Solvency, Auditing Guidelines for LLPs on the Cards

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The government is set to introduce stringent solvency and auditing norms for limited liability partnerships (LLPs), which would increase the compliance burden for them but bring in more transparency to satisfy the regulatory concerns raised by the Reserve Bank of India.

The government had allowed foreign direct investment (FDI) into LLPs almost a year back but the central bank is yet to notify it.

"The RBI had made it clear to us in our several correspondence that they have their reservations about the LLP Act," a senior official of the Corporate Affairs ministry told **ET**.

"We have decided to tighten some crucial rules under the purview of the current Act to win confidence of investors and regulators," he said adding that the changes will make LLPs more competent and easier to monitor.

LLPs are a hybrid of a company and a partnership form of business, but unlike a regular partnership, an LLP partner is not responsible or liable for another partner's negligence.

The RBI has been awry about this new form of business structure because instead of small businesses and law and audit firms that the Act intended to benefit many corporate houses are increasingly using the LLP law to save significant amounts of tax and side step regulatory burden.

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LLPs are spared of dividend distribution tax thereby implying that a holding company, which has converted several of its group investment companies into LLPs can now pass on higher dividends.

Even the incidence of Minimum Alternative Tax on LLP is much lower.

The ministry is now designing stricter solvency rules, imposing additional disclosures on undisputed statutory dues such as late TDS deposits and payments of provident funds, employees insurance and bringing in higher forms of penalty to ensure compliance.

Experts welcomed the changes in the rules. Clearer and more elaborate solvency and auditing norms will make LLP a more credible business structure and signal its financial soundness. Banks would also have added confidence in lending to the LLP," explained Hitendra Mehta, partner at Vaish Associates Advocates.

The government has now asked the Institute of Chartered Accountants of India (ICAI) to draw out separate accounting standards for LLPs to avoid gray areas in functioning of such firms.

"ICAI has proposed that for professional LLPs (business, commercial and industry) accounting under accrual basis should be made mandatory. This is necessary as we intend to introduce XBRL for LLPs later as well," said G Ramaswamy, President ICAI.

The ministry is also developing mandatory cost audit standards for LLPs similar to Companies (Auditor's Report) Order, 2003 (CARO) to help improve quality of reporting and ensure transparency.

However, some feel that it will increase the compliance burden and defeat the entire purpose of setting up such hybrid easy to set up firms.

"We have been slow in notifying these changes as we are being cautious. Although compliance costs in terms of time and money might increase but on the whole it will bring in transparency and greater weight to these structures," another MCA official clarified.