of bonus shall place a heavy burden on the industry. Confusion shall prevail until there is a formal clarification from the Ministry of Labour on the multiple grey areas that are riddling the industry. One may hope that in the time to come, employee friendly legislations shall consider practicability and clarity in implementation from the employer's lens.

Impact of data analytics in internal audit

Introduction

In this rapidly changing economy and technology, the style of conducting audit has also gone through many changes, one of them being the use of data analytics in internal audit. The concept of data analytics is not new to the audit field. Traditional audit uses methods ranging from simple trend analysis to advanced regression analysis in a limited fashion. The emergence of advanced technologies has tremendously increased the appeal of data analytics in audit and has enabled a massive leap from the traditional audit approach to one that completely integrates data and analytics in a continuous and seamless manner.

In simple terms, data analytics is the science of examining raw data for the purpose of drawing useful conclusions from the same.

Stages of data analytics

There are three stages of analysing data, and the mathematical complexity grows with each stage. The three stages are given below:

a. Descriptive reports - In this stage, we have to visualise and understand what has already happened.

b. Predictive Understanding – In this stage, we have to comprehend why something has happened and predict what will happen in a given scenario or different scenarios.

c. Prescriptive Determination – In this stage, we have to determine which decision or action will produce most effective result.

Importance of data analytics

- The advancement in technology and availability of data from various sources provides many opportunities for companies to generate powerful and timely data, even in complex situations. Boards, business committees, regulators, risk committees, etc. use data analytics to understand and monitor the emerging business dynamics and use this knowledge to drive growth and ensure that compliances are met in the most efficient manner.
- Internal auditors use data analytics efficiently by refining and redefining the focus on risk to derive deep insights of the organisation's workings to understand the risk control environment. By analysing data of the key organisational processes, internal auditors are able to identify existing vulnerabilities or process weaknesses that could expose the organisation to unplanned risk and help in the construction of essential safeguards/preventive controls.

Barriers of using effective data analysis

Data analysis technology has certain benefits. However, the adoption rates show that there are a lot of barriers to overcome before the use of data analysis becomes common. These barriers might exist among the analysts while performing data analysis or even among the audience for that matter. Some of the barriers are listed below:

a. Ambiguities in facts and opinions:

Effective analysis requires obtaining relevant facts that can answer specific questions and support a conclusion. A fact by definition is irrefutable but opinions are subjective, which may differ from person to person. When making the leap from facts to opinions, there is a possibility that the opinions are erroneous.

b. Rational differences:

There are a variety of rational differences that can adversely affect data analysis. For example, data validation is the tendency to interpret information in a way that confirms one's presumptions. Analysts must be trained to become aware of such biases and overcome them.

c. Innumeracy:

Effective analysts are generally adept with a variety of numerical techniques. However, the audience may not have literacy with numerical techniques. They are said to be innumerate. Bad numerical techniques might be performed to mislead or deliberately misinform.

The role of internal auditor

Organisations require assurance, business insights and strategic advice from internal auditors which should anchor continuous monitoring and assurance into the framework of the organisation. The effective use of data is thus a precursor for effective Enterprise Risk Management (ERM) which helps in sustaining business for longer periods.

Data analysis technology can also be used to determine if semi-automated or manual controls are being followed as per the designed process by seeking indicators in the data. By analysing the relevant transactions and comparing data from various sources, conducting internal audit may assist in identifying instances of non-compliance, errors and inefficiencies and provide a stable and faster growth for the business.

Recognising the potential created by analytics

With the support of various data analytic tools available in the market, internal audit can meet various objectives, few of which are given below:

a. Deriving comfort by testing all the data rather than performing test checks.
b. Aiding risk assessments through identification of anomalies and trends/patterns.
c. Providing audit evidence through comprehensive analysis of organisations' data base.
d. Improving data discovery and presentation which will enhance risk coverage.
e. Integrating the data analytics techniques with audit planning and thus managing cost effectively.
f. Data analytics helps in preventing wastage of time in unproductive audit activities like structuring/formatting data.

Best practices for data analytics

Audit analytics tools cover a wide range of application, which varies according to the size and complexity of the audit organisation and industry. In order to apply the best practices and achieve the highest value from audit analytics, three key areas must be addressed, which are described below.

Access and management of data

Effective data access and management requires continuous security, understanding of best organisational practices and access to data. Creating and maintaining an audit data repository is perhaps the most common and effective solution for the problem faced by many audit organisations.

The key strategy should be to develop and maintain an intelligent data dictionary within the central server which can be used by auditors to describe data elements by its significance and purpose.

Quality and control of audit analytics processes

The most effective quality assurance solutions are:

a. To develop standard procedures and tests; and
b. To create audit analysis process controls. In a central server environment, audit organisations can house procedures and test libraries for audit analytics.

Collaboration, efficiency and sustainability

Audit analytics are effective when the analysis is a fundamental part of the audit strategy, and is used in an environment of collaboration, shared knowledge, and repeatable processes.

Practical steps to establish best practices for audit analytics

Implementing audit analytics effectively and efficiently is a strategic decision and companies should avoid taking a tactical approach. The strategic approach requires audit management to engage other individuals in the organisation to explain desired outcomes, manage changes to existing policies and procedures, and to plan the transition to a centralised, systematic and secure approach to audit analytics. Following are the steps to establish best practices for audit analytics:

a. Understanding business requirements
b. Understanding technology environment
c. Develop a data analytics strategy
d. Defining the audit analytics architecture
e. Planning the technology rollout
f. Assign roles and responsibilities within the audit team
g. Implement a training program

Utilising analytics across the internal audit life cycle

Today, multiple large organisations hire internal auditors exclusively for data analysis only. The company gathers relevant data and allows internal auditors to use different data analytics techniques to generate factual information required by the management for effective decision making.

Three different ways in which the internal auditors can participate in data analytics of the internal audit life cycle are as follows:

a. **Assessment:** The internal auditor analyses the current capabilities, both within the organisation and outside it, and develops concepts which identifies the challenges and opportunities in the business.
b. **Roadmap:** The internal auditor creates long-term strategy and vision for the organisation with the help of different data analytics techniques, which helps the organisation to decide their future goals, expansion plans, etc.
c. **Deliver and Monitor:** The internal auditor initiates the program for achievement of organisation's goals and analyses the same on a regular basis to monitor the success of the implementation program against key performance indicators.

Conclusion:

Data analytics should form an integral part of audit procedures to a keep track of changing dynamics, not only within the business, but the external environment as well. Analytics today are not just recommended but mandatory, because of its importance in making strategic decisions. Internal auditors have a pivotal role to play here and must be equipped with the required skill sets to integrate, assess and analyse vast amount of data, referred to as the big data of organisations. Internal auditors can play the role of strategic advisor by providing relevant information required for effective decision making to the management of companies in a timely manner with the help of data analytics.

The Companies Act, 2013: Key Updates

Clarifications regarding closure of place of business by a foreign company.

Section 391(2) of the Companies Act, 2013 states that the provision of chapter XX relating to winding up shall apply mutatis mutandis for closure of the place of business of a foreign company as if it were a company incorporated in India.

On 22 February 2017, the MCA has further clarified that the provisions of section 391(2) of the Companies Act, 2013 will apply only to those foreign companies which have issued a prospectus or Indian Depository Receipts (IDRs) relating to chapter XXII of the Companies Act, 2013. The provisions of chapter XXII of the Companies Act, 2013 deals with the companies incorporated outside India.

Source: Clarifications regarding foreign company

About SKP

SKP is a long established and rapidly growing professional services group located in seven major cities across India. We specialise in providing sound business and tax guidance and accounting services to international companies that are currently conducting or initiating business in India as well as those expanding overseas. We serve over 1,200 clients including multinational companies, companies listed on exchanges, privately held firms and family-owned businesses from more than 45 countries.

From consulting on entry strategies to implementing business set-up and M&A transactional support, the SKP team assists clients with assurance, domestic and international tax, transfer pricing, corporate services, and finance and accounting outsourcing matters, all under one roof. Our team is dedicated to ensuring clients receive continuity of support, right across the business lifecycle.

Contact Us

Mumbai
19, Adi Marzban Path
Ballard Estate, Fort
Mumbai 400 001
T: +91 22 6730 9000

New Delhi
B-376
Nirman Vihar
New Delhi 110 092
T: +91 11 4252 8800

Toronto
269 The East Mall
Toronto
ON M9B 3Z1
T: +1 647 707 5066

Pune
VEN Business Centre
Baner–Pashan Link Road
Pune 411 021
T: +91 20 6720 3800

Chennai
Office No. 3, Crown Court
128 Cathedral Road
Chennai 600 086
T: +91 44 4208 0337

Dubai
2303 Orra Marina
Nasaq Street, Dubai Marina
Dubai, UAE
T: +971 4325 2245

Hyderabad
6-3-249/3/1, SSK Building
Ranga Raju Lane
Road No. 1, Banjara Hills
Hyderabad 500 034
T: +91 40 2325 1800

Bengaluru
Office No. 312/313, Barton Centre
Mahatma Gandhi Road
Bengaluru 560 001
T: +91 80 4277 7800

Chicago
2917 Oak Brook Hill Road
Oak Brook
Chicago 60623
T: +1 630 632 9705

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