

MICRO, SMALL AND MEDIUM ENTERPRISES DEVELOPMENT ACT 2006 W.R.T.

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INTRODUCTION

MSMED act was established to provide for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises and for matters connected therewith or incidental thereto.

The Act is operational from October 2,2006

The MSMED Act is superior as compared to the provisions for SSI under the IDRA in many ways.

The scope of the promotion and protection measures under the IDRA was restricted only to SSI. However, during last 60 years of independence, the norms for the promotions and development have changed and the requirement to motivate the higher and different versions of SSI is felt. The MSMED Act not only addresses these issues but it also takes care of Micro, Small and Medium Scale enterprises (“MSM enterprises”).

Another major highlight of the MSMED Act is that the MSM enterprises in the service sector are also covered under the Act. Separate investment limit for plant and machinery has been prescribed for MSM enterprises in the service sector.

The MSMED Act was framed with the following objects:

To facilitate the promotion and development of micro, small and medium scale enterprises (MSM enterprises);

To enhance the competitiveness of MSM enterprises;

To concentrate on the related matters of MSM enterprises;

To extend the scope of benefits from SSI undertaking and ancillary industries to MSM enterprises.

MSMED ACT 2006 AND ITS IMPACT

Clause	Salient Features	Impact
1. Establishment of National Small and Medium Enterprises Board –Women Maximum No. of members 47	1. Specific representation for 2. Mandatory Quarterly Meeting	Statutory Status, compact board and quarterly meetings will address problems of SMEs immediately to take corrective action
2. Concept of Enterprises	Clear-cut demarcation of manufacturing/production and rendering services	Facilitates SMEs to enter into service enterprises aggressively
3. Definition of Enterprises	Specific ceiling limit for manufacturing/production and service enterprise definition for Medium enterprises	Existing small units can graduate into Medium units and avail facilities under the act.

4. Filing of memoranda optional for Micro and Small enterprises in manufacturing and service sector
Medium enterprises in Service Sector but mandatory for Medium enterprises in manufacturing sector

Replacement of registration with memorandum

Facilitates SMEs to avail the benefits of the act immediately after setting up of the unit.

5. Procurement Policies

Notification of preference policies by central or State Governments for goods and services provided by Micro & Small enterprises

Facilitates opportunity for supply of goods/services without any hassles.

6. Delayed Payment Penalty & dispute resolution

Period of payment by the procuring organizations – 45 days
Penal interest 200% of PLR

SMEs can plan their cash flow/financial requirement

7. Dispute Resolution	Establishment of MSE facilitation Council; 90 days framework for dispute resolution	Easy financial planning and no waste of human resources for chasing/follow up.
8. Delayed Payment – allowable deduction under IT Act 1961	Deduction disallowed u/s 23 of MSMED Act. [Clause 17A of tax audit]	This will encourage procurement agencies to ensure timely payment to SMEs.
9. Closure of Business	Statutory notification of scheme for closure	Facilitates expedition of liquidation
10. Notification of guidelines or instructions for promotion of SMEs – wrt. Funds appropriation and release	Statutory	Mandatory on all facilitating development of SMEs ensuring fast growth
11. Facilitating Credit	Statutory	Mandatory on all providing credit. Guidelines for credit for 20% year on year growth

BENEFITS TO MSMEs UNDER THE ACT

Sr. No.	Benefits available under the act	Whether available to Micro enterprises	Whether available to Small enterprises	Whether available to Medium enterprises
1.	Protection against delayed payments by buyers of goods/services (Chapter V of the act) and right to interest for delayed payments and time-bound settlement of payment-related disputes through conciliation and arbitration.	Yes (see Note 1 below)	Yes (see Note 1 below)	No
2.	Central Governments's measures for promotion and development [Sec 9 of the act]	Yes	Yes	Yes
3.	RBI's progressive credit policies for ensuring timely and smooth flow of credit [Sec 10 of the act]	Yes	Yes	Yes (see Note 4 below)
4.	Reservation of items for manufacture and production u/s 29B of the 1951 Act	Yes (see Note 2 below)	Yes (see Note 2 below)	No

5.	Preference policies (preference to micro enterprises in respect of goods and services procured by Government Departments/ aided institutions/ PSEs) notified by Central/ state government [Sec 11 of the act].	Yes	Yes	No
6.	Simplified exit scheme (winding up the business) u/s 25 of the act.	Yes (see Note 3 below)	Yes (see Note 3 below)	Yes (see Note 3 below)

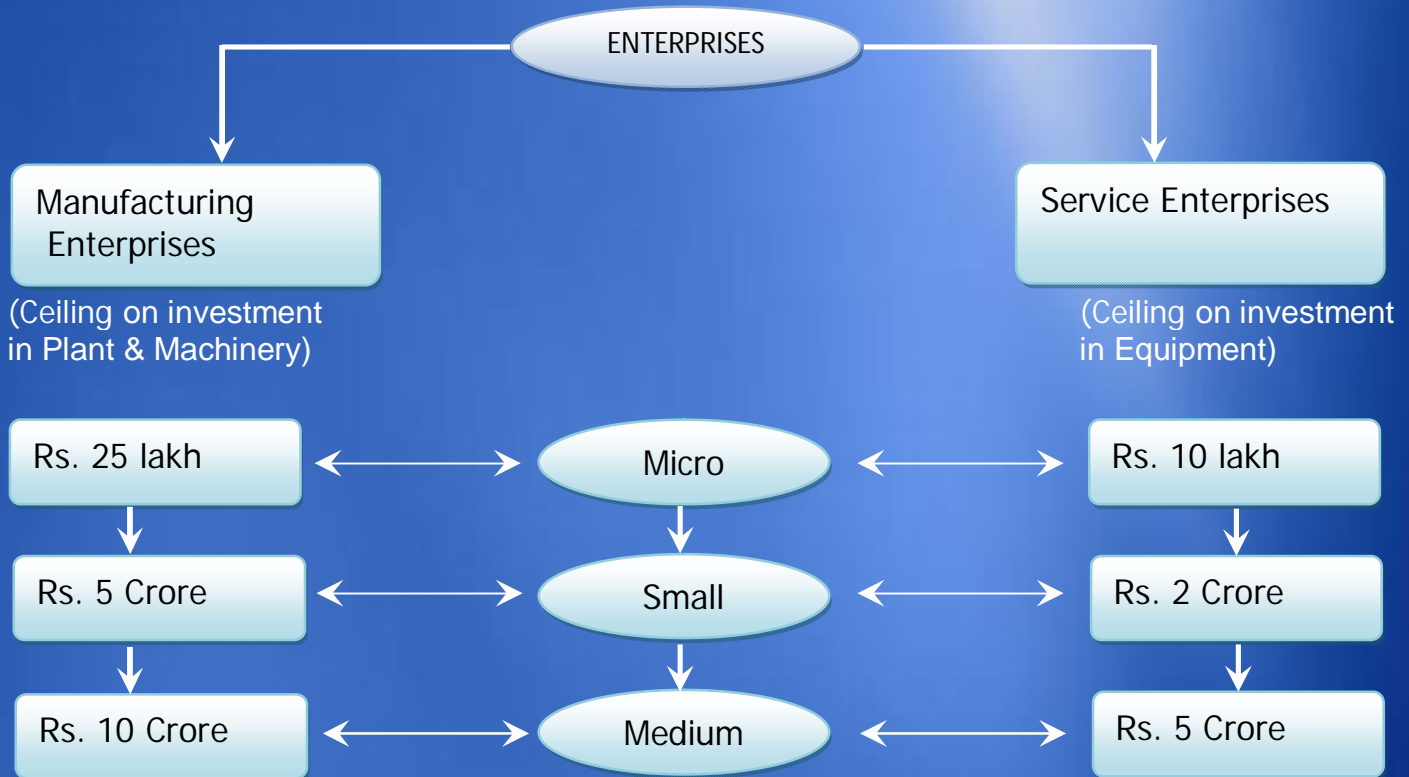
Note 1: This benefit shall be available only if the micro/small enterprise has filed memorandum u/s 8 of the act.

Note 2: This benefit is available only to enterprises engaged in manufacturing or production of goods in any scheduled industry. There is no provision under any law which permits the government to reserve any services for exclusively being rendered only by micro and small enterprises.

Note 3: This scheme shall not apply to companies.

Note 4: As per RBI's master circular, dated 2-7-2007 lending by banks to medium enterprises is not considered as "priority sector credit".

CLASSIFICATION OF MSME



As per Ministry of small scale industries notification dated 5th October, 2006, the investment in Plant & Machinery to in respective limits is the original price, irrespective of whether the plant & machinery are new or second hand. In respect of imported machinery, the following is to be *included* in calculating the value:

- a) import duty (excluding miscellaneous expenses such as transportation from the port to the site of the factory, demurrage paid at the port);
- b) shipping charges;
- c) customs clearance charges and
- d) sales tax or value added tax.

Further, as per the said notification, the following are *excluded* while calculating the investment in plant & machinery:

- a) Equipments such as tools, jigs, dies, moulds and spare parts for maintenance and the cost of consumable stores;
- b) Installation expenditure for plant & machinery;
- c) Research & development equipment and pollution control equipment;
- d) Power generation set and extra transformer installed by the enterprise as per the regulations of the state electricity board;
- e) Bank charges and service charges paid to the national small industries corporation of the state small industries corporation;
- f) Procurement or installation of cables, wiring, bus bars, electrical control panels (not mounted on individual machines), oil circuit breakers or miniature circuit breakers which are necessarily to be used for providing electrical power to the plant & machinery or for safety measures;
- g) Gas producer plants;
- h) Fire fighting equipment;

- i) Transportation charges (excluding sales-tax or value added tax and excise duty) for indigenous machinery from the place of their manufacture to the site of the enterprise;
- j) Charges paid for technical know-how for erection of plant & machinery and
- k) Such storage tanks which store raw materials and finished products only and are not linked with the manufacturing process.

Further, investment in land, building, vehicles, furniture & fixtures, office equipments etc. shall not be considered in determining the threshold limits of plant & machinery or equipment as the case may be.

REGISTRATION

As per Sec 8(1) of the act, registration of micro or small enterprise (both manufacturing and rendering of services) or a medium enterprise engaged in providing or rendering of services is optional. However, a medium enterprise engaged in manufacture or production of goods pertaining to any industry specified in the First schedule to the IDR act, 1951 is required to file the memorandum with the General manager, District Industries Centre or any District level officer of equivalent rank in the Directorate or the Department dealing with Micro, small and medium enterprises of the state government or union territory administration.

The memorandum should be filed in the form 'Entrepreneurs Memorandum' notified by the central government. It is in two parts i.e. Part-I and Part-II and is to be filed with the respective District Industries Centre.

Any person who intends to establish Micro, Small & Medium enterprise engaged either in manufacturing of products or providing or rendering of services shall file Part-I. Once Enterprise starts the production or starts providing or rendering services then they shall file Part-II of the Entrepreneur Memorandum. Validity of Entrepreneur's Memorandum (Part-I) is two years. No Renewal shall be granted.

Existing enterprise shall file Part-II of Entrepreneurs Memorandum.

The units which are presently registered under SSI or Medium Category are required to file Entrepreneurs Memorandum in case of following changes:

- a) Change of Status from Small Scale to Micro Scale due to revisions in definitions in Investment Limits.
- b) Change of Status from Medium Scale to Small Scale due to revisions in definitions in Investment Limits even if the unit has previously filed an I.E.M.
- c) Any Change in other contents like Name of the Unit, Address/ Location, Addition/Deletion/Change of Activity, Nature of operations, Nature of Constitution (Proprietary/HUF/Partnership/co-operative/Private Ltd. Co./Public Ltd. Co./Self Help Group/Others) etc.

In case of change in investment in Plant & Machinery or in equipments, the enterprises, which have already filed Entrepreneurs Memorandum, shall inform the District Industries Centre about the same in writing within three month of the change in investments. Failure to do so is contravention of law and is punishable as specified in section 27 of MSMED Act.

The code numbers mentioned in the Entrepreneurs Memorandum viz. NIC Code, ASICC Code, Codes for Tehsil / Taluka / District and State will be filled by the officials of District Industries Centre.

In case of change of products & that of services or addition in product or services, the enterprises which have already filed Entrepreneurs Memorandum should inform the District Industries Centre about the same in writing within three months of the change. Failure to do so is contravention of law and is punishable as specified in section 27 of MSMED Act.

Advantage/ benefit of registering a micro or small enterprise with the state government:

Apart from getting other benefits, if a micro or small enterprise has filed a memorandum with DIC of its area, then it stands to gain as to timely payment in respect of supply of goods or rendering of services to any buyer.

With the enactment of MSMED Act, 2006, the Interest on delayed payments to small scale and ancillary industrial undertakings act, 1993 is repealed w.e.f. 2/10/06.

As per this act, if the buyer has purchased goods or availed services from micro or small enterprise, which has filed a memorandum with the authority, then the buyer shall make the payment on or before the date agreed upon between him and the supplier in writing. If no agreement is there in writing, then within a period of 15 days from the day the goods are delivered or services are rendered. The act

further stipulates that even if the buyer and supplier is agreed in writing, such period shall not exceed 45 days from the day of delivery of goods or rendering of services.

in brief, any credit term from a micro or small enterprise stipulating payment terms beyond 45 days, shall be in violation of the MSMED Act, 2006.

Consequences of not filing memorandum.

Since filing is optional, no penalty is attracted. However, filing the memorandum is pre-requisite to qualify as a 'supplier' for Chapter V purposes and non-filing will make the supplier ineligible to benefits under Chapter V relating to right to receive timely payment and right to receive interest under Sec 16 for delayed payment.

According to Sec 28(1), whoever intentionally contravenes or attempts to contravene or abets the contravention of any of the provisions contained in sub-section (1) of Sec8 shall be punishable:

- a) First conviction : Fine < 1000
- b) Second or subsequent conviction : 1000 < Fine >10,000

Filing should be by person. There is no definition of person which treats entities like HUF and partnership firms as “persons”.

Procedure for filing memorandum:

- a) four copies of the memorandum should be filed.
- b) no processing fee of the memorandum.

c) in case of any change in the information at any point of time, details of the same should be informed within three months to DIC.

d) the form should be filled up in block (capital) letters.

e) after each word one blank box should be left.

f) fill up whichever is applicable.

g) all codes other than pin code shall be filled by the office.

h) form will be machine numbered by DIC office.

i) undertaking at the end should be signed.

Form of Entrepreneurs Memorandum can be downloaded from the internet, the address of which can be obtained from the Directorate dealing with Micro, Small and Medium Enterprises of the State Governments or the Union Territories or the hard copies of the same can be obtained from the District Industries Centres. This form can also be downloaded from the Small Industries Development Organisation website i.e. www.laghu-udyog.com or www.smallindustryindia.com

For MSMED registration, below mentioned office should be contacted:

National Small Industries Corporation Limited

NSIC Bhawan,

Okhla Industrial Estate

New Delhi – 110 020, India

Tel: ++91-11-, 26926275, 26910910, 26926370

Fax: ++91-11-26932075, 26311109

Email: info@nsic.co.in, pro@nsic.co.in

Website: www.nsic.co.in

OBLIGATION FOR THE BUYERS

The Buyers have to ensure whether those suppliers of goods and services are under the purview of MSMED Act i.e. the Buyers have to confirm the registration of the suppliers under the MSMED Act.

Date of Credit Period is to be considered either the date as agreed between the Supplier and Buyer as per agreement between them or as per the MSMED Act i.e. 45 days from the date of Delivery/ deemed date of Delivery, whichever is earlier.

The Buyers should be aware that the day following immediately after the expiry of 15 days from the date of acceptance or the day of deemed acceptance of any goods or services from a supplier would be treated as the credit period if nothing is agreed between the Buyer and Supplier.

The Buyer should to ensure the payment before the end of credit period decided else the interest would be payable.

The MSMED Act does not prescribe the interest at compounded rate. Therefore, Interest on interest is not applicable if Buyer has paid the Principal amount in full. The Buyers should pay towards Principal amount first. This would stop the growing Interest portion.

In case of disputes, application to Micro and Small Enterprises Facilitation Council (MSEFC) would trigger the conciliation and arbitration process. Once the application is done under MSEFC, there is no provision to withdraw the proceedings. Therefore, the Buyer should ensure the best ways to resolve the disputes, if any instead approaching to MSEFC in the initial stages of dispute.

The Buyers need to ensure that the Buyer does not owe any outstanding amount including interest due to MSM Enterprises for minimum 15 days. Otherwise, the Buyer needs to disclose this non-payment in the Annual Financials of the Buyer.

DISCLOSURE REQUIREMENTS

Part I of Schedule VI of companies act requires disclosure of break-up of Sundry creditors in the balance sheet as:

- (i) Total outstanding dues of small scale industrial undertaking(s);
and
- (ii) Total outstanding dues of creditors other than small scale industrial undertaking(s).

The names of the small scale industrial undertaking(s) to whom the company owe any sum together with interest outstanding for more than 15 days, are to be disclosed.

As per *Sec 22 of MSMED Act, 2006*, the buyer is required to furnish the following additional information in his annual statement of accounts:

- a) The principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier as at the end of each accounting year;

- b) The amount of interest paid by the buyer under MSMED act, 2006 along with the amounts of the payment made to the supplier beyond the appointed day during each accounting year;
- c) The amount of interest due and payable for the period (where the principal has been paid but interest under the MSMED act is not paid);
- d) The amount of interest accrued and remaining unpaid at the end of each accounting year; and
- e) The amount of further interest due and payable even in the succeeding years, until such date when the interest dues as above are actually paid to the small enterprise, for the purpose of disallowance as a deductible expenditure u/s 23.

The disclosures norms laid down by Sec 22 apply only to those buyers who are required to get their annual accounts audited under any law for the time being in force.

If any buyer contravenes Sec 22, he shall be punishable with a fine which shall not be less than Rs. 10,000. There is no maximum limit.

MSMED ACT VIS-À-VIS AUDITOR

MSMED Act requires the buyers to make disclosures in the annual accounts. But this does not mean that the Auditor has no duty to verify these disclosures. The auditor is very much required to ensure the compliance of various provisions (for example, provision of interest under section 16, disclosures required under section 22, etc.) of the MSMED Act. This is evident from Auditing and Assurance Standard (AAS) 21, "Consideration of Laws and Regulations in an Audit of Financial Statements." The salient features of this AAS are given below:

When planning and performing audit procedures and in evaluating and reporting the results thereof, the auditor should recognise that the non-compliance by the entity with the laws and regulations may materiality affect the financial statements. The term 'noncompliance' as used in this AAS refers to acts of omission or commission by the entity being audited, either intentional or unintentional, which are contrary to the prevailing laws or regulations. However, non-compliance does not include personal misconduct of the employees or management of the entity. It is to be noted that sometimes, noncompliance of relevant rules and regulations may be subject to different interpretations and in such a case the auditor may take help of legal experts.

This AAS applies to audits of financial statements and does not apply to other engagements in which the auditor is specifically engaged to test and report separately on compliance with specific laws or regulations.

It is the management's responsibility to ensure that the entity's operations are conducted in accordance with the laws and regulations. The responsibility for the prevention and detection of non-compliance rests with the management.

The auditor is not, and cannot be held responsible for preventing non-compliance. The fact that an audit is carried out, may, however, act as a deterrent. The auditor should plan and perform the audit recognising that the audit may reveal conditions or events that would lead to questioning whether an entity is complying with the laws and regulations. In order to plan the audit, the auditor should obtain a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with the framework.

The auditor should also obtain sufficient appropriate audit evidence about the compliance with those laws and regulations generally recognised by the auditor to have an effect on the determination of material amounts and disclosures in the financial statements. The auditor should obtain a written representation from the management that it has disclosed all the known actual or possible non-compliance with the laws and regulations whose effects should be considered when preparing financial statements. In the absence of the evidence to the contrary, the auditor is entitled to assume that the entity has complied these laws and regulations.

The auditor should document the findings as to non-compliance and discuss them with the management. When adequate information about the suspected non-compliance cannot be obtained, the auditor should consider the effect of lack of audit evidence on the auditor's report. The auditor should also consider the implications of no-compliance in relation to other aspects of the audit, particularly regarding management representations.

The non-compliance may be communicated by the auditor to (i) the management; (ii) the users of the auditor's report on the financial statements; and (iii) the regulatory and enforcement authorities.

The auditor may either seek legal advice or consider withdrawal from the engagement if he concludes that the highest authority of the entity is involved in the non-compliance (this will effect the reliability of management's representation) or the entity does not take the remedial action that is necessary in the circumstances.

Sample disclosure:

The entity (buyer) should add a Notes to Accounts along the following lines:

Where all suppliers have confirmed that they are not micro or small enterprises:

“As per the written confirmation obtained by the company from suppliers of goods and services (and relied upon by the auditors), none of the suppliers of the company are micro enterprises or small enterprises under the Micro, Small and Medium Enterprises Development Act, 2006. Therefore, disclosures under section 22 of the said act are not necessary.”

Where some of the suppliers of the entity are micro or small enterprises:

“The company has a system of obtaining periodical written confirmations from its suppliers to identify micro enterprises or small enterprises. Based on such identification company makes provision for unpaid statutory interest under Sec 16 of the Micro, Small and Medium Enterprises Development Act, 2006 and disclosures required by Sec 22 of the said Act.”

Principal amount remaining unpaid to any supplier as at the year end	Nil
Interest due thereon	Nil

Amount of interest paid by the company in terms of section 16 of the MSMED, along with the amount of the payment made to the supplier beyond the appointed day during the accounting year Nil

Amount of interest due and payable for the period of delay in Nil
making payment (which have been paid but beyond the
appointed day during the year) but without adding the interest
specified under the MSMED

Amount of interest accrued and remaining unpaid at the end
of the accounting year

Nil

THANK YOU