Notes on Companies (Auditors' Report) Order, 2015

Applicability

1. **Applicability:** CARO 2015 applies to all Companies including a Foreign Company as defined u/s 2(42).

2. **Exceptions / Exemptions:** CARO **does not apply** to the following classes of Companies –
   (a) Banking Company as defined u/s 5(c) of the Banking Regulation Act, 1949, **(BUT APPLICABLE TO NBFC) (If NBFC Converted to bank and as on date of B/S it is bank then CARO not applicable)**
   (b) Insurance Company as defined Insurance Act, 1938.
   (c) Company licensed to operate u/s 8 of the Companies Act, 2013 and
   (d) One person Company as per Sec.2(62) and a Small Company as per Sec.2(85) of the Companies Act,
   (e) Private Limited Companies subject to the following conditions –
   - Aggregate of Paid Up Capital and Reserves should not exceed Rs. 50 Lakhs.
   - Loan outstanding from any Bank or Financial Institution should not exceed Rs. 25 Lakhs.
   - Turnover should not exceed Rs. 5 Crores.

3. Companies Act

1. **Reporting [Sec.143(11)]:** The Central Government may order for the inclusion of a Statement on specified matters in the Auditor's Report for specified class or description of Companies. Accordingly, CARO, 2015 is issued by the Central Government on 10/04/2015 should be complied by the Statutory Auditor of the Company.

4. List the matters to be reported under CARO, 2015 (para 3).

1. **FIXED ASSETS [3(i)]:**
   (a) **Adequacy of Records:** Whether or not proper records have been maintained to show full particulars including quantitative details and details about situation of Fixed Assets.

   (b) **Verification:**
   - Whether the Management of the Company has physically verified the Fixed Assets, at reasonable intervals, and
   - Whether material discrepancies observed, if any, on such verification have been suitably dealt with in the books of account.

2. **INVENTORIES [3(ii)]:**
   (a) **Verification:** Whether Management has physically verified all the inventories at suitable intervals.
   (b) **Adequacy of procedures:** Whether the procedures for physical verification of inventory are reasonable and adequate, having regard to the size of the Company and the nature of its business.
   (c) **Adequacy of Records:**
   - Whether the Company is maintaining proper records of inventory, and
   - Whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account.

3. **LOANS TO DIRECTORS AND INTERESTED PARTIES [3(iii)]:**
   LOANS GIVEN: Has the Company granted any loans, secured or unsecured, to Companies, Firms or other parties covered in the Register maintained u/s 189 of the Act.
   (a) **Repayment:** Whether receipt of the Principal and the interest amount are regular.
   (b) **Steps for recovery:** If overdue amount is more than ` 1,00,000, whether reasonable steps have been taken by the Company for recovery of Principal and Interest.

4. **INTERNAL CONTROL [3(iv)]:**
   (a) **Adequacy:** Is there an adequate Internal Control procedure commensurate with the size of the Company and the nature of its business, for the purchase of inventory and Fixed Assets and for the sale of its goods and services.

(b) **Correction of Weakness:** Whether there is a continuing failure to correct major weaknesses in Internal Control.

5. **DEPOSITS FROM PUBLIC [3(v)]:** If the Company has accepted Deposits from public, whether the following are complied with –
   (a) Directives issued by the Reserve Bank of India,
   (b) Provisions of Sec. 73 to 76 or any other relevant provision of the Companies Act, 2013 and its rules.
   (c) Orders, if any, passed by the Company Law Board / NCLT / RBI / any Court / Tribunal.
   (d) The nature of contraventions, if any, should be stated in the Report.

6. **COST ACCOUNTING RECORDS [3(vi)]:** If the Central Government had prescribed maintenance of Cost Records u/s 148(1), whether or not such accounts and records have been prepared and maintained properly.

7. **STATUTORY DUES [3(vii)]:**
   (a) Is the Company regular in depositing Undisputed Statutory Dues including Provident Fund, Employees' State Insurance, Income Tax, Wealth Tax, Service Tax, Sales Tax, Customs Duty, Excise Duty, Value Added Tax, Cess and any other Statutory dues with the appropriate authorities. If not paid regularly, the extent of the arrears of outstanding statutory dues as at the last day of the Financial Year concerned for a period of more than 6 months from the date they became payable, shall be indicated in the Report.
   (b) If such non–payment of dues is on account of any dispute, then the amount involved and the forum where the dispute is pending should also be mentioned.
   (c) Whether the amount required to be transferred to Investor Education and Protection Fund in accordance with the provision of Companies Act, 1956 has been transferred to such fund within time.

8. **LOSS MAKING COMPANIES [3(viii]:** In case of a Company which has been registered for a period not less than five years, the following should be reported :
   - Whether the Accumulated Losses at the end of the relevant Financial Year exceeded 50% of the Company's Net Worth,
   - Whether the Company has incurred Cash Losses in the immediately preceding Financial Year.

9. **REPAYMENT OF DUES [3(ix)]:**
   (a) Has the Company paid the Principal and Interest dues to Financial Institutions, Banks or Debentureholders without default,
   (b) In case of default, the period and the amount of default shall be reported.

10. **GUARANTEES GIVEN [3(x)]:** Where the Company has given any guarantee for loans taken by others from Bank or Financial Institutions, whether or not the terms and conditions thereof are prejudicial to the interest of the Company.

11. **END USE OF BORROWINGS [3(xi)] :** Whether or not Term Loans are applied for the purpose for which such loans were obtained.

12. **FRAUD [3(xii)]:** Whether any Fraud on or by the Company has been noticed or reported during the year. Where any Fraud is noticed and reported, the nature and the amount involved should be indicated.

Reasons to be stated for unfavourable or qualified answers [Para 4]

1. Where the answer to any of the above questions is unfavourable or qualified, the Auditor's Report shall state the reasons for such unfavourable or qualified answer, as the case may be.
2. If the Auditor is unable to express any opinion in answer to any particular question, his Report shall indicate such fact, together with reasons why it is not possible for him to give an answer to such a question.

5. Applicability of CARO to Foreign Companies.

1. CARO applies to **all Companies** except certain categories of Companies specifically exempted therein.

2. CARO also **applies to Foreign Companies** as defined u/s 2(42) of the Act. "Foreign Company" means any Company or body corporate incorporated outside India which –
   (a) Has a place of business in India whether by itself or through an agent, physically or through electronic mode, **and**
   (b) Conducts any business activity in India in any other manner.

3. In respect of Foreign Companies, an established place of business in India would **include a Liaison Office**.

Branch Audit and CARO

1. Sec.143(8) specifies that a Branch Auditor has the same duties in respect of Audit as the Company's Auditor.
2. Hence, CARO is applicable for Branch Audits also.

Reporting on using branch auditor's report apply Sec. 143 (3)(c), SA-600 and Other Matter para as per SA-706

CARO would be **applicable to Private Unlimited Companies,** irrespective of the size of their Paid–Up Capital and Reserves, Turnover, Borrowings from Banks/Financial Institutions.

A Pvt Ltd has 2 Branches – in Delhi and in Mumbai with separate branch Auditor Comment on applicability of CARO.

Details	Delhi Branch	Mumbai Branch	Total
Paid up Capital and Reserves (in ` Lakhs)	40	30	70
Outstanding Loans from Banks and FI (in `	10	30	40
Turnover (in ` Crores)	3	6	9

1. CARO conditions are applicable for company as a whole and not individual branch wise. Hence if CARO is applicable to company it is applicable to branch
2. The Branch Auditor has the same reporting responsibilities in respect of the Branch as those of the Auditor appointed u/s 139 of the Act has in respect of the Company.
3. Hence in this case, all the three Auditors must comply with CARO.

WHAT IS PAID UP SHARE CAPITAL & RESERVES

1. **Companies Act:** Sec.2(64) of the Companies Act defines the term "Paid–Up Capital" as Capital credited as Paid–Up.
2. **ICAI Guidance Note:** As per ICAI Guidance Note on Terms used in Financial Statements, the term "Paid–Up Share Capital" is defined as that part of the Subscribed Share Capital for which consideration in Cash or otherwise has been received. This includes Bonus Shares allotted by the Corporate Enterprise.
3. Paid–Up Share Capital would include both Equity Share Capital as well as Preference Share Capital.
4. Exclusions: Share Application Money received should not be considered as part of the Paid–Up Capital.
5. Other Items: While calculating Paid–Up Capital, amount of Calls Unpaid should be deducted therefrom, and the Amount Originally Paid–Up on Forfeited Shares should be added to the figure of Paid–Up Capital.

WHAT IS RESERVES FOR THE PURPOSE OF CARO

1. **Reserves:** As per ICAI Guidance Note on Terms used in Financial Statements, **"Reserve"** is the portion of Earnings, Receipts or other Surplus of an Enterprise (whether Capital or Revenue) appropriated by Management for a General or Specific Purpose, other than Provision for Depreciation or Diminution in the value of Assets or for a known Liability.
2. **Capital Reserve** is a Reserve of a Corporate Enterprise which is **not** available for distribution as Dividend. **Revenue Reserve** means any Reserve other than Capital Reserve.
3. **Reserves for the purpose of CARO =** Any Reserve (Capital Reserves + Revenue Reserves + Other Reserves)

Any accumulated losses shall be reduced only from revenue reserves

Note: Disclosure Requirements under Schedule III, i.e. netting off Dr. Balance of P&L under the heading "Reserves and Surplus", should be **distinguished** from the applicability of CARO, where the Dr. Balance of P&L can be reduced only from **Revenue Reserves**.

"LOANS OUTSTANDING"

1. Outstanding Loans from Banks or Financial Institutions includes Term Loans, Demand Loans, Export Credits, Working Capital Limits, Cash Credits, Overdraft Facilities, Bills Purchased or Discounted. Outstanding balances of such loans should be considered as **"Loan Outstanding"** for computing the limit of ` 25 Lakhs.

2. **Non–Fund Based Credit Facilities (NFBC)** (e.g. Guarantees, Letter of Credit, etc.)**:**
   (a) Such facilities are **not** considered as "Loans Outstanding" for the purpose of CARO.
   (b) However, **to the extent such Facilities have devolved** and have been converted into Fund–Based Credit Facilities, should be considered as "Loan Outstanding". So, "Loan Outstanding" would include the amount of Bank Guarantees issued by the Company, where such Guarantees have been **invoked and encashed** or where, say, a Letter of Credit has **devolved** on the Company.

3. **Fluctuating Balances:** In case a Company enjoys a facility, (e.g. Cash Credit facility), whose balance is fluctuating in nature, the Order would apply in case **on any day** during the Financial Year, the amount outstanding in Cash Credit Facility exceeds ` 25 Lakhs.

4. **Tenure of Loan:** Loans outstanding for the purpose of the applicability shall include both Long Term and Short Term Loans, whether secured or not.

5. **Other Points:**
   (a) Where the Company is granted an Overdraft Facility against Fixed Deposits of the concerned Bank, the amount Outstanding in Overdraft Facility (and **not net of FD**) is considered for the purpose of CARO.
   (b) Outstanding Dues in respect of **Credit Cards** would also be considered while calculating the limit of ` 25 Lakhs in respect of Loan Outstanding from a Bank or Financial Institution.

Loan against FD: Amount outstanding must be included in determining the limit. It should not be netted off against the amount of Fixed Deposit

Balance Outstanding from a Bank or Financial Institution for the purpose of applicability of CARO, shall be construed **at any point of time** during the year and not as at the end of the year (i.e. 31st of March).

"Banks" and "Financial Institution" for the purpose of applicability of CARO.

1. The term **"Banks"** refers to a Bank as defined under Banking Regulation Act, 1949. Therefore, even Loans taken from a Private Bank or a Foreign Bank would also be taken into consideration while examining the applicability of CARO.

2. The term **"Financial Institution"** used in CARO includes a scheduled bank and any other Financial Institution, defined or notified by RBI. However, NBFCs is **not** a "Financial Institution".

Explain the term "Financial Institution" under Companies Act.

Under Sec.2(39) Companies Act, the term **'Financial Institution'** is defined as follows –

"Financial Institution" includes a Scheduled Bank, and any other Financial Institution defined or notified under the Reserve Bank of India Act, 1934.

TURNOVER FOR THE PURPOSE OF CARO

1. **Meaning:** The term "Turnover" is not defined under CARO. Also as per Schedule III, the terms used shall be as per the applicable Accounting Standards. The term "Turnover" is a **commercial term** and it should be construed in accordance with the method of accounting regularly employed by the Company.

2. **Inclusions & Exclusions:** For ascertaining the limit of ` 5 Crores –
   (a) Sales Tax Collected or Excise Duty Collected should **not** be included, if they are credited **separately** to Sales Tax Account or Excise Duty Account.
   (b) Trade Discounts should be **deducted** from the figure of Turnover.
   (c) Commission Allowed to third parties should **not** be deducted from the figure of Turnover.
   (d) Sales Returns should be **deducted** from the figure of Turnover, even if the Returns are from the Sales made in the

earlier years. [As a corollary, any Sales Returns, etc. in respect of Sales made during the year under report, if received **after** the end of that year, would **not** be deductible from the figure of Turnover of such year.]

(e) Income received by way of Rent or Dividend/Interest would **not** form part of "Turnover".

3. **Service Entities:** In the case of Companies rendering or supplying services, **Gross Income** derived from services Rendered or Supplied, would be shown as Turnover. So, in cases where the principal business of the Company is letting out of property of the Company or it is an Investment Company, the Rent or Dividend/ Interest, respectively, would constitute "Turnover".

4. **Agency Business:** In an Agency relationship, Turnover is the amount of **Commission** earned by the Agent, and not the Aggregate Amount for which Sales are effected or Services are rendered.

A Pvt Ltd is incorporated on 1st July 2015. During the year ended 31st March 2016, it had issued Shares (fully paid up) of ` 40 Lakhs, had borrowed ` 7.5 Lakhs each from 2 Financial Institutions and its Turnover (Net of Excise of ` 50 Lakhs which is credited to a separate account) is ` 475 Lakhs. Will CARO be applicable to A Pvt Ltd?

Note: Refer to the conditions for exemption of Private Companies, given in Q.1 above.

1. Aggregate of Paid Up Capital and Reserves is ` 40 Lakhs (lower than the specified limit of ` 50 Lakhs).
2. Total Loans outstanding = 7.5 Lakhs × 2 = ` 15 Lakhs (lower than the specified limit of ` 25 Lakhs).
3. If Excise Duty is taken / credited to a separate account, it shall **not** form part of the Turnover. Hence, Turnover for this Company = ` 4.75 Crores (lower than the specified limit of ` 5 Crores).

Bring out the requirements under CARO with regard to proper maintenance of Fixed Assets Register.

Refer Para 3(i)(a) of CARO

1. **Contents of FA Register:** The records relating to Fixed Assets should contain, the following details – (a) Description of Asset, (b) Classification (e.g. Plant and Machinery, Office Equipment, etc.), (c) Situation, (d) Quantity, (e) Original Cost, (f) Year of Purchase, (g) Adjustment for Revaluation or for any increase / decrease in cost, (h) Date of Revaluation, (i) Rate(s) / Basis of Depreciation or Amortization, (j) Depreciation / Amortisation Amount for the current year, (k) Accumulated Depreciation / Amortization, (l) Particulars regarding Impairment, (m) Particulars regarding Sale, Discarding, Demolition, Destruction, (n) Distinctive Number of Assets, etc.

2. **Coverage:** The FA Register must contain details in respect of the following assets –

   (a) Both Tangible or Intangible Assets.

   (b) Self–Financed or Acquired through Finance Lease.

   (c) Assets which are fully held for disposal, retired from active use, fully depreciated assets, period of useful life as per Schedule II of the Act.

   (d) Fully Impaired Assets.

3. **Form of Record:** FA Register can be maintained in manual form or in electronic form. The conditions relating to Electronic Form FA Register are –

   (a) It should be maintained such that it can be retrieved in a **legible form**.

   (b) It will have to be ensured that the information contained in the electronic records remains **accessible and unaltered** and its origin, destination, date, etc. can be identified.

   Even if one of the above conditions is not satisfied, the Auditor should obtain a duly authenticated print–out of the Fixed Assets Register.

4. **Special Points:**

   (a) In case of Fixed Assets with **changing locations** (e.g. a Construction Equipment which has to be moved to various sites), it is sufficient if records of movement / custody of the Equipment is maintained.

   (b) In case of Assets like Furniture, etc. located in the **residential premises of the Staff,** the FA Register should indicate the Name / Designation of the Staff.

   (c) Electrical Installations need not be shown as a separate asset. For purposes of identification, it is suggested that the initial sub–division may be made according to the User, e.g. Factory Buildings, Plant, Service Departments, Township Buildings, etc. A further sub–division can be made according to the sub–division already made for Buildings, Plant, etc.

(d) For Furniture & Fittings, individual identification can be made for high–value items, and by groups for other items.

Bring out the responsibilities of Management in relation to Verification of Fixed Assets. Also explain the Auditor's duties in this regard, with reference to CARO.

A Ltd, having Fixed Assets at 7 different locations, in total valuing Rs. 2,000 Crores, have been physically verifying the assets every third year. Auditor insists for yearly verification of the same – Comment.

Refer Para 3(i)(b) of CARO

1. **Outsourcing:** It is not necessary that only the Company's Staff should make the verification. It is also possible that the same may be verified by outside Expert Agencies engaged by the Management.
2. **Method of Verification:**
   (a) The Auditor should examine whether the method of verification is **reasonable,** in the circumstances relating to each asset. For example, in the case of certain process industries, verification by direct physical check may not be possible in the case of Assets which are in continuous use or which are concealed within larger units.
   (b) Also, it is not always possible to suspend manufacturing operations merely to conduct a physical verification of the Fixed Assets, unless there are compelling reasons which would justify such an extreme procedure. In such cases, indirect evidence of the existence of the Assets may suffice. For example, the very fact that an Oil Refinery is producing at normal levels of efficiency may be sufficient to indicate the existence of the various process units even where each such unit cannot be verified by physical or visual inspection.
3. **Reasonable Intervals:**
   (a) What constitutes "reasonable intervals" depends upon the **circumstances of each case**.
   (b) While an **annual** verification may be **reasonable**, it may be impracticable to carry out the same in some cases (due to nature of assets, difficulty in verification, spread, etc). Even in such cases, the verification programme should be such that all assets are verified at least once in **every 3 years.**
   (c) Where verification of all assets is not made during the year, it will be necessary for the Auditor to report that fact, but if he is satisfied regarding the frequency of verification he should also make a suitable comment to that effect.
4. **Material Discrepancies:** If a material discrepancy has been properly dealt with in the Books of Accounts (which may or may not imply a separate disclosure in the accounts), it is not necessary for the Auditor to give details of the discrepancy / its treatment in the Accounts. However, he is required to make a statement that a material discrepancy was noticed on the verification of Fixed Assets and that the same has been properly dealt with in the Books of Account.

CA Tejal was appointed as the Auditor of AKS Ltd, which is covered under CARO. The Company has not maintained its Fixed Asset Register for the period April 2014 to December 2014. But from 1st Jan 2015, the Company started to maintain its Asset Registers properly and as on 31st March 2015, the FA Register is properly kept. Should CA Tejal report on the maintenance of FA Register in his report?

1. **Reporting Responsibilities:** The Auditor's reporting duties can be analysed from two perspectives, i.e. in the Main Audit Report (where he expresses his opinion on the Financial Statements) and in the CARO Report.
2. **CARO Reporting:** Compliance with CARO requirements should be judged based on the **whole Accounting Year** and not merely with reference to the position existing at the Balance Sheet date, or the date on which the Auditor makes his Report. Hence, in the above case, the Auditor will make a negative remark in his CARO Report.
3. **Main Audit Report:**
   (a) In the Main Audit Report, the Auditor reports on the State of Affairs as they existed during the Accounting Year.
   (b) In deciding whether or not to make an Adverse Report, the Auditor should consider what detrimental effect, if any, has been caused by the failure to comply with the requirements of CARO, for any part of the year.
   (c) For example, if records for Fixed Assets were not properly maintained for some part of the year but were properly maintained at the Balance Sheet date and physical verification was made after the records were properly maintained, there is no detrimental effect on the Company. However, for example, if Internal Control with respect to the items specified in CARO Clauses was inadequate during a part of the year, there may be a detrimental effect on the Company.

(d) Also, the Auditor cannot ignore the position existing at the Balance Sheet date or at the time at which he makes his Report. The Auditor might consider, in the light of the circumstances and provided he is able to satisfy himself regarding the facts, as to whether a reference to the State of Affairs existing at the BS Date or at the date when he makes his report would be necessary to give a more complete picture to the Members to whom he is reporting.

4. **Conclusion:** In the present situation, the Auditor would comment on the non–maintenance of FA Register (for the part of the year) in his CARO Report & may consider issuing a Qualified Opinion in his Audit Report (considering facts of the case).

5. **Non–Reporting:** Also, where a requirement of CARO is not complied with, but still the Auditor decides to issue a Clean Report, he should record in his **working papers,** the reasons for not doing so.

Refer Para 3(ii)(a) of CARO

1. **Periodicity:** Physical Verification of Inventory is the responsibility of the Management. Hence, Management should **verify all material items at least once in a year** and more often in appropriate cases. The Auditor should satisfy himself that the Physical Verification of Inventories has been conducted at "reasonable intervals" by the Management and that there is adequate evidence on the basis of which the Auditor can arrive at such a conclusion.

2. **Reasonable Intervals:** What constitutes "Reasonable Intervals" depends on **circumstances of each case**. The Management normally determines the periodicity of the Physical Verification of Inventories. Wherever practicable, all the items of inventories should be verified by the Management **at least once in a year**. It may be useful for the Company to determine the frequency of verification by **'A–B–C' classification** of Inventories, 'A' Category Items being verified more frequently than 'B' Category and the latter more frequently than 'C' Category items.

What are the requirements in CARO for Physical Verification of Inventory? What are the Auditor's duties in this regard?

Refer Para 3(ii)(b) of CARO

1. **Auditor's Duties:** The Auditor is required to comment on the reasonableness and adequacy of the inventory verification procedures followed by the Management. [For Audit Procedures, refer **SA–501** on Auditor's Duties on Physical Verification of Inventory.]

2. **Methods of Physical Verification:**
   (a) There are 2 principal methods of Physical Verification of Inventories, viz –
   - **Periodic** Physical Verification Method, which involves verification of all inventories at a single point of time, usually at the year–end or at a selected date just prior to or shortly after the year–end.
   - **Continuous** Physical Verification Method, which involves verification throughout the year, with different items of inventory being physically verified at different points of time. However, each material item is physically verified atleast once in a year and more often in appropriate cases.

   (b) Where Continuous Verification is done by the Entity, the Auditor should in addition ascertain the following –
   - Whether adequate Stock Records are kept up–to–date
   - Whether the Verification Programme covers all material items of inventory atleast once during the year, and
   - Whether all material differences are investigated and corrected.

3. **Reporting:** While commenting under this Clause, the Auditor should point out the specific areas where he believes the procedure of Inventory Verification is **not** reasonable or adequate.

Comment on the following extracts from the Statutory Auditor's reports on the accounts of Limited Companies indicating with reasons, whether or not the form of reporting complies with the statutory and professional requirements –

"On the basis of examination, the valuation of Inventories is fair and proper and in accordance with normally accepted accounting principles, and is on the same basis as in the previous year except for some changes in the method of valuation of the inventories of Finished Goods".

CARO Requirements: Refer to **Clause 3(ii) Point 2 of CARO.**

1. **Principle: AS–2** requires that any change in the accounting policy relating to Inventories which has a material

effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. When there is a change in accounting policy (which has a material effect in the current period) the amount by which any item in the Financial Statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

2. **Conclusion:**
   (a) Change in basis of Inventory Valuation amounts to a change in the basis of accounting. If the effect on profit is material, adequate disclosure should be made in the accounts or notes.
   (b) The Auditor should ensure such change in method of valuation (including quantification of effect on the Financial Statements) should be disclosed in the Financial Statements or in the Notes. Else, he would not have satisfied the statutory reporting requirements.

Raji Ltd has fully computerized its accounting operations. The Stock Records are maintained up to date with timely entries passed for all receipts and issues. The Company has hired a professional security agency, which monitors and implements a close vigilance over the operations of the Company. As such, the Company had dispensed with the practice of taking stock of their Inventories as at the year–end, as in their opinion the exercise is redundant, time consuming and intrusion to normal functioning of the operations.

CARO Requirements: Refer to **Clause 3(ii) Point 2 of CARO.**

The Auditor should **report** that the Company does not have any system of physical verification of Stock. Further, Stock being a material item in the P&L and Balance Sheet, the Auditor should qualify his report on the truth and fairness of Financial Statements.

What are the aspects that the Auditor has to verify in relation to Stock Registers? State with reference to CARO.

Refer Para 3(ii)(c) of CARO

1. **Proper Records:**
   (a) Records relating to Inventories should contain data like – (a) Particulars of the Item like Nomenclature, Nature, etc. (b) Identification Code of the Item, (c) Details regarding Quantity of Receipts, Issues, Balances and Dates of Transactions in a chronological manner, (d) Relevant Document Number and Department Identification, Location.
   (b) If Priced Stores Ledger is maintained, the records of the inventory should also disclose the Prices at which the recording of the Issues and Receipts is made.
   (c) The records should contain the particulars in respect of all items of inventories.
   (d) The record of movement/custody of the inventory should be maintained.

2. **Auditor's Duties:** The Auditor should ensure that the Stock Registers are updated as and when the transactions occur. He should also verify that the transactions entered in Stock Registers are duly supported by relevant documents.

3. **Work in Progress:**
   (a) If the Company maintains Stock Records for WIP, the Auditor would normally be able to verify the same.
   (b) If it is impracticable to maintain Stock Records for WIP, the Auditor should consider the fact whether the Company, at any point of time, can arrive or calculate the quantity and amount involved in the WIP. For example, the value of WIP can be calculated based on production cycle, input/ output ratio analysis, production and stock records for the immediately following period, etc.
   (c) If the Company is able to do so, then no adverse comment of the Auditor under this Clause would be required.

Bring out the reporting responsibilities of Auditor in relation to Loans given to related parties by the Company under Para 3(iii) of CARO.

Refer Para 3(iii) of CARO

1. **Period of Review:**

(a) The Auditor is required to disclose the requisite information in his report in respect of all parties covered in the Register maintained u/s 189 of the Act, **irrespective of the period** to which such loan relates.

(b) The Clause covers not only Loans granted during the year, but all Loans **including Opening Balances**.

(c) It may so happen that a Related Party u/s 189 may take a Loan from the Company and repay it back to the Company within the Financial Year concerned. So, while examining the loans, the Auditor should also take into consideration the loan **transactions that have been squared–up** / settled during the year, and report such transactions under this Clause.

2. **Loans in Kind:** Further, there is no stipulation regarding the loan being given in cash or in kind. In the absence of such stipulation, the Auditor is required to disclose the requisite information in his report in respect of all kind of Loans whether given in cash or in kind, to the parties covered in the Register maintained u/s 189 of the Act.

What are the areas of enquiry for an Auditor in relation to receipt of Loans given by the Company?

Refer Para 3 (iii)(a) of CARO

1. **Audit Aspect:** The Auditor has to examine whether the receipt of Principal amount and Interest is regular. The word 'Regular' should be taken to mean that the Principal and Interest should normally be received whenever they fall due.
2. **Due date not specified:** If a due date for receipt of interest is not specified, it would be reasonable to assume that it falls due annually.
3. **Loan on Demand:** A Loan repayable on demand falls due as and when the Lender calls back the loan.
4. **No Stipulation for Repayment:** Where no stipulation has been made for the recovery of the loan, the Auditor is not in a position to make any specific comments. However, the Auditor should state the fact that he has not made any comments because the terms of recovery have not been stipulated.
5. **NBFC:** Where the Auditee Company is a NBFC, for reporting under this Clause, the Auditor should also refer to the Policy for Demand / Call Loans framed under Clause 6A of NBFCs Prudential Norms (RBI Directions), 1998 issued by RBI.

Explain the Auditors' Duties under CARO, when an amount is overdue (receivable) by the Company.

Refer Para 3(iii)(b) of CARO

1. **Overdue:** A Loan is considered to be Overdue when the Payment has not been received on the due date as per the lending arrangements.
2. **Scope:** The scope of the Auditor's inquiry under this Clause is restricted to loans given by the Company to Parties covered in the Register maintained u/s 189 of the Act.
3. **Reasonable Steps:** It is not necessary that steps to be taken must necessarily be **legal steps**. Depending upon the circumstances, the degree of delay in recovery and other similar factors, issue of reminders or the sending of an Advocate's or Solicitor's notice, may amount to "reasonable steps" even though no legal action is taken.
4. **Auditors' Duty:** The Auditor should obtain sufficient appropriate audit evidence to support the fact that **reasonable steps** have been taken for recovery of the Principal and Interest of loans taken/granted by the Company.

INTERNAL CONTROLS

Refer Para 3(iv) of CARO

1. **Scope:** CARO requirement is confined only to Internal Control procedures regarding Purchase of Inventory, Fixed Assets and Sale of Goods and Services. However, it does not mean that the duty of the Auditor to examine Internal Control with regard to other areas is in any way diminished.

2. **Major Weakness:** Any weakness in the Internal Controls that exposes the Company to a **risk of significant loss** or the **risk of a material mis–statement** in the Financial Statements may be considered as a "major weakness" and therefore, may come within the ambit of reporting under this Clause. The Auditor should, however, recognise that some weaknesses are of such nature that individually they may not seem to be "major" but when evaluated along with others might become relevant for the Auditor while commenting upon this clause of the Order.

3. **Audit Procedures: –** The Auditor shall review the following to identify major weakness in internal controls:

(a) Reports of Internal Auditor, if any,

(b) Minutes of the Meetings of the Board of Directors and Audit Committee,

(c) Previous years' Working Papers,

(d) Follow–up actions taken by the Management in response to weaknesses communicated to the Management.

4. **Reporting Responsibilities:**

(a) **Assessment:** The Auditor makes an assessment whether the major weakness noted by him has been **corrected** by the Management **as at the Balance Sheet date**.

(b) **Weakness not corrected:** If the Auditor is of the opinion that the weakness has not been corrected, then he should report the fact while commenting under this Clause. Apart from stating that there has been a continuing failure to correct major weakness, the Auditor should report the weakness and the steps to be taken by the Management to correct the weakness, if any.

(c) **Weakness Corrected:** It may also happen that the weakness is corrected by the date on which the Auditor issues the Audit Report. In such a case, the Auditor's Report should state the fact that although as at the Balance Sheet date, there was a continuing failure to correct a major weakness on the date of the Financial Statements, the weakness has been corrected by the date the Auditor issued his Report.

(d) **Continuing Weakness:** Even if the Management has taken reasonable steps to correct the weakness but the weakness continues, the Auditor is required to report the same under this Clause.

(e) **Impact on Main Audit Report:** If the Auditor is of the opinion that the major weaknesses in the internal control system have serious implications on the adequacy or reliability of the Books of Account of the Company, the Auditor should consider modifying his Audit Report on the Financial Statements.

CA Ramesh reported under Clause 3(iv) of CARO that the Internal Controls in relation to the Company's Fixed Assets is inadequate. Further, he reports that there is no continuing failure on the part of Management to correct major weakness in Internal Control. Is the reporting self–contradictory?

1. The requirements in regard to adequacy of Internal Controls and Continuing Failure to correct major weakness(es) are not inter–related. These are two distinct aspects of the Clause.
2. The first part requires the Auditor to comment on the adequacy of the Internal Controls in regard to purchase of Inventories, purchase of Fixed Assets and Sale of Goods and Services. The second aspect requires the Auditor to comment whether there was a continuing failure to correct a major weakness in such Internal Controls.
3. Since these two aspects are **not related** to each other, it cannot be concluded that if no major weakness was reported during the period covered by the Audit Report, the internal control system is adequate. Hence, the reporting is not self–contradictory.

DEPOSITS

Refer Para 3(v) of CARO

1. **Scope:** This Clause requires the Auditors to report on compliance with the requirement of Sec.73 to 76, Rules made thereon and the directives of RBI relating thereto.

2. **Audit Procedures:**

(a) **Understanding:** The Auditor should obtain an **understanding** of the requirements of Sec.73 to 76 and those of the relevant Rules and should verify their compliance.

(b) **Audit Plan:** The Auditor should **plan** to test for compliance with the provisions of Sec.73 to 76 of the Act.

(c) **Examining Controls:** The Auditor should examine the **efficacy of Internal Controls** instituted by the Company so that the Deposits accepted by the Company remain within the limits. It may be difficult for the Auditor to ascertain that Deposits accepted by the Company are within the limits **on each day** of the Accounting Year. He would, therefore, be justified in making a reasonable **test check** to ensure that the Company has not accepted Deposits during the year in excess of the limits.

(d) **Check List:** The Auditor may also make a "Check List" to ensure that all the requirements of the Rules regarding the records to be maintained, returns to be filed, etc. are complied with.

(e) **Verifying Documentation:** The Auditor should examine the system by which deposits are accepted and records are maintained and make a reasonable **test check** to ensure the correctness of the system.

(f) **Special Consideration:** For Financial Companies, the Auditor should make a similar examination having regard to the RBI directives (e.g. Sec.45MA of RBI Act) in force from time to time.

(g) **Verifying Default:** The Auditor has to determine whether there is a default in any repayment of Deposits. Non–compliance of provisions.

(h) **Management Representation:** The Auditor should obtain a Management Representation to the effect whether the Company has complied Sec. 73 to 76, Rules thereon, Directives issued by RBI & any other relevant orders.

(i) **Reporting:** If the Auditor is of the view that any kind of contravention of Sec.73 to 76 or any other relevant provisions of the Act or Rules, has taken place, he should state in his report that the provisions have not been complied with, along with the nature of contraventions.

A Public Company defaulted in the repayment of deposits together with interest on the due date for more than a year and the CFO contends that the Auditor need not report on the default committed by the Company. Comment.

Deposits from Public: Refer to Clause 3(v) Point 5 of CARO

In view of the above, the Auditor should report on default committed by the Company.

Note: Reporting implications of **Sec.143(3)(g),** i.e. Reporting on Directors' Disqualification u/s 164(2).

COST ACCOUNTING RECORDS

Refer Para 3(vi) of CARO.

1. **Maintenance of Cost Records [Sec.148(1)]:**

(a) **Requirement:** Companies notified by Central Government are required to maintain proper Books of Account showing particulars relating to utilization of material or labour or to other items of Cost as may be prescribed.

(b) The Cost Accounting Records Rules issued for various industries contain requirements relating to two matters:

- maintenance of proper **Books of Account** relating to Materials, Labour, and Other items of Cost, and
- preparation of **Cost Statements** at the end of the Financial Year in accordance with the Industry Rules.

(c) **Periodicity:** While the records relating to Materials, Labour, etc. are required to be maintained on a day–to–day basis, the Cost Statements have to be prepared periodically.

2. **Cost Audit [Sec.148(2)]:**

(a) Where in the opinion of the Central Government, it is necessary to do so in relation to any Company required u/s 148(1) to maintain the particulars prescribed under that Section, it may order a Cost Audit to be conducted of its Cost Accounts.

(b) While a Cost Audit can be done only in respect of Companies governed by the Rules made u/s 148(1), Cost Audit is not necessary in respect of every Company which is required to maintain Cost Records.

3. **Audit Considerations:**

Scope of Review	• CARO does not require a detailed examination of Cost Records. The Auditor should, therefore, conduct a **general review** of Cost Records to ensure that the records as prescribed are made and maintained. • CARO requires the Auditor to report whether Cost Accounts and Records have been made and maintained. The word "**made**" applies in respect of **Cost Accounts** (or Cost Statements) and the word "**maintained**" applies in respect of **Cost Records** relating to Materials, Labour, Overheads, etc. • The Auditor has to Report under the clause **irrespective of** whether a **Cost Audit** has been ordered by the CG. • Where the Auditor finds that the records have not been written up or are not prima facie complete, it will be necessary for the Auditor to make a suitable comment in his report.
Management Representation	The Auditor should obtain a Written Representation from Management stating – • Whether Cost Records are to be maintained for any product of the Company u/s 148(1), • Whether Cost Accounts and Records are being made and maintained regularly, and • List of Books/records made and maintained in this regard.

Reporting Format	The following reporting format is suggested – "We have broadly reviewed the Books of Account maintained by the Company pursuant to the Rules made by the CG for the maintenance of Cost Records u/s 148(1) of the Act and are of the opinion that prima facie, the prescribed Accounts & Records have been made & maintained."

STATUTORY DUES

Refer Para 3(vii)(a) of CARO

1. **Scope:**
   (a) **Regular Levies:** The intention of this Clause is to ascertain how **regular** the Company is in depositing Statutory Dues with the appropriate authorities. Since the emphasis of the Clause is on the **regularity**, the scope of Auditor's inquiry is restricted to only those Statutory dues, which the Company is required to deposit regularly to an Authority.
   (b) **Other Levies:** The Auditor is not required to ascertain whether the Company is regular in depositing amounts, which may be levied by an Appropriate Authority from time to time upon occurrence or non–occurrence of certain events and therefore are not required to be paid regularly.

2. **Meaning of Statutory Due:**
   (a) Any sum, which is to be regularly **paid to an Appropriate Authority under a Statute** (whether Central, State or Local or Foreign) applicable to the Company, should be considered as a "Statutory Due". So, the **obligation** to pay a Statutory Due is created or **arises out of a Statute**, rather than being based on an Independent Contractual or Legal relationship.
   (b) Where any dues are **recoverable as Arrears of Land Revenue** by the concerned Authority, the same shall be treated as a Statutory Due. **Examples:** Municipal Taxes, TDS, License Fees (for Cinema Halls, etc).
   (c) Any sum payable to an Electricity Company as **Electricity Bill** would **not** constitute a Statutory Due, despite the fact that such a Company has been established under a Statute. This is so because the due has arisen on account of Contract of Supply of Goods or Services between the Parties.

3. **Regularity:**
   (a) The Auditor should understand clearly, the nature of each Statutory Due payable by the Company while examining the aspect of regularity before commenting on the same.
   (b) Regularity is a normal feature in case of certain Statutory Dues such as, PF, ESI, VAT, etc. because the Companies are required to deposit the money with Appropriate Authorities on a Monthly or Quarterly basis.
   (c) But this is not the case in respect of, say, Custom Duty on import of goods or Demands arising on account of Assessment Orders, etc. which a Company is required to pay as and when an event giving rise to the liability of the Company occurs. Such Dues should be construed to have been paid regularly if the Company deposits them as & when they become due.
   (d) However, the Auditor would be required to comment upon the regularity of the Company in depositing the installments, if any, granted by an Authority in respect of a Demand against the Company.

Statement of Arrears of Statutory Dues Outstanding for More than Six Months

Name of the Statute	Nature of the Dues	Amount (`)	Period to which the amount relates	Due Date	Date of Payment

4. **Other Points:**

   Amounts not fallen due: The Report should be restricted to the Actual Arrears, and should not include the amounts which have not fallen due for payment to Appropriate Authority and have been recognized as Outstanding Dues at the Balance Sheet date.

ABC Ltd has not deposited Provident Fund Contributions of ` 20 Lakhs to the authorities, but accounted in the books. Comment on the above.

1. **Accrual:** Provident Fund contributions should be accounted in the books on accrual basis, whether paid or not. As per

Sec.128(1) a Company has to maintain proper books of account, on accrual basis of accounting.

2. **Companies Act:** Under Sec.143(3)(e), the Auditor shall state whether the Balance Sheet and the Profit & Loss Account comply with the Accounting Standards u/s 133.

3. **CARO Requirements: Note: Refer to Clause 3(vii) Point 7 of CARO.**

4. **Conclusion:** In the instant case, even though accrual principles have been followed, disclosure of non– payment is necessary in view of CARO. The Auditor should disclose the fact of non–payment of ` 20 Lakhs in his Report.

Amj Imports Ltd imported goods 5 years back and were placed in Bonded Warehouse. The Import Duty remains due, and payable by the Company. The goods have not been removed from the Warehouse till the end of the Financial Year under audit. Bring out the reporting duties of the Auditor under CARO.

1. **Import Duty:** When the Imported Goods are lodged in a Bonded Warehouse, Import Duty should be paid, only when the goods are removed from the Bonded Warehouse.
2. **Rent & Interest:** Till the time the Importer opts to remove the goods from the Bonded Warehouse, he is required to incur the Rent and Interest expenditure on the amount of Customs Duty Payable.
3. **Customs Duty:** Since the payment of the Custom Duty is not due in the current case, the question of Regularity does not arise in respect of Custom Duty.
4. **Interest and Rent Dues:** Interest & Rent that are required to be incurred under Customs Act would come under "Other Statutory Dues". The Auditor should examine & comment under CARO, on the regularity of the Company in depositing such interest and rent.

Bhargava Ltd has not paid Advance Tax for the current Financial Year. Is it an irregularity in payment of Statutory Dues? Should the Auditor comment under CARO?

1. **General Rule:** Non–payment of Advance Income Tax **would constitute default** in payment of Statutory Dues, since there are specified due–dates in respect of payment of Advance Income Tax.
2. **Windfall Gains:** It may, however, happen that the Company might not have any Taxable Income on the due dates on which Advance Tax is required to be paid. If such a Company has an Income after the last date on which the Advance Tax was required to be paid and consequently the Company incurs interest under the relevant provisions of the Income Tax Act, 1961, it should not be construed as irregularity in Advance Tax payment.

Bring out the meaning of the term "Disputed Due" for the purpose of Clause 3(vii) of CARO.

1. **Meaning:** The Auditor should consider a matter as "disputed" where there is a positive evidence or action on the part of the Company to show that it has not accepted the demand for payment of tax or duty, e.g. where it has gone into appeal.
2. **Rectification:** For this purpose, where an application for rectification of mistake (e.g. u/s 154 of Income Tax Act, 1961) has been made by the Company, the amount should be regarded as disputed.
3. **Representation:** Mere representation to the concerned Department does **not** by itself constitute a dispute.
4. **Dispute in part:** Where the Demand Notice/Intimation for the payment of a Statutory Due is for a certain amount and the dispute relates only to a part and not the whole of such amount, only such amount should be treated as disputed and the balance amount should be regarded as undisputed.
5. **Scope:** The Auditor need not examine the sustainability or otherwise of the claim of the Company regarding disputed amounts. It is sufficient for his purpose if the evidence available shows that the amount is disputed by the Company.

RND Services Ltd provides "specified services" which was erstwhile exempt from Service Tax. In the current year, the Company, for the first 5 months, has neither collected nor remitted the Service Tax. However, the Central Government brought in the "specified services" in the ambit of Service Tax Levy, with retrospective effect from 1^{st} April of current financial year. The Department of Excise and Customs raised a demand notice on the Company for the full year's Service Tax (along with interest for delayed payment for the first 5 months). The Demand Notice specified a due date of March 15^{th} and the Company paid the entire due on that date. Is it an irregularity in Statutory Payment?

1. **First View:** The Statutory Dues referred to in this Clause become payable on the last date by which payment can be

made without attracting penalty and/or interest under the relevant law. Hence, in the above case, there is an irregularity in relation to the first 5 months Service Tax due.

2. **Second View:** It can also be argued that the amounts referred to in the clause become so payable as at the date of the expiry of the stay granted by the Authorities or, where instalments have been granted for the payment of Statutory Dues referred to in the Clause, the date on which the default occurs and the amount becomes payable to the Authorities. If this view is taken, in the above case, there is no irregularity in remittance of Service Tax.
3. **Conclusion:** As the purpose of this Clause is to indicate the amounts which have become actually payable & are outstanding as at the Balance Sheet date for a period of more than 6 months from the date they became payable, the latter view conforms more closely to the requirements of CARO. Hence it can be concluded that the Company is not irregular in depositing Statutory Dues.

Bring out the reporting duties of an Auditor in CARO in relation to Disputed Statutory Due.

1. **Scope of Reporting:** In case of Disputed Statutory dues, the Auditor is required to report the amounts involved, along with the Forum where the dispute is pending.

2. **Disputed Due:**

(a) **Show Cause Notice (SCN)**	• A SCN generally contains the requirements / queries of the Assessing Officer. However, normally, mere issuance of a SCN by the concerned department should **not** be construed to be a demand payable by the Company. • In some cases, a SCN and Demand may be combined in one document. Normally, in such cases, the Demand would not be construed to have arisen till the time the Assessee has disposed–off the requirements of the SCN. Hence, it is necessary to evaluate each situation individually.
(b) **Demands Set Aside**	Tax Demands that have been set aside are clearly not ‘dues’.
(c) **Re–Assess–ment**	If a demand has been referred for re–assessment and the effect of such referral is the cancellation of the earlier demand, this would not constitute an amount due. The wording of the Re–assessment Order would be of significance, if the demand is not cancelled, it will remain Disputed Dues.
(d) **Demands in Stay**	Demands that have been stayed should be regarded as Disputed Dues. These should be disclosed along with a disclosure of the fact of stay. The Stay normally is a **concession** that the amount may not be deposited immediately or that it may be deposited in installments.
(e) **Appeal by the Depart–ment**	There may be a situation that the Appellate Authority has decided a case in favour of the Company but the Department may prefer to make an appeal to a Higher Authority. In such case, there is no dispute until the time the Department makes an appeal to the relevant Appellate Authority.
(f) **Cases Pending Appeal**	Where the amount under the dispute is pending for an Appeal to be filed and the time limit for filing the Appeal has **lapsed**, the disputed amount would become a **Statutory Due.** The reporting responsibilities of the Auditor as are applicable to any other Undisputed Statutory Due under Clause 3(vii) of CARO.

3. **Accounting Consideration:** The amounts to be reported under this Clause are those which have not been deposited on account of any Dispute, irrespective of the treatment of such disputed amounts in accounts.
   (a) **If Provision created:** It is quite possible that an amount is disputed and has not been deposited but on consideration of the likely outcome of the dispute, a Provision has been made in the accounts. Such an amount will need to be **reported**, notwithstanding that it has been provided for.
   (b) **Provision not created:** Even if it had not been provided for, it has to be reported as long as it is **not deposited**.
   (c) **Treated as Recoverable**: It is also possible that an amount is disputed, has been deposited and on consideration of the likely outcome of the dispute, has been shown as a **Recoverable** (Asset in Balance Sheet). Though such an amount is not contemplated for reporting under the clause, since it has been deposited, the fact of such deposit having been made under protest should be brought out by the Auditor in his report under the clause.

4. **Reporting Format:** The information required under this Clause may be reported in the following format:

Statement of Disputed Dues	Statute	Financial Year	Nature of Dues	Amount (`)	Period to which the amount relates	Forum where dispute is pending

XYZ Pvt Ltd has submitted the Financial Statements for the year ended 31.03.2015 for audit. The Audit Assistant observes & brings to your notice that the Company's records show the following dues. As an Auditor, how would you bring this fact to the Members?

(a) Income Tax relating to AY 2011–2012 ` 125 Lakhs. Appeal is pending before Hon'ble ITAT since 30.09.2013.

(b) Customs Duty ` 85 Lakhs. Demand Notice received on 15.09.2014, but no action has been taken to pay or appeal.

1. **Income Tax Appeal:** **Refer Clause 3(vii) of CARO**
   (a) **Audit Procedures:** Obtain Management Representation and perform other audit procedures to verify the same.
   (b) **AS–29:** Check whether there is a need for the Company to make a provision for the liability.
   (c) **Reporting:** Since the matter is under appeal, non–payment of dues is on account of a dispute. So, the amount involved and the forum where the dispute is pending should also be mentioned while reporting under CARO.

2. **Customs Duty Notice:** **Refer Clause 3(vii) of CARO**
   (a) Demand Notice has been received but no action has been taken for 6 months.
   (b) The Auditor shall report , the extent of the arrears of outstanding statutory dues as at the last day of the Financial Year concerned for a period of more than 6 months from the date they became payable, shall be indicated in the Report.

Big and Small Ltd received a Show Cause Notice from Central Excise Department intending to levy a demand of ` 25 Lakhs in December 2014. The Company replied to the above notice in January 2015, contending that it is not liable for the levy. No further action was initiated by the Central Excise Department upto the finalization of the audit for the year ended on 31st March 2015. As the Auditor of the Company, what is your role in this?

Hint: There is a **mere** Show Cause Notice and reply for the same. There is **no demand** made by the Department. Hence there is no dispute. The Auditor need **not** report on the same.

There is a Sales–Tax Demand of ` 3 Crores against X Ltd, relating to prior years against which the Company has gone into an appeal. Comment.

Hint / Principle: Refer Clause 3(vii) of CARO

1. **CARO:** It is a **disputed** statutory due. Hence, the Auditor has to report under **Clause 3(vii) of CARO**.
2. **AS–29:** The Auditor has to verify whether there is a need for the Company to make a provision for the liability.

Nature of Reporting: Auditor should report whether or not the amount required to be transferred to Investor Education and Protection Fund as per the provisions of **Companies Act, 1956** has been transferred within the stipulated time.

Investors Education and Protection Fund as per Companies Act, 1956

1. **Transfer of Unpaid / Unclaimed Dividend:** Any money transferred to the Unpaid Dividend Account of a Company and which remains unpaid / unclaimed for a period of **7 years** from the date of such transfer, shall be transferred by the Company to the **"Investor Education and Protection Fund"** established by the Central Government **u/s 205C of the Companies Act, 1956.**

2. **Moneys due to the Fund:** The following amounts shall be credited to the "Investor Education and Protection Fund" established u/s 205C –
   (a) Amounts in the Unpaid Dividend Accounts of Companies.
   (b) Application moneys received by Companies for allotment of any securities and due for refund.
   (c) Matured Deposits with Companies.
   (d) Matured Debentures with Companies.
   (e) Interest accrued on amounts referred above.
   (f) Grants and Donations given by Government, Companies and Other Institutions.
   (g) Interest or other income received out of investments made from the Fund.

   Note: The first 4 items shall form part of the Fund only after the expiry of 7 years from the date they became due for payment.

3. **Objectives of Fund:** No claim for payment of any moneys from the Fund can be entertained. The Fund shall be

utilised for – (i) Promotion of Investor Awareness, and (ii) Protection of the interests of Investors, in accordance with the prescribed Rules.

4. **Details to be furnished:** When Unclaimed Dividends are transferred to the Fund Account, the Company must furnish the following details to the prescribed authority – (i) Nature of sum transferred, (ii) Name and last known address of the rightful recipients, (iii) Amount to which each person is entitled, (iv) Nature of his claim thereto, and (v) Other prescribed particulars.

LOSS MAKING COMPANIES

Refer Clause 3(viii) of CARO

1. **Loss:** "Loss" should be construed to mean the Net Profit/Loss shown by the P&L A/c of the Company, as **adjusted** after taking into account, the **qualifications** in the Audit Report, to the extent the qualifications are **quantified**.

2. **Net Worth:** As per Sec.2(57), of the Companies Act, 2013, the term "**Net Worth**" is defined as the aggregate value of the paid–up Share Capital and all reserves created out of the profits and Securities Premium Account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited Balance Sheet. While calculating reserves, it should not include reserves created out of revaluation of assets, write–back of depreciation and amalgamation. The figure of Net Worth computed from the Balance Sheet of the Company should also be **adjusted for** the effect of **Qualifications** in Audit Report, to the extent the Qualifications are **quantified**.

3. **Cash Loss:**
   (a) For determining Cash Loss for the Financial Year, the figure of Profit/Loss shown by the P&L Account is adjusted for the effects of transactions of a non–cash nature, such as Depreciation, Amortisation, Deferred Tax Expenses, etc.
   (b) The figure of Cash Loss of the Company for the Financial Year covered by the Audit Report and the immediately preceding Financial Year should also be adjusted, for the effect of qualifications in the respective Audit Reports, to the extent the qualifications are **quantified**.
   (c) Where the Company has suffered Cash Losses in only one of the years referred to in the Clause, the Auditor shall comment on the two years separately (e.g. it would be proper to report that the Company has incurred Cash Losses only during the preceding year, but has not incurred any Cash Loss during the current Financial Year).

4. **Qualifications not quantified:** Where any of the Qualifications in the Audit Report is not capable of being quantified, the Auditor should state that the effect of such Unquantified Qualification(s) has not been taken into consideration for the purpose of making comments in respect of this Clause.

64. Yoganand Ltd had the following Outstanding Loans as on 31.03.2016. As an Auditor, what are the reporting aspects under CARO? What will be your answer if the Company has applied for re–scheduling with ICICI and IDBI Loans?

Name of the Bank	Due Date for	Amount of Default (` in	Amt Outstanding as on 31.03.2016 (`
ICICI	1.1.2016	10	10
IFCI	1.1.2016	15	–
IDBI	1.1.2015	7	7
Other Banks	1.1.2015	8	–

Kapalinath Ltd had taken a Term Loan from a Nationalized Bank in 2011 for ` 200 Lakhs repayable in 5 equal instalments of ` 40 Lakhs from 31st March 2012 onwards. It had repaid the loan instalments due in 2012 & 2013, but defaulted in 2014, 2015 & 2016. What is the responsibility of the Company Auditor, assuming that Company has sought re–schedulement of loan? Explain.

R Ltd as at 31st March 2016 defaulted in the repayment of interest and principal due to a Financial Institution. The due date was 28th February 2016. However the defaulted amount was paid on 5th April 2016. The Company's Management is of the opinion that since the default is set right before the audit completion, these need not be reported in CARO. Comment and draft a suitable report.

Refer Clause 3(ix) in CARO.

1. **Period of Default:** The Auditor should report the period and amount of all defaults existing at the Balance Sheet date **irrespective of when those defaults have occurred**. Where a default has been made good by the Company during the accounting period covered by the Auditor's Report, the Auditor should state in his Audit Report the fact of default having been made good.
2. **Amount of Default:** Dues to Financial Institutions, Banks or Debenture Holders would include the Principal as well as any interest on any kind of dues payable to them.
3. **Time of Default:** The word "default" would mean non–payment of dues to Banks, Financial Institutions or Debenture Holders on the last dates specified in Loan Documents or Debentures Trust Deed, as the case may be.
4. **Reporting Format:** The following is an example of **negative reporting** under this Clause – "The Company has defaulted in repayment of dues to Banks. Principal and Interest amounting to **` 17 Crores** became due for payment on 01.01.2016 (` 10 Crores) and 01.01.2015 (` 7 Crores) which were outstanding as on the date of Balance Sheet. In addition to the above, Loans amounting to **` 23 Crores** (` 15 Crores – due on 1.1.2016 and ` 8 Crores – due on 1.1.2015) has been defaulted by the Company, and made good before the date of Balance Sheet.
5. **Re–Scheduling:** Submission of application for Re–Scheduling / Re–structuring does not mean that no default has occurred. So, in such situations also, the Auditor should report the period of default and the amount of default. However, if the application for Re–Scheduling of loan has been **approved** by the concerned Bank or Financial Institution, the Auditor should state the same in his report.
6. **Disputed Due:** There can be situations where there is a dispute between the Company and the Lender on certain issues relating to repayments. In such cases when the amount is due, the Auditor should give a Disclaimer that since there is a dispute between the Company and the Lender, he is unable to determine whether there is a default in repayment of dues to the Lender concerned.

GUARANTEES GIVEN

Refer Para 3(x) of CARO.

1. **Applicability:** This Clause is applicable in respect of **Guarantees** issued by the Company in respect of Borrowings from **Banks or Financial Institutions** (i.e. Guarantees in respect of loans taken from sources "Other than Bank or Financial Institutions" is not covered under this Clause)
2. **Compliance with MOA:** The Auditor shall verify whether the MOA of the Company permits providing Guarantees for Other Parties. Else the Auditor has to make a necessary reporting in his Report.
3. **Register of Guarantees:** The Auditor should obtain a list of the Guarantees issued by the Company during the year from the Management of the Company, which should be checked with the Register of Guarantees.
4. **Approval:** The Auditor should ascertain whether the Guarantees have been issued by or under sanction of the Competent Authority (ex. with reference to Minutes book, etc)
5. **Reasonableness:** The Auditor should review the Guarantee(s), to establish the reasonableness thereof, in the light of previous experience and knowledge of the Current Year's activities.
6. **Terms of Guarantee:** In determining whether the guarantee is prejudicial to the interest of the Company, the Auditor would consider the financial standing of the party on whose behalf the Company has given the Guarantee, Party's ability to borrow, Nature of the Security offered by the Party, Availability of alternative sources of Finance, Urgency of the Borrowing, etc. The Auditor should obtain this information from the Management.
7. **Legal Compliance:** The Auditor should also ensure whether the Company has complied with Sec.185 & 186 of the Act. Further, if the Company has obtained the approval of the CG u/s 185, it is construed that the Guarantee is not prejudicial to the interest of the Company.
8. **Management Representation:** The Auditor should obtain a Written Representation from the Management that:
   (a) There are no Guarantees issued up to the year–end which are yet to be recorded, and
   (b) All obligations in respect of Guarantees have been duly recorded in the Register of Guarantees and disclosed.
9. **Reporting Consideration:** If the Auditor is unable to comment on the Clause because of the absence of the necessary Resolution / Register / other records, he should issue a disclaimer with regard to the Clause stating reasons for the same.

TERMS LOANS

Refer Para 3(xi) of CARO

1. **Applicability:** This Clause is applicable in respect of Term Loans availed from **any person** (Banks, Financial Institutions, Directors, Subsidiaries, etc.)
2. **Audit Process:** The Auditor should examine the loan proposal, loan document with the Terms and Conditions, Sanction Letter (for understanding the purpose of Loan) and should also compare it with the actual utilisation of the loans.
3. **Deposit in Common Pool:** It is **not** necessary to establish a one–to–one relationship with the amount of Term Loan & its utilisation. For example, if the amount of Term Loan disbursed by the Bank is deposited in the Common A/c of the Company from which subsequently the utilisation is made, it should not be construed as a mis–application.
4. **Better Utilisation:** Where a Company applies a Term Loan for buying an Asset and if the same has been used for buying an improved version / model of that Asset, it is not considered as a mis–application.
5. **Temporary Deposits during Construction Period:** During Construction Phase, Companies, temporarily invest the surplus funds in Deposits, to reduce the Cost of Capital or for other business reasons. However, subsequently the same are utilised for the stated objectives. In such cases, the Auditor should **mention the fact** that pending utilisation of the Term Loan for the stated purpose, the funds were temporarily used for the purpose other than for which the loan was sanctioned but were ultimately utilised for the stated end–use.
6. **Year–end Disbursement:** It may so happen that the Term Loans taken during the year might not have been applied for the stated purpose during the year (e.g. Loan disbursed at the end of the year). In such a case, the Auditor should mention in his Audit Report that the Term Loan obtained during the year has not been utilised.
7. **Loans Disbursed in Previous Year:** Based on the above point, it is clear that the Auditor, while making inquiry in respect of this clause, should also consider the Term Loans which although were taken in the previous accounting period but have been actually utilised during the current accounting period and report accordingly.
8. **Purpose of Loan not specified:** In case of Term Loans from Banks, raised against Title Deeds, Long Term FDRs, NSCs, etc. where the Bank is not concerned with the purpose for which it is being obtained, the Auditor should clearly **mention the fact,** that in the absence of any stipulation regarding the utilization of loans from the Lender, he is unable to comment as to whether the Term Loans have been applied for the purposes for which they were obtained. It may, however, be noted that the Auditor, in such cases, should verify that the Company has not invested or utilized the money for purposes that are **prohibited** under law.
9. **Reporting:** If the Auditor finds that the Term Loans have **not** been utilized for the purpose for which they were obtained, the Auditor's Report should **state the fact**, and mentions in his Report, the amount of such Term Loan.

Mani Ltd had obtained a Term Loan of ` 300 Lakhs from a Bank for the construction of a Factory. Since there was a delay in the construction activities, the said funds were temporarily invested in Short Term Deposits. Comment.

1. **Clause 3(xi) of CARO** requires the Auditor to report on whether or not Term Loans are applied for the purpose for which such loans were obtained.
2. During the Construction phase, Companies, generally, temporarily invest the surplus funds to reduce the cost of capital or for other business reasons. However, subsequently the same are utilized for the stated objectives.
3. In such cases, the Auditor should mention the fact that pending utilization of the Term Loan for the stated purpose, the funds were temporarily used for the purpose other than for which the loan was sanctioned but were ultimately utilized for the stated end–use.

Lakshmi, a CA, argues that clause 3(xii) of CARO requires an Auditor to report on the Frauds evidenced in the Company. Hence, indirectly it casts responsibility on the part of the Auditor to find out all the Frauds happened in the Company. However Harini, another CA, rejects the above statement saying that the Auditor is not responsible for finding the frauds in the Company. Comment on the correctness of above statements.

FRAUD REPORTING

Refer Para 3(xii) Point 12 of CARO

1. **Scope of Audit:** The Clause does **not** require the Auditor to discover the Frauds on the Company and by the Company. The scope of Auditor's inquiry under this Clause is restricted to Frauds '**noticed or reported**' during the year. The use of the words "**noticed or reported**" indicates that the Management should have the knowledge about the Frauds on the Company or by the Company that have occurred during the period covered by the Auditor's Report.

2. **Duties under SA:** However, this Clause does not relieve the Auditor from his responsibility to consider Fraud and Error in an audit of Financial Statements. In other words, irrespective of the Auditor's comments under this Clause, the Auditor is also required to comply with the requirements of SA–240 on "The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements".

3. **Duties under Companies Act:** Also refer to Auditors duties on reporting regarding frauds u/s 143(12).

During the course of production, a Company accumulates huge quantity of Scraps and certain By–Products. The Scraps are sold by auction and for the sale of By–Products, reasonable records are maintained, but no records are maintained for recording the generation of Scraps and By–Products and accordingly not being satisfied with the state of affairs, you want to qualify your report. But Management views that under CARO, the Auditor is not required to report about maintenance of records in connection with generation of Scraps and By–Products. Comment on the view of the Management.

1. **CARO Requirements:** The following reporting requirements of CARO are relevant in this regard –
   (a) **Internal Control [3(iv)]:** Refer to **Clause 3(iv) Point 4 of CARO**.
   (b) **Cost Accounting Records [3(vi)]:** Refer to **Clause 3(vi) Point 6 of CARO**.
   (c) **Fraud [3(xii)]:** Refer to **Clause 3(xii) Point 12 of CARO**.

2. **Observations:**
   (a) Since the quantum of Scrap and By–Products is considerable, it appears that maintenance of records for generation as well as records for sale of Scrap/ By–Products is necessary, but the Company has not maintained such records.
   (b) The Auditor has to evaluate and consider the effect of non–maintenance of records for Scrap & By–Products in the light of – (a) effectiveness of internal control system, (b) compliance with Cost Accounting (Records) Rules, where applicable, & (c) possibility of frauds in relation to such Scrap & By–Products.
   (c) The Auditor will have to issue an adverse comment on non–maintenance of reasonable records for sale of Scrap/ By–Products and decide on the aspect of records on generation, on the basis of facts and circumstances of the case.

Purchases of Raw Materials by a business were supported by Invoices, Challans and Receipts of Suppliers. Invoices were authorised by the Purchase Manager and payments were made to the Suppliers by Account Payee "Cheques". After the accounts were audited, it was discovered that the Raw Materials were purchased at inflated prices resulting in a loss of ` 3 Lakhs to the business. Will the Auditor be held liable in this connection?

1. **CARO Requirements:** In the given case, the purchase of materials have been documented by Invoices, Challans acknowledging actual supply, payment by Account Payee Cheques and valid receipts from Suppliers. It is also observed that the Auditor has verified the purchase transactions. The Auditor's reporting duties in this regard under CARO involve the following –
   (a) **Internal Control [3(iv)]: Refer to Clause 3(iv) Point 4 of CARO**.
   (b) **Fraud [3(xii)]: Refer to Clause 3(xii) Point 12 of CARO**.

2. **Auditors' Duties:**
   (a) The Auditor had examined the Company's Internal Control System in relation to purchases, e.g. procedures like obtaining quotations from competitive Suppliers, analysis thereof to choose the Supplier, and placing the order on a correct understanding of the terms contained in the quotations.
   (b) The Auditor is also required to examine whether there has been any fraud detected / noticed / reported in relation to purchases.

3. **Conclusion:** If the Auditor had properly examined all these and also had satisfied himself about compliance of these in placing orders for purchases of Raw Materials, he will **not** be liable for the excess price paid. However, if he has not exercised due care and diligence in the performance of his duties, he may be guilty of negligence.

As the Statutory Auditor of B Ltd, to whom CARO is applicable, how would you report in the following situations?

(a) The Company has stood Guarantee to its sister concern, whose financial condition was not healthy, for a sum of ` 20 Lakhs borrowed from a Bank.

(b) Physical Verification of only 50% (in value) of items of Stock has been conducted by the Company. The balance 50% will be conducted in next year, due to lack of time and resources.

(c) Accumulated Losses of the Company are 50.9% of its Net Worth and it is incurring continuous losses since last 2 years.

Clause	Auditors' Duties
Guarantees given 3(x)	1. Examine the MOA to determine whether the Company has the power to give guarantees. 2. Verify the Minutes Book and Register of Guarantee, to confirm whether the guarantee has been sanctioned by the competent authority. 3. See whether the requirements of Sec.185 and 186 are complied with. 4. Confirm whether the Guarantee given, has been disclosed as a **Contingent Liability**. 5. Consider the financial standing of the party, nature of security offered etc, in determining whether the guarantee is prejudicial to the Company's interests. 6. Since the financial condition of the Sister Concern is not good, express the opinion that –"The terms and conditions of the guarantee for ` 20 Lakhs, given for Loans taken by M/s … (sister concern) from M/s ……..Bank, are prejudicial to the interest of the Company."
Verification of Inventories 3(ii)	**Note:** Refer to reporting requirements under **Clause 3(ii) of CARO**, given above. Since Physical Verification has not been carried out adequately, the Auditor should – 1. Point out the specific areas where he believes the procedure of inventory verification is not reasonable adequate. 2. Analyse the impact on Financial Statements and report accordingly.
Loss Making Co.3(vii)	**Note:** Refer to reporting requirements under **Clause 3(viii) of CARO,** given above. Assuming that the Company is in existence for more than 5 years, the Auditor should report on the lines specified above.

As the Statutory Auditor, how would you report on the following under CARO?

ABC Pvt Ltd is a manufacturer of Jewellery. A Senior Employee of the Company informed you that the Company does not disclose the purity of gold used on the Jewellery.

Clause	Auditors' Duties
Frau d 3(xii)	**Note:** Refer to reporting requirements under **Clause 3(xii) of CARO**. • If purity of gold is not properly disclosed on the jewellery, it amounts to defrauding of customers by the Company's Management, in order to obtain an illegal advantage. However, this does not create any material mis–statement in the Financial Statements, and hence the Auditor is not concerned with the same. • Purity of Gold may have an impact on valuation of inventory, but the Auditor is not required to comment and report on the valuation of inventory under CARO. • As long as the books of account are not falsified arising out of the difference in the purity of gold, i.e. actual cost of gold and sale price thereof, there is no implication for mis–statement in the Financial Statements. In such cases, the Auditor need not report on non–disclosure of purity of gold on the jewellery.

The Auditor's reporting considerations under CARO may involve adverse comments also. Would these adverse comments necessarily call for a Qualified Audit Report?

There is a need for consistency between CARO Remarks and Main Audit Report. Comment.

1. **Consistency:** It is normally expected that CARO Report and the Main Audit Report should go hand in hand. If any of the comments in CARO are adverse, the Auditor should consider whether his comments have a bearing on the True and Fair view presented by the Financial Statements and, therefore, might warrant a modification in the report u/s 143(2), (3), (4).

2. **Adverse CARO Comment vs Qualified Audit Report:** Every adverse comment under CARO need **not** necessarily result in a Qualified Audit Report. This is due to the following reasons –
   (a) **Irrelevant to True and Fair:** The adverse comment may arise regarding a matter which has no relevance to the true and fair view of the accounts, e.g. delayed payment of PF / ESI dues to the statutory authorities.
   (b) **Immaterial:** The non–compliance may be material enough to warrant an adverse comment under CARO, but not material enough to vitiate a true and fair view of the accounts.
   (c) **Remediable:** The non–compliance under CARO may be in an area which calls for remedial action from the Management, e.g. lack of internal control in a certain minor operational area, which does not affect the truth and fairness of Financial Statements.

   The Auditor must use his discretion based on facts and circumstances of each case, in deciding whether the adverse comment under CARO should result in an adverse audit opinion.

3. **Mandatory Phrases:**
   (a) Many of the requirements in CARO will involve Expression of Opinion and not necessarily Statement of Facts. Hence it is necessary to prefix such Statements by the words "In our opinion" or "In terms of the information and explanations given to us and the books and records examined by us in the normal course of audit and to the best of our knowledge and belief, we state that............................."
   (b) Even when there are no Adverse Comments under CARO, it may be advisable for the Auditor to preface his report u/s 143 (2), (3) & (4) with the words: "Further to our comments in the Annexure, we state that................"

4. **Sequence of Items in Audit Report:** The following is the sequence of preparing an Audit Report:
   (a) **First,** the comments, if any, u/s 143(1) shall be given,
   (b) **Second,** the comments under CARO,
   (c) **Thirdly,** the report u/s 143(2), (3), (4).

   Note:
   - **Annexure:** The comments under CARO may, alternatively, be given in the form of an Annexure to the Report. However, when the comments are given in an Annexure, it is necessary to refer to the Annexure in the Main Report and it is advisable to sign the Annexure in addition to signing the Main Report.
   - **Order of Qualification:** Where there is a Qualification both u/s 143(1) and in CARO, it is suggested that the Qualification u/s 143(1) shall precede the Qualification under CARO.

Is the Board of Directors required to disclose their explanations in Director's Report on the Auditor's comments and remarks under CARO?

1. **Responsibilities of BOD:** Sec.314 of the Act requires that the Board shall be bound to give in its Report, the fullest information & explanations regarding every reservation, qualification or adverse remark contained in the Auditor's Report. In this regard, Audit Report includes CARO and hence the Board's responsibility is extended to this.

2. **Consensus–ad–idem:** The Auditor's comments in CARO may be in respect of Matters of Fact or they may be an Expression of Opinion. It is necessary that there should be no inconsistency in the facts as stated by the Auditor and as explained in the Board's Report. It is, therefore, suggested that wherever possible, a Draft Report should be submitted to the Board to verify and confirm the facts stated therein.

3. **Difference of opinion:** It is, however, possible that, on the same facts, there may be a genuine difference of opinion between the Auditor and the Board. In such a case, each is entitled to hold his or its view. Therefore, the expression of a different opinion in the Board's Report should not be regarded as any reflection on the Opinion expressed by Auditor.

4. **Inclusion in Audit Report:** It is not necessary that the Management's Explanation for any matter on which he makes an Adverse Comment be included in the Audit Report. However in the following cases, the same may be included–
   (a) **To make the comment more meaningful and complete**. (e.g. Physical Verification of Inventories, though planned, may not have been carried out because of a Strike or a Lockout. An Adverse Comment without this explanation would be misleading.)
   (b) **To explain the fact** why in spite of an Adverse Comment, the **True and Fair view** of the Financial Statements is **not vitiated** (e.g. Physical Verification of a part of the Inventories at the year–end may not have been carried out, but there is sufficient other evidence produced by the Management which satisfies the Auditor regarding the existence, condition and value of the Inventories).