Highlights of the statutory provisions under the Companies Act, 2015 that affect the accounting and audit work carried out on private companies

The coming into effect of the provisions of the Companies Act, 2015 on the 15th of June 2016 will have significant impact on the conduct of accounting and audit work relating to companies.

Some of the new terminology and requirements on auditors that feature in the newly operationalized provisions of the Act that need consideration by persons engaged in accounting work for a private company are set out hereunder.

New terminology with regard to determination of the financial year of a company

The repealed Companies Act Cap 486 at section 148 required directors of a new company to present its profit and loss account and balance sheet at a general meeting of the company on a date not later than 18 months from its incorporation and subsequently once in every calendar year.

The Companies Act, 2015 now introduces the term ***accounting reference period*** to refer to the period in relation to which a company makes up its accounts (Section 632). The Act also comes up with the term ***accounting reference date*** and defines it as the last day of the month in which the anniversary of a company's incorporation occurs. According to section 633(3) of the Act, the accounting reference period of a newly incorporated company runs from its accounting reference date for a duration that should not be less than 6 months when computed from the date of the company's incorporation.

The accounting reference period for a newly incorporated company should, however, not go beyond an 18 month duration computed from the date of the company's incorporation. In addition, where a newly incorporated company is a subsidiary, the Act requires that its first accounting reference period allows for its subsequent accounting reference periods to be successive periods of 12 months that coincide with the financial year of its parent company. This is a mandatory requirement of the Act at Section 632(4) that can only be departed from by the directors of a company where there are good reasons.

Description of proper accounting records to be kept by a company

Section 147 of the repealed statute made it mandatory for every company to keep proper books of account and went on to state that proper books of account would not be deemed to have been kept where a company failed to keep such books as were necessary to give a true and fair view of the state of the company's affairs and to explain its transactions.

The Companies Act 2015, in addition to requiring that every company keep proper accounting records at section 628, also clarifies the meaning of proper accounting records by providing three criteria that are to be met by accounting records of a company for them to be considered proper accounting records. First, they must show and explain the transactions of the company. Second, they must disclose with reasonable accuracy up to the end of the previous three month trading period the financial position of the company. Lastly they should enable the directors of the company to ensure that every financial statement required to be prepared by the company complies with the requirements of the Act.

Enhanced auditors reporting requirements under the Companies Act, 2015

The repealed statute required auditors to make a report on accounts examined, the balance sheet and the profit and loss account. The Companies Act, 2015 requires an

auditor to state his opinion on the following components of a company financial statements:

- The director's report stating whether in his opinion the information given therein for the financial year for which the financial statement is prepared is consistent with the statement (Section 728).
- The auditable part of the directors' remuneration report stating whether in his opinion it has been properly prepared in accordance with the provisions of the Companies Act (Section 729)
- Non-adherence of company directors' to the provisions of the Act as is the case where a company's financial statement and director's report are prepared in accordance with the small company's regime yet in the auditor's opinion the company is not entitled to do so.

Additional requirements connected to an auditor ceasing to hold office under the Companies Act, 2015

The Companies Act, 2015 just like the repealed statute provides a procedure to protect the auditor from unfair termination by allowing him to make representations at a general meeting. This entitlement was left to the discretion of the auditor. However, the Companies Act, 2015 now makes it a mandatory requirement for the auditor to lodge a statement of the circumstances connected with the auditor ceasing to hold office where the auditor resigns or fails to seek reappointment (Section 748).

The Act also accords a resigning auditor similar rights to those of an auditor that has been otherwise removed from office. The Act provides that a resigning auditor is entitled to make representations regarding his resignation in a similar manner to an auditor removed from office. The Act further makes it mandatory that a notice by an auditor informing the company of his resignation be accompanied by a statement of the circumstances connected with the auditor ceasing to hold office. A resignation notice issued by an auditor that is not accompanied with the said statement is not considered to have taken effect.

An auditor that ceases to hold office before the end of the term for which the auditor was appointed must also notify the appropriate audit authority (Section 751). The said notification by the auditor is to be accompanied with the statement of the circumstances connected with the auditor ceasing to hold office.

Enactment of stiffer penalties to be levied on errant auditors

The Companies Act, 2015 has enhanced the penalties to auditors for failure to adhere to responsibilities required of them under the Act. Section 738(4) of the Act provides that an auditor will suffer a fine of one million Kenya shillings and or imprisonment for 3 years upon conviction for failure to state where he comes up with any one of the following opinions in his report in relation to a company under his audit:

- that the company has not kept adequate accounting records;
- that the company's financial statement is not in agreement with the company's accounting records;
- that he failed to obtain all the information and explanations that, to the best of the auditor's knowledge and belief, are necessary for the purposes of the audit;
- That a company has prepared a financial statement and director's report in accordance with the small company's regime yet in the auditor's opinion they were not entitled to do so;
- The Act at Section 738 also provides for offences by the auditor in connection to his inclusion into his report on the financial statements information or an explanation that the auditor knew or ought to have known was false or misleading in a material respect.

In addition, an auditor that fails to lodge a statement of the circumstances connected with the auditor ceasing to hold office where the auditor resigns or fails to seek reappointment at the companies registered office as set out in Section 748 commits an offence and is liable to a fine of Five Hundred Thousand Kenya Shillings upon conviction.

The auditor is further required to lodge the said statement with the Registrar of companies within a specified time frame set out at Section 750 of the Act failing which the auditor commits an offence and is liable upon conviction to a fine of one million Kenya shillings.

An auditor who having ceased to hold office fails to notify the appropriate audit authority as set out in section 751 of the Act commits an offence and is liable upon conviction to a fine of five hundred thousand Kenya shillings.

Enactment of penalties aimed at persons that hamper the auditor's right to information

Enhanced penalties have also come into effect to deal with instances where persons hamper an auditor's quest for information relating to his audit work. At Section 733 the Act levies a fine of up to one million Kenya shillings and/or three year imprisonment on a person convicted of knowingly making a materially false or misleading statement in accounting records and financial statements containing information or explanations that an auditor requires or is entitled to require. The said punishment is also imposed upon conviction for making such statement recklessly without caring whether the statement is true or false.

Conclusion

Accounting and audit practitioners would do well to acquaint themselves with the highlighted provisions of the Companies Act, 2015 to avoid having to pay hefty monetary fines in addition to the possibility of serving jail terms.