Guidance Note on the Companies (Auditor's Report) Order, 2016

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Foreword

The Ministry of Corporate Affairs has issued the Companies (Auditor's Report) Order, 2016 (CARO 2016) which is applicable for audits of financial statements for periods beginning on or after April 1, 2015. The CARO 2016 contains several new reporting requirements which were not there in the earlier Orders, i.e, CARO 2003 and CARO 2015. An urgent need was felt by ICAI for providing appropriate guidance on CARO 2016 to the members so that the requirements and expectations of the Order can be fulfilled in letter and spirit by the auditors.

I am happy that the Auditing and Assurance Standards Board has brought out this Guidance Note on the Companies (Auditor's Report) Order, 2016 for the benefit of the members. The Guidance Note was initially developed by three expert groups constituted by the Board for this purpose and thereafter finalised with the contribution of all the members of the Board and the Council. The Guidance Note has been written in an easy to understand language and contains detailed guidance on the various Clauses of CARO 2016 and the various issues and intricacies involved therein. I am also happy that the Guidance Note is comprehensive and self-contained reference document for the members.

I wish to compliment CA. Shyam Lal Agarwal, Chairman, Auditing and Assurance Standard Board, CA. Sanjay Vasudeva, Vice-Chairman and all the members of the Auditing and Assurance Standards Board for bringing out this highly useful Guidance Note by putting their hard and day night efforts to provide in time for the benefit of the

members. I am sure that the members and other interested readers would find the Guidance Note immensely useful.

April 21, 2016
New Delhi

CA. M Devaraja Reddy
President, ICAI

Preface

The Ministry of Corporate Affairs has issued the Companies (Auditor's Report) Order, 2016 (CARO 2016) vide Order dated 29th March 2016. The Order would be applicable for audit of the financial statements for the period beginning on or after April 1, 2015. As such it is applicable for the audits of financial year 2015-16 also. The Order contains several changes and new reporting requirements which were not covered in earlier CARO. These substantial changes made by the CARO 2016 necessitated the revision of the Statement on CARO 2003 earlier issued by ICAI.

I feel immense pleasure in placing in hands of the members this Guidance Note on the Companies (Auditor's Report) Order, 2016 which has been finalised in light of the requirements of the CARO 2016. This Guidance Note supersedes the earlier Statement on CARO 2003 for audit of financial statements for the period beginning on or after April 1, 2015.

At this juncture, I wish to place on record my gratitude to members of all the three study groups constituted for the purpose, Jaipur, New Delhi and Kolkata, for their dedicated efforts, despite the engagement in their professional matters and demands in their personal lives. My sincere thanks to: i) all the Jaipur Study Group Members, viz., CA Bhupendra Mantri, CA Ashok Singhal, CA Vijay Kumar Jain, CA Vishnu Mantri, CA Vijay Jain, CA Vikas Gupta, CA Prahalad Gupta, CA Ajay Atolia, CA Ravi Raniwala, CA Jugal Agrawal, CA Shailendra Agarwal, CA Anil Jain, CA Rohit Ruwatia, CA Pramod Kumar Boob, CA P D Baid, CA Dinesh Kumar Jain, CA Sanjay Kumar Maheswari and CA Keshav Garg, ii) all the Delhi Study Group Members, viz., CA. Anil Sharma (Deputy Convenor), CA. R Balasubramanian, CA. Anil Jobanputra, CA. Ashok Kumar Agarwal, CA. Rajiv Puri, CA. Sharad Chaudhry, CA. Nitin Chaudhry, CA. Munish Saraogi,

CA. V Rethinam, CA. Gurmeet Grewal, CA. Avineesh Matta, CA. Arun Saxena, CA. Anil Gupta and iii) all the Kolkata Study Group Members, viz., CA. Debashis Mitra (Convenor), CA. Abhijit Bandyopadhyay, CA. Bhaskar Banerjee, CA. Arijit Chakraborty, CA. Mohit Bhuteria, CA. Santanu Ghosh, CA. Partha Sarathi De, CA. Nirupam Haldar, CA. Anindra Nath Chatterjee, CA. Sumit Binani, CA Animesh Mukerji and CA Nilima Joshi.

I also wish to express my deep gratitude to CA. M Devaraja Reddy, President, ICAI and CA. Nilesh Vikamsey, Vice President, ICAI for their vision, guidance and support in this matter and to the activities of the Board.

I also wish to thank all my colleagues at the Central Council for their suggestions, cooperation and guidance in formulating and finalizing this Guidance Note and also to various authoritative pronouncements of the Board. My sincere thanks are also due to the members of the Auditing and Assurance Standards Board, viz., CA. Sanjay Vasudeva, (Vice Chairman), CA. Nand kishore Chidamber Hegde, CA. Nihar Niranjan Jambusaria, CA. Dhinal Ashvinbhai Shah, CA. Babu Abraham Kallivayalil, CA. Madhukar Narayan Hiregange, CA. G. Sekar, CA. K. Sripriya, CA. M P Vijay Kumar, CA. Ranjeet Kumar Agarwal, CA. Sushil Kumar Goyal, CA. Debashis Mitra, CA. Manu Agrawal, CA. Kemisha Soni, CA. Sanjiv Kumar Chaudhary, CA. Mangesh Pandurang Kinare, Shri P.K. Mishra, Dr. P.C. Jain, Ms. Indu Malhotra, CA. Abhijit Bandyopadhyay, CA. Harinderjit Singh, CA. Murali Krishna, CA Vijay Kumar Jain, CA. Akhil Bhalla, CA. Sandeep Dinanath Welling and CA. V. Balaji for their kind suggestions, support and guidance to finalise this Guidance Note and all other activities of the Board.

My special thanks to CA. Sanjay Vasudeva, Vice Chairman of the Board who has put all his efforts all the time, irrespective of his prior engagements in his profession, other committees of ICAI and family matters, in finalising this

Guidance Note in such a short time. My hearty thanks to the Secretary AASB and all her team members for their dedicated working even beyond the normal working hours of the Institute. I am confident that this Guidance Note on CARO 2016 would be found useful and well received by the members and other interested readers.

April 21, 2016
New Delhi

CA. Shyam Lal Agarwal
Chairman,
Auditing and Assurance Standards Board

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Introduction

1. The Central Government, in exercise of the powers conferred, under sub-section (11) of section 143 of the Companies Act, 2013[*] (hereinafter referred to as "the Act"), issued the Companies (Auditor's Report) Order, 2016, (CARO, 2016/ "the Order") *vide* Order No. S.O. 1228(E) dated 29th March, 2016. CARO, 2016 contains certain matters on which the auditors of companies (except of those categories of companies which are specifically exempted under the Order) have to make a statement in their audit report. The text of the CARO, 2016 is given in **Appendix I** to this Guidance Note.

2. This Order is in supersession of the earlier Order issued in 2015, viz., the Companies (Auditor's Report) Order, 2015 (CARO 2015). **Appendix II** to this Guidance Note contains a clause-by-clause comparison of the reporting requirements of the Order and the erstwhile CARO 2015.

3. The purpose of this Guidance Note is to enable the members to comply with the reporting requirements of the Order. It should, however, be noted that the clarifications and explanations contained in this Guidance Note are not intended to be exhaustive and the auditors should exercise their professional judgment and experience on various matters on which they are required to report under the Order.

General Provisions Regarding Auditor's Report

4. The requirements of the Order are supplemental to the existing provisions of section 143 of the Act regarding the auditor's report. In this regard the following points may be noted:

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[*]Readers' attention is invited to the fact that the Companies (Amendment) Bill 2016 is before the Parliament for approval. This Guidance Note does not take into account the amendments to the Companies Act, 2013 as proposed in the aforesaid Bill.

(i) the provisions of sub-sections (1), (2) & (3) of section 143 are applicable to all companies while the Order exempts certain categories of companies from its application; and

(ii) the provisions of sub-section (1) require the auditor to make certain specific enquiries during the course of his audit. The auditor is, however, not required to report on any of the matters specified in the sub-section unless he has any special comments to make on the said matters. In other words, if he is satisfied with the results of his enquiries, he has no further duty to report that he is so satisfied. The Order, on the other hand, requires a statement on each of the matters specified therein, as applicable to the company.

5. Another question that arises is about the status of the Order *vis a vis* the directions given by the Comptroller and Auditor General of India under section 143(5) of the Act. In this regard, it may be noted that the Order is supplemental to the directions given by the Comptroller and Auditor General of India under section 143(5) in respect of government companies. These directions continue to be in force. Therefore, in respect of government companies, the matters specified in the Order will form part of the auditor's report submitted to the members and the replies to the aforesaid questionnaire issued by the Comptroller and Auditor General of India will be governed by the requirements of section 143(5) of the Act.

6. The Order is not intended to limit the duties and responsibilities of auditors but only requires a statement to be included in the audit report in respect of the matters specified therein.

Applicability of the Order

Companies Covered by the Order

7. The Order applies to all companies except certain

categories of companies specifically exempted from the application of the Order.

8. The Order also applies to foreign companies as defined in clause (42) of section 2 of the Act. According to the aforesaid section, a "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."

9. In the case of a foreign company, wherever under any of the provisions of the Act, an audit under Chapter X of the Act is required to be carried out, the Order would be applicable.

10. The Order is also applicable to the audits of branch(es) of a company since sub-section 8 of section 143 of the Act read with Rule 12 of the Companies (Audit and Auditors) Rules, 2014 clearly specifies that a branch auditor has the same duties in respect of audit as the company's auditor. It is, therefore, necessary that the report submitted by the branch auditor contains a statement on all the matters specified in the Order, as applicable to the company, except where the company is exempt from the applicability of the Order, to enable the company's auditor to consider the same while complying with the provisions of the Order.

Companies Not Covered by the Order

11. The Order provides that it shall not apply to:

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an insurance company as defined under the Insurance

Act, 1938 (4 of 1938);

(iii) a company licensed to operate under section 8 of the Act;

(iv) a One person Company as defined under clause (62) of section 2 of the Act and a Small Company as defined under clause (85) of the section 2 of the Act; and

(v) a private limited company, not being a subsidiary or holding company of a public company, having a paid-up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Schedule III to the Act, (including revenue from discontinuing operations) exceeding rupees ten crores during the financial year as per the financial statements.

12. The Order specifically exempts banking companies, insurance companies and companies which have been licensed to operate under section 8 of the Act. The Order also exempts One Person Company and a Small Company from its application. The applicability of the Order would be based on the status of the company as at the balance sheet date. It may also be noted that in case a company is covered under the definition of small company, it will remain exempted from the applicability of the Order even if it falls under any of the criteria specified for private company.

13. The specific exemption under the Order is given to companies licensed under section 8 of the Act. However, it would appear that in view of the provisions of section 465 of the Act, the exemption would also extend to companies licensed to operate under section 25 of the Companies Act 1956.

14. A private limited company, in order to be exempt from the applicability of the Order, must satisfy all the conditions mentioned above collectively. In other words, even if one of the conditions is not satisfied, a private limited company's auditor has to report on the matters specified in the Order.

Private Limited Company

15. The term "private limited company", as used in the Order, should be construed to mean a company registered as a "private company" {as defined in sub-section (68) of section 2 of the Act}.

Paid-up Capital and Reserves and Surplus

16. Sub-section (64) of section 2 of the Act defines the term "paid-up capital" as such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid up in respect of shares issued and also includes any amount credited as paid up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called.

The Guidance Note on Terms Used in Financial Statements, issued by the Institute of Chartered Accountants of India, defines the term "paid-up share capital" 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". Paid-up share capital would include both equity share capital as well as the preference share capital. While calculating the paid-up capital, amount of calls unpaid should be deducted from and the amount originally paid-up on forfeited shares should be added to the figure of paid-up capital. Share application money received should not be considered as part of the paid-up capital.

The Guidance Note on Terms Used in Financial Statements defines the term "reserve" as, "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.

17. As per schedule III of Companies Act 2013 "Reserves & Surplus" consists of:-

- Capital Reserves;
- Capital Redemption Reserve;
- Securities Premium Reserve;
- Debenture Redemption Reserve;
- Revaluation Reserve;
- Share Options Outstanding Account;
- Other Reserves–(specify the nature and purpose of each reserve and the amount in respect thereof);
- Surplus i.e., balance in Statement of Profit and Loss

(Debit balance of Statement of Profit and Loss shall be shown as a negative figure under the head "Surplus".)

Reserves are primarily of two types–capital reserves and revenue reserves. According to the Guidance Note on Terms Used in Financial Statements, the term "capital reserve" means "a reserve of a corporate enterprise which is not available for distribution as dividend". The said Guidance Note defines the term "revenue reserve" as "any reserve other than capital reserve". For determining the applicability of the Order to a private limited company, both capital as well as revenue reserves should be taken into consideration while computing the limit of rupees one crore; prescribed for paid-up capital and reserves & surplus. Revaluation reserve, if any, should also be taken into consideration while determining the figure of reserves for the limited purpose of determining the applicability of the Order. In case of debit balance of profit and loss, the same shall be netted for computing reserves & surplus. To summarise, total of reserves and surplus as disclosed in the financial statements should be considered in evaluating the threshold.

Borrowings

18. Borrowings from banks or financial institutions can be long term or short term and are normally in the form of term loans, demand loans, export credits, cash credits, overdraft facilities, bills purchased or discounted. Outstanding balances of such borrowings should be considered as borrowing outstanding for the purpose of computing the limit of rupees one crore. Non-fund based credit facilities, to the extent such facilities have devolved and have been converted into fund-based credit facilities, should also be considered as outstanding borrowings. The figures of outstanding borrowing would also include the amount of bank guarantees issued by the company where such guarantee(s) has (have) been invoked and encashed or where, say, a letter of credit has been devolved on the company. In case of term loans, interest accrued and due is considered as a borrowing whereas interest accrued but not due is not considered as a borrowing. Further, in case the company enjoys a facility, say, a cash credit facility, whose balance is fluctuating in nature, the Order would apply to the company in case on any day during the financial year concerned, the amount outstanding in the cash credit facility exceeds Rs. one crore as per books of the company along with other borrowings. The condition laid down in the Order is that the private company does not have total borrowing exceeding rupees one crore from any bank or financial institution at any point of time during the financial year. There is no stipulation in the Order that the borrowing should be a long-term borrowing or a short-term borrowing or that it should be a secured borrowing or an unsecured borrowing. Further, the condition would also apply notwithstanding the fact that the company has been granted an overdraft facility against, say, fixed deposits, of the company with the concerned bank. Current maturity of long term borrowings will also form part of borrowings. Moreover, outstanding dues in respect of credit cards

would also be considered while calculating the limit of Rs. one crore; in respect of borrowings outstanding from a bank or financial institution. It is clarified that since the words used by the Order are 'any bank or financial institution', the limit of "exceeding one crore rupees" would apply in aggregate to all borrowings and not with reference to each bank or financial institution.

Financial Institution

19. Sub section (39) of section 2 of the Act defines the term "financial institution" to include a scheduled bank, and any other financial institution defined or notified under the Reserve Bank of India Act, 1934 (2 of 1934)". The term financial institution has been defined under clause (c) of Section 45I of the RBI Act 1934 as under:-

"45I (c) "financial institution" means any ***non-banking institution*** which carries on as its business or part of its business any of the following activities, namely:–

(i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own;

(ii) the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature;

(iii) letting or delivering of any goods to a hirer under a hire-purchase agreement as defined in clause (c) of section 2 of the Hire-Purchase Act, 1972;

(iv) the carrying on of any class of insurance business;

(v) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;

(vi) collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in

lumpsum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person, [but does not include any institution, which carries on as its principal business;

(a) agricultural operations; or

(aa) industrial activity; or]

(b) the purchase or sale of any goods (other than securities) or the providing of any services; or

(c) the purchase, construction or sale of immovable property, so however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons;

Explanation.– For the purposes of this clause, ‘‘industrial activity’’ means any activity specified in sub-clauses (i) to (xviii) of clause (c) of section 2 of the Industrial Development Bank of India Act, 1964;

Further ‘‘non-banking institution’’ has been defined under clause (e) of Section 45I of RBI Act 1934 as under:-

45I (e) ‘‘non-banking institution’’ means a company, corporation (cooperative society).

Further, the term “financial institution” is also referred to in the context of the definition of a non-banking financial company as defined by the RBI Act, 1934. The term ‘‘non-banking financial company’’ has been defined under clause (f) of Section 45I of RBI Act 1934 as under:-

“45I (f) ‘‘non-banking financial company’’ means–

(i) a financial institution which is a company;

(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;

(iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify;"

Accordingly the term "financial institution" shall also cover a non-banking financial company (NBFC). A list of financial institutions covered under the Companies (Acceptance of Deposits) Rules, 2014 is given in **Appendix III** to this Guidance Note. Further, private banks or foreign banks are banking institutions under the Banking Regulation Act, 1949. Therefore, loans taken from a private bank or a foreign bank would also be taken into consideration while examining the applicability of the Order.

Revenue

20. The term, "revenue", has been defined by the Order as total revenue disclosed in Schedule III of the Act. Accordingly, the total revenue would include other income as per Schedule III. Here revenue will also include revenue from discontinuing operations as specified in the Order.

Auditor's Report to Contain Matters Specified in Paragraphs 3 and 4 of the Order

21. Every report made by the auditor under section 143 of the Act on the accounts of every company audited by him, to which this Order applies, for the financial year commencing on or after 1st April 2015 shall, in addition, contain the matters specified in paragraphs 3 and 4 of the Order **as may be applicable**. Accordingly, the reporting under this Order shall be applicable for the financial year 2015-16 and onwards. In case the auditor has to report on the financial statements for the financial year prior to 2015-16, then the

relevant earlier Order shall be applicable.

Here it is pertinent to mention that the Order specify the applicability of the matters by the words "as may be applicable", reporting on the matters specified in paragraph 3 and 4 of the Order are to be made only on those matters which are applicable to the Company.

Non-applicability to the Consolidated Financial Statements

The Order specifically provides that it shall not apply to the auditor's report on consolidated financial statements.

Period of Compliance

22. A question might arise as to the period in relation to which the auditor should comment or report upon the matters specified in the Order. For example, several of the questions relate to the maintenance of proper records. What should be the position of the auditor when records were improperly maintained for some part of the financial year but have been properly maintained at the balance sheet date? One view of the matter would be that no adverse report is necessary since the deficiencies existing during the year have been rectified before the auditor makes his report. However, this view does not recognise the fact that maintenance of records is not an end by itself but is a necessary condition for the auditor to satisfy himself regarding the authenticity of the transactions on which he is reporting. The better view, therefore, is to consider that the auditor is reporting on the state of affairs as they existed during the accounting year and compliance with the requirements of the Order should be judged with reference to the whole accounting year and not merely with reference to the position existing at the balance sheet date or the date at which he makes his report. However, in deciding whether or not to make an unfavourable comment, the auditor should consider what detrimental effect, if any, has been caused by the failure to comply with the requirements of the Order for

any part of the year. 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, if internal control with respect to the items specified in the relevant clause of the Order was inadequate during a part of the year, some detrimental effect on the company could have occurred.

At the same time, 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 balance sheet 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.

It is not necessary that the auditor should refer individually to each of the transactions throughout the year where there has not been compliance with the requirements of the Order unless the non-compliance is so significant as to merit individual attention. Normally, it should be sufficient if he indicates in general terms whether or not the requirements have been complied with.

General Approach

23. In formulating a general approach to the requirements of the Order, it is necessary to take a view regarding the objective behind the issuance of the Order. The Order does not replace an audit by an investigation in respect of the matters specified therein. Many of these matters, in any case, are covered by an auditor in the normal course of his audit and the emphasis of the Order is not, therefore, on requiring the auditor to carry out an investigation but on requiring him to give specific information on certain aspects of his work.

24. The reporting under the Order, issued under section 143(11) of the Act, is only supplemental to the audit of financial statements of the company and the auditor's report issued in terms of section 143(2) and 143(3) of the Act. Reporting under the Order should not, therefore, be construed as a separate reporting engagement. Section 143(9) of the Act, casts a duty on the auditor to comply with the auditing standards specified under section 143(10) of the Act. Hence, it should be noted that the auditor's procedures for reporting on the Order would, as in the case of audit of financial statements, need to be within the framework of the principles enunciated in the aforementioned Standards on Auditing.

25. It is possible that for the purposes of the Order, the auditor needs greater information from the management and, therefore, closer interaction with the management becomes necessary. This will ensure that there is sufficient advance planning regarding the manner in which the examination necessary for reporting on matters specified in the Order would be carried out by the auditor and the form in which the company should maintain its records so that they provide the necessary information and evidence to the auditor. An example of this would be the documents and records to be maintained by the company to provide the requisite evidence to the auditor regarding verification of fixed assets or inventories. It is, therefore, suggested that the auditor should intimate to the management, in writing, his requirements before the commencement of each audit. The auditor should also consider intimating additional requirements, if any, during the course of the audit. The auditor should also consider obtaining management representations, on matters on which the Order requires the auditor to make a statement on certain aspects.

26. For a number of reasons, the necessity for preserving working papers by the auditors assumes greater importance in the context of the requirements of the Order. Firstly, there should be evidence that the opinion expressed by the auditor

is based on an examination made by him. Secondly, there should be evidence to show that in arriving at his opinion, the auditor has given due cognisance to the information and explanations given by the company and that his opinion is not arbitrary. Thirdly, there should be evidence to show that the information and explanations obtained were full and complete, that is, the auditor has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary to be considered before arriving at his opinion. Finally, there should be evidence to show that the auditor did not merely rely upon the information or explanations given by the company but that he subjected such information and explanations to reasonable tests to verify their accuracy and completeness.

27. As the auditor needs to comply with the requirements of Standard on Auditing (SA) 230, "Audit Documentation", the auditor may take the following steps to ensure that he has adequate working papers to support the conclusions drawn in his report:

(a) submit to the company, a questionnaire on all important matters covered by the Order.

(b) make specific inquiries in writing on all important matters not covered by the questionnaire.

(c) insist that replies of the company are furnished in writing and are signed by a responsible officer of the company.

(d) where the explanations are not already separately recorded, maintain a record of the discussions with the management.

(e) prepare his own "check-list" in respect of the requirements of the Order and record the names of the members of his staff who made the examination and the name of the company's staff who provided the information. An illustrative check-list in respect of the requirements of the Order is given in **Appendix IV** to this Guidance Note.

28. Where a requirement of the Order is not complied with but the auditor decides not to make an adverse comment, in view of the immateriality of the item, he should record rationale for the same in his working papers.

29. The mere fact that the Order is confined to certain specific matters should not be interpreted to imply that the auditor's duties in respect of other matters normally covered in the course of an audit of the financial statements are, in any way, limited or abridged by the Order. At the same time, it should be recognised that the reporting obligations under the Order are confined to the specific items stated in the Order.

30. Many of the matters covered by the Order require exercise of judgement by the auditor rather than the application of a purely objective test. For example, the auditor is required to state whether any material discrepancy noticed on physical verification of fixed assets have been properly dealt with in the accounts. This requires the exercise of judgement—firstly, in determining whether the discrepancies are material, and secondly, in deciding whether the accounting treatment is proper.

31. It may be noted that while reporting on matters specified in the Order, the auditor should consider the **materiality**, in accordance with the principles enunciated in Standard on Auditing (SA) 320(Revised), *Materiality in Planning and Performing an Audit.* The auditor obtains reasonable assurance by obtaining audit evidences to reduce audit risk to an acceptable low level. Materiality and audit risk are considered throughout the audit, in particular, when determining the nature, timing and extent of further audit procedures to be performed. For example, the auditor, in case of loans granted by the company, as referred to in Clause 3(iii) of the Order, while reporting, on the repayment schedule of various loans granted, the auditor examines the loan documentation of all large loans and conducts a test check examination of the rest, having regard to the materiality.

32. It is necessary to remember that the exercise of judgement is bound to be a somewhat subjective matter. This is, in fact, recognised by the provisions of the Act which require the expression of an opinion by the auditor. When a professional expresses an opinion, he does not guarantee that his opinion is infallible nor does he hold out that his opinion will invariably agree with the opinion of another professional on the same facts. The test of an auditor's liability in a matter which involves the exercise of judgement is not whether his opinion coincides with that of another person or authority, but whether he has expressed his opinion in good faith and after the exercise of reasonable care and skill. No liability can attach to an auditor in a matter involving the expression of an opinion based on the exercise of judgement, merely because there is a difference of opinion between him and some other person or authority or merely because some other person or authority comes to the conclusion that in expressing the opinion the auditor committed an error of judgement. The auditor may be liable, however, if it is found that he has expressed his opinion without exercising reasonable care and skill, or without applying his mind to the facts, or if he has expressed his opinion recklessly, in complete disregard of the facts.

Matters to be Included in the Auditor's Report

33. The matters to be included in the auditor's report are specified in paragraph 3 of the Order. It has sixteen clauses in all. The Clause-wise Comments are given below:-

34. Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets. **[Paragraph 3(i)(a)]**

Relevant Provisions

(a) The clause requires the auditor to comment whether the company is maintaining proper records showing full particulars, including quantitative details and situation

of fixed assets. Accounting Standard (AS) 10[1], "Accounting for Fixed Assets" defines "Fixed Asset" as an "asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business".[2]

(b) The Order does not define as to what constitutes 'proper records'. In general, however, the records relating to fixed assets should contain, *inter alia*, the following details:

(i) sufficient description of the asset to make identification possible;

(ii) classification, that is, the head under which it is shown in the accounts, e.g., plant and machinery, office equipment, etc;

(iii) situation;

(iv) quantity, i.e., number of units;

(v) original cost;

(vi) year of purchase;

(vii) useful life;

(viii) residual Value;

(ix) component-wise breakup; (Wherever applicable)

(x) adjustment for revaluation or for any increase or decrease in cost;

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[1] As per revised Accounting Standard (AS) 10 (applicable from FY 2016-17),The head " Fixed Assets" replaced by "Property Plant and Equipment" which defines the term "the tangible items" that:

a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

b) are expected to be used during more than a period of twelve months".

[2] As per AS 26, Intangible Assets, an Intangible Asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

(xi) date of revaluation, if any;

(xii) rate(s)/basis of depreciation or amortisation, as the case may be;

(xiii) depreciation/amortisation for the current year;

(xiv) accumulated depreciation/amortisation;

(xv) particulars regarding impairment;

(xvi) particulars regarding sale, discarding, demolition, destruction, etc.

(c) The records should contain the above-mentioned particulars in respect of all items of fixed assets, whether tangible or intangible, self-financed or acquired through finance lease. These records should also contain particulars in respect of those items of fixed assets that have been fully depreciated or amortised or have been retired from active use and held for disposal. The records should also contain necessary particulars in respect of items of fixed assets that have been fully impaired during the period covered by the audit report.

Thus, what constitutes proper records is a matter of professional judgment made by the auditor after considering the facts and circumstances of each case.

(d) It is necessary that the aggregate original cost, depreciation or amortisation to date, and impairment loss, if any, as per these records under individual heads should reconcile with the figures shown in the books of account.

(e) It is not possible to specify any single form in which the records should be maintained. This would depend upon the mode of account keeping (manual or computerized), the number of operating locations, the systems of control, etc. It may be noted that with the widespread use of the information technology, many

companies maintain electronic records. In fact, section 2(12) of the Act, defines the terms "book and paper" and "book or paper" as including books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form". Rule 3 of the Companies (Accounts) Rules, 2014 dealing with the "manner of books of account to be kept in electronic mode" states as under:

"(1) The books of account and other relevant books and papers maintained in electronic mode shall remain accessible in India so as to be usable for subsequent reference.

(2) The books of account and other relevant books and papers referred to in sub-rule (1) shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered.

(3) The information received from branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches.

(4) The information in the electronic record of the document shall be capable of being displayed in a legible form.

(5) There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee, if any, or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law."

The Rule further explains that the term "electronic

mode" includes "electronic form" as defined in section 2(1)(r) of the Information Technology Act, 2000 and also includes an electronic record as defined in section 2(1)(t) of the Information Technology Act, 2000 (as amended by the Amendment Act of 2008)[3]. Accordingly, where any law requires that any information or matter should be in the typewritten or printed form, then such requirement shall be deemed to be satisfied if it is in an electronic form. However, 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.

Audit Procedures and Reporting

(f) The auditor may, therefore, accept fixed assets register in electronic form if the following two conditions are satisfied:

(i) The controls and security measures in the company are such that once finalised, the fixed assets register cannot be altered without proper authorization and audit trail.[4]

(ii) The fixed assets register is in such a form that it can be retrieved in a legible form. In other words, the emphasis is on whether it can be read

[3] Section 2(r) of the Information Technology Act, 2000 defines "electronic form" as follows:

"electronic form" with reference to information means any information generated, sent, received or stored in media, magnetic, optical, computer memory, micro film, computer generated micro fiche or similar device"

Section 2(t) of the information Technology Act, 2000 defines "electronic records" as follows:

"electronic record" means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer generated micro fiche."

[4] In this context, attention of the members is also drawn to Standard on Auditing (SA) 315, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment" as also the "Guidance Note on Audit of Internal Financial Controls Over Financial Reporting", issued by ICAI.

on the screen or a hard copy can be taken. If this is so, one can contend that it is capable of being retrieved in a legible form.

In case the above two conditions or either of the two conditions are not satisfied, the auditor should obtain a duly authenticated print-out of the fixed assets register. In case the auditor decides to rely on electronically maintained fixed assets register, he should maintain adequate documentation evidencing the evaluation of controls that seek to ensure the completeness, accuracy and security of the register.

(g) The purpose of showing the situation of the assets is to make verification possible. There may, however, be certain classes of fixed assets whose situation keeps changing, for example, construction equipment which has to be moved to sites. In such circumstances, it should be sufficient if record of movement/custody of the equipment is maintained.

(h) Where assets like furniture, etc., are located in the residential premises of members of the staff, the fixed assets register should indicate the name & designation of the person who has custody of the asset for the time being.

(i) While, generally, the quantity, value and situation have to be recorded item-wise, assets of small individual value, e.g., chairs, tables, etc., may be conveniently grouped for purposes of entry in the register. Similarly, for assets having same useful life, it may not be necessary to indicate the accumulated depreciation for each item; instead, depreciation for the group as a whole may be shown.

(j) Quantitative details in respect of fixed assets may be maintained on the following lines:

(i) Land may be identified by survey numbers and by

deeds of conveyance.

(ii) Leaseholds can be identified by individual leases.

(iii) Buildings may, initially, be classified into factory buildings, office buildings, township buildings, service buildings (like water works), etc. These may then be further sub-divided. Factory buildings may be further classified into individual buildings which house a manufacturing unit or a plant or sub-plant. Service buildings may be similarly classified according to nature of service and location. Township buildings can be further classified into individual units or into groups of units taking into consideration the type of construction, the location and the year of construction. For example, if a company's township has four categories of quarters, e.g., A, B, C and D, the fixed assets register may not record each individual quarter but may have a single entry for all 'A' type quarters constructed in a particular year and located in a particular area and show only the number of quarters covered by the entry.

(iv) Railway sidings can be identified by length and location.

(v) Plant and Machinery may be sub-divided into fixed and movable. For movable machinery, a separate record may be kept for each individual item. Movable machinery would include, for this purpose, items of plant which are for the moment fixed to the shop-floor but which can be moved, e.g., machine tools. In respect of fixed plant and machinery, a sub-division can be made according to the process, a plant for each separate process being considered as a separate identifiable unit. A further sub-division may be useful when within a

process, there are plants which are capable of working independently of each other. The degree to which a sub-division of fixed plant and machinery should be made depends upon the circumstances of each case bearing in mind the objectives of sub-division, namely, the determination of individual cost and the facility for physical verification and componentisation[5].

(vi) Furniture and fittings and assets like office appliances, air-conditioners, water coolers, etc., consist of individual items which can be easily identified. Some difficulty may, however, be faced with regard to the large number of items and their relative mobility. In such cases, a distinction by value may be necessary, individual identification being made for high-value items and by groups for other items.

(vii) Development of property is an asset head which can be easily sub-divided according to the buildings or plant for which the development work is undertaken.

(viii) Patents, trademarks and designs are normally identifiable by the purchase agreements or the letters granting patent and by registration references in case of trademarks and designs. Intangible assets can be identified by reference to the purchase agreements (in case an intangible asset has been purchased) and by reference to the records and documents that substantiate the costs incurred by the company in the generation and development of an intangible asset.

(ix) Vehicles can be identified by reference to the registration books.

[5] Attention of the readers is invited to the requirements of Schedule II to the Companies Act 2013 in respect of componentisation.

(k) In cases where the details regarding allocation of cost over identified units of assets are not available, it would have to be made by an analysis of the purchases and the disposals of the preceding years. Among the difficulties which may be faced could be: (i) records for some of the years may not be available; (ii) the description in the records may not be complete; (iii) details of disposals may not have been properly recorded; (iv) subsequent additions to an existing asset may have been shown as a separate asset; (v) a single figure of cost may be assigned to a number of assets which have to be separately identified; (vi) assets purchased for one department may have been moved to other departments, and so on. The management, in consultation with the auditor, should make the best effort possible under the circumstances to identify the cost of each asset. In doing so, reasonable assumptions or approximations may be made, where necessary. For example, when details of disposals are not available, it may be assumed that the asset sold is the asset which was acquired earliest in point of time. Similarly, when the individual cost of a large number of small items is not available, one can estimate the cost of each item and pro-rate the total cost in the proportion of the estimated cost of the item to the aggregate estimated cost.

(l) It may be useful if initial identification of assets is done by persons who are familiar with them, e.g., the maintenance staff. At the point of identification, a code number may be affixed on the asset which would give sufficient details for future identification.

(m) The initial identification of assets will often reveal a number of discrepancies between the assets as verified and the details compiled from the records. This may be on account of the features already considered in (k) above. This may also be due to the fact that assets might have been scrapped in earlier years but

proper documentation may not have been made or that assets may have been broken up into smaller units or amalgamated into larger units or otherwise modified without changing the asset records. The degree of further inquiry necessary to reconcile these discrepancies would depend upon the nature of the asset, its cost, the age of the asset, the extent of accounting or other records available and other relevant factors. However, the concept of materiality should be borne in mind in making these further inquiries, greater attention being devoted to assets which are of large value or of relatively recent purchase. Any adjustments that finally have to be made should be properly documented. The auditor should request the appropriate level of management to carry out necessary adjustments.

***35. Whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;* [Paragraph 3(i)(b)]**

Relevant Provisions

(a) The clause requires the auditor to comment whether the fixed assets of the company have been physically verified by the management at reasonable intervals. The clause further requires the auditor to comment whether any material discrepancies were noticed on such verification and if so, whether those discrepancies have been properly dealt with in the books of account.

(b) Physical verification of the assets is the responsibility of the management and, therefore, has to be carried out by the management itself and not by the auditor. It is, however, necessary that the auditor satisfies himself that such verification was done and that there is adequate evidence on the basis of which he can arrive

at such a conclusion. The auditor may prefer to observe the verification, particularly when verification of all assets can be made by the management on a single day or within a relatively short period of time. If, however, verification is a continuous process or if the auditor is not present when verification is made, then he should examine the instructions issued to the staff (which should, therefore, be in writing) by the management and should examine the working papers of the staff to substantiate the fact that verification was done and to determine the name and competence of the person who did the verification. In making this examination, it is necessary to ensure that the person making the verification had the necessary technical knowledge where such knowledge is required. It is not necessary that only the company's staff should make verification. It is also possible for verification to be made by outside expert agencies engaged by the management for the purpose.

Audit Procedures and Reporting

(c) The auditor should examine whether the method of verification was 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. It would not be realistic to expect the management 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. It may not be necessary to verify assets like

building by measurement except where there is evidence of alteration/demolition. At the same time, in view of the possibility of encroachment, adverse possession, etc., it may be necessary for a survey to be made periodically of open land.

(d) It is advisable that the assets are marked with "distinctive numbers" especially where assets are movable in nature and where verification of all assets is not being conducted at the same time.

(e) The Order requires the auditor to report whether the management" has verified the fixed assets at reasonable intervals. What constitutes "reasonable intervals" depends upon the circumstances of each case. The factors to be taken into consideration in this regard include the number of assets, the nature of assets, the relative value of assets, difficulty in verification, situation and geographical spread of the location of the assets, etc. The management may decide about the periodicity of physical verification of fixed assets considering the above factors. While an annual verification may be reasonable, it may be impracticable to carry out the same in some cases. Even in such cases, the verification programme should be such that all assets are verified at least once in every three years. 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.

(f) The auditor is required to state whether any material discrepancies were noticed on verification and, if so, whether the same have been properly dealt with in the books of account. The latter part of the statement is required to be made only if the discrepancies are material. The auditor has, therefore, to use his judgement to determine whether a discrepancy is

material or not. In making this judgement, the auditor should consider not merely the cost of the asset and its relationship to the total cost of all assets but also the nature of the asset, its situation and other relevant factors. If a material discrepancy has been properly dealt with in the books of account (which may or may not imply a separate disclosure in the accounts depending on the circumstances of the case), it is not necessary for the auditor to give details of the discrepancy or of its treatment in the accounts but 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.

36. Whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof; [Paragraph 3(i)(c)]

Relevant Provision

(a) The clause requires the auditor to comment whether the title deeds of immovable properties are held in the name of the company, if not, to provide the details thereof. This clause shall cover the immovable properties which are included under the head Fixed Assets, as the reporting under Clause 3(i)(a) & 3(i)(b) pertains to Fixed Assets only.

(b) The Act does not define the term "Immovable Property". However, as per General Clauses Act, 1897, "Immovable Property" shall include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth.

Audit Procedures and Reporting

(c) Based on review of the Fixed Assets Register, the auditor is required to identify immovable properties and verify the title deeds of such immovable

properties. TDRs(Transfer Development Rights), Plant and Machinery embedded in land etc., are not considered as an immovable property.

(d) The Order is silent as to what constitutes 'title deeds'. In general, title deeds means a legal deed or document constituting evidence of a right, especially to the legal ownership of the immovable property.

(e) Following documents mainly constitute title deeds of the immovable property:-

(i) Registered sale deed / transfer deed / conveyance deed, etc. of land, land & building together, etc. purchased, allotted, transferred by any person including any government, government authority / body/ agency / corporation, etc. to the company.

(ii) In case of leasehold land and land & buildings together, covered under the head fixed assets, the lease agreement duly registered with the appropriate authority.

(f) The auditor should carry out detailed examination in the cases where immovable property is transferred as a result of conversion of partnership firm or LLP into company or amalgamation of companies, as in such cases title deeds may be in the name of the erstwhile entity.

(g) Where the title deeds of the immovable property have been mortgaged with the Banks/ Financial Institutions, etc., for securing the borrowings and loan raised by the company, a confirmation about the same should be sought from the respective institution to this effect. The auditor may also consider verifying this information from the online records, if available, of the relevant State.

(h) There may be instances where the title deeds were lost

accidentally or otherwise. In such cases, the certified copies of the documents, as available with the company, and details about the FIR filed, about loss of such documents needs to be obtained and documented. The auditor should also seek written representation from the management in this regard.

(i) The management is responsible for legal determination of the validity of title deeds, the auditor may refer SA 250 "Consideration of Laws and Regulations in an audit of Financial Statements" to the extent considered relevant and obtain sufficient and appropriate audit evidence. Further any discrepancy, including any pending/disputed court cases relating to ownership, needs detailed discussion with the management and should be properly documented. In this context, the auditor may also consider communicating with the legal counsel, whether in-house or external, in accordance with the principles enunciated in SA 501, *Audit Evidence – Specific Considerations for Selected Items.* The auditor may also consider disclosing the dispute while reporting under this clause.

(j) The auditor should verify the title deeds available and reconcile the same with the fixed assets register. The scrutiny of the title deeds of the immovable property may reveal a number of discrepancies between the details in the fixed assets register and the details available in the title deeds. This may be due to various reasons which needs to be examined.

(k) The reporting under this clause, where the title deeds of the immovable property are not held in the name of the Company, may be made incorporating following details, in the form of a table or otherwise:

a. In case of land:-

total number of cases,

whether leasehold / freehold,

gross block and net block, (as at Balance Sheet date), and

remarks, if any.

b. In case of Buildings:-

Total number of cases,

gross block & net block, (as at Balance Sheet date) and

remarks, if any.

37. *Whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account;* [Paragraph 3(ii)]

Relevant Provisions

(a) The clause requires the auditor to comment whether the management has conducted physical verification of inventory at reasonable intervals. The clause also requires the auditor to comment whether any material discrepancies were noticed on physical verification of inventory and if so, whether those material discrepancies have been properly dealt with in the books of account.

(b) According to Accounting Standard (AS) 2, "Valuation of Inventories":

"Inventories are assets:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services."

(c) Inventories encompass goods purchased and held for resale, for example, merchandise purchased by a

retailer and held for resale, computer software held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the enterprise and include materials, maintenance supplies, stores and spares, consumables and loose tools awaiting use in the production process. It may be noted that packing materials are also included in inventories. Inventories do not include machinery spares covered by Accounting Standard (AS) 10, "Accounting for Fixed Assets", which can be used only in connection with an item of fixed asset and the use of which is expected to be irregular[6].

Audit Procedures and Reporting

(d) Physical verification of inventory is the responsibility of the management of the company which should verify all material items at least once in a year and more often in appropriate cases. It is, however, necessary that the auditor satisfies 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. For example, the auditor may examine the documents relating to physical verification conducted by the management during the year as also at the end of the financial year covered by the auditor's report.

(e) What constitutes "reasonable intervals" depends on circumstances of each case. The periodicity of the physical verification of inventories depends upon the nature of inventories, their location and the feasibility of

[6] Here it may be noted that AS-2 has been amended effective from 2016-17 which describe the same as "Inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS 10, "Property, Plant and Equipment".

conducting a physical verification. The management of a company normally determines the periodicity of the physical verification of inventories considering these factors. Normally, wherever practicable, all the items of inventories should be verified by the management of the company 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.

(f) The Order further requires the auditor to examine whether material discrepancies have been noticed on verification of inventories when compared with book records. Such an examination is possible when quantitative records are maintained for inventories but in many cases circumstances may warrant that records of individual issues (particularly for stores items) are not separately maintained and the closing inventory is established only on the basis of a year-end physical verification. Where such day-to-day records are not maintained, the auditor will not be able to arrive at book inventories except on the basis of an annual reconciliation of opening inventory, purchases and consumption. This reconciliation is possible when consumption in units can be co-related to the production, or can be established with reasonable accuracy. Where such reconciliation is not possible, the auditor would be unable to determine the discrepancies. If the item for which the discrepancy cannot be established is not material, the discrepancy, if any, will also not be material. For example, an item categorised as 'C' in ABC analysis might not be material and therefore, the discrepancy, if any, in regard to such an item would not be material. In other cases, however, the auditor will have to report that he is unable to determine the discrepancy, if any, on

physical verification for the item or class of items to be specified.

38. *Whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,*

a) Whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;

b) Whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

c) If the amount is overdue, state the total amount overdue for more than 90 days, and whether reasonable steps have been taken by the company for recovery of the principal and interest. [Paragraph 3(iii)]

Relevant Provisions

(a) There are three clauses under paragraph 3(iii) of the Order. It is clarified that the auditor's comments on all the three clauses are to be made with reference to the loans granted to companies, firms, limited liability partnerships or other parties covered in the register maintained under section 189 of the Act.

(b) Clause 3(iii)(a) covers determination of terms and conditions at the time of the grant of the loan. In this regard it may be noted that though the clause uses the term "grant" which would ordinarily be understood to mean loans granted/given during the year, however, it may be appropriate to include such loans also that were renewed during the year. Clauses 3(iii)(b) and 3(iii)(c) cover the loans granted during the year and also all loans having opening balances.

Audit Procedures and Reporting

(c) The duty of the auditor, under this clause, is to determine whether the company has granted any loans, secured or unsecured to companies, firms, limited liability partnerships or other parties covered in the register maintained under section 189 of the Act. If the company has done so, the auditor should report on the matters specified in sub-clauses (a), (b) and (c) of the clause 3(iii). The auditor is required to disclose the requisite information in his report in respect of all parties covered in the register maintained under section 189 of the Act irrespective of the period to which such loan relates. 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 as specified in sub-clauses (a), (b) and (c) of the clause 3(iii), in his report in respect of all kind of loans whether long term or short term, whether given in cash or in kind to the parties covered in the register maintained under section 189 of the Act.

(d) Under section 189 of the Act, every company is required to maintain one or more registers which contain the particulars of all contracts or arrangements to which sub-section (2) of section 184 or section 188 of the Act applies. The particulars of all contracts or arrangements in which directors are interested is required to be maintained by every company in Form MBP-4 as specified in Rule 16(1) of the Companies (Meetings of Board and its Powers) Rules, 2014. It is, however, suggested that the auditor should acquaint himself with all the requirements of sections 184, 188 and 189 of the Act and rules there under.

(e) The auditor should obtain a list of companies, firms, limited liability partnerships or other parties covered in the register maintained under section 189 of the Act from the management. The auditor may also consider

verifying returns filed or certificates obtained by the management in this regard. The auditor should examine all loans (secured or unsecured) granted by the company to identify those loans granted to companies, firms, limited liability partnerships or other parties covered in the register maintained under section 189 of the Act.

(f) It may so happen that a party listed in the register maintained under section 189 of the Act might have taken a loan from a company and repaid it during the same financial year. Therefore, while examining the loans, the auditor should also take into consideration the loan transactions that have been squared-up during the year and report such transactions under this clause. For example, the company has, during the financial year, granted a loan of Rs. 1,00,000/- to a firm in which one of the directors of the company is interested and the firm repays the loan during the financial year concerned. The auditor is also required to consider such transaction while commenting upon this clause of the Order.

A. Whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest; [Paragraph 3(iii)(a)]

Relevant Provision

(a) This clause, read with Paragraph 3(iii) of the Order, requires the auditor to examine and comment whether the terms and conditions of loans granted by the company (whether secured or unsecured) to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Act are prejudicial to the interest of the company.

Audit Procedures and Reporting

(b) The auditor should examine agreements entered into by the company with the parties covered in the register

maintained under section 189 of the Act or any other supporting documents available for ascertaining the terms and conditions of all loans granted by the company to such companies, firms, Limited Liability Partnerships or other parties.

(c) The auditor's duty is to determine whether, in his opinion, the terms and conditions of the loans given are prejudicial to the interest of the company. The "terms and conditions" would primarily include rate of interest, security, terms and period of repayment and restrictive covenants, if any. In determining whether the terms of the loans are prejudicial, the auditor would have to give due consideration to the other factors connected with the loan, including its ability to lend, terms of its borrowings, borrower's financial standing, credit rating, if available, the nature of the security, rate of interest and so on.

For the purpose of reporting under this clause the auditor may consider clause (7) of Section 186 of the Act wherein it is specified that no loan, covered under this section, shall be given at a rate of interest lower than the prevailing yield of one year, three year, five year or ten year government security closest to the tenor of the loan, to the extent applicable.

(d) It may be mentioned that clause (a) of sub-section (1) of section 143 of the Act also requires the auditor to inquire whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members. The auditor's inquiry under the aforesaid clause may also be useful for the purposes of reporting under this clause.

(e) Further, the auditor may also come across a situation where the company has a policy of providing loans at concessional rates of interest to its employees and

such a loan has been given to a relative of the director who is also an employee of the company. In such a case also, the auditor would be required to examine and comment whether loan is prejudicial to the interests of the company. It may, however, be noted that normally such terms as per the policy followed by the company cannot be said to be prejudicial to the interest of the company if other employees of the company also receive the loan on the same terms.

(f) The following is an example of an unfavourable comment by the auditor under this clause:

"According to the information and explanations given to us and based on the audit procedures conducted by us, we are of the opinion that the terms and conditions of loans granted by the company to two parties covered in the register maintained under section 189 of the Companies Act, 2013, (total loan amount granted Rs ---- and balance outstanding as at balance sheet date Rs --------) are prejudicial to the company's interest on account of the fact that the loans have been granted at an interest rate of X% per annum which is significantly lower than the cost of funds to the company and also lower than the prevailing yield of government security close to the tenor of the loan"

B. Whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular; [Paragraph 3(iii)(b)]

Relevant Provision

(a) This part of the clause requires the auditor to report upon the stipulation of schedule of repayment of principal and payment of interest and on regularity of repayments of principal amount of loans and receipts of interest thereon. The scope of auditor's inquiry under this clause is restricted in respect of companies, firms,

Limited Liability partnerships or other parties covered in the register maintained under section 189 of the Act.

Audit Procedures and Reporting

(b) The auditor has to examine from the loan agreements / mutually agreed letter of arrangement, as the case may be, whether the schedule of repayment of principal and payment of interest has been stipulated at the time of sanction. If there is no such agreement / arrangement or the agreement / arrangement does not contain the schedule of repayment of principal and payment of interest, the auditor shall report that there is no stipulation of schedule of repayment of principal and payment of interest.

(c) The auditor has to examine whether the repayment of principal and receipt of interest are regular. The word 'regular' should be taken to mean that the principal and interest should normally be received whenever they fall due, respectively.

(d) In case where the auditee company is a non-banking financial company, the auditor, for reporting under this clause, would also need to refer various directions for non-banking financial companies issued by Reserve Bank of India.

(e) In case of non-stipulation of schedule of repayment of principal & payment of Interest, the auditor should state the fact and may report that he is unable to make specific comment on the regularity of repayment of principal & payment of interest, in such cases.

(f) In case where the schedule of repayment of principal & payment of interest is stipulated but repayment of principal or payment of interest is not regular then the auditor may report the fact and may give no. of cases and remarks, if any.

C. If the amount is overdue, state the total amount overdue for more than 90 days, and whether reasonable steps have been taken by the company for recovery of the principal and interest. [Paragraph 3(iii)(c)]

Relevant Provision

(a) This clause requires the auditor to state the total amount overdue for more than 90 days and whether reasonable steps have been taken by the company for recovery of the principal and interest. An amount is considered to be overdue when the payment has not been received on the due date as per the lending arrangement. In such cases, the auditor has to examine the steps, if any, taken for recovery of this amount. It may, however, be noted that 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 under section 189 of the Act.

Audit Procedures and Reporting

(b) Under this clause, the auditor is required to disclose total amount overdue for more than 90 days. The auditor should examine the agreement or other documents containing the schedule of repayment of the loans granted to parties covered in the register maintained under section 189 of the Act. The auditor should then verify whether the repayments as per the books of account are in accordance with the schedule of repayment of the loans as per agreement or arrangement. This examination would enable the auditor to determine the total amount overdue (principal and interest) for more than 90 days from such parties as at balance sheet date. The auditor should disclose the aggregate of the total amount of overdue for more

than 90 days in respect of loans granted to such parties.

(c) While examining whether reasonable steps have been taken by the company for recovery of principal and interest, the auditor would have to consider the facts and circumstances of each case, including the amounts involved. 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. The auditor is not, therefore, required to comment on the mere absence of legal steps if he is otherwise satisfied that reasonable steps have been taken by the company. 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 granted by the company. The auditor should ask the management to give in writing, the steps which have been taken. The auditor should arrive at his opinion only after consideration of the management's representations and other relevant evidence.

(d) Reporting of such cases may be made incorporating following details:

No. of Cases

Principal Amount Overdue

Interest Overdue

Total Amount Overdue

Remarks, if any (specify whether reasonable steps have been taken by the Company for recovery of principal amount and interest)

39. In respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof. [Paragraph 3(iv)]

A. Compliance of Section 185 of the Companies Act 2013: Loan to directors, etc.

Relevant Provisions

(a) Under this clause the auditor is required to report on the compliance of Section 185 of the Act. The text of section 185 is reproduced in **Appendix V** to this Guidance Note.

Audit Procedures and Reporting

(b) For this purpose, the auditor should carry out the following procedures:

(i) Obtain from the management the details of the directors or any other person in whom the director is interested. He may also check the details of the persons covered under this clause from Form MBP-1 and from the Register maintained u/s 189 of the Act.

(ii) Obtain and check the details of the transactions carried out with such persons, including of any guarantee given and security provided.

(iii) Further examine the details to find out whether any of the transaction is attracting the provisions of section 185 of the Act.

(iv) In case of transactions that are covered under the exceptions as provided under section 185, the auditor should obtain the necessary evidence in support of such exception.

(c) Section 185 prohibits advance of any loan to directors, etc., directly or indirectly. What is an indirect loan is not defined in section 185 or elsewhere in the Act. Indirect

is interpreted in case of Dr. Fredie Ardeshir Mehta v. Union of India [1991] 70 Comp. Cas. 210 (Bom.) to mean a loan to a director through the agency of one or more intermediaries. For example, if company A borrows from company B and lends the same to company C and loan from B to C is covered by section 185. In this case section 185 shall also be applicable in case of lending from company A to C because it would be construed as an indirect loan from B to C.

(d) The auditor should report the nature of non-compliance, the maximum amount outstanding during the year and the amount outstanding as at the balance sheet date in respect of

(i) the Directors; and

(ii) persons in whom directors are interested (specify the relationship with the Director concerned).

B. Compliance of Section 186 of the Companies Act 2013: Loan and investment by company

Relevant Provisions

(a) Under this clause the auditor is also required to report on the compliance of Section 186 of the Act, which governs giving of loans, and guarantee or providing and security in connection with a loan, by a company to any person or other body corporate and acquiring securities of any other body corporate by a company. The section also prohibits a company from making investments through more than two layers of investment companies. The text of Section 186 and relevant extract of Rules 11, 12 & 13 of Companies (Meeting of Board and its Powers) Rules, 2014 is reproduced in **Appendix V** to this Guidance Note.

Audit Procedures and Reporting

(b) The duty of the auditor under this clause is to determine whether the loans and investments made by

the company comply with the requirements of the provisions of Section 186 of the Act.

For this purpose, the auditor should:

(i) Obtain the details of, loans given to any person or other body corporate, guarantee given or security provided in connection with a loan to any other body corporate or person and securities acquired of any other body corporate by way of subscription, purchase or otherwise, made during the year as well as the outstanding balances as at the beginning of the year.

(ii) Check whether, at any point of time during the year in case of aforesaid transactions, the company has exceeded the limit of sixty per cent of its paid-up share capital, free reserves and securities premium account or one hundred per cent of its free reserves (as defined in section 2(43) of the Act and securities premium account, whichever is more.

If it exceeds the limits specified above, whether prior approval by means of a special resolution passed at a general meeting has been obtained.

(iii) Check whether the company has made investments through more than two layers of investment companies. [7]

(iv) Check whether the company has disclosed the full particulars of the loan given, investment made or guarantee given or security provided in the financial statement including the purpose for which the same is proposed to be utilized by the recipient.

[7] The Sub section 1 of Section 186 which restricts investment through more than two layers of investment companies is proposed to be deleted by Companies (Amendment) Bill, 2016 pending at appropriate level for approval.

(v) Check whether the company has passed the board resolution as prescribed and obtained the prior approval, wherever required, from the public financial institution concerned where any term loan is subsisting.

(vi) Check whether the loan has been given to company registered under section 12 of the Securities and Exchange Board of India Act, 1992, if so, whether the inter-corporate loan or deposits taken by such company are within the limits prescribed, if so, obtain the certificate of statutory auditors of that company from the management to ensure the compliance.

(vii) Check whether rate of interest is not lower than the prevailing yield of one year, three year, five year or ten year government security closest to the tenor of the loan granted.

(viii) Check if the company is in default in the repayment of any deposits accepted or in payment of interest thereon, then the company is not allowed to give any loan or guarantee or any security or an acquisition till such default is subsisting.

(ix) Check whether the company has maintained a register (as per Form MBP-2) in the manner as prescribed and also check the compliances of other provisions and relevant rules.

(x) It may be noted that the aforesaid section is not applicable in respect of loan made, guarantee given or security provided by banking company or an insurance company or a housing finance company in the ordinary course of its business or a company engaged in the business of financing of companies or of providing infrastructural facilities. However the restriction with regard to the investment through more than two layers of investment companies would be applicable for

such companies also. The auditor may ensure compliance accordingly.

(c) It may also be noted that the provisions of section 186 of the Act shall not apply to a government company engaged in defence production and a government company, other than a listed company, in case such company obtains approval of the ministry or department of the central government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security or making any investment under the section. [vide Notification F. No. 1/2/2014-CL.V dated 5th June 2015]

Non-compliance may be reported incorporating following details:-

S. No.	Non-compliance of Section 186				Remarks, if any
		Name of Company/ Party	Amount Involved	Balance as at Balance Sheet	
1.	Investment through more than two layers of investment companies				
2.	Loan given or guarantee given or security provided or acquisition of securities				

	exceeding the limits without prior approval by means of a special resolution				
3.	Loan given at rate of interest lower than prescribed				
4.	Any other default				

40. ***In case, the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act, 2013 and the rules framed thereunder, where applicable, have been complied with? If not, the nature of such contraventions be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal, whether the same has been complied with or not?*** **[Paragraph 3(v)]**[8]

Relevant Provisions

(a) The clause, in addition to requiring the auditors to report on compliance with the requirements of sections 73 to 76 of the Act, and the directives of the Reserve Bank of India for acceptance of public deposits, also requires the auditor to report on compliance with the

[8] The text of sections 73 to 76 of the Act is reproduced in **Appendix XII** to this Guidance Note. The text of the Companies (Acceptance of Deposits) Rules, 2014 is given in **Appendix XIII** to this Guidance Note**.**

order, if any, passed by the Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal.

(b) Section 2(31) has defined 'deposit' to include any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India.

(c) Section 73 of the Act, prohibits a company (other than a banking company, non-banking financial company (NBFC) and such other company as may be specified by the central government in consultation with the Reserve Bank of India), to invite, accept or renew deposits from the public except in the manner provided in this section and the Companies (Acceptance of Deposits) Rules, 2014.

(d) Section 76 of the Act, permits the public companies having specified net worth or turnover, to accept deposits from persons other than its members subject to compliance with section 73 and the Companies (Acceptance of Deposits) Rules, 2014.

(e) The central government in consultation with the Reserve Bank of India has notified the Companies (Acceptance of Deposits) Rules, 2014. These Rules are not applicable to a banking company, a NBFC, a housing finance company and a company specified by the central government under the proviso to sub-section (1) of section 73 of the Act.

(f) The Companies (Acceptance of Deposits) Rules, 2014 cover the following main items:

(i) the nature of deposits which may be accepted;

(ii) the terms and conditions of acceptance of deposits by companies from its members and persons other than its members;

(iii) the limits up to which the deposits can be

accepted;

(iv) the form and particulars of advertisement for deposits;

(v) the form of application for deposits;

(vi) furnishing of deposit receipts to depositors;

(vii) Maintenance of liquid assets, creation of security and appointment of trustee for depositors;

(viii) maintenance of register(s) of depositors;

(ix) Manner and extent of deposit insurance;

(x) general provisions regarding the repayment of deposits and payment of interest;

(xi) the returns to be filed with the Registrar of Companies.

Audit Procedures and Reporting

(g) The auditor should plan to test for compliance with the provisions of sections 73 to 76 of the Act and the Rules made thereunder i.e. the Companies (Acceptance of Deposits) Rules, 2014. For such purpose, the auditor should also obtain an understanding of the requirements of sections 73 to 76 and rules thereunder.

(h) The auditor should examine compliance by the company with regard to all the matters specified in the sections and the Rules and not merely to the limits of the deposits. Where the number of deposits is very large, it is obviously not feasible for the auditor to satisfy himself that every single deposit complies with the rules. He should, therefore, 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. 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.

(i) The auditor should examine the efficacy of the 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. For financing companies, the auditor should make a similar examination having regard to the Reserve Bank directives in force from time to time.

(j) Apart from the audit procedures mentioned above, the auditor should also enquire from the management about the possible instances of non-compliance with sections 73 to 76 or any other relevant provisions of the Act and the relevant rules. The auditor should also enquire from the management about any order passed by the Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal for contravention of these sections or any other relevant provision(s) of the Act and the relevant rules. The auditor should obtain a management representation to the effect whether:

(i) the company has complied with the directives issued by the Reserve Bank of India and the provision of section 73 to 76 (as the case may be) of the Act and the relevant rules; and

(ii) where an order has been passed by any of the relevant authorities mentioned in the clause, and if so, the company has complied with the requirements of the Order.

(k) In case where the auditor is of the view that any kind of contravention of sections 73 to 76 or any other relevant provisions of the Act or relevant rules or directives from Reserve Bank of India, if any, has taken place, the auditor should state in his report that the provisions of that section(s) and/or relevant rules, as the case may

be, have not been complied with. The auditor should also report the nature of contraventions.

(l) The auditor, under this clause, is required to verify whether the company has complied with the order passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal. Where any of such authorities has passed an order, the auditor should examine the steps taken by the company to comply with the said order. If the company has not complied with the order, the same is to be reported stating therein the nature of contravention and the fact that the company has not complied with the order issued by the Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal.

41. *Whether maintenance of cost records has been specified by the Central Government under sub-section (1) of Section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.* [Paragraph 3(vi)]

Relevant Provisions

(a) Section 148(1) of the Act, specifies that the Central Government may, by order, in respect of such class of companies engaged in production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilization of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies. Pursuant to this requirement and in exercise of the powers conferred by sub-section (1) of section 469 of the Act, the Central Government has made rules in respect of a number of classes of companies. These books of account and records form part of the books of account of the company within the meaning of Section 2(13) of the Act.

In exercise of the power conferred by sub-section (1) and (2) of section 469 and section 148 of the Act, the Central Government has issued the Companies (Cost Records and Audit) Rules, 2014 which has specified the list of class of companies in which maintenance of cost record is prescribed under section 148 of the Act. The Companies (Cost Records and Audit) Rules, 2014 are reproduced in **Appendix VI** to this Guidance Note**.**

(b) The Companies (Cost Records and Audit) Rules, 2014 has defined "cost records" as books of account relating to utilization of materials, labour and other items of cost as applicable to the production of goods or provision of services as provided in section 148 of the Act, and these rules. These rules also prescribed the items of cost to be included in the Books of Account.

(c) Sub-section (2) of Section 148 of the Act, also provides that where, in the opinion of the Central Government, it is necessary to do so it may by order, direct that the audit of cost records of class of companies, which are covered under sub-section (1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

(d) Rule 4 of the aforesaid Rules lays down the conditions subject to which the companies covered by these Rules need to get their cost records audited.

Audit Procedures and Reporting

(e) The Order 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 central government. The auditor should obtain a written representation from

the management stating (a) whether cost records are required to be maintained for any product(s) or services of the company under section 148 of the Act, and the Companies (Cost Records and Audit) Rules, 2014; and (b) whether cost accounts and records are being made and maintained regularly. The auditor should also obtain a list of books/records made and maintained in this regard. The Order does not require a detailed examination of such records. The auditor should, therefore, conduct a general review of the cost records to ensure that the records as prescribed are made and maintained. He should, of course, make such reference to the records as is necessary for the purposes of his audit.

(f) It is necessary that the extent of the examination made by the auditor is clearly brought out in his report. The following wording is, therefore, suggested:

"We have broadly reviewed the books of account maintained by the company pursuant to the Rules made by the Central Government for the maintenance of cost records under section 148 of the Act, and are of the opinion that *prima facie*, the prescribed accounts and records have been made and maintained."

(g) Where the auditor finds that the records have not been written or are not *prima facie* complete, it will be necessary for the auditor to make a suitable comment in his report.

***42. Whether the company is regular in depositing undisputed statutory dues including Provident Fund, employees' State Insurance, Income-tax, Sales-tax, Service Tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated*; [Paragraph 3(vii)(a)]**

Relevant Provisions

(a) This clause requires the auditor to report upon the regularity of the company in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of custom, duty of excise, value added tax, cess and any other statutory dues to appropriate authorities. If the company is not regular in depositing the above mentioned undisputed statutory dues, the auditor is required to state the extent of arrears of statutory dues which have remained outstanding as at the last day of the financial year concerned for a period of more than six months from the date they became payable.

(b) It may be noted that the use of the words "any other statutory dues" indicates that the clause covers all type of dues under various statues which may be applicable to a company having regard to its nature of business. Apart from the statutory dues listed, the auditor is required to report on the regularity of the company in depositing "any other statutory dues" payable by the company to appropriate authorities under the statutes applicable to the company.

(c) The intention of the government, in 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. 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. 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" for the purpose of this clause. In other words, 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. Thus, examples of "statutory dues" would include municipal taxes, taxes deducted at source, fees payable to the licensing authority in respect of business being carried on under license granted by an authority, say a cinema hall. Accordingly, 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. However, care shall have to be taken that in case any dues are recoverable as arrears of land revenue by the concerned authority, the same shall be treated as a statutory due.

(d) With reference to regularity, it is also important to distinguish amongst the various items stated in the clause. The auditor should very clearly understand the nature of each statutory due payable by the company while examining the aspect of regularity before commenting on the same. For instance, the regularity is a normal feature in case of certain statutory dues such as, provident fund, employees' state insurance, sales tax, etc., because the companies are required to deposit the money with appropriate authorities on a monthly or quarterly basis. But this is not the case in respect of, say, duty of custom 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 and when they become due. 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.

(e) An important issue to consider is the question of regularity of payment of import duty where the goods had been imported, say, five years back and were placed in the bonded warehouse and even till the end of the financial year under audit, the goods have not been removed from such warehouse. It may be noted that when the imported goods are lodged in a bonded warehouse, the payment of import duty is to be made when the goods are removed from the bonded warehouse. Till the time[9] the importer opts to remove the goods from the warehouse, the importer is required to incur the rent and interest expenditure on the amount of customs duty payable. 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. However, it may be noted that the interest and rent that are required to be incurred under section 61 of the Customs Act, 1962 would come under other statutory dues and the auditor would have to examine and comment upon the regularity of the company in depositing such interest and rent.

(f) Non-payment of advance income tax would constitute default in payment of statutory dues. 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

[9] It may be noted that section 61 of the Customs Act, 1962 provides that any goods deposited in the warehouse may be stored upto a period of one year in the bonded warehouse. The time limit is five years in case of capital goods and for other good three years which are intended for use in any 100% EOU. The said Act, however, also provides for extension of the warehousing period by the relevant authorities subject to certain prescribed conditions.

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 that the company is not regular in depositing advance tax.

(g) It may be noted that the auditor has to report on the regularity of deposit of statutory dues irrespective of the fact whether or not there are any arrears on the balance sheet date. This is because there may be situations where a company has deposited the relevant dues before the end of the year while it has been in default in the matter for a significant part of the year. In cases where there are no arrears on the balance sheet date but the company has been irregular during the year in depositing the statutory dues, the auditor should state this fact while reporting under this clause.

(h) For the purpose of this clause, 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. For this purpose, where an application for rectification of mistake (e.g., under section 154 of the Income Tax Act, 1961) has been made by the company, the amount should be regarded as disputed. 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. It is not necessary for the auditor to 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. It may also be noted that the Order has clarified that mere representation to the concerned Department shall not be treated as a dispute.

(i) A question may arise that when do the statutory dues become payable. There can be two views with regard to the question. On the one hand, it can be argued that 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. On the other hand, 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 installments 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. As the purpose of this clause is to indicate the amounts which have become actually payable and are outstanding as at the last day of the financial year concerned for a period of more than six months from the date they became payable, the latter view seems to conform more closely to the requirements of the Order.

(j) It may be noted that penalty and/or interest levied under the respective laws would be covered within the term “amounts payable”.

(k) 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 recognised as outstanding dues at the balance sheet date.

(l) It is possible that in a large company where there are a number of departments with separate payrolls and where payments are spread over a number of days, the collection of data regarding the provident fund/employees’ state insurance collections and the company’s contribution thereto may take some time. In order to ensure that deposit of the dues is made in time, the company may make lump-sum deposits of estimated amounts and adjust the excess or deficit

against the following month's deposit. If this method is consistently followed and the difference between the total dues and the lump-sum deposit is not significant, it need not be considered that dues have not been regularly deposited and no unfavorable comment is necessary.[10]

Audit Procedures and Reporting

(m) The auditor should make plans to test whether the company is regular in depositing undisputed statutory dues. The auditor, in order to be able to comment on this clause, should have a general understanding of the various statutes governing the company and the dues payable by the company under those statutes. The auditor should also enquire of the management of the company about the statutes under which the company is required to pay any statutory dues. The auditor should also discuss with the management, the policies or procedures adopted for identification and payment of statutory dues. The auditor may also obtain from the management or himself prepare a calendar of dates for submission of various statutory dues by the company for his reference.

(n) The information necessary to comply with this requirement of the Order may be obtained from the company in the form of a statement. The statement should contain a list of various statutes under which the company is required to make payments regularly to appropriate authorities, the kind of payments under each statute, the due date for making the payment to the appropriate authority, the date on which the payment is made by the company, the arrears not due and the arrears overdue for more than six months. The

[10] This concept of materiality – which is fundamental to the entire auditing process – should be borne in mind while reporting on this clause as in case of other clauses of the Order.

auditor should verify the statement provided by the management with the underlying documents and records. The auditor's general understanding of the various statutes governing the company and the dues payable by the company under those statutes would help the auditor in assessing the completeness of the statement. The auditor should recognise that there could be a situation that a statutory due might have become payable but has not been captured by the accounting and internal control systems established by the enterprise and, therefore, the auditor should perform procedures to mitigate risk arising from such a situation.

(o) The auditor should obtain a written representation with reference to the date of the balance sheet from the management:

(i) specifying the cases and the amounts considered disputed;

(ii) containing a list of the cases and the amounts in respect of the statutory dues which are undisputed and have remained outstanding for a period of more than six months from the date they became payable; and

(iii) containing a statement as to the completeness of the information provided by the management.

(p) While the auditor has to report upon the regularity of the deposit, he is not required to specify in detail each instance where there has been a delay or the extent of the delay. It should be sufficient if he indicates whether generally the deposits have been regular or otherwise. The following are examples of the wordings, which may be used in relevant situations:

(i) "undisputed statutory dues including provident

fund, employees' state insurance, income-tax, sales-tax, service tax, duty of custom, duty of excise, value added tax, cess have been regularly deposited by the company with the appropriate authorities in all cases during the year".

(ii) "undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of custom, duty of excise, value added tax, cess have generally been regularly deposited with the appropriate authorities though there has been a slight delay in a few cases".

(iii) "undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of custom, duty of excise, value added tax, cess have not generally been regularly deposited with the appropriate authorities though the delays in deposit have not been serious".

(iv) "undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of custom, duty of excise, value added tax, cess have not been regularly deposited with the appropriate authorities and there have been serious delays in a large number of cases".

(q) If the auditor is of the opinion that the company is not regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of custom, duty of excise, value added tax, cess and any other statutory dues with the appropriate authorities, 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 six months from the date they became payable, are required to be mentioned by the auditor in his audit report. In indicating the arrears, the period to which the arrears relate should also preferably be given and further, wherever possible, the fact of subsequent clearance or otherwise may also be indicated. The auditor may report in the following format:-

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

Name of the Statute	*Nature of the Dues*	*Amount (Rs.)*	*Period to which the amount relates*	*Due Date*	*Date of Payment*	*Remarks, if any*

43. Where dues of income Tax or sales Tax or service Tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. {A mere representation to the concerned Department shall not be treated as a dispute.} **[Paragraph 3(vii)(b)]**

Relevant Provisions

(a) This clause requires that in case of disputed statutory dues, the amounts involved should be stated along with the forum where the dispute is pending. Therefore, even minor amounts would be required to be reported under this clause. The amount should be reported in a manner so that the reader is able to understand the dispute and the amount involved therein.

Audit Procedures and Reporting

(b) The audit procedures applied by the auditor for

commenting on the previous clause, including obtaining a statement from the management in regard to the matters specified in the clause, would help the auditor in determining the dues of sales tax/income tax/duty of customs/service tax/duty of excise that have not been deposited on account of any dispute, the amounts involved and the forum where dispute is pending. The auditor should also obtain a management representation about the disputed dues, the amounts involved and the forum where the dispute is pending. The auditor should carry out necessary audit procedures to verify the information provided by the management.

(c) A show-cause or similar notice generally contains the requirements/queries of the assessing officer. Normally, issuance of a show cause notice by the concerned department should not be construed to be a demand payable by the company. However, in some cases, a show cause notice 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 show cause order. Hence, it would be necessary to evaluate each situation individually.

(d) Tax demands that have been set aside are clearly not 'dues'. Similarly, if a demand has been referred for reassessment and the effect of such referral is the cancellation of the earlier demand, this too would not constitute an amount due. The wording of the order would be of significance; if the demand is not cancelled, it will remain disputed dues. As far as demands that have been stayed are concerned, these should be regarded as disputed dues. These should be disclosed along with a disclosure of the fact of stay. The fact that a stay has been granted does not mean

that the authority granting the stay has held that the amount in question is not a valid demand against the company. The stay normally is a concession that the amount may not be deposited immediately or that it may be deposited in installments. Sometimes a stay is granted if the assessee provides a bank guarantee. It may also be noted that 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 a case, there is considered to be no dispute until the time the Department makes an appeal to the relevant appellate authority. Further, in case 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 and the reporting responsibilities of the auditor as are applicable to any other undisputed statutory due under clause 3(vii)(a) of the Order would become applicable. Further, in case where the amount under dispute has not been paid before filing the appeal and no appeal is filed within the time allowed and the time limit for filing the appeal has expired, the disputed amount would become a statutory due.

(e) It is possible that in respect of same nature of statutory dues, there may be more than one dispute pertaining to different periods for which, appeals might have been filed separately. For example, different years' income tax liabilities might have been disputed at different levels of appellate authorities. Hence, in such cases, the information required by the clause should be given separately in respect of each period. In the case of a large company having a number of manufacturing and marketing divisions, it would be quite normal that many cases relating to sales tax, income tax, excise,

customs, value added tax, etc., are disputed and are pending at various stages. It cannot be the intention of the clause that each case is listed separately. It is, therefore, proper to summarise the cases stage-wise under each broad head, e.g., sales tax, income-tax, duty of customs, duty of excise, and give the particulars as indicated in paragraph (f) below.

(f) The information required by the clause may be reported in the following format:

Statement of Disputed Dues

Name of the Statute	*Nature of the Dues*	*Amount (Rs.)*	*Period to which the amount relates*	*Forum where dispute is pending*	*Remarks, if any*

(g) Further, a plain reading of the clause suggests that the amounts to be reported under clause 3(vii)(b) of the Order are those which have not been deposited on account of any dispute, irrespective of the treatment of such disputed amounts in accounts. 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. Similarly, even if it had not been provided for, it would have to be reported as long as it is not deposited. 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. 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.

Whether a disputed amount should be provided for in the accounts or not will need to be judged in the context of Accounting Standard (AS) 4, "Contingencies and Events Occurring After the Balance Sheet Date and/or Accounting Standard (AS) 29, "Provisions, Contingent Liabilities and Contingent Assets".

44. Whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and government, lender wise details to be provided). [Paragraph 3(viii)]

Relevant Provisions

(a) Under this clause, the auditor is required to report whether the company has defaulted in repayment of loans or borrowings[11] to a financial institution or bank or Government or dues to debenture holders. If the answer is in the affirmative, the auditor is also required to mention the period of default and the amount of default, lender wise.

(b) A question that arises is whether the scope of the auditor's inquiry would cover defaults made by the company during the year only or whether the defaults committed in previous years and continuing until the year end would also be covered. It is clarified that the auditor should report the period and amount of all defaults existing at the balance sheet date irrespective of when those defaults have occurred.

(c) Though the word "default" has not been defined, in this regard, the word "default" would mean non-payment of

[11] The term "Borrowings" has been explained in paragraph 18 of this Guidance Note.

dues to banks, Government, financial institutions or debenture holders on the last dates specified in loan documents or debentures trust deed, as the case may be.

For example, in the case of term loans, fixed dates are prescribed for repayment in the agreement or terms and conditions of the loans. The dates prescribed for repayments would operate as the last date of payments and any delay after this fixed date would amount to default and reporting required in case of aggregate default on account of repayment of loan.

(d) Section 2(39) of the Act defines "financial institution" to include a scheduled bank, and any other financial institution defined or notified under the Reserve Bank of India Act, 1934. Text of Section 45-I(c) of RBI Act, 1934 is given in **Appendix III** to this Guidance Note**.**

In view of the said definition, Financial Institution includes all Banks, Public Financial Institutions, as well as Non–Banking Institutions and also includes Non-Banking Financial Companies.[12]

(e) This clause also requires reporting on default in repayment of loans or borrowings taken from the Government. The term "Government" means the department of the Central Government, a State Government and its department and a Union Territory and its department, but shall not include any entity, whether created by a statute or otherwise, the accounts of which are not required to be kept in accordance with article 150 of the constitution or the rules made there under. (As defined u/s 65B(26A) of the Finance Act 1994). Accordingly, the term "Government" does not

[12] Attention of the readers is invited to paragraphs 7 to 21 relating to applicability of the Order.

include Government Company/ Public Sector Undertaking/Boards/Authority/Corporation and Foreign Government.

Audit Procedures and Reporting

(f) The auditor should obtain the schedule of repayments to banks, financial institutions, government and debenture holders from the management of the company. The schedule should indicate the amount and the due dates of the payments that the company is required to make to banks, financial institutions, government and debenture holders.

(g) The auditor should examine the agreement or other documents containing the terms and conditions of the loans and borrowings of the company taken from banks, Government and financial institutions. The auditor should also examine the debenture trust deed. This examination would enable the auditor in verifying the amount and due dates of the payments mentioned in schedule of repayments provided by the management of the company. The auditor should then verify whether the repayments as per the books of account are in accordance with the terms and conditions of the relevant agreement.

(h) The auditor should obtain the confirmation of the concerned bank or financial institution as to the status of the loan account including the overdue position as at the balance sheet date.

(i) It may happen that the company might have submitted application for reschedulement/restructuring proposals to the lenders, which may be in different stages of processing. Submission of application for reschedulement/restructuring does not mean that no default has occurred. Accordingly, in such situations also the auditor should report the period of default and the amount of default. However, if the application for

reschedulement of loan has been approved by the concerned bank or financial institution or if the default has been made good by the company during the year covered by the auditor's report, the auditor should state in his audit report the fact of reschedulement of loan or the fact of default having been made good.

(j) It may be noted that for the purposes of reporting of default under this clause the term "borrowings" may be construed as the principal amount since it has been used in the context of the word "repayment" and the term "dues" would mean the principal and the interest.

(k) The auditor may come across a situation where there may be disputes between the company and the lender on certain issues relating to repayments. In such situations, the auditor should consider the prevailing terms and conditions only. However, he may give a brief nature of the dispute while reporting under this clause.

(l) Under this clause the auditor is required to give lender wise details in case of banks, financial institutions and Government only and not in respect of individual debenture holders and may incorporate the following details:-

Particulars	Amount of default as at the balance sheet date	Period of default	Remarks, if any.
i) Name of the Lenders: In case of: Bank Financial Institution & Government			
ii) Debentures			

45. Whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported; [Paragraph 3(ix)]

Under this clause the auditor is required to report whether money raised by the company through Initial Public Offer or Further Public Offer (including debt instruments) and term loans have been utilised for the purposes for which those were raised.

Relevant Provisions

(a) In case the company has made an Initial Public Offer or Further Public Offer (including debt instruments) the auditor is required to report upon the disclosure of end-use of the money by the management in the financial statements. The auditor is also required to state whether he has verified the disclosure made by the management in this regard. 'Securities' has been defined in Section 2(81) of the Act which refers to the definition of 'securities' in section 2(h) of the Securities Contracts (Regulation) Act, 1956. Initial public offer or further public offer shall cover issue of equity shares, convertible securities, non-convertible debt securities, non-convertible redeemable preference shares, perpetual debt instruments, perpetual non-cumulative preference shares, Indian depository receipts, and securitized debt instruments.

(b) Part 1 of Chapter III of the Act consisting of Sections 23 to 41 deals with Public Offer. Section 23(1)(a) of the said Act, provides that, "a public company may issue securities to public through prospectus which is also referred to as "public offer". Explanation to Section 23 states that for the purpose of aforesaid Chapter III, the expression, "public offer" includes initial public offer or

further public offer of securities to public by a company, or an offer for sale of securities to the public by an existing shareholder, through issue of prospectus. In terms of Section 24 of the said Act, the Securities & Exchange Board of India (SEBI) is empowered to regulate issue of securities by making regulations on that behalf. Therefore, a company raising moneys by way of Initial Public Offer or Further Public Offer shall have to follow the requirements of the applicable provisions of the Act, as well as the relevant SEBI Regulations.

(c) Currently, there is no legal requirement under the Act to disclose the end use of money raised by Initial Public Offer or Further Public Offer (including debt instruments) in the financial statements. The companies, however, make such a disclosure in the Board's Report. Schedule III to the Act requires that only unutilized amount of any Initial Public Offer or Further Public Offer (including debt instruments) made by the company should be disclosed in the financial statements of a company. In the absence of any legal requirement of such disclosure, it appears that the clause envisages that the companies should disclose the end use of money raised by the Initial Public Offer or Further Public Offer (including debt instruments) in the financial statements by way of notes and the auditor should verify the same.

Audit Procedures and Reporting

(d) Normally, the companies do mention the end-use of the money proposed to be raised through the Initial Public Offer or Further Public Offer (including debt instruments) in the offer document. An examination of the offer document would provide the auditor an understanding of the proposed end-use of money raised from public. The auditor should verify that the amount of end-use of money disclosed in the financial

statements by the management is not materially different from the proposed and actual end use. The auditor should obtain a representation from the management as to the completeness of the disclosure with regard to the end-use of money raised as well as actual end utilization of money raised by Initial Public Offer or Further Public Offer (including debt instruments). If, for any reason, the auditor is not able to verify the end-use of money raised from Initial Public Offer or Further Public Offer (including debt instruments), he should state that he is not able to comment upon the disclosure of end-use of money by the company since he could not verify the same. He should also mention the reasons which resulted in the auditor's inability to verify the disclosure.

(e) It may be noted that while reporting under this clause, the auditor should also have regard to the SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015 (hereinafter referred as "LODR"), which contain a number of disclosure requirements in the balance sheet with respect to utilization of proceeds of monies raised from public, whether by shares or debentures, as also disclosure requirements in respect of unutilized monies from such proceeds. From a perusal of the LODR, it would be apparent that the details have to be given of both 'utilised' and 'unutilised' monies. Since the purpose is to provide a picture to the reader of 'utilisation of issue proceeds', it is only logical that the sum total of utilised and unutilised portions equal the total issue size. This implies that the figure of 'utilised' money should be cumulative.

(f) It may also be noted that according to the LODR, the issuer company is required to make arrangements for the use of proceeds of the issue to be monitored by financial institutions. The monitoring agency so appointed is required to submit its report to the SEBI, on a half-yearly basis, till the completion of the project.

In case, the company has appointed a monitoring agency for the purpose of the issue, reports of the monitoring agency would also be helpful to the auditor while reporting under the clause.

(g) The expression "debt instrument" is neither defined in the Order not under the Act. However, SEBI (Issue and Listing of Debt Securities), Regulations, 2008 which apply to public issue of debt securities and its listing, define the term "debt securities". In terms of Regulation 2(1)(e) of the said regulations, it means a non-convertible debt securities which create or acknowledge indebtedness, and include debenture, bonds and such other securities of a body corporate or any statutory body constituted by virtue of a legislation, whether constituting a charge on the assets of the body corporate or not, but excludes bonds issued by Government or such other bodies as may be specified by the Board, security receipts and securitized debt instruments. Further, in terms of the Explanation to Section 23 of the Act, "Public Offer" would include ADRs and GDRs.

(h) In view of the aforesaid, the reporting by an auditor as stated in paragraph (a) above should only relate to moneys raised by the company by way of initial public offer or further public offer of equity shares, convertible securities (defined above) and debt securities (defined above). Since, offer for sale of specified securities (i.e. equity shares and convertible securities) to the public by any existing holder does not result in any moneys raised in a company, the same is outside the purview of the reporting requirement under this clause. It seems that strictly in terms of the definitions of public offer, initial public offer and further public offer cited above, moneys raised from foreign capital markets and by way of issuance of Global Depository Receipts and American Depository Receipts may not fall within the scope of reporting under this clause.

(i) This clause also requires the auditor to examine whether term loans were applied for the purpose for which these loans were obtained. First of all, the auditor should ascertain whether the company has taken any "term loans". Term loans normally have a fixed or pre-determined maturity period or a repayment schedule. In the banking industry, for example, loans with repayment period beyond 36 months are usually known as "term loans". Cash credit, overdraft and call money accounts/deposits are, therefore, not covered by the expression "term loans". Terms loans are generally provided by banks and financial institutions for acquisition of capital assets which then become the security for the loan, i.e., end use of funds is normally fixed.

(j) The Order is silent as to whether this clause also covers term loans obtained from entities/persons other than banks/financial institutions. A strict interpretation of the clause would mean that the term loan obtained from entities/persons other than banks/financial institutions would also have to be examined by the auditor for the purpose of reporting under the clause.

(k) The auditor should examine the terms and conditions subject to which the company has obtained the term loans. The auditor may also examine the proposal for grant of loan made to the bank. As mentioned above, normally, the end use of the funds raised by term loans is mentioned in the sanction letter or documents containing the terms and conditions of the loan. The auditor should ascertain the purpose for which term loans were sanctioned. The auditor should also compare the purpose for which term loans were sanctioned with the actual utilisation of the loans. The auditor should obtain sufficient appropriate audit evidence regarding the utilisation of the amounts raised. If the auditor finds that the funds have not been utilized for the purpose for which they were obtained,

the auditor's report should state the fact.

(l) It is not necessary to establish a one-to-one relationship with the amount of term loan and its utilisation. It is quite often found that the amount of term loan disbursed by the bank is deposited in the common account of the company from which subsequently the utilisation is made. In such cases, it should not be construed that the amount has not been utilised for the purpose it was raised.

(m) It may happen that the company might have acquired improved version/model of assets as against the assets for which the loan had been sanctioned. For example, if out of a loan sanctioned for purchase of machinery to be used for manufacture of shoe upper is instead used to purchase a machine, which apart from manufacturing shoe uppers has certain additional manufacturing facilities. In such cases, it should not be construed that the loan has not been applied for the purpose for which it was raised.

(n) Normally, the term lenders directly make the payment to the vendors/suppliers. In such cases, it becomes easier for the auditor to comment on the application of term loans.

(o) It may so happen that the term loans taken during the year might not have been applied for the stated purpose during the year, for example, the loan was disbursed at the fag 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. This also implies 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.

(p) In case of term loans, raised against title deeds, long term FDRs, NSCs etc., where the lender is not

concerned with the purpose for which it is being obtained, the auditor should clearly mention the fact that in 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. In case the specific purpose is not recorded and the general purpose/ bone fide business use is stated; in such cases the auditor should verify whether the company has invested or utilized the money for purposes other than objects of the company.

(q) During construction phase, companies, may, temporarily invest the surplus funds 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 funds raised through Initial Public Offer or Further Public Offer (including debt instruments) or term loans for the stated purpose, the funds were temporarily used for the purpose other than for which they were raised but were ultimately utilised for the stated end-use.

(r) Where the auditor concludes that the initial public offer or the further public offer (including debt instruments) or the term loans were not applied for the purpose for which the same were raised/obtained, the auditor should mention in his report that the amount involved as well as the nature of default including delay in utilization. The auditor is also required to report the details of any subsequent rectifications made by the company.

(s) A suggested reporting format under this cause is as follows:

In our opinion and according to the information and explanations given to us, the Company has utilized the money raised by way of initial public offer/ further

public offer (including debt instruments) and the term loans during the year for the purposes for which they were raised, except for:

Nature of the fund raised	Details of default (Reason /Delay)	Amount (Rs.)	Subsequently rectified (Yes/No) and details

46. ***Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.*** **[Paragraph 3(x)]**

Relevant Provisions

(a) This clause requires the auditor to report whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year. If yes, the auditor is required to state the amount involved and the nature of fraud. The clause does not require the auditor to discover such frauds. 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 of the company should have the knowledge about the frauds by the company or on the company by its Officer and employees that have occurred during the period covered by the auditor's report. It may be noted that this clause of the Order, by requiring the auditor to report whether any fraud by the company or on the company by its Officer or employees has been noticed or reported, 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 Standard on Auditing (SA) 240, "The Auditor's Responsibility Relating to Fraud in an Audit of Financial Statements". In this context, the auditor should also have regard to the Guidance Note on Reporting on Fraud under Section 143(12) of the Companies Act, 2013, issued by ICAI.

(b) The term "fraud" refers to an intentional act by one or more individuals among management, those charged with governance, employees, involving the use of deception to obtain an unjust or illegal advantage. Although fraud is a broad legal concept, the auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements. Misstatement of the financial statements may not be the objective of some frauds. Auditors do not make legal determinations of whether fraud has actually occurred. Fraud involving one or more members of management or those charged with governance is referred to as "management fraud"; fraud involving only employees including officers of the entity is referred to as "employee fraud". In either case, there may be collusion with third parties outside the entity. In fact, generally speaking, the "management fraud" can be construed as "fraud by the company".

(c) Two types of intentional misstatements are relevant to the auditor's consideration of fraud - misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

(d) Fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting may involve:

(i) Deception such as manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared.

(ii) Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information.

(iii) Intentional misapplication of accounting principles relating to measurement, recognition, classification, presentation, or disclosure.

(e) Misappropriation of assets involves the theft of an entity's assets. Misappropriation of assets can be accomplished in a variety of ways (including embezzling receipts, stealing physical or intangible assets, or causing an entity to pay for goods and services not received); it is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing.

(f) Fraudulent financial reporting may be committed by the company because management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target particularly when the consequences to management of failing to meet financial goals can be significant. The auditor must appreciate that a perceived opportunity for fraudulent financial reporting or misappropriation of assets may exist when an individual believes internal control could be circumvented, for example, because the individual is in a position of trust or has knowledge of specific weaknesses in the internal control system.

Audit Procedures and Reporting

(g) While planning the audit, the auditor should discuss with other members of the audit team, the susceptibility of the company to material misstatements in the

financial statements resulting from fraud. While planning, the auditor should also make inquiries of management to determine whether management is aware of any known fraud or suspected fraud that the company is investigating.

(h) The auditor should examine the reports of the internal auditor with a view to ascertain whether any fraud has been reported or noticed by the management. The auditor should examine the minutes of the audit committee, if available, to ascertain whether any instance of fraud pertaining to the company has been reported and actions taken thereon. The auditor should enquire from the management about any frauds on the company that it has noticed or that have been reported to it. The auditor should also discuss the matter with other employees including officers of the company. The auditor should also examine the minute book of the board meeting of the company in this regard.

(i) The auditor should obtain written representations from management that:

(i) it acknowledges its responsibility for the implementation and operation of accounting and internal control systems that are designed to prevent and detect fraud and error;

(ii) it believes the effects of those uncorrected misstatements in financial statements, aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such items should be included in or attached to the written representation;

(iii) it has disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity; and

(iv) it has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

(j) Because management is responsible for adjusting the financial statements to correct material misstatements, it is important that the auditor obtains written representation from management that any uncorrected misstatements resulting from fraud are, in management's opinion, immaterial, both individually and in the aggregate. Such representations are not a substitute for obtaining sufficient appropriate audit evidence. In some circumstances, management may not believe that certain of the uncorrected financial statement misstatements aggregated by the auditor during the audit are misstatements. For that reason, management may want to add to their written representation words such as, "We do not agree that items constitute misstatements because [description of reasons]."

(k) The auditor should consider if any fraud has been reported by them during the year under section 143(12) of the Act and if so whether that same would be reported under this Clause. It may be mentioned here that section 143(12) of the Act requires the auditor has reasons to believe that a fraud is being committed or has been committed by an employee or officer. In such a case the auditor needs to report to the Central Government or the Audit Committee. However, this Clause will include only the reported frauds and not suspected fraud.

(l) Where the auditor notices that any fraud by the company or on the company by its officers or employees has been noticed by or reported during the year, the auditor should, apart from reporting the existence of fraud, also required to report, the nature of

fraud and amount involved. For reporting under this clause, the auditor may consider the following:

(i) This clause requires all frauds noticed or reported during the year shall be reported indicating the nature and amount involved. As specified the fraud by the company or on the company by its officers or employees are only covered.

(ii) Of the frauds covered under section 143(12) of the Act, only noticed frauds shall be included here and not the suspected frauds.

(iii) While reporting under this clause with regard to the nature and the amount involved of the frauds noticed or reported, the auditor may also consider the principles of materiality outlined in Standards on Auditing.

47. Whether Managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with schedule V to the Companies Act? If not, state the amount involved and steps taken by the Company for securing refund of the same [Paragraph 3(xi)]

Relevant Provisions

(a) This clause requires the auditor to examine the compliance of Section 197 read with Schedule V of the Act, in respect of managerial remuneration paid or provided by the company and if not, then to report the amount involved along with the steps taken to secure refund of such amount. The text of section 197, the relevant extract of the Rules 4 & 5 of the Companies (Appointment & Remuneration of Managerial Personnel) Rules 2014 and Schedule V is reproduced in **Appendix VII** to this Guidance Note.

Audit Procedures and Reporting

(b) Section 197 of the Act prescribes that the maximum ceiling for payment of managerial remuneration by a public company to its directors, including managing director and whole-time director and its manager which shall not exceed 11% of the net profit of the company in that financial year, computed in accordance with section 198 of the Act, except that the remuneration of the directors shall not be deducted from the gross profits.

(c) It may be noted that section 197 applies only to a public company. The term "public company" has been defined under section 2(71) of the Act. Thereby, section 197 of the Act is not applicable to a Private Company, and, accordingly, reporting under this clause would not be required.

(d) The term "Remuneration" under section 2(78) is defined to mean any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income Tax Act, 1961. It may be noted that for the purposes of the Act, the term remuneration would include salaries, perquisites and commission on profits but would not include:

  (i) Sitting fees paid to directors in accordance with the provisions of the Act (sub-sections 2 and 5 of Section 197).

  (ii) Remuneration payable to directors for services rendered by him of a professional nature (sub-section 4 of Section 197).

(e) The auditor's duty is to determine whether requisite approval mandated by the provisions of Section 197 read with Schedule V to the Act has been complied with:-

(i) The overall managerial remuneration and requisite approval is summarized as under:-

S. No	**Person entitled for remuneration**	**Maximum Remuneration in any financial year**	**If remuneration exceeds maximum remuneration in any financial year as provided under column (b)**
	(a)	**(b)**	**(c)**
1.	Directors including managing director, whole time director and managers of public company (for all such directors and manager together)	11% of the net profits* of the company for that financial year	Company in general meeting with approval of Central Government subject to provisions of Schedule V may pay remuneration in excess of 11% of the net profits of the company.
2	One managing Director/ Whole time director/ manager	5% of the net profits* of the company for that financial year	With the approval of the company in general meeting this limit may be exceeded.
3	More than one managing Director/ Whole time	10% of the net profits* of the company for that financial	With the approval of the company in general meeting

	director/ manager (for all such directors and manager together)	year	this limit may be exceeded.
4	Directors who are neither managing director nor whole time directors	1% of the net profits* of the company, (if there is a Managing or whole time director or Manager) for that financial year. In any other case 3% of net profits.	With the approval of the company in general meeting this limit may be exceeded.

*Net profits as computed in the manner referred to in section 198.

The above percentage will be exclusive of any fees (sitting fees) payable to the directors under Section 197(5) of the Act.

(ii) Where remuneration (other than sitting fees) is paid in case company has no profits or inadequate profits, the same should be in accordance with the limits prescribed in section II of Part II of Schedule V to the Act by passing a resolution as prescribed and when there is no default in repayment of any of its debts (including public deposits) or debentures or interest thereon for a continuous period of thirty days in the preceding financial year before the appointment of such managerial personnel. The limit as prescribed shall be doubled if the resolution

passed by the shareholder is a special resolution and passed in the manner prescribed complying with conditions specified in Schedule V itself. The auditor needs to examine the conditions prescribed including required disclosures in the financial statements and compliance of such provisions.

(iii) If the company pays remuneration to a managerial person in excess of the amounts in section II of Part II of schedule V, the approval from Central Government is also required in the manner prescribed in section III.

(f) If the managerial remuneration has been paid or provided which is not in accordance with the requisite approval mandated by the provisions of section 197 read with Schedule V to the Act, the clause requires that the auditor should disclose the "amount involved" and report the steps taken by the company to secure refund of the same. Since the Order does not clarify what constitutes "amounts involved", the same may be construed as meaning such amount of remuneration that has been paid or provided in excess of the limits prescribed under section 197 read with Schedule V of the Act. For this purpose, any amount that may have recovered or partially recovered by the company during the year would not be reduced from the "amount involved".

(g) Section 197(10) of the Act provides that without the permission of Central Government, the company shall not waive recovery of the excess amount paid over and above the prescribed limit. The auditor must examine the arrangement or agreements entered by the company in respect of securing refund of excess amount paid and should ask the management to give in writing, the steps which have been taken in this regard. The auditor should obtain sufficient appropriate audit

evidence to support the fact that steps have been taken by the company for securing refund of the same.

(h) The default may be reported incorporating the following details:-

(i) Payment made to Director/ Whole time Director / Managing Director / Manager.

(ii) Amount paid/ provided in excess of the limits prescribed.

(iii) Amount due for recovery as at Balance Sheet date.

(iv) Steps taken to secure the recovery of the amount.

(v) Remarks, if any.

48. Whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability; [Paragraph 3(xii)]

Relevant Provisions

(a) This clause requires the auditor to report whether, in the case of a Nidhi Company, net-owned funds to deposit liability ratio is more than 1:20 and the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules 2014 to meet out the liability.

(b) Section 406(1) of the Act defines “Nidhi” to mean a company which has been incorporated as a Nidhi with the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit, and which complies with such rules as are prescribed by the Central Government for regulation of such class of companies.

(c) It may be noted that Ministry of Corporate Affairs on 31st March 2014, vide its Notification No. GSR 258(E) notified the 'Nidhi Rules 2014', which came into force on the first day of April 2014. The said Rules are reproduced in the **Appendix VIII** to this Guidance Note. These Rules apply to Nidhi company incorporated as a Nidhi pursuant to the provisions of Section 406 of the Act and also to the Nidhi companies declared under sub-section (1) of section 620A of the Companies Act 1956.

Audit Procedures and Reporting

(d) It may be noted that Rule 5(1) prescribes the requirements for minimum number of members, net owned fund etc. As per Rule 5(1) every Nidhi shall, within a period of one year from the commencement of these rules, ensure that it has—

(i) not less than two hundred members;

(ii) net owned funds of ten lakh rupees or more;

(iii) unencumbered term deposits of not less than ten per cent of the outstanding deposits as specified in Rule 14; and

(iv) ratio of net owned funds to deposits of not more than 1:20.

The auditor should note that as such a Nidhi Company can accept deposits not exceeding twenty times of its net owned funds as per last audited balance sheet. Furthermore as per Rule 14, every Nidhi is to invest and continue to keep invested, in encumbered term deposits with a Scheduled commercial bank (other than a co-operative bank or a regional rural bank), or post office deposits in its own name an amount which shall not be less than ten per cent of the deposits outstanding at the close of business on the last working

day of the second preceding month, which needs to be examined.

(e) As per Rule 3(d) Net Owned Funds are defined as the aggregate of paid up equity share capital and free reserves as reduced by accumulated losses and intangible assets appearing in the last audited balance sheet:

Provided that, the amount representing the proceeds of issue of preference shares, shall not be included for calculating Net Owned Funds.

(f) A Nidhi company can accept fixed deposits, recurring deposits accounts and savings deposits from its members in accordance with the directions notified by the Central Government. The aggregate of such deposits is referred to as "deposit liability".

(g) The auditor should ask the management to provide the computation of the deposit liability and net owned funds on the basis of the requirements contained herein above. This would enable him to verify that the ratio of deposit liability to net owned funds is in accordance with the requirements prescribed in this regard. The auditor should verify the ratio using the figures of net owned funds and deposit liability computed in accordance with what is stated above. The comments of the auditor should be based upon such a statement provided by the management and verification of the same by the auditor.

(h) The auditor may report, incorporating the following as at the balance sheet date:-

(i) In case of shortfall in the ratio of net owned funds to the deposits, report the amount of shortfall and state the actual ratio of net owned funds to the deposits.

(ii) In case of shortfall with regard to the minimum

amount of 10% as unencumbered term deposits, as specified in Nidhi Rules 2014, report the amount thereof.

49. Whether all transactions with the related parties are in compliance with section 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards; [Paragraph 3(xiii)]

Relevant Provisions

(a) The duty of the auditor, under this clause is to report:

(i) Whether all transactions with the related parties are in compliance with section 177 and 188 of the Companies Act, 2013 ("Act")

(ii) Whether related party disclosures as required by relevant Accounting Standards (AS 18, as may be applicable) are disclosed in the financial statements

(b) Section 188 of the Act is applicable to all classes of companies (including private companies). The Act envisages the approval of Board of Directors and/or the approval of the shareholders (by way of resolution passed in the general meeting of the company), as the case may be, in accordance with the provisions of section 188. However:-

(i) approval of shareholders by way of resolution is not required for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

(ii) approval of the Board of Directors and shareholders is not required in respect of related

party transactions entered into by the company in its ordinary course of business and on an arm's length basis.

(c) The Related Party, with reference to a company is defined in section 2(76) of the Act. The transactions which are covered by section 188 are:

(i) sale, purchase or supply of any goods or materials;

(ii) selling or otherwise disposing of, or buying, property of any kind;

(iii) leasing of property of any kind;

(iv) availing or rendering of any services;

(v) appointment of any agent for purchase or sale of goods, materials, services or property;

(vi) related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and

(vii) Underwriting the subscription of any securities or derivatives thereof, of the company.

(d) Explanation (b) to Section 188(1) defines 'arm's length transaction' to mean a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest. Standard on Auditing (SA) 550, "Related Parties" defines arm's length transaction as "a transaction conducted on such terms and conditions as between a willing buyer and a willing seller who are unrelated and are acting independently of each other and pursuing their own best interest." The decision as to whether a transaction is at an arm's length or not would need considering several factors such as benefits/ consideration for each of the parties to enter into the agreement, the prevalent market/industry practice, economic circumstances, the

specific contractual understanding and / or terms between the parties, similar contracts executed between other unrelated parties, etc. For the purpose of this Clause the auditor may test the transaction of arm's length basis based on the transfer pricing mechanism in use for the purposes of Income Tax Act, 1961.

(e) The phrase 'ordinary course of business' is not defined under the Act. It seems that the ordinary course of business will cover the usual transactions, customs and practices of a business and of a Company. In many cases, it may be obvious that a transaction is in the 'ordinary course of business.' For example, a car manufacturing company sells a car to its group company. The price charged for the sale is the same as what it charges to other corporate customers who are unrelated parties. In this case, one may be able to conclude, without much difficulty, that the transaction has been entered into by the company in its ordinary course of business. Similarly, in certain extreme cases, it may be clear that the transaction is highly unusual and/ or extraordinary from the perspective of the company as well as its line of business. Hence, it may not be construed as being in the 'ordinary course of business. SA 550, "Related Parties" (Paragraph A25) has listed certain examples of transactions outside the entity's normal course of business:

(i) Complex equity transactions, such as corporate restructurings or acquisitions.

(ii) Transactions with offshore entities in jurisdictions with weak corporate laws.

(iii) The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged.

(iv) Sales transactions with unusually large discounts or returns.

(v) Transactions with circular arrangements, for example, sales with a commitment to repurchase.

(vi) Transactions under contracts whose terms are changed before expiry.

(f) The above examples are just illustrative and are not conclusive for the purposes of analysis under the Act. However, it provides some indicators based on which one may consider following aspects while performing evaluation of 'ordinary course of business':

(i) Whether the transaction is covered in the objects of the company as envisaged in the Memorandum of Association;

(ii) Whether a transaction is usual or unusual, both from the company and its line of business perspective;

(iii) Frequency: If a transaction is happening quite frequently over a period of time, it is more likely to be treated as an ordinary course of business. However, the inverse does not necessarily hold true;

(iv) Whether transaction is taking place at arm's length;

(v) Business purpose of the transaction;

(vi) Whether transaction is done on similar basis with other third parties; and

(vii) Size and volume of transaction.

The assessment of whether a transaction is in the ordinary course of business is likely to be very subjective, judgmental and will vary on case-to-case basis. The factors mentioned above may help in making this assessment.

Audit Procedures and Reporting

(g) The auditor should obtain written representations from management and, where appropriate, those charged with governance that:

(i) They have disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware; and

(ii) They have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.

(h) Circumstances in which it may be appropriate to obtain written representations from those charged with governance include:

(i) When they have approved specific related party transactions that

a) materially affect the financial statements, or

b) involve management.

(ii) When they have made specific oral representations to the auditor on details of certain related party transactions.

(iii) When they have financial or other interests in the related parties or the related party transactions.

(iv) Management's assertion of responsibility that related party transactions were conducted on terms equivalent to those prevailing in an arm's length transaction.

(i) The auditor may also decide to obtain written representations regarding specific assertions that management may have made, such as a representation that specific related party transactions do not involve undisclosed side agreements.

(j) The auditor should obtain a list of companies, firms or other parties, the particulars of which are required to be entered in the register maintained under section 189 of the Act. The auditor should verify the entries made in the register maintained under section 189 of the Act from the declarations made by the directors in Form MBP-1 i.e., general notice received from a director under Rule 9(1) of the Companies (Meetings of Board and Power) Rules, 2014. The auditor should also obtain a written representation from the management concerning the completeness of the information so provided to the auditor. The auditor should review the information provided by the management. The auditor should also perform the following procedures in respect of the completeness of this information:

(i) review his working papers for the prior years, if any, for names of known companies, firms or other parties the particulars of which are required to be entered in the register maintained under section 189 of the Act; and

(ii) review the entity's procedures for identification of companies, firms or other parties the particulars of which are required to be entered in the register maintained under section 189 of the Act.

(k) A difficulty in judging the arm's length of prices may also arise in cases where transactions are entered with sole suppliers. In such cases, the auditor may examine the prices paid with reference to list prices of the supplier concerned, other trade terms of the supplier, etc. It may be noted that the Company while determining whether the transactions entered into by it in its ordinary course of business with its related parties are on an arm's length basis must have documentary proof of same while entering into the transaction.

(l) Section 177(4)(iv) of the Act requires that audit committee (of every listed companies and other

classes of companies which is required to constitute audit committee) to approve transactions of the company with related parties.

(m) The auditor is required to perform appropriate procedures to satisfy himself as regards compliance with section 177 and 188 of the Act so that auditor is able to appropriately report under this clause. Auditor can refer SA 550, "Related Parties" which has prescribed auditor's responsibilities regarding related party relationships and transactions when performing an audit of financial statements, including guidance on the procedures to be performed by auditors. The key aspects of SA 550 which would be relevant for reporting on this clause are:

(i) Identified significant related party transactions outside the entity's normal course of business, detailed guidance is available in paragraph A38 to A41 of SA 550.

(ii) Assertions that related party transactions were conducted on terms equivalent to those prevailing in an arm's length transaction, detailed guidance is available in paragraph A42 to A45 of SA 550.

(iii) Evaluation of the accounting for and disclosure of identified related party relationships and transactions, detailed guidance is available in paragraph A46 to A47 of SA 550.

(n) A smaller entity may not have the same controls provided by different levels of authority and approval that may exist in a larger entity. Accordingly, when auditing a smaller entity, the auditor may rely to a lesser degree on authorization and approval for audit evidence regarding the validity of significant related party transactions outside the entity's normal course of business. Instead, the auditor may consider performing other audit procedures such as inspecting relevant documents, confirming specific aspects of the

transactions with relevant parties, or observing the owner-manager's involvement with the transactions.

(o) Based on the procedures performed by the auditor, if auditor comes across any non-compliance, then, it should be duly reported. The following particulars may be incorporated:

Nature of the related party relationship and the underlying transaction	Amount involved (Rs.)	Remarks (*details of non-compliance may be given*)

50. Whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of Section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance; [Paragraph 3(xiv)]

Relevant Provisions

(a) This clause requires that in case of private placement of shares or fully or partly convertible debentures, during the year under review, whether the requirements of section 42 of the Act and the Rules framed thereunder have been complied with. Further this clause also requires the auditor to report upon the utilization of the said funds for the purposes for which it has been raised, if not, the reporting is required giving details of the amount involved and nature of non-compliance.

Audit Procedures and Reporting

(b) (i) The term 'Private Placement' has been defined

under the Explanation (ii) to section 42(2) to mean any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in section 42 of the Act. In addition, the provisions of Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 also need to be complied with while reporting under this clause.

The text of Section 42 of the Act and Rule 14 of the Companies (Prospectus & Allotment of Securities) Rules, 2014 are reproduced in **Appendix IX** and **Appendix X** to this Guidance Note.

(ii) It may be noted that the term "preferential allotment" is not defined under the Act. Further this clause specifically relates to the compliance under section 42 of the Act only with respect to equity shares, preference share and fully or partly convertible debenture issued. The auditor needs to examine the compliance of the requirements of section 42 of the Act which deals with the private placement.

(c) Section 42 of the Act requires, *inter alia*, as under:

(i) Such private placement, i.e., offer of securities or invitation to subscribe securities should be made to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter.

The offer of securities or invitation to subscribe securities shall be made to such number of persons not exceeding two hundred, [excluding qualified institutional buyers and employees of the

company being offered securities under a scheme of employees stock option as per provisions of clause (*b*) of sub-section (*1*) of section 62], in a financial year and on such conditions (including the form and manner of private placement) as may be prescribed.

Qualified institutional buyer means as defined in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009. Section 42 provides maximum number of persons 50 or higher number which is prescribed by rule 14 of the Companies (Prospectus & allotment of securities) Rules, 2014 as 200 persons.

(ii) If a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an offer to the public and shall accordingly be governed by the provisions of Public offer.

(iii) No fresh offer or invitation of private placement shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company.

(iv) Any offer or invitation not in compliance with the provisions of section 42 of the Act shall be treated as a public offer and respective provisions of the Act, the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of

India Act, 1992 shall be required to be complied with.

(v) All monies payable towards subscription of securities under section 42 of the Act shall be paid through cheque or demand draft or other banking channels but not by cash.

(vi) A company making an offer or invitation on private placement shall allot its securities within sixty days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within fifteen days from the date of completion of sixty days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of twelve percent per annum from the expiry of the sixtieth day.

(vii) Also monies received on application under private placement shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than (*a*) for adjustment against allotment of securities; or (*b*) for the repayment of monies where the company is unable to allot securities.

(viii) All offers covered under section 42 of the Act shall be made only to such persons whose names are recorded by the company prior to the invitation to subscribe, and that such persons shall receive the offer by name, and that a complete record of such offers shall be kept by the company in such manner as may be prescribed and complete information about such offer shall be filed with the Registrar within a period of thirty days of circulation of relevant private placement offer letter.

(ix) No company offering securities under section 42 of the Act shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer.

(x) The company making any allotment of securities under section 42 of the Act shall file with the Registrar a return of allotment in such manner as may be prescribed, including the complete list of all security-holders, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

(xi) If a company makes an offer or accepts monies in contravention of section 42 of the Act and an order imposing the penalty for such contravention is passed, then the company shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty.

(d) In case the requirements of section 42 of the Act and rules framed in this regard are not complied with, the auditor should report incorporating following details:

Nature of securities *viz.* Equity shares/ Preference shares/ Convertible debentures	Amount Involved	Nature of non-compliance

(e) This clause also requires the auditor to examine whether funds so raised from private placement of shares or fully or partly convertible debentures were applied for the purpose for which these securities were issued. The examination of auditor may cover following aspects:

(i) Paragraph 2(i) of the Form PAS-4, Private

Placement Offer Letter[13], requires the company to provide particulars in respect of the purposes and objects of the offer. Accordingly, the auditor should compare such information provided by the Company in Form PAS-4 with the actual utilization of the monies as per the books of account of the Company.

(ii) It is not necessary to establish a one-to-one relationship with the amount of fund raised and its utilisation. It is quite often found that the amount of fund raised is not deposited in a separate bank account of the company from which subsequent utilisation is made. In such cases, it should not be construed that the amount has not been utilised for the purpose for which it was raised.

(iii) During construction phase, companies may temporarily invest the surplus funds prudently. However, subsequently the same are utilised for the stated objectives. In such cases, the auditor should mention the fact that pending utilisation of the fund raised for the stated purpose, the funds were temporarily used for the purpose other than for which the funds was raised.

(iv) However if the funds were ultimately utilised for the stated end-use, the reporting for the same may be made as and when the same have been utilized.

(v) It may so happen that the funds raised during the year might not have been applied for the stated purpose during the year, for example, the funds were raised at the fag-end of the year. In such a case, the auditor should mention in his audit report that the funds raised during the year has not been utilised. This also implies that the auditor, while making inquiry in respect of this clause, should also consider that the funds raised,

[13] Prescribed in the Companies (Prospectus of Securities) Rules, 2014.

which were raised in the previous accounting period but have been actually utilised during the current accounting period.

(vi) In case the specific purpose is not recorded and the general purpose/*bona-fide* business use etc., are stated then in such cases, auditor should verify that the company has invested or utilized the money for general purpose/*bona-fide* business use of the company.

(f) The auditor may report the non-compliances incorporating the following details:

Nature of Securities viz. Equity shares /Preference shares /Convertible debentures	Purpose for which funds raised	Total Amount Raised /opening un-utilized balance	Amount utilized for the other purpose	Un-utilized balance as at Balance sheet date	Remarks, if any

51. Whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with. [Paragraph 3(xv)]

Relevant Provisions

(a) Section 192 of the Act deals with restriction on non-cash transactions involving directors or persons connected with them. The section prohibits the company from entering into following types of arrangements unless it meets the conditions laid out in the said section:

(i) An arrangement by which a director of the company or its holding, subsidiary or associate company or a person connected with such director acquires or is to acquire assets for consideration other than cash, from the company.

(ii) An arrangement by which the company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.

(b) Arrangements, as discussed herein above, can only be entered by the company on fulfillment of the conditions laid out in Section 192 of the Act which are as under:

(i) The company should have obtained prior approval for such arrangement through a resolution of the company in general meeting.

(ii) In case the concerned director or the person connected therewith, is also a director of its holding company, a similar approval should have been obtained by the holding company through a resolution at its general meeting.

(c) The reporting requirements under this clause are in two parts. The first part requires the auditor to report on whether the company has entered into any non-cash transactions with the directors or any persons connected with such director/s. The second part of the clause requires the auditor to report whether the provisions of section 192 of the Act have been complied with. Therefore, the second part of the clause becomes reportable only if the answer to the first part is in affirmative.

(d) In other words, such transactions involving change in the assets or liabilities of a company but not involving "cash" or cash equivalents" as defined under Accounting Standard (AS) 3, "Cash Flow Statement" may be construed as non-cash transactions. At this

point, it may be appropriate to also refer to the definition and discussion on "non-cash transactions" & "cash and cash equivalents", as given in AS 3.

(e) There may be a situation where the acquisition of the asset takes place in one year and the corresponding liability is created in the financial statements, the corresponding settlement in the following year. The said transaction will not be considered as non-cash transaction. Further, mergers under Court schemes would be entered into subject to requisite approvals of Court etc., would not be considered non-cash transactions.

(f) The term "person connected with the director" has not been defined in the Act, or the Rules thereunder. Instead, the term "to any other person in whom the director is interested" is defined in the Explanation to sub section (1) of section 185 of the Act, which is reproduced as under and may be used as the reference point for reporting under this clause.

"(a) any director of the lending company, or of a company which is its holding company or any partner or relative of any such director;

(b) any firm in which any such director or relative is a partner;

(c) any private company of which any such director is a director or member;

(d) any body corporate at a general meeting of which not less than twenty-five per cent. of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or

(e) any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the

directions or instructions of the Board, or of any director or directors, of the lending company."

(g) Section 2(77) of the Companies Act, 2013 read with Rule 4 of the Companies (Specification of Definition Details) Rules, 2014 defines the term *"relative"*. As per the aforesaid section 2(77),

"Relative, with reference to any person, means anyone who is related to another, if –

(i) they are members of a Hindu Undivided Family;

(ii) they are husband and wife; or

(iii) one person is related to the other in such manner as may be prescribed"

As per Rule 4 of the Companies (Specification of Definition Details) Rules, 2014, a person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely –

(i) Father, including step father

(ii) Mother, including step mother

(iii) Son, including step son

(iv) Son's wife

(v) Daughter

(vi) Daughter's husband

(vii) Brother, including step brother

(viii) Sister, including step sister

(h) The term "acquire" simply means to come into possession of something. A thing that cannot be sold

cannot be acquired[14]. Thus, an acquisition would necessarily involve existence of two parties and a transfer of rights and/or obligations in a thing. In the context of section 192 of the Act, this transfer is between the company and the director and/or a person connected with a director. Such "director" is not restricted to being a director of the concerned company, but extends to director of a holding company, subsidiary or associate of the company under question.

(i) As provided in section 192, the acquisition by/from the company has to be that of an "asset". Further, the term assets should be construed to have the same meaning as described in the Framework for Preparation and Presentation of Financial Statements, issued by the Institute of Chartered Accountants of India. The auditor would need to evaluate whether the subject matter of acquisition by/ from the company satisfies the characteristic of an "asset".

Audit Procedures and Reporting

(j) For reporting on the first leg of the reporting clause, the starting point of the auditor's procedures could be obtaining a management representation as to whether the company has undertaken any non-cash transactions with the directors or persons connected with the directors, as envisaged in section 192(1) of the Act. The auditor would need to corroborate the management representation with sufficient appropriate audit evidence. A scrutiny of the following books of account, records and documents could provide source of such audit evidence to the auditor as to the existence of such non cash transactions as well as persons connected with the Directors:

[14] Acquire. (n.d.) *A Law Dictionary, Adapted to the Constitution and Laws of the United States. By John Bouvier*(1856). Retrieved March 26, 2016 from http://legal-dictionary.thefreedictionary.com/acquire

Persons connected with Director	Acquisition by/ From Company
Form No. MBP 1, *Notice of Interest by Director*, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014 [Ref: Sec 184(1) and Rule 9(1)]	Form No. MBP 2, *Register of Loans, Guarantee, Security and Acquisition Made by the Company*, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014 [Ref: Sec 186(9) and Rule 12(1)]
	Form No. MBP 4, *Register of Contracts with Related Party and Contracts and Bodies etc in which Directors are Interested*, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014 [Ref: Sec 189(1) and Rule 16(1)]
	Movements in the Fixed Asset Register
	Minutes book of the General Meeting and Meetings of Directors
	Report on Annual General Meeting pursuant to Companies (Management and Administration) Rules, 2014 {Ref Sec 121(1) and Rule 31(2)}

(k) The above documents and records would provide evidence of any such non-cash transactions that have actually taken place. The language of section 192(1) also uses the term "is to acquire" in the context of such transactions, indicating the existence of intention to acquire. The management may be requested to provide details of its intention to enter into transactions covered under section 192, after the date of the financial statements under audit. The minutes of the meetings of the Board of Directors and the Audit Committee may provide evidence of such intention. Besides, a scrutiny of the information for subsequent period as contained in the aforesaid records and documents may provide corroborative audit evidence of such intention having existed as at the date of the auditor's report.

(l) Where the company has entered into/is to enter into any non-cash transactions as discussed above, the auditor would make a report to that effect under this clause. The second leg of the clause requires the auditor to report whether the Company has complied with the provisions of section 192 in this regard. Section 192(1) and (2) envisage the following compliances in respect of such transactions:

(i) The company should have obtained a prior approval for such arrangement by a resolution in the General Meeting.

(ii) If the concerned Director or connected person is a director of the company's holding company, the latter too should have obtained a similar prior approval for the arrangement by a resolution at its General Meeting.

(iii) Notice for approval of the resolution should contain details of the arrangement along with the

value of assets involved duly calculated by a registered valuer.

The auditor should check compliance with Section 192(2) and verify the notice of the General Meeting that it includes particulars of arrangement along with the value of the assets involved such arrangements. The said value should be calculated by the register valuer.

(m) In case where the concerned director/connected person is also a director of the holding company, the auditor would need to check whether the holding company has complied with the requirements. For this purpose, the auditor would need to obtain a management representation letter from the holding company through the management of the auditee company.

Suggested paragraph on reporting:

According to the information and explanations given to us, the Company has entered into non-cash transactions with one of the directors/ person connected with the director during the year, by the acquisition of assets by assuming directly related liabilities, which in our opinion is covered under the provisions of Section 192 of the Act, and for which approval has not yet been obtained in a general meeting of the Company.

52. *Whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained. [Paragraph 3(xvi)]*

Relevant Provisions

(a) The auditor is required to examine whether the company is engaged in the business which attract the requirements of the registration. The registration is

required where the financing activity is a principal business of the company.

(b) The Reserve Bank of India restrict companies from carrying on the business of a non-banking financial institution without obtaining the certificate of registration. The relevant Text of the Section 45-IA is reproduced in **Appendix XI** to this Guidance Note.

(c) A Non-Banking Financial Company (NBFC) is a company registered under the Act, engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

(d) What does conducting financial activity as "principal business" mean? The response to an FAQ as given by Reserve Bank of India required to be considered while examining the requirement of registration:-

"Financial activity as principal business is when a company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria will

be registered as NBFC by RBI. The term 'principal business' is not defined by the Reserve Bank of India Act. The Reserve Bank has defined it so as to ensure that only companies predominantly engaged in financial activity get registered with it and are regulated and supervised by it. Hence if there are companies engaged in agricultural operations, industrial activity, purchase and sale of goods, providing services or purchase, sale or construction of immovable property as their principal business and are doing some financial business in a small way, they will not be regulated by the Reserve Bank. Interestingly, this test is popularly known as 50-50 test and is applied to determine whether or not a company is into financial business. (As per FAQ response of question - What does conducting financial activity as "principal business" mean?
https://www.rbi.org.in/Scripts/FAQView.aspx?Id=92)"

(e) NBFCs are doing functions similar to banks, however there exist difference between banks & NBFCs. NBFCs lend and make investments and hence their activities are akin to that of banks; however there are a few differences as given below:

(i) NBFC cannot accept demand deposits;

(ii) NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;

(iii) deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

(As per FAQ response of question NBFCs are doing functions similar to banks. What is difference between banks & NBFCs?

https://www.rbi.org.in/Scripts/FAQView.aspx?Id=92)"

(f) As per Reserve Bank of India Act, 1934 Section 45I Clause (c) any company carries on as its business or part of its business any activity considered as carrying on the business of Financial Institution. The relevant text of the Section 45I(c) is reproduced in **Appendix III** to this Guidance Note.

(g) Further Section 45-I Clause (f) of the Reserve Bank of India Act, 1934 defines the Non-Banking Financial Company reproduced in **Appendix III** to this Guidance Note.

(h) The Reserve Bank of India defined "net owned fund" as (a) the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance-sheet of the company after deducting there from (i) accumulated balance of loss; (ii) deferred revenue expenditure; and (iii) other intangible assets; and (b) further reduced by the amounts representing– (1) investments of such company in shares of– (i) its subsidiaries; (ii) companies in the same group; (iii) all other non-banking financial companies; and (2) the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with,– (i) subsidiaries of such company; and (ii) companies in the same group, to the extent such amount exceeds ten per cent of (a) above. ("Subsidiaries" and "companies in the same group" shall have the same meanings assigned to them in the Companies Act, 1956.)

Audit Procedures and Reporting

(i) The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the Non-Banking Financial Companies.

(j) The financial statements should be examined to ascertain whether *company's financial assets*

constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.

(k) Whether the company has net owned funds as required for the registration as NBFC.

(l) Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented.

(m) The auditor should report incorporating the following:-

(i) Whether the registration is required under section 45-IA of the RBI Act, 1934.

(ii) If so, whether it has obtained the registration.

(iii) If the registration not obtained, reasons thereof.

Comments on Form of Report

53. The Order requires that the auditor should make a statement on all such matters contained therein as are applicable to the company. The Order further provides that where an auditor is unable to express any opinion, he should indicate such fact. The auditor is also required to give reasons for any unfavourable or qualified answer. Further, where the auditor is unable to express an opinion on any such matter which is applicable to the company, he is also required to indicate in his report such fact together with the reasons as to why he is unable to express any opinion.

54. A question may also arise whether it is necessary for the auditor to include in his report the management's explanation for any matter on which he makes an unfavourable comment. Normally, such an explanation need not be included but there may be circumstances where the auditor feels such inclusion is necessary. Examples of such circumstances would be:

(a) to make the comment itself more meaningful and

complete. For example, physical verification of inventories, though planned, may not have been carried out because of a strike or a lockout. An unfavourable comment without this explanation would be misleading;

(b) to explain the fact why in spite of an unfavourable comment, the true and fair view of the financial statements is not vitiated. For example, 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.

55. If any of the comments on matters specified in the Order 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 under sub-sections (2), (3) and (4) of section 143.

56. If the auditor is of the opinion that any of the unfavourable comments on matters specified in the Order results in a qualification under sub-sections (2) and (3) of section 143 the manner of reporting would have to be in accordance with the principles enunciated in SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

57. Even where there are no unfavourable comments under the Order, it may be advisable for the auditor to preface his report under sub-sections (2) and (3) of section 143 with the words:

> "Further to our comments in the Annexure, we state that....."

58. It should not, however, be assumed that every unfavourable comment under the Order would necessarily

result in a qualification in the report under sub-sections (2) and (3) of section 143. Firstly, the unfavourable comment may be regarding a matter which has no relevance to a true and fair view presented by the financial statements, for example, the failure of the company to deposit provident fund dues in time or to comply with the requirements regarding acceptance of deposits. Secondly, while the non-compliance may be material enough to warrant an unfavourable comment under the Order, it may not be material enough to affect the true and fair view presented by the financial statements. Finally, the non-compliance may be in an area which calls for remedial action on the part of the management, and may be important for that reason but may not be sufficiently important in the context of the report under sub-sections (2) and (3). In deciding, therefore, whether a qualification in the report under sub-sections (2) & (3) is necessary, the auditor should use his professional judgement in the facts and circumstances of each case.

59. Where there is an unfavourable comment both under sub-section (1) of section 143 of the Act and under the Order, it is suggested that the qualification under sub-section (1) precede the qualification under the Order.

60. It is important to note that replies to many of the requirements of the Order will involve expression of opinion and not necessarily statement of facts. It is necessary, therefore, that this is indicated when making the report under the Order. This can be done in either of the following ways:

(a) By a general preface to the comments under the Order on the following lines:

> "In terms of the information and explanations sought by us and given by the company 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....."

or

(b) by a preface to individual comments, for example,

"In our opinion" or "In our opinion and according to the information and explanations given to us during the course of the audit..."

61. The Order requires that where the answer to a question is unfavourable or qualified, the auditor's report should also state the reasons for such unfavourable or qualified answer. While it is not necessary for the auditor to give very detailed reasons for an unfavourable or qualified answer, he is expected to explain the general nature of the qualification or adverse comment in clear and unambiguous terms.

62. Similar considerations would apply when the auditor is unable to express an opinion. In such circumstances, he should clearly state that he is unable to express an opinion because such records or evidence have not been produced before him.

63. In expressing an opinion, the auditor should be quite clear as to whether the circumstances of the case warrant a negative answer or whether his opinion can be expressed subject to a qualification.

64. The auditor's report under sub-section (3) of section 143 is required to state whether the auditor has sought and obtained all the information and explanations which to the best of his knowledge and belief, were necessary for the purposes of his audit and if not, the details thereof and the effect of such information on the financial statements. The term "audit" would include the reporting requirements under the Order. Therefore, when making his report, the auditor has to consider whether he has sought and obtained the information and explanations needed not merely for the purposes of normal audit, but also for the purpose of reporting in terms of the Order. If he has sought but not received the information and explanations necessary for reporting in terms of the Order, he should mention that fact both when reporting on the specific question in the Order

and also consider the impact of such non receipt of the information on the auditor's report under section 143(3)(a) of the Act.

Board's Report

65. Section 134(3)(f) of the Act requires that the board of directors shall be bound to give in its report the fullest information and explanations regarding every reservation, qualification or adverse remark or disclaimer contained in the auditor's report. The auditor's comments in terms of the Order form part of his report and, therefore, the Board will be bound to give in its report the fullest information and explanations regarding every unfavourable comment or qualification therein.

66. The auditor's comments in terms of the Order 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.

67. 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 the auditor.

Appendix I

Text of the Companies (Auditor's Report) Order, 2016

MINISTRY OF CORPORATE AFFAIRS

ORDER

New Delhi, the 29th March, 2016

S.O 1228(E).—In exercise of the powers conferred by sub-section (11) of section 143 of the Companies Act, 2013 (18 of 2013) and in supersession of the Companies (Auditor's Report) Order, 2015 published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (ii), vide number S.O. 990 (E), dated the 10th April, 2015, except as respects things done or omitted to be done before such supersession, the Central Government, after consultation with the, committee constituted under proviso to sub-section (11) of section 143 of the Companies Act, 2013 hereby makes the following Order, namely:—

1. **Short title, application and commencement.**- (1) This Order may be called the Companies (Auditor's Report) Order, 2016.

(2) It shall apply to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013 (18 of 2013) [hereinafter referred to as the Companies Act], except–

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an insurance company as defined under the Insurance Act,1938 (4 of 1938);

(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act and a small company as defined under clause (85) of section 2 of the Companies Act; and

(v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

2. Auditor's report to contain matters specified in paragraphs 3 and 4. - Every report made by the auditor under section 143 of the Companies Act, 2013 on the accounts of every company audited by him, to which this Order applies, for the financial years commencing on or after 1st April, 2015, shall in addition, contain the matters specified in paragraphs 3 and 4, as may be applicable:

Provided the Order shall not apply to the auditor's report on consolidated financial statements.

3. Matters to be included in the auditor's report. - The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:-

(i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

(b) whether these fixed assets have been physically verified by the management at reasonable intervals;

whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

(c) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;

(ii) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account;

(iii) whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,

(a) whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;

(b) whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

(c) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

(iv) in respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.

(v) in case, the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant

provisions of the Companies Act, 2013 and the rules framed thereunder, where applicable, have been complied with? If not, the nature of such contraventions be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

(vi) whether maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.

(vii) (a) whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

(b) where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).

(viii) whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and government, lender wise details to be provided).

(ix) whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;

(x) whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;

(xi) whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same;

(xii) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

(xiii) whether all transactions with the related parties are in compliance with section 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;

(xiv) whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not,

provide the details in respect of the amount involved and nature of non-compliance;

(xv) whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with;

(xvi) whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.

4. Reasons to be stated for unfavourable or qualified answers.- (1) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.

(2) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

[F. No. 17/45/2015-CL-V]

AMARDEEP SINGH BHATIA, Jt. Secy.

Appendix II

Clause-by-clause comparison of the reporting requirements of the Order and the erstwhile CARO 2015

1. **Short title, application and commencement.** -

(1) This order may be called the Companies (Auditor's Report) Order, ~~2015~~2016.

(2) It shall apply to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013 (18 of 2013) [hereinafter referred to as the Companies Act], except -

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an insurance company as defined under the Insurance Act, 1938 (4 of 1938);

(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act, and a small company as defined under clause (85) of section 2 of the Companies Act, 2013; and

(v) a private limited company, not being a subsidiary or holding company of a public company, ~~with~~ having a paid up capital and reserves and surplus not more than rupees ~~fifty lakh~~ one crore as on the balance sheet date and which does not have total borrowings ~~loan outstanding~~ exceeding rupees ~~twenty five lakh~~ one crore from any bank or financial institution at any point of time during the financial year; and which does not have a total revenue as disclosed in Schedule III to the

Companies Act, 2013 (including revenue from discontinuing operations) ~~turnover~~ exceeding rupees ~~five~~ ten crore ~~at any point of time during the financial year.~~ during the financial year as per the financial statements.

2. Auditor's report to contain matters specified in paragraphs 3 and 4. - Every report made by the auditor under section 143 of the Companies Act, 2013 on the accounts of every company audited ~~examined~~ by him to which this Order applies for the financial year commencing on or after 1st April, 2015~~4~~, shall contain the matters specified in paragraphs 3 and 4.

Provided the Order shall not apply to the auditor's report on consolidated financial statements.

3. Matters to be included in the auditor's report. - The auditor's report on the account of a company to which this Order applies shall include a statement on the following matters, namely:

(i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

(b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

(c) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof.

(ii) (a) whether physical verification or inventory has been conducted at reasonable intervals by the management~~;~~

~~(b) are the procedures of physical verification of inventory followed by the management reasonable and~~

~~adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported;~~

~~(c) 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;

(iii) whether the company has granted any loans, secured or unsecured to companies, firms, limited liability partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,

(a) whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;

(~~a~~b) whether the schedule of repayment ~~receipt or~~ the principal ~~amount~~ and payment of interest has been stipulated and whether repayments or receipts are ~~also~~ regular; ~~and~~

(c~~b~~) if the amount is overdue, state the total amount overdue for more than ninety days, and ~~amount is more than rupees one lakh,~~ whether reasonable steps have been taken by the company for recovery of the principal and interest;

(~~iv~~) ~~is there an adequate internal control system 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 goods and services.~~

(iv) in respect of loans, investments, guarantees and security whether provisions of section 185 and 186 of the Companies Act 2013 have been complied with. If not, provide the details thereof.

(v) in case the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules framed there under, where applicable, have been complied with? if not, the nature of contraventions should be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

(vi) where maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act, whether such accounts and records have been made and maintained;

(vii) (a) ~~is~~ Whether the company regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-~~L~~tax, ~~wealth tax,~~ service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as ~~at~~ on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated ~~by the auditor~~.

(b) where ~~in case~~ dues of income tax or sales tax ~~or wealth tax~~ or service tax or duty of customs or duty of excise or value added tax or cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not constitute a dispute).

~~(c) whether the amount required to be transferred to investor education and protection fund in accordance with the relevant provisions of the Companies Act,~~

~~1956 (1 of 1956) and rules made thereunder has been transferred to such fund within time.~~

~~(viii) whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year;~~

(viii~~ix~~) whether the company has defaulted in repayment of loans or borrowing ~~dues~~ to a financial institution~~,or~~ bank, government or dues to debenture holders? If yes, the period and amount of default to be reported (in case of defaults to banks, financial institutions, and government, lenderwise details to be provided);

~~(x) whether the company has given any guarantee for loans taken by others (other than to subsidiaries) from banks or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company;~~

(~~xi~~ix) whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purpose for which those are raised?~~;~~ If not, the details together with delaysordefaults and subsequent rectification, if any, as may be applicable, ~~to~~ be reported;

(x~~i~~) whether any fraud ~~on or~~ by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

(xi) Whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with schedule V to the Companies Act? If not, the amount involved and steps taken by the company for securing refund of the same.

(xii) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability and whether the Nidhi Company is maintaining ten percent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

(xiii) whether all transactions with the related parties are in compliance with section 177 and 188 of the Companies Act, 2013 where applicable and the details have been disclosed in the financial statements etc., as required by the applicable accounting standards;

(xiv) Whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;

(xv) whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act 2013 have been complied with;

(xvi) whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.

4. Reasons to be stated for unfavourable or qualified answers.-(1) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified answer, as the case may be.

(2) Where the auditor is unable to express any opinion on

any specified matter ~~in answer to a particular question~~, his report shall indicate such fact together with the reasons why it is not possible for him to give ~~an answer to such question~~ his opinion on the same.

Appendix-III

List of Financial Institutions Covered Under the Companies (Acceptance of Deposit) Rules, 2014

1. Sub section (39) of section 2 of Companies Act,2013 defines the term "financial institution" as, it includes a scheduled bank, and any other financial institution defined or notified under the Reserve Bank of India Act, 1934 (2 of 1934). The term financial institution has been defined under Section 45I clause (c) of the RBI Act 1934 as under:-

45I (c) "financial institution" *means any non-banking institution which carries on as its business or part of its business any of the following activities, namely:–*

(i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own:

(ii) the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature:

(iii) letting or delivering of any goods to a hirer under a hire-purchase agreement as defined in clause (c) of section 2 of the Hire-Purchase Act, 1972:

(iv) the carrying on of any class of insurance business;

(v) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;

(vi) collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lumpsum or otherwise, by way of subscriptions or by

sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person, 2 [but does not include any institution, which carries on as its principal business,–

(a) agricultural operations; or

(aa) industrial activity; or]

(b) the purchase or sale of any goods (other than securities) or the providing of any services; or

(c) the purchase, construction or sale of immovable property, so however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons;

Explanation.– For the purposes of this clause, ''industrial activity'' means any activity specified in sub-clauses (i) to (xviii) of clause (c) of section 2 of the Industrial Development Bank of India Act, 1964;

Further ''non-banking institution'' has been defined under clause (e) of Section 45-I of RBI Act 1934 as under:-

45-I (e) ''non-banking institution'' means a company, corporation or cooperative society.

Further ''non-banking financial company'' has been defined under clause (f) of Section 45-I of RBI Act 1934 as under:-

45-I (f) ''non-banking financial company'' means–

(i) a financial institution which is a company;

(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;

(iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify;

2. Section 2(72) of the Companies Act, 2013 defines "public financial institutions "as follows:

(i) the Life Insurance Corporation of India, established under section 3 of the Life Insurance Corporation Act, 1956;

(ii) the Infrastructure Development Finance Company Limited, referred to in clause (vi) of sub-section (1) of section 4A of the Companies Act, 1956 so repealed under section 465 of this Act;

(iii) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002;

(iv) institutions notified by the Central Government under sub-section (2) of section 4A of the Companies Act, 1956 so repealed under section 465 of this Act;

(v) such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India:

Provided that no institution shall be so notified unless—

(A) it has been established or constituted by or under any Central or State Act; or

(B) not less than fifty-one per cent of the paid-up

share capital is held or controlled by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments;

3. Sub-section (72) of section 2 of the Act, empowers the Central Government to notify in the Official gazette such other institution as it may think fit to be a public financial institution. The Central Government has so far notified the following 58 public financial institutions:

1. The Industrial Reconstruction Bank of India established under the Industrial Reconstruction Bank of India Act, 1984.
2. The General Insurance Corporation of India, formed and registered under the General Insurance Business (Nationalisation) Act, 1984.
3. The National Insurance Company Limited, formed and registered under the Companies Act, 1956.
4. The New India Assurance Company Limited, formed and registered under the Companies Act, 1956.
5. The Oriental Fire and General Insurance Company Limited, formed and registered under the Companies Act, 1956.
6. The United Fire and General Insurance Company Limited, formed and registered under the Companies Act, 1956.
7. The Shipping Company and Investment Company of India Limited.
8. Tourism Finance Corporation of India Limited, formed and registered under the Companies Act, 1956.
9. IFCI Venture Capital Funds Limited formed and registered under the Companies Act, 1956.

10. Technology Development and Informations Company of India Limited, formed and registered under the Companies Act, 1956.
11. Power Finance Corporation Limited, formed and registered under the Companies Act, 1956.
12. National Housing Bank, established under the NHB Act, 1987.
13. Small Industries Development Bank of India Limited established under the Small Industries Development Bank of India Act, 1989.
14. Rural Electrification Corporation Limited formed and registered under the Companies Act, 1956.
15. Indian Railway Finance Corporation Limited, formed and registered under the Companies Act, 1956.
16. Industrial Finance Corporation of India Limited, formed and registered under the Companies Act, 1956.
17. Andhra Pradesh State Financial Corporation.
18. Assam Financial Corporation.
19. Bihar State Financial Corporation.
20. Delhi Financial Corporation.
21. Gujarat Financial Corporation.
22. Haryana Financial Corporation.
23. Himachal Pradesh Financial Corporation.
24. Jammu and Kashmir State Financial Corporation.
25. Karnataka State Financial Corporation.
26. Kerala Financial Corporation.
27. Madhya Pradesh Financial Corporation.
28. Maharashtra State Financial Corporation.

29. Orissa State Financial Corporation.
30. Punjab Financial Corporation.
31. Rajasthan Financial Corporation.
32. Tamil Nadu Industrial Investment Corporation Limited.
33. Uttar Pradesh Financial Corporation.
34. West Bengal Financial Corporation.
35. Indian Renewable Energy Development Agency Limited.
36. North Eastern Development Finance Corporation Limited.
37. Housing and Urban Development Corporation Limited.
38. Export and Import Bank of India.
39. National Bank for Agriculture and Rural Development (NABARD).
40. National Co-operative Department Corporation (NCDC).
41. National Dairy Development Bank (NDDB)
42. The Pradeshiya Industrial Development and Investment Corporation Limited.
43. Rajasthan State Industrial Development and Investment Corporation Limited.
44. The State Industrial and Investment Corporation of Maharashtra Limited.
45. West Bengal Industrial Development Corporation Limited.
46. Tamil Nadu Industrial Development Corporation Limited.
47. The Punjab State Industrial Development Corporation

Limited (PSIDC).

48. Edc Limited
49. Tamil Nadu Power Finance And Infrastructure Development Corporation Limited
50. Tamilnadu Urban Finance And Infrastructure Development Corporation Limited
51. Kerala State Power And Infrastructure Finance Corporation Limited
52. Jammu And Kashmir Development Financial Corporation Limited
53. Kerala State Industrial Development Corporation Limited
54. India Infrastructure Finance Company Limited
55. Gujarat Industrial Investment Corporation Limited.
56. Andhra Pradesh Industrial Development Corporation Limited.
57. Karnataka Urban Infrastructure Development and Finance Corporation Limited
58. L&T Infrastructure Finance Company Limited.

Appendix IV

This checklist does not form part of the Guidance Note and is only illustrative in nature. Members are expected to exercise their professional judgment while making its use depending upon facts and circumstances of each case and read this check list in conjunction with the Guidance Note on Companies (Auditor's Report) Order 2016.

An Illustrative Checklist
on Companies (Auditor's Report) Order, 2016

Client :

Audit Period :

Manager In-Charge:

Clause no.	Particulars	Remarks	Working Paper Reference
3(i)(a)	**Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets.**		
(a)	Whether records of Fixed Assets (tangible, intangible and leased assets) are maintained showing the following particulars:		
	(i) Sufficient description (distinctive numbers, purchase agreement, documents, records and registration references, etc.) of the asset to make identification possible.		

(ii) Classification, that is, the head under which it is shown in the accounts, e.g., plant and machinery, office equipment, etc. component-wise, as applicable

(iii) Location/situation.

(iv) Quantity, i.e., number of units.

(v) Original cost.

(vi) Year of purchase.

(vii) Adjustment for revaluation or for any increase or decrease in cost, e.g., on revaluation of foreign exchange liabilities.

(viii) Date of revaluation, if any.

(ix) Rate and basis of depreciation, useful life, particulars regarding amortisation and impairment

(x) Depreciation, amortisation and impairment for the current year.

(xi) Accumulated depreciation, amortisation and impairment loss.

(xii) Particulars regarding sale, discarding, demolition, destruction etc.

(xiii) Particulars of fixed

assets that have been retired from active use and held for disposal.

(xiv) Particulars of fixed assets that have been fully depreciated or amortised or impaired.

(b) Whether aggregate original cost, depreciation or amortisation to date and impairment loss, if any, as per the register/records agrees with General Ledger balances? If not, note the disagreements in respect of each class of assets.

Conclusion:

3(i)(b) Whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account.

(a) (i) Whether Fixed Assets were physically verified at any time during the year or earlier years according to a phased program?

(ii) What is the periodicity of physical verification and whether the same is reasonable?

(iii) Whether assets physically verified agreed/

reconciled with book figures?

If not, note the discrepancies against each class of assets in terms of value, and state how the discrepancies have been dealt with.

(iv) Instructions to officials for carrying out physical verification to include procedures, timing, competency of team members, count sheets/tags, formats etc.

(b) Physically verify few items from the fixed asset register & vice versa.

(c) Whether management representation is obtained confirming that:

♦ fixed assets are physically verified by the company in accordance with the policy of the company.

♦ periodicity of the physical verification of fixed assets.

♦ details of the material discrepancies noticed during the physical verification of the fixed assets.

♦ If no discrepancies

were noted during physical verification, the same should be clearly mentioned.

Conclusion:

3(i)(c) Whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;

(a) Does the company have any immovable properties (land and buildings)?

Has the Company identified the land and building on the basis of Fixed Asset Register.

(b) Whether the title deeds of these immovable properties are in the name of the company?

Whether the details as per title deeds reconcile with the details in Fixed assets register, if not, is there any material difference to be reported here

(c) Has the management provided details of immovable properties not held in company's name (for example, location, description, and reasons for not being held in the company's name?

(i) In case the title deeds are lost, assess whether the certified copies of such documents are available with the company and what actions have been taken by the management in this regard?

(ii) In case the title deeds are mortgaged with the lenders, assess if the confirmation from the lenders is obtained for the same.

(iii) The discrepancies observed should be reported in the CARO report.

3(ii) **Whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account.**

(a) Has the management physically verified the inventory, as defined in AS 2? Inventory normally includes-

- Raw materials and Components
- Packing materials
- Maintenance supplies

- ♦ Work in progress
- ♦ Finished Goods
- ♦ Stores and Spares
- ♦ Consumables and Loose tools

(b) Whether evidence of physical verification has been seen and reasonableness of periodicity of physical verification evaluated? If yes, verify:

- ♦ written instructions issued by the management.
- ♦ duly authenticated physical verification sheets.
- ♦ duly authenticated summary sheets/ consolidation sheet
- ♦ internal memo etc. regarding issues arising on physical verification.
- ♦ any other documents evidencing physical verification.

(c) Whether the original physical verification sheets have been reviewed and selected items traced into the final inventories? (including the more valuable ones as per ABC

classification)

(d) Whether the comparison of final inventories with stock has been done? Whether records and other corroborative evidence, e.g. inventory statements submitted to banks?

(e) In case of continuous stock taking method, whether management:

(i) maintains adequate and up-to-date stock records;

(ii) has established adequate procedures for physical verification of inventories, so that in the normal circumstances, the programme of physical verification will cover all material items of inventory at least once during the year; and

(iii) check/examine thoroughly and corrects all material differences between the book records and the physical counts.

(f) Whether stock register is updated and value of inventory extracted from it tally with the books of account.

(g) If any material discrepancies were found as compared to stock records, what were the extent of discrepancies (in terms of value) and how the same have been dealt with in the books of account as well as in the stock records?

Conclusion:

3(iii)(a) Whether the company has granted any loans, secured or unsecured to companies, firms, limited liability partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so, whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;

(i) Has the Company granted any loans (Secured or Unsecured) to companies, firms, limited liability partnerships or other parties covered in the register maintained under Section 189 of the Companies Act 2013?

(ii) Where the company has granted any loans to parties covered in the register maintained under section 189 of the Act and squared off during the year, obtain details of such transactions.

(iii) Whether the terms of the above loans are prima facie prejudicial, due consideration to be given to the factors mentioned below:

- ♦ terms & condition of the loan repayment, rate of interest, restrictive covenants etc.,
- ♦ company's financial standing, its ability to lend, and terms of its borrowings
- ♦ borrower's financial standing
- ♦ the nature of the security,
- ♦ prevailing rate of interest, etc.

Conclusion:

3(iii)(b) Whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

(a) Whether the schedule of repayment of principal and payment of interest has been stipulated in the loan agreements / mutually agreed letter of arrangement at the time of sanction?

(b) Whether repayment of

principal amount and interest thereon are received regularly on the due date or immediately thereafter?

(c) If not, the fact and details should be Obtained.

Conclusion:

3(iii)(c) If the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest.

(a) Whether list of overdue amount has been prepared &recorded and reasonable steps taken for recovery of amount of loan which is overdue more than ninety days?

(b) Following documents may be seen for verification of reasonableness of steps taken by the company for recovery of principal and accrued interest on loan granted:

- Facts of each case including amounts involved
- Issue of reminder
- Sending of advocates or solicitor's notice

In absence of legal steps

whether auditor is satisfied that reasonable steps have been taken

(c) Obtain management's representation regarding steps that have been taken for recovery of total amount overdue more than ninety days.

Conclusion:

3(iv) In respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.

(a) Where Companies has given loans to directors etc.:

(i) Whether any loans given to directors or any other person in whom the director is interested, or given any guarantee or provided any security in connection with any loan taken by directors or such other person?

(ii) Whether any of the transaction is attracting the provisions of section 185?

(iii) Whether any of such transactions are covered under the exceptions provided under section 185? If so, obtain the relevant

evidences ensuring such exemption.

(b) Where company has made loan/ investment

(i) Obtain the details of loans and investment made by the Company including opening balances

(ii) Whether company has made investment through more than two layers of investment companies?

(iii) Whether the company has exceeded the limit of sixty per cent of its paid-up share capital, free reserves and securities premium account or one hundred per cent of its free reserves and securities premium account, whichever is more?

(iv) If so, whether prior approval by means of a special resolution passed at a general meeting has been obtained?

(v) Whether the rate of interest charges is more or at par to the rates specified in subsection (7) of section 186 of the Act, if not, the reasons thereof,

Conclusion:

3(v) **In case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act, 2013 and the rules framed there under, where applicable, have been complied with. If not, the nature of such contraventions should be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal whether the same has been complied with or not?**

(a) If the Company has accepted deposits from the public state whether:

(i) The directives issued by the Reserve Bank of India have been complied with and also that:

(ii) The provisions of Section 73 to 76 of the Companies Act, 2013 and the rules framed there under have been complied with.

(iii) List out contraventions, if any.

(b) Where an order has been passed by the CLB or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal in respect of

above, examine the steps taken by the company to comply with the order, and if not, report briefly stating there in the nature of contravention and the fact that Company has not complied with the order.

Conclusion:

3(vi) Whether maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.

(a) Whether cost accounting records have been prescribed for the company under section 148(1) of the Companies Ac, 2013t? If so verify whether proper cost accounts and records are made and maintained by the Company as specified.

Conclusion:

3(vii)(a) Whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they

became payable, shall be indicated.

(a) Whether a list of statutory dues which company is required to deposit regularly has been obtained.

(b) In case where there are no arrears on the balance sheet date but the company has been irregular during the year in depositing the statutory dues, the fact should be stated.

(c) Whether the Company has been generally regular in depositing statutory dues or otherwise, indicate the same.

Note: A matter is 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.

(d) Whether penalty and/or interest levied under the respective law is included under amounts payable.

(e) Ensure that disclosure is restricted to the actual arrears and should not include the amounts which have not fallen due for

deposit and have been shown as arrears at the balance sheet date.

(f) Whether the information about arrears of outstanding statutory dues is provided in the format:

- Name of the Statute
- Nature of the dues
- Amount (Rs.)
- Period to which amount relates
- Due date
- Date of Payment

(g) Whether a written representation with reference to the date of the balance sheet from the management obtained:

- specifying the cases and the amounts considered disputed;
- containing a list of the cases and the amounts in respect of the statutory dues which are undisputed and have remained outstanding for a period of more than six months from the date they became payable;
- containing a statement

as to the completeness of the information provided by the management.

(h) Whether any register of significant laws with which the entity has to comply within its particular industry and a record of complaints in respect of non-compliance been maintained

Conclusion:

3(vii)(b) Where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the department shall not treated as a dispute.)

(a) Review internal audit report, minutes of the meeting of the board of Directors and audit committee

(b) Ensure that information about arrears of disputed statutory dues is provided in the format:

- ♦ Name of the Statute
- ♦ Nature of the dues
- ♦ Amount (Rs.)
- ♦ Period to which

amount relates

♦ Forum where dispute is pending

Conclusion:

3(viii) Whether the company has defaulted in repayment of loans or borrowings to a financial institution, bank, government or dues to debenture holders? If yes, the period and the amount of default to be reported. (in case of defaults to banks, financial institutions, and government, lender wise details to be provided).

(a) Whether all defaults existing at the balance sheet date are reported irrespective of when those defaults have occurred.

(b) In case of defaults to banks, financial institutions, and government, whether lender wise details reported?

(c) If application of reschedulement of loan has been made/accepted or default has been made good during the accounting period, whether the fact has been stated.

(d) Whether the disputes between the company and the lender on various issues give rise to disclaimer stating the fact there is a dispute between the

company and the lender and auditor is unable to determine whether there is a default in repayment of dues to the lender concerned.

Conclusion:

3(ix) Whether moneys raised by way of initial public offer or further public offer (including debt instruments) and the term loans were applied for the purpose for which those were raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported.

(a) Whether the company raised money by way of initial public offer or further public offer of equity shares, convertible securities and debt securities?

(b) Examine the terms and conditions stated in the offer document subject to which the company has raised the above mentioned money.

(c) Whether the end use of the money raised (as mentioned above) is capable of being determined? If not state the fact.

(d) Whether the said end-use of money disclosed in the financial statements by way of a Note is significantly different from the actual end

use? If so, state the fact.

(e) Examine the various documents submitted to SEBI, offer document and also examine the report of board of directors, if available, to find out whether funds raised have been utilized for the purpose for which they were raised.

(f) Whether a representation of the management has been obtained as to the completeness of the disclosures with regard to the end-use of moneys raised by initial public offer and further public offer?

(g) Whether the fund flow statement has been reviewed where one to one correlation is not possible.

(h) Whether the company has taken any term loan?

(i) Examine the terms and conditions subject to which the company has obtained the term loans including purpose for which term loans were sanctioned?

(j) Compare the purpose for which term loans were sanctioned with the actual utilisation of the loans and

obtain sufficient appropriate audit evidence regarding the utilisation of the amounts raised.

(k) In case during a construction phase surplus funds were temporarily invested, however, subsequently the same are utilised for the stated objectives, mention the fact that 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.

(l) Whether term loans taken were not applied for stated purpose during the year for any reason? If yes, mention the facts and amount. Also disclose the fact about utilization of term loan of earlier year in current year.

(m) Whether the fund flow statement has been reviewed where one to one correlation was not possible.

Conclusion:

3(x) Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated.

(a) Has SA 240 been complied with? (Attach the check list for compliance of SA 240 with this check list also).

(b) Examine the following to ascertain whether any fraud has been reported or noticed by the management?

- ♦ the reports of the internal Audit
- ♦ the auditor should enquire from the management about any frauds by the company or any fraud on the company by its officers or employees, that it has noticed or that have been reported to it.
- ♦ discuss the matter with other employees including officers of the company.
- ♦ examine the minutes book of the board meeting, audit committee etc., of the company in this regard.

(c) Where any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported, determine the nature and amount of frauds and disclose the same. Obtain management representation to this effect.

(d) Whether any fraud has been reported by the auditor during the year under section 143(12)? If so, determine whether that same would be reported under this clause?

Conclusion:

3 (xi) whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same;

(a) Has the company paid or provided for any managerial remuneration?

(b) Obtain from management the details of managerial remuneration paid/ provided by the Company

Ensure that the computation of managerial remuneration is done in accordance with the provisions of section 197 read with Schedule V of Companies Act, 2013 The remuneration does not include :

- Sitting Fees (within prescribed limits) (sub section 2 and 5 of Section 197)

- Remuneration for professional services rendered (Sub section 4 of Section 197)

(c) Obtain a general understanding of Section 197 read with Schedule V to the Act. Ascertain the system and procedures of the company to ensure compliance with the provisions of section 197 and Schedule V

(d) Based on the understanding so gained, perform a reasonable test check of compliance with the aforesaid requirements of the Act.

(e) Examine the steps taken by the company to comply with requirements of the Act with respect to managerial remuneration. Examine the correspondence and documents filed with the Registrar of Companies, Company Law Board, legal correspondence for orders passed, minutes of the meetings of the Board and shareholders.

(f) Examine whether the Company has obtained requisite approvals

mandated by section 197 read with Schedule V to the Act.

(g) Obtain a listing of managerial remuneration rejected/ partially approved. Examine the same with underlying documents and obtain understanding of the steps taken by the Company for refund of unapproved managerial remuneration for reporting along with the amount involved.

Assess if the management has waived recovery of the excess amount paid over and above the prescribed limit.

(h) Consider the implications of non-compliances above also in the auditors' opinion on the financial statements.

In case of non-compliance, the amount involved would be the total amount involved which is in excess of the limit prescribed even though during the year the company may have recovered or partially recovered such amount. Obtain, examine and record the steps taken to secure the refund also

3(xii) Whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability.

(a) Is the Company a nidhi company?

Assess if the Company is registered as a Nidhi Company as per provisions of Section 406 of the Companies Act 2013 or Section 620A of the Companies Act, 1956.

(b) To check compliance with the following:

a) Whether the net owned funds to deposits ratio is more than 1:20 to meet out the liability as on the date of balance sheet?

b) Examine whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability

Whether the calculation of net owned funds is done as per Rule 3(d) which includes equity share capital, and free reserves as reduced by

accumulated losses and intangible assets appearing in the last audited balance sheet:

Assess if the proceeds of issue of preference shares have been included in the net owned funds.

Ensure that ratio is computed by using the figures of net owned funds and deposit liability computed in accordance with as stated under this clause.

Conclusion:

3 (xiii) Whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;

(a) Obtain a statement containing details of transactions with related parties

Obtain a list of companies, firms or other parties, the particulars of which are required to be entered in the register maintained under section 189 of the Act.

Obtain declarations made

by the directors in Form MBP-1 i.e., general notice received from a director under Rule 9(1) of The Companies (Meetings of Board and Power) Rules, 2014

Verify the entries made in the register under section 189 with such statement from management and declarations received from directors.

Assess the additions/ deletions to such list for appropriateness based on relevant declarations

(b) Obtain understanding of requirements of section 177 and 188 of the Act in relation to related party transactions

(c) Perform reasonable check to ascertain completeness and accuracy of details in the statement.

(d) Ascertain the system and procedures of the company to ensure compliance with the provisions of section 177 and 188 of the Act Including the assessment of identification of related parties and whether the transaction is at arm's

length and basis of such conclusion.

(e) Based on the understanding so gained, perform a reasonable test check of compliance with the aforesaid requirements of the Act.

(f) Examine minutes of meetings of the audit committee and agreements underlying related party transactions to ascertain audit committee approval for the transactions.

(g) Examine the minutes of Board meetings to ascertain whether requisite approvals of Board is obtained for certain related party transactions as required under section 188 of the Act.

(h) Where shareholders' approval is required, check whether the requisite approvals have been obtained as required under Section 188 of the Act

(i) Examine whether related party disclosures are made in the financial statements as per the requirements of Accounting Standard 18

(j) Examine whether disclosure related to contracts or arrangements with related parties as mandated by section 188 are made in Board's report

Including the assessment of identification of related parties and whether the transaction is at arm's length and basis of such conclusion.

(k) Consider the implications of non-compliances above also in the auditors' opinion on the financial statements.

3 (xiv) Whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;

(a) Has the Company made any preferential allotment or private placement of shares or fully convertible debentures during the year.

(b) Obtain a statement containing the specific terms of offer for private

placement, including purpose for which funds were raised, and the details of subsequent application-amounts, dates and the purpose.

(c) Ascertain whether the offer and allotment of securities referred in 1 above are in compliance with the requirements mandated by section 42 of the Act.

(d) Based on the understanding so gained, perform a reasonable test check of compliance with the requirements of the Act.

(e) Consider the implications of non-compliances above also in the auditors' report on the financial statements.

Note: Reporting under this Clause is required also in instances where the amounts have been raised in earlier year(s) and is being utilized under the year under review.

3 (xv) Whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with.

(a) Obtain a statement

containing list of directors of the company, its holding company, subsidiary and associate companies and persons connected with the directors

(b) Scrutinise the following books of account, records and documents could provide source of such audit evidence to the auditor as to the existence of such non-cash transactions as well as persons connected with the Directors:

(i) Form No. MBP 1, Notice of Interest by Director, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014

(ii) Form No. MBP 2, Register of Loans, Guarantee, Security and Acquisition Made by the Company, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014

(iii) Form No. MBP 4, Register of Contracts with Related Party and Contracts and Bodies etc in which Directors are Interested, filed pursuant to

the Companies (Meetings of Board and Its Powers) Rules, 2014

(iv) Movements in the Fixed Asset Register

(v) Minutes book of the General Meeting and Meetings of Directors

(vi) Report on Annual General Meeting pursuant to Companies (Management and Administration) Rules, 2014

Minutes of meetings of Board of Directors and Audit committee

(c) Obtain a statement from management containing transactions between the Company and director(s) referred to above

(d) Perform reasonable check to ascertain non cash transactions

(e) Obtain understanding of requirements of section 192 of the Act.

(f) Based on the understanding so gained, perform a reasonable test check of compliance with the aforesaid requirements of the Act.

(g) Consider the implications of non-compliances above also in the auditors' opinion on the financial statements.

3 (xvi) Whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.

(a) Examine the financial statements of the Company and assess whether the company has financial assets and financial income

Note: According to the RBI press release 1998-99/1269 dated 08.04.1999, a company will be treated as NBFC if its financial assets are more than 50% of its total assets (netted off by intangible assets) and income from financial assets should be more than 50% of its gross income.

(b) Check whether the company has financing activity as a principal business of the Company.

(c) Obtain understanding of the requirements of section 45-IA of RBI Act, 1934 with regard to registration of the company with RBI

(d) Examine whether the

	Company is carrying out NBFC activity / Core investment company.
(e)	Examine the steps taken by the company to comply with requirements of the RBI Act, 1934 with respect to registration as a NBFC. Also examine the correspondence and documents filed with the RBI, minutes of the Board meeting.
(f)	Examine whether the Company has obtained Certificate of Registration from RBI in terms of section 45-IA of the RBI Act, 1934.
(g)	Consider the implications of non-compliances above also in the auditors' opinion on the financial statements.

Discussed with……
Designation…….
Date……

Appendix V

Text of Sections 185 and 186 of the Companies Act, 2013 and Relevant Extract of the Rules

Text of Section 185 of the Companies Act, 2013

(1) Save as otherwise provided in this Act, no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person:

Provided that nothing contained in this sub-section shall apply to—

(a) the giving of any loan to a managing or whole-time director—

(i) as a part of the conditions of service extended by the company to all its employees; or

(ii) pursuant to any scheme approved by the members by a special resolution; or

(b) a company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans and interest is charged at a rate not less than the bank rate declared by the Reserve Bank of India; or

(c) any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company; or

(d) any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company:

Provided that the loans made under clauses (c) and (d) are utilised by the subsidiary company for its principal business activities.

Explanation.—For the purposes of this section, the expression "to any other person in whom director is interested" means—

(a) any director of the lending company, or of a company which is its holding company or any partner or relative of any such director;

(b) any firm in which any such director or relative is a partner;

(c) any private company of which any such director is a director or member;

(d) any body corporate at a general meeting of which not less than twenty five per cent. of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or

(e) any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

(2) If any loan is advanced or a guarantee or security is given or provided in contravention of the provisions of sub-section (1), the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, and the director or the other person to whom any loan is

advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person, shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, or with both.

Text of Section 186 of the Companies Act, 2013 and Relevant Extract of the Rules

(1) Without prejudice to the provisions contained in this Act, a company shall unless otherwise prescribed, make investment through not more than two layers of investment companies:

Provided that the provisions of this sub-section shall not affect,—

(i) a company from acquiring any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country;

(ii) a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

(2) No company shall directly or indirectly —

(a) give any loan to any person or other body corporate;

(b) give any guarantee or provide security in connection with a loan to any other body corporate or person; and

(c) acquire by way of subscription, purchase or otherwise, the securities of any other body

corporate, exceeding sixty per cent. of its paid-up share capital, free reserves and securities premium account or one hundred per cent. of its free reserves and securities premium account, whichever is more.

(3) Where the giving of any loan or guarantee or providing any security or the acquisition under sub-section (2) exceeds the limits specified in that sub-section, prior approval by means of a special resolution passed at a general meeting shall be necessary.

(4) The company shall disclose to the members in the financial statement the full particulars of the loans given, investment made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security.

(5) No investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained:

Provided that prior approval of a public financial institution shall not be required where the aggregate of the loans and investments so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate, along with the investments, loans, guarantee or security proposed to be made or given does not exceed the limit as specified in sub-section (2), and there is no default in repayment of loan instalments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution.

(6) No company, which is registered under section 12 of the Securities and Exchange Board of India Act, 1992 and covered under such class or classes of companies as may be prescribed, shall take inter-corporate loan or deposits exceeding the prescribed limit and such company shall furnish in its financial statement the details of the loan or deposits.

(7) No loan shall be given under this section at a rate of interest lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

(8) No company which is in default in the repayment of any deposits accepted before or after the commencement of this Act or in payment of interest thereon, shall give any loan or give any guarantee or provide any security or make an acquisition till such default is subsisting.

(9) Every company giving loan or giving a guarantee or providing security or making an acquisition under this section shall keep a register which shall contain such particulars and shall be maintained in such manner as may be prescribed.

(10) The register referred to in sub-section (9) shall be kept at the registered office of the company and —

(a) shall be open to inspection at such office; and

(b) extracts may be taken therefrom by any member, and copies thereof may be furnished to any member of the company on payment of such fees as may be prescribed.

(11) Nothing contained in this section, except sub-section (1), shall apply—

(a) to a loan made, guarantee given or security provided by a banking company or an insurance company or a housing finance company in the

ordinary course of its business or a company engaged in the business of financing of companies or of providing infrastructural facilities;

(b) to any acquisition—

(i) made by a non-banking financial company registered under Chapter IIIB of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities:

Provided that exemption to non-banking financial company shall be in respect of its investment and lending activities;

(ii) made by a company whose principal business is the acquisition of securities; of shares allotted in pursuance of clause (a) of sub-section (1) of section 62.

(iii) made by a banking company or an insurance company or a housing finance company, making acquisition of securities in the ordinary course of its business.

(12) The Central Government may make rules for the purposes of this section.

(13) If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

Explanation.—For the purposes of this section,—

(a) the expression “investment company” means a company whose principal business is the

acquisition of shares, debentures or other securities;

(b) the expression "infrastructure facilities" means the facilities specified in Schedule VI.

Rules 11, 12 and 13 of the Companies (Meeting of Board and its Powers) Rules, 2014

Rule.11. Loan and investment by a company under section 186 of the Act.-

(1) Where a loan or guarantee is given or where a security has been provided by a company to its wholly owned subsidiary company or a joint venture company, or acquisition is made by a holding company, by way of subscription, purchase or otherwise of, the securities of its wholly owned subsidiary company, the requirement of sub-section (3) of section 186 shall not apply.

Provided that the company shall disclose the details of such loans or guarantee or security or acquisition in the financial statement as provided under sub-section (4) of section 186.

(2) For the purposes of clause (a) of sub-section (11) of section 186, the expression "business of financing of companies" shall include, with regard to a Non-Banking Financial Company registered with the Reserve Bank of India, "business of giving of any loan to a person or providing any guaranty or security for due repayment of any loan availed by any person in the ordinary course of its business".

(3) No company registered under section 12 of the Securities and Exchange Board of India Act, 1992 and also covered under such class or classes of companies which may be notified by the Central Government in consultation with the Securities and Exchange Board, shall take any inter-corporate loan or deposits, in excess of the limits specified under the regulations

applicable to such company, pursuant to which it has obtained certificate of registration from the Securities and Exchange Board of India.

Rule.12. Register.-

(1) Every company giving loan or giving guarantee or providing security or making an acquisition of securities shall, from the date of its incorporation, maintain a register in Form MBP 2 and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made as aforesaid

(2) The entries in the register shall be made chronologically in respect of each such transaction within seven days of making such loan or giving guarantee or providing security or making acquisition.

(3) The register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.

(4) The entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

(5) For the purpose of sub-rule (4), the register can be maintained either manually or in electronic mode.

(6) The extracts from the register maintained under sub-section (9) of section 186 may be furnished to any member of the company on payment of such fee as may be prescribed in the Articles of the company which shall not exceed ten rupees for each page.

Rule 13.Special Resolution.-

(1) Where the aggregate of the loans and investment so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate along

with the investment, loan, guarantee or security proposed to be made or given by the Board, exceed the limits specified under section 186, no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorised by a special resolution passed in a general meeting.

Explanation.-For the purpose of this sub-rule, it is clarified that it would sufficient compliance if such special resolution is passed within one year from the date of notification of this section.

(2) A resolution passed at a general meeting in terms of sub-section (3) of section 186 to give any loan or guarantee or investment or providing any security or the acquisition under sub section (2) of section 186 shall specify the total amount up to which the Board of Directors are authorised to give such loan or guarantee, to provide such security or make such acquisition:

Provided, that the company shall disclose to the members in the financial statement the full particulars in accordance with the provision of sub-section (4) of section 186.

Clarification with regard to section 185 and 186 of the Companies Act 2013 - loans and advances to employees-

Ministry of Corporate Affairs vide General Circular No, 04/2015 dated 10th March, 2015 has clarified that loans and/or advances made by the companies to their employees, other than the managing or whole time directors (which is governed by section 185) are not governed by the requirements of section 186 of the Companies Act, 2013. This clarification will, however, be applicable if such loans/advances to employees are in accordance with the conditions of service applicable to employees and are also in accordance with the remuneration policy, in cases where such policy is required to be formulated.

Appendix VI

Text of the Companies (Cost Records and Audit) Rules, 2014

1. Short title and commencement.- (1) These rules may be called the Companies (Cost Records and Audit) Rules, 2014.

(2) They shall come into force on the date of publication in the Official Gazette.

2. Definitions: In these rules, unless the context otherwise requires –

(a) "Act" means the Companies Act, 2013 (18 of 2013);

(aa) "Central Excise Tariff Act Heading" means the heading as referred to in the additional notes in the first schedule to the Central Excise Tariff Act,1985;

(b) "Cost Accountant in practice" means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of 1959), who holds a valid certificate of practice under sub-section (1) of section 6 of that Act and who is deemed to be in practice under sub-section (2) of section 2 thereof, and includes a firm or limited liability partnership of cost accountants;

(c) "cost auditor" means a Cost Accountant in practice, as defined in clause (b), who is appointed by the Board;

(d) "cost audit report" means the report duly audited and signed by the cost auditor including attachment, annexure, qualifications or observations etc. to cost audit report;

(e) "cost records" means books of account relating to utilisation of materials, labour and other items of cost as applicable to the production of goods or provision of

services as provided in section 148 of the Act and these rules;

(f) "form" means a form annexed to these rules;

(g) "institute" means the Institute of Cost Accountants of India constituted under the Cost and Works Accountants Act, 1959 (23 of 1959);

(h) all other words and expressions used in these rules but not defined, and defined in the Act or in the Companies (Specification of Definition Details) Rules, 2014 shall have the same meanings as assigned to them in the Act or in the said rules.

3. Application of cost records.—For the purposes of sub-section (1) of section 148 of the Act, the class of companies, including Foreign Companies defined clause (42) of section 2 of the Act, engaged in the production of the goods or providing services, specified in the table below, having an overall turnover from all its products and services of rupees thirty five crore or more during the immediately preceding financial year, shall include cost records for such products or services in their books of account, namely:-

Note - Readers may refer the table as given in the Rules for further details.

4. Applicability for cost audit.-

(1) Every company specified in item (A) of the rule of rule 3 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preeding financial year is rupees fifty crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees twenty five crore or more.

(2) Every company specified in item (B) of rule 3, shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees one hundred crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees thirty five crore or more.

(3) The requirement for cost audit under these rules shall not apply to a company which is covered in rule 3 and –

(i) whose revenue from exports, in foreign exchange, exceeds, seventy five percent of its total revenue; or

(ii) which is operating from a special economic zone.

5. Maintenance of records.-

(1) Every company under these rules including all units and branches thereof, shall, in respect of each of its financial year commencing on or after the 1st day of April, 2014, maintain cost records in form CRA-1.

Provided that in case of company covered in serial numbers 12 and serial numbers 24 to 32 of item (B) of rule 3, the requirement under this rule shall apply in respect of each of its financial year commencing on or after 1st day of April, 2015.

(2) The cost records referred to in sub-rule (1) shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

(3) The cost records shall be maintained in such manner so as to enable the company to exercise, as far as possible, control over the various operations and costs to achieve optimum economies in utilization of resources and these records shall also provide necessary data which is required to be furnished under these rules.

6. Cost audit.-

(1) The category of companies specified in rule 3 and the thresholds limits laid down in rule 4, shall within one hundred and eighty days of the commencement of every financial year, appoint a cost auditor.

(2) Every company referred to in sub-rule (1) shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

(3) Every cost auditor appointed as such shall continue in such capacity till the expiry of one hundred and eighty days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

(3A) Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Director within thirty days of occurrence of such vacancy and the company shall inform the central government in Form CRA-2 within thirty days of such appointment of cost auditor;

(4) Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in form CRA-3.

(5) Every cost auditor shall forward his report to the Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report particularly any reservation or qualification contained therein.

(6) Every company covered under these rules shall, within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in form CRA-4 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

(7) The provisions of sub-section (12) of section 143 of the Act and the relevant rules made thereunder shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules.

Text of Section 197 of Companies Act, 2013 and Relevant Extract of the Rules and Schedule V

197. (1) The total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed eleven per cent of the net profits of that company for that financial year computed in the manner laid down in section 198 except that the remuneration of the directors shall not be deducted from the gross profits:

Provided that the company in general meeting may, with the approval of the Central Government, authorise the payment of remuneration exceeding eleven per cent of the net profits of the company, subject to the provisions of Schedule V:

Provided further that, except with the approval of the company in general meeting,—

(i) the remuneration payable to any one managing director; or whole-time director or manager shall not exceed five per cent of the net profits of the company and if there is more than one such director remuneration shall not exceed ten per cent of the net profits to all such directors and manager taken together;

(ii) the remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed,—

  (A) one per cent of the net profits of the company, if there is a managing or whole-time director or manager;

  (B) three per cent of the net profits in any other case.

(2) The percentages aforesaid shall be exclusive of any fees payable to directors under sub-section (5).

(3) Notwithstanding anything contained in sub-sections (1) and (2), but subject to the provisions of Schedule V, if, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including any managing or whole time director or manager, by way of remuneration any sum exclusive of any fees payable to directors under sub-section (5) hereunder except in accordance with the provisions of Schedule V and if it is not able to comply with such provisions, with the previous approval of the Central Government.

(4) The remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of this section, either by the articles of the company, or by a resolution or, if the articles so require, by a special resolution, passed by the company in general meeting and the remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity:

Provided that any remuneration for services rendered by any such director in other capacity shall not be so included if—

(a) the services rendered are of a professional nature; and

(b) in the opinion of the Nomination and Remuneration Committee, if the company is covered under sub-section (1) of section 178, or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

(5) A director may receive remuneration by way of fee for attending meetings of the Board or Committee thereof or for any other purpose whatsoever as may be decided by the Board:

Provided that the amount of such fees shall not exceed the amount as may be prescribed:

Provided further that different fees for different classes of companies and fees in respect of independent director may be such as may be prescribed.

(6) A director or manager may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other.

(7) Notwithstanding anything contained in any other provision of this Act but subject to the provisions of this section, an independent director shall not be entitled to any stock option and may receive remuneration by way of fees provided under sub-section (5), reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.

(8) The net profits for the purposes of this section shall be computed in the manner referred to in section 198.

(9) If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed by this section or without the prior sanction of the Central Government, where it is required, he shall refund such sums to the company and until such sum is refunded, hold it in trust for the company.

(10) The company shall not waive the recovery of any sum refundable to it under sub-section (9) unless permitted by the Central Government.

(11) In cases where Schedule V is applicable on grounds of no profits or inadequate profits, any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, whether the provision be contained in the company's memorandum or articles, or in an agreement entered into by it, or in any resolution passed by the company in general meeting or its

Board, shall not have any effect unless such increase is in accordance with the conditions specified in that Schedule and if such conditions are not being complied, the approval of the Central Government had been obtained.

(12) Every listed company shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and such other details as may be prescribed.

(13) Where any insurance is taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel:

Provided that if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration.

(14) Subject to the provisions of this section, any director who is in receipt of any commission from the company and who is a managing or whole-time director of the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board's report.

(15) If any person contravenes the provisions of this section, he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Rule 4 and 5 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.

Rule 4. Sitting fees.- A company may pay a sitting fee to a director for attending meetings of the Board or committees

thereof, such sum as may be decided by the Board of directors thereof which shall not exceed one lakh rupees per meeting of the Board or committee thereof:

Provided that for Independent Directors and Women Directors, the sitting fee shall not be less than the sitting fee payable to other directors.

Rule 5. Disclosure in Board's report.-(1) Every listed company shall disclose in the Board's report-

(i) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year;

(ii) the percentage increase in remuneration of each director, Chief Financial Officer, Chief Executive Officer, Company Secretary or Manager, if any, in the financial year;

(iii) the percentage increase in the median remuneration of employees in the financial year;

(iv) the number of permanent employees on the rolls of company;

(v) the explanation on the relationship between average increase in remuneration and company performance;

(vi) comparison of the remuneration of the Key Managerial Personnel against the performance of the company;

(vii) variations in the market capitalisation of the company, price earnings ratio as at the closing date of the current financial year and previous financial year and percentage increase over decrease in the market quotations of the shares of the company in comparison to the rate at which the company came out with the last public offer in case of listed companies, and in case of unlisted companies, the variations in the net worth of the company as at the close of the current financial year and previous financial year;

(viii) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;

(ix) comparison of the each remuneration of the Key Managerial Personnel against the performance of the company;

(x) the key parameters for any variable component of remuneration availed by the directors;

(xi) the ratio of the remuneration of the highest paid director to that of the employees who are not directors but receive remuneration in excess of the highest paid director during the year; and

(xii) affirmation that the remuneration is as per the remuneration policy of the company.

Explanation.- For the purposes of this rule.- (i) the expression "median" means the numerical value separating the higher half of a population from the lower half and the median of a finite list of numbers may be found by arranging all the observations from lowest value to highest value and picking the middle one;

(ii) if there is an even number of observations, the median shall be the average of the two middle values.

(2) The Board's report shall include a statement showing the name of every employee of the company, who-

(i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than sixty lakh rupees;

(ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a

rate which, in the aggregate, was not less than five lakh rupees per month;

(iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.

(3) The statement referred to in sub-rule (2) shall also indicate -

(i) designation of the employee;

(ii) remuneration received;

(iii) nature of employment, whether contractual or otherwise;

(iv) qualifications and experience of the employee;

(v) date of commencement of employment;

(vi) the age of such employee;

(vii) the last employment held by such employee before joining the company;

(viii) the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of sub-rule (2) above; and

(ix) whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager:

Provided that the particulars of employees posted and working in a country outside India, not being directors or their relatives, drawing more than sixty lakh rupees per financial year or five lakh rupees per month, as the case may

be, as may be decided by the Board, shall not be circulated to the members in the Board's report, but such particulars shall be filed with the Registrar of Companies while filing the financial statement and Board Reports:

Provided further that such particulars shall be made available to any shareholder on a specific request made by him in writing before the date of such Annual General Meeting wherein financial statements for the relevant financial year are proposed to be adopted by shareholders and such particulars shall be made available by the company within three days from the date of receipt of such request from shareholders:

Provided also that, in case of request received even after the date of completion of Annual General Meeting, such particulars shall be made available to the shareholders, within seven days from the date of receipt of such request.

Schedule V

PART II - REMUNERATION

Section I.— Remuneration payable by companies having profits:

Subject to the provisions of section 197, a company having profits in a financial year may pay remuneration to a managerial person or persons not exceeding the limits specified in such section.

Section II.— Remuneration payable by companies having no profit or inadequate profit without Central Government approval:

Where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may, without Central Government approval, pay remuneration to the managerial person not exceeding the higher of the limits under (*A*) and (*B*) given below:—

(*A*):

(1)	(2)
Where the effective capital is	Limit of yearly remuneration payable shall not exceed (Rupees)
(*i*) Negative or less than 5 crores	30 lakhs
(*ii*) 5 crores and above but less than100 crores	42 lakhs
(*iii*) 100 crores and above but less than250 crores	60 lakhs
(*iv*) 250 crores and above	60 lakhs *plus* 0.01% of the effective capital in excess of Rs. 250 crores:

Provided that the above limits shall be doubled if the resolution passed by the shareholders is a special resolution.

Explanation.—It is hereby clarified that for a period less than one year, the limits shall be pro-rated.

(*B*) In the case of a managerial person who was not a security holder holding securities of the company of nominal value of rupees five lakh or more or an employee or a director of the company or not related to any director or promoter at any time during the two years prior to his appointment as a managerial person, — 2.5% of the current relevant profit:

Provided that if the resolution passed by the shareholders is a special resolution, this limit shall be doubled:

Provided further that the limits specified under this section shall apply, if—

(*i*) payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under sub-section (*1*) of section 178 also by the Nomination and Remuneration Committee;

(*ii*) the company has not made any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in the preceding financial year before the date of appointment of such managerial person;

(*iii*) a special resolution has been passed at the general meeting of the company for payment of remuneration for a period not exceeding three years;

(*iv*) a statement along with a notice calling the general meeting referred to in clause (*iii*) is given to the shareholders containing the following information, namely:—

I. General Information:

(1) Nature of industry

(2) Date or expected date of commencement of commercial production

(3) In case of new companies, expected date of commencement of activities as per project approved by financial institutions appearing in the prospectus

(4) Financial performance based on given indicators

(5) Foreign investments or collaborations, if any.

II. Information about the appointee:

(1) Background details

(2) Past remuneration

(3) Recognition or awards

(4) Job profile and his suitability

(5) Remuneration proposed

(6) Comparative remuneration profile with respect to industry, size of the company, profile of the position and person (in case of expatriates the relevant details would be with respect to the country of his origin)

(7) Pecuniary relationship directly or indirectly with the company, or relationship with the managerial personnel, if any.

III. Other information:

(1) Reasons of loss or inadequate profits

(2) Steps taken or proposed to be taken for improvement

(3) Expected increase in productivity and profits in measurable terms.

IV. Disclosures:

The following disclosures shall be mentioned in the Board of Director's report under the heading "Corporate Governance", if any, attached to the financial statement:—

(*i*) all elements of remuneration package such as salary, benefits, bonuses, stock options, pension, etc., of all the directors;

(*ii*) details of fixed component and performance linked incentives along with the performance criteria;

(*iii*) service contracts, notice period, severance fees;

(*iv*) stock option details, if any, and whether the same has been issued at a discount as well as the period over which accrued and over which exercisable.

Section III.— Remuneration payable by companies having no profit or inadequate profit without Central Government approval in certain special circumstances:

In the following circumstances a company may, without the Central Government approval, pay remuneration to a managerial person in excess of the amounts provided in Section II above:—

(*a*) where the remuneration in excess of the limits specified in Section I or II is paid by any other company and that other company is either a foreign company or has got the approval of its shareholders in general meeting to make such payment, and treats this amount as managerial remuneration for the purpose of section 197 and the total managerial remuneration payable by such other company to its managerial persons including such amount or amounts is within permissible limits under section 197.

(*b*) where the company—

(*i*) is a newly incorporated company, for a period of seven years from the date of its incorporation, or

(*ii*) is a sick company, for whom a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction or National Company Law Tribunal, for a period of five years from the date of sanction of scheme of revival, it may pay remuneration up to two times the amount permissible under Section II.

(*c*) where remuneration of a managerial person exceeds the limits in Section II but the remuneration has been fixed by the Board for Industrial and Financial Reconstruction or the National Company Law Tribunal:

Provided that the limits under this Section shall be applicable subject to meeting all the conditions specified under Section II and the following additional conditions:—

(*i*) except as provided in para (*a*) of this Section, the managerial person is not receiving remuneration from any other company;

(*ii*) the auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice, certifies that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person as well as the quantum of remuneration and such certificate is filed along with the return as prescribed under sub-section (*4*) of section 196.

(*iii*) the auditor or Company Secretary or where the company has not appointed a secretary, a secretary in whole-time practice certifies that there is no default on payments to any creditors, and all dues to deposit holders are being settled on time.

(*d*) a company in a Special Economic Zone as notified by Department of Commerce from time to time which has not raised any money by public issue of shares or debentures in India, and has not made any default in India in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in any financial year, may pay remuneration up to Rs. 2,40,00,000 per annum.

Section IV.— Perquisites not included in managerial remuneration:

1. A managerial person shall be eligible for the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II and Section III:—

(*a*) contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income-tax Act, 1961(43 of 1961);

(*b*) gratuity payable at a rate not exceeding half a month's salary for each completed year of service; and

(*c*) encashment of leave at the end of the tenure.

2. In addition to the perquisites specified in paragraph 1 of this section, an expatriate managerial person (including a non-resident Indian) shall be eligible to the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II or Section III—

(*a*) *Children's education allowance*: In case of children studying in or outside India, an allowance limited to a maximum of Rs. 12,000 per month per child or actual expenses incurred, whichever is less. Such allowance is admissible up to a maximum of two children.

(*b*) *Holiday passage for children studying outside India or family staying abroad:*

Return holiday passage once in a year by economy class or once in two years by first class to children and to the members of the family from the place of their study or stay abroad to India if they are not residing in India, with the managerial person.

(*c*) *Leave travel concession:* Return passage for self and family in accordance with the rules specified by the company where it is proposed that the leave be spent in home country instead of anywhere in India.

Explanation I.— For the purposes of Section II of this Part, "effective capital" means the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after one year (excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as

reduced by the aggregate of any investments (except in case of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities),accumulated losses and preliminary expenses not written off.

Explanation II.— (*a*) Where the appointment of the managerial person is made in the year in which company has been incorporated, the effective capital shall be calculated as on the date of such appointment;

(*b*) In any other case the effective capital shall be calculated as on the last date of the financial year preceding the financial year in which the appointment of the managerial person is made.

Explanation III.— For the purposes of this Schedule, ‘‘family’’ means the spouse, dependent children and dependent parents of the managerial person.

Explanation IV.— The Nomination and Remuneration Committee while approving the remuneration under Section II or Section III, shall—

(*a*) take into account, financial position of the company, trend in the industry, appointee’s qualification, experience, past performance, past remuneration, etc.;

(*b*) be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and the shareholders.

Explanation V.— For the purposes of this Schedule, “negative effective capital” means the effective capital which is calculated in accordance with the provisions contained in *Explanation* I of this Part is less than zero.

Explanation VI.— For the purposes of this Schedule:—

(*A*) “current relevant profit” means the profit as calculated under section 198 but without deducting the excess of

expenditure over income referred to in sub-section 4(l) thereof in respect of those years during which the managerial person was not an employee, director or shareholder of the company or its holding or subsidiary companies.

(*B*) "Remuneration" means remuneration as defined in clause (*78*) of section 2and includes reimbursement of any direct taxes to the managerial person.

Section V. —Remuneration payable to a managerial person in two companies:

Subject to the provisions of sections I to IV, a managerial person shall draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person.

PART III

Provisions applicable to Parts I and II of this Schedule

1. The appointment and remuneration referred to in Part I and Part II of this Schedule shall be subject to approval by a resolution of the shareholders in general meeting.

2. The auditor or the Secretary of the company or where the company is not required to appointed a Secretary, a Secretary in whole-time practice shall certify that the requirement of this Schedule have been complied with and such certificate shall be incorporated in the return filed with the Registrar under sub-section (*4*) of section 196.

PART IV

The Central Government may, by notification, exempt any class or classes of companies from any of the requirements contained in this Schedule.

Appendix VIII

Text of Nidhi Rules, 2014

1. **Short title and commencement**.—(1) These Rules may be called Nidhi Rules, 2014. (2) They shall come into force on the 1st day of April, 2014.

2. **Application**.—These rules shall apply to,—

(a) every company which had been declared as a Nidhi or Mutual Benefit Society under sub-section (1) of Section 620A of the Companies Act, 1956;

(b) every company functioning on the lines of a Nidhi company or Mutual Benefit Society but has either not applied for or has applied for and is awaiting notification to be a Nidhi or Mutual Benefit Society under sub-section (1) of Section 620A of the Companies Act, 1956; and

(c) every company incorporated as a Nidhi pursuant to the provisions of Section 406 of the Act.

3. **Definitions**.—(1) In these rules, unless the context otherwise requires,—

(a) "Act" means the Companies Act, 2013 (18 of 2013);

(b) "Doubtful Asset" means a borrowal account which has remained a Non-performing asset for more than two years but less than three years;

(c) "Loss Asset" means a borrowal account which has remained a Non-performing asset for more than three years or where in the opinion of the Board, a shortfall in the recovery of the loan account is expected because the documents executed may

become invalid if subjected to legal process or for any other reason;

(d) "Net Owned Funds" means the aggregate of paid up equity share capital and free reserves as reduced by accumulated losses and intangible assets appearing in the last audited balance sheet:

Provided that the amount representing the proceeds of issue of preference shares shall not be included for calculating Net Owned Funds.

(e) "Non-Performing Asset" means a borrowal account in respect of which interest income or instalment of loan towards re payment of principal amount has remained unrealised for twelve months;

(f) "Standard Asset" means the asset in respect of which no default in re-payment of principal or payment of interest has occurred or is perceived and which has neither shown signs of any problem relating to re-payment of principal sum or interest nor does it carry more than normal risk attached to the business;

(g) "Sub-Standard Asset" means a borrowal account which is a Non-performing asset:

Provided that reschedulement or re-negotiation or re-phasement of the loan instalment or interest payment shall not change the classification of an asset unless the borrowal account has satisfactorily performed for at least twelve months after such reschedulement or renegotiation or rephasement.

(2) Words and expressions used herein, but not defined in these rules and defined in the Act or in the Companies (Specification of definitions details) Rules, 2014 shall have the same meaning as assigned to them in the Act or in the said Rules.

4. Incorporation and incidental matters.—(1) A Nidhi to be incorporated under the Act shall be a public company and shall have a minimum paid up equity share capital of five lakh rupees.

(2) On and after the commencement of the Act, no Nidhi shall issue preference shares.

(3) If preference shares had been issued by a Nidhi before the commencement of this Act, such preference shares shall be redeemed in accordance with the terms of issue of such shares.

(4) Except as provided under the proviso to sub-rule (e) to rule 6, no Nidhi shall have any object in its Memorandum of Association other than the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit.

(5) Every Company incorporated as a "Nidhi" shall have the last words 'Nidhi Limited' as part of its name.

5. **Requirements for minimum number of members, net owned fund etc**.—(1) Every Nidhi shall, within a period of one year from the commencement of these rules, ensure that it has—

(a) not less than two hundred members;

(b) Net Owned Funds of ten lakh rupees or more;

(c) unencumbered term deposits of not less than ten per cent of the outstanding deposits as specified in rule 14; and

(d) ratio of Net Owned Funds to deposits of not more than 1:20.

(2) Within ninety days from the close of the first financial year after its incorporation and where applicable, the second financial year, Nidhi shall file a return of statutory compliances in Form NDH-1 along with such fee as provided in Companies (Registration Offices and Fees) Rules, 2014 with the Registrar duly certified by a company secretary in practice or a chartered accountant in practice or a cost accountant in practice.

(3) If a Nidhi is not complying with clauses (a) or (d) of sub-rule (1) above, it shall within thirty days from the close of the first financial year, apply to the Regional Director in Form NDH-2 along with fee specified in Companies (Registration Offices and Fees) Rules, 2014 for extension of time and the Regional Director may consider the application and pass orders within thirty days of receipt of the application.

Explanation.—For the purpose of this rule "Regional Director" means the person appointed by the Central Government in the Ministry of Corporate Affairs as a Regional Director;

(4) If the failure to comply with sub-rule (1) of this rule extends beyond the second financial year, Nidhi shall not accept any further deposits from the commencement of the second financial year till it complies with the provisions contained in sub-rule (1), besides being liable for penal consequences as provided in the Act.

6. **General restrictions or prohibitions**.—No Nidhi shall—

(a) carry on the business of chit fund, hire purchase finance, leasing finance, insurance or acquisition of securities issued by any body corporate;

(b) issue preference shares, debentures or any other debt instrument by any name or in any form whatsoever;

(c) open any current account with its members;

(d) acquire another company by purchase of securities or control the composition of the Board of Directors of any other company in any manner whatsoever or enter into any arrangement for the change of its management, unless it has passed a special resolution in its general meeting and also obtained the previous approval of the Regional Director having jurisdiction over such Nidhi;

Explanation.—For the purposes of this sub-rule, "control" shall have the same meaning assigned to it in clause (27) of section 2 of the Act;

(e) carry on any business other than the business of borrowing or lending in its own name:

Provided that Nidhis which have adhered to all the provisions of these rules may provide locker facilities on rent to its members subject to the rental income from such facilities not exceeding twenty per cent of the gross income of the Nidhi at any point of time during a financial year.

(f) accept deposits from or lend to any person, other than its members;

(g) pledge any of the assets lodged by its members as security;

(h) take deposits from or lend money to any body corporate;

(i) enter into any partnership arrangement in its borrowing or lending activities;

(j) issue or cause to be issued any advertisement in any form for soliciting deposit:

Provided that private circulation of the details of fixed deposit Schemes among the members of the Nidhi carrying the words "for private circulation to members only" shall not be considered to be an advertisement for soliciting deposits.

(k) pay any brokerage or incentive for mobilising deposits from members or for deployment of funds or for granting loans.

7. **Share capital and allotment**.—(1) Every Nidhi shall issue equity shares of the nominal value of not less than ten rupees each:

Provided that this requirement shall not apply to a company referred to in sub-rules (a) and (b) of rule 2.

(2) No service charge shall be levied for issue of shares.

(3) Every Nidhi shall allot to each deposit holder at least a minimum of ten equity shares or shares equivalent to one hundred rupees:

Provided that a savings account holder and a recurring deposit account holder shall hold at least one equity share of rupees ten.

8. **Membership**.—(1) A Nidhi shall not admit a body corporate or trust as a member.

(2) Except as otherwise permitted under these rules, every Nidhi shall ensure that its membership is

not reduced to less than two hundred members at any time.

(3) A minor shall not be admitted as a member of Nidhi:

Provided that deposits may be accepted in the name of a minor, if they are made by the natural or legal guardian who is a member of Nidhi.

9. **Net owned funds**.—Every Nidhi shall maintain Net Owned Funds (excluding the proceeds of any preference share capital) of not less than ten lakh rupees or such higher amount as the Central Government may specify from time to time.

10. **Branches**.—(1) A Nidhi may open branches, only if it has earned net profits after tax continuously during the preceding three financial years.

(2) Subject to the provisions contained in sub-rule (1), a Nidhi may open up to three branches within the district.

(3) If a Nidhi proposes to open more than three branches within the district or any branch outside the district, it shall obtain the prior permission of the Regional Director and an intimation is to be given to the Registrar about opening of every branch within thirty days of such opening.

(4) No Nidhi shall open branches or collection centres or offices or deposit centres, or by whatever name called outside the State where its registered office is situated.

(5) No Nidhi shall open branches or collection centres or offices or deposit centres, or by whatever name called unless financial statement and annual return (up to date) are filed with the Registrar.

(6) A Nidhi shall not close any branch unless it—

(a) publishes an advertisement in a newspaper in vernacular language in the place where it carries on business at least thirty days prior to such closure, informing the public about such closure;

(b) fixes a copy of such advertisement or a notice informing such closure of the branch on the notice board of Nidhi for a period of at least thirty days from the date on which advertisement was published under clause (a); and

(c) gives an intimation to the Registrar within thirty days of such closure.

11. **Acceptance of deposits by Nidhis**.—(1) A Nidhi shall not accept deposits exceeding twenty times of its Net Owned Funds (NOF) as per its last audited financial statements.

(2) In the case of companies covered under clauses (a) and (b) of rule 2 and existing on or before 26th July, 2001 and which have accepted deposits in excess of the aforesaid limits, the same shall be restored to the prescribed limit by increasing the Net Owned Funds position or alternatively by reducing the deposit according to the table given below:

TABLE

Ratio of Net Owned Funds to Deposits (as on 31.3. 2013)	*Date by which the company has to achieve prescribed ceiling of 1:20*
a) More than 1:20 but up to 1:35	By 31.3. 2015

b) More than 1:35 but up to 1:45	By 31.3. 2016
c) More than 1:45	By 31.3. 2017

(3) The companies which are covered under the Table in sub-rule (2) above shall not accept fresh deposits or renew existing deposits if such acceptance or renewal leads to violation of the prescribed ratio.

(4) The ratio specified in sub-rule (2) above shall also apply to incremental deposits.

12. **Application form for deposit**.—(1) Every application form for placing a deposit with a Nidhi shall contain the following particulars, namely:—

(a) Name of Nidhi;

(b) Date of incorporation of Nidhi;

(c) The business carried on by Nidhi with details of branches, if any;

(d) Brief particulars of the management of Nidhi (name, addresses and occupation of the directors, including DIN);

(e) Net profits of Nidhi before and after making provision for tax for the preceding three financial years;

(f) Dividend declared by Nidhi during the preceding three financial years;

(g) Mode of repayment of the deposit;

(h) Maturity period of the deposit;

(i) Interest payable on the deposit;

(j) The rate of interest payable to the depositor in case the depositor withdraws the deposit prematurely;

(k) The terms and conditions subject to which the deposit may be accepted or renewed;

(l) A summary of the financials of the company as per the latest two audited financial statements as given below:

(i) Net Owned Funds

(ii) Deposits accepted

(iii) Deposits repaid

(iv) Deposits claimed but remaining unpaid

(v) Loans disbursed against—

(a) immovable property;

(b) deposits; and

(c) gold and jewellery

(vi) Profit before tax

(vii) Provision for tax

(viii) Profit after tax

(ix) Dividend per share

(m) any other special features or terms and conditions subject to which the deposit is accepted or renewed.

(2) The application form shall also contain the following statements, namely:—

(a) in case of Non-payment of the deposit or part thereof as per the terms and conditions of such deposit, the depositor may approach the Registrar

of companies having jurisdiction over Nidhi; (b) in case of any deficiency of Nidhi in servicing its depositors, the depositor may approach the National Consumers Disputes Redressal Forum, the State Consumers Disputes Redressal Forum or District Consumers Disputes Redressal Forum, as the case may be, for redressal of his relief;

(c) a declaration by the Board of Directors to the effect that the financial position of Nidhi as disclosed and the representations made in the application form are true and correct and that Nidhi has complied with all the applicable rules;

(d) a statement to the effect that the Central Government does not undertake any responsibility for the financial soundness of Nidhi or for the correctness of any of the statement or the representations made or opinions expressed by Nidhi; (e) the deposits accepted by Nidhi are not insured and the repayment of deposits is not guaranteed by either the Central Government or the Reserve Bank of India; and (f) a verification clause by the depositor stating that he had read and understood the financial and other particulars furnished and representations made by Nidhi in his application form and after careful consideration he is making the deposit with Nidhi at his own risk and volition.

(3) Every Nidhi shall obtain proper introduction of new depositors before opening their accounts or accepting their deposits and keep on its record the evidence on which it has relied upon for the purpose of such introduction.

(4) For the purposes of introduction of depositors, a Nidhi shall obtain documentary evidence of the depositor in the form of proof of identity and address as under:

(a) Proof of Identity (any one of the following)

(i) Passport

(ii) Unique Identification Number

(iii) Income-tax PAN card

(iv) Elector Photo Identity Card

(v) Driving licence

(vi) Ration card

(b) Proof of address (any one of the following)

(i) Passport

(ii) Unique Identification Number

(iii) Elector Photo Identity Card

(iv) Driving licence

(v) Ration card

(vi) Telephone bill

(vii) Bank account statement

(viii) Electricity bill

(documents referred to serial numbers (vi), (vii) and (viii) above shall not be more than two months old)

13. Deposits.—(1) The fixed deposits shall be accepted for a minimum period of six months and a maximum period of sixty months.

(2) Recurring deposits shall be accepted for a minimum period of twelve months and a maximum period of sixty months.

(3) In case of recurring deposits relating to mortgage loans, the maximum period of recurring deposits

shall correspond to the repayment period of such loans granted by Nidhi.

(4) The maximum balance in a savings deposit account at any given time qualifying for interest shall not exceed one lakh rupees at any point of time and the rate of interest shall not exceed two per cent above the rate of interest payable on savings bank account by nationalised banks.

(5) A Nidhi may offer interest on fixed and recurring deposits at a rate not exceeding the maximum rate of interest prescribed by the Reserve Bank of India which the Non-Banking Financial Companies can pay on their public deposits.

(6) A fixed deposit account or a recurring deposit account shall be foreclosed by the depositor subject to the following conditions, namely:—

(a) a Nidhi shall not repay any deposit within a period of three months from the date of its acceptance;

(b) where at the request of the depositor, a Nidhi repays any deposit after a period of three months, the depositor shall not be entitled to any interest up to six months from the date of deposit;

(c) where at the request of the depositor, a Nidhi makes repayment of a deposit before the expiry of the period for which such deposit was accepted by Nidhi, the rate of interest payable by Nidhi on such deposit shall be reduced by two per cent from the rate which Nidhi would have ordinarily paid, had the deposit been accepted for the period for which such deposit had run:

Provided that in the event of death of a depositor, the deposit may be repaid prematurely to the surviving depositor or depositors in the case of joint holding with survivor clause, or to the nominee or to legal heir with interest up to the date of repayment at the rate which the company would have ordinarily paid, had such deposit been accepted for the period for which such deposit had run.

14. Un-encumbered term deposits.—Every Nidhi shall invest and continue to keep invested, in unencumbered term deposits with a Scheduled commercial bank (other than a co-operative bank or a regional rural bank), or post office deposits in its own name an amount which shall not be less than ten per cent of the deposits outstanding at the close of business on the last working day of the second preceding month:

Provided that in cases of unforeseen commitments, temporary withdrawal may be permitted with the prior approval of the Regional Director for the purpose of repayment to depositors, subject to such conditions and time limit which may be specified by the Regional Director to ensure restoration of the prescribed limit of ten per cent.

15. Loans.—(1) A Nidhi shall provide loans only to its members.

(2) The loans given by a Nidhi to a member shall be subject to the following limits, namely:—

(a) two lakh rupees, where the total amount of deposits of such Nidhi from its members is less than two crore rupees;

(b) seven lakh fifty thousand rupees, where the total amount of deposits of such Nidhi from

its members is more than two crore rupees but less than twenty crore rupees;

(c) twelve lakh rupees, where the total amount of deposits of such Nidhi from its members is more than twenty crore rupees but less than fifty crore rupees; and

(d) fifteen lakh rupees, where the total amount of deposits of such Nidhi from its members is more than fifty crore rupees:

Provided that where a Nidhi has not made profits continuously in the three preceding financial years, it shall not make any fresh loans exceeding fifty per cent of the maximum amounts of loans specified in clauses (a), (b), (c) or (d).

Provided further that, a member shall not be eligible for any further loan if he has borrowed any earlier loan from the Nidhi and has defaulted in repayment of such loan.

(3) For the purposes of sub-rule (2), the amount of deposits shall be calculated on the basis of the last audited annual financial statements.

(4) A Nidhi shall give loans to its members only against the following securities, namely:—

(a) gold, silver and jewellery:

Provided that the re-payment period of such loan shall not exceed one year.

(b) immovable property:

Provided that the total loans against immovable property [excluding mortgage loans granted on the security of property by registered mortgage, being a registered mortgage under section 69 of the Transfer of Property Act, 1882 (IV of 1882)]

shall not exceed fifty per cent of the overall loan outstanding on the date of approval by the board, the individual loan shall not exceed fifty per cent of the value of property offered as security and the period of repayment of such loan shall not exceed seven years.

(c) fixed deposit receipts, National Savings Certificates, other Government Securities and insurance policies:

Provided that such securities duly discharged shall be pledged with Nidhi and the maturity date of such securities shall not fall beyond the loan period or one year whichever is earlier:

Provided further that in the case of loan against fixed deposits, the period of loan shall not exceed the unexpired period of the fixed deposits.

16. Rate of interest.—The rate of interest to be charged on any loan given by a Nidhi shall not exceed seven and half per cent above the highest rate of interest offered on deposits by Nidhi and shall be calculated on reducing balance method:

Provided that Nidhi shall charge the same rate of interest on the borrowers in respect of the same class of loans and the rates of interest of all classes of loans shall be prominently displayed on the notice board at the registered office and each branch office of Nidhi.

17. Rules relating to Directors.—(1) The Director shall be a member of Nidhi.

(2) The Director of a Nidhi shall hold office for a term up to ten consecutive years on the Board of Nidhi.

(3) The Director shall be eligible for re-appointment only after the expiration of two years of ceasing to be a Director.

(4) Where the tenure of any Director in any case had already been extended by the Central Government, it shall terminate on expiry of such extended tenure.

(5) The person to be appointed as a Director shall comply with the requirements of sub-section (4) of Section 152 of the Act and shall not have been disqualified from appointment as provided in section 164 of the Act.

18. Dividend.- A Nidhi shall not declare dividend exceeding twenty five per cent or such higher amount as may be specifically approved by the Regional Director for reasons to be recorded in writing and further subject to the following conditions, namely:−

(a) an equal amount is transferred to General Reserve;

(b) there has been no default in repayment of matured deposits and interest; and

(c) it has complied with all the rules as applicable to Nidhis.

19. Auditor.—(1) No Nidhi shall appoint or re-appoint an individual as auditor for more than one term of five consecutive years.

(2) No Nidhi shall appoint or re-appoint an audit firm as auditor for more than two terms of five consecutive years: Provided that an auditor (whether an individual or an audit firm) shall be eligible for subsequent appointment after the expiration of two years from the completion of his or its term:

Explanation: For the purposes of this proviso:

(i) in case of an auditor (whether an individual or audit firm), the period for which he or it

has been holding office as auditor prior to the commencement of these rules shall be taken into account in calculating the period of five consecutive years or ten consecutive years, as the case may be;

(ii) appointment includes re-appointment.

20. Prudential norms.—(1) Every Nidhi shall adhere to the prudential norms for revenue recognition and classification of assets in respect of mortgage loans or jewel loans as contained hereunder.

(2) Income including interest or any other charges on non-performing assets shall be recognised only when it is actually realised and any such income recognised before the asset became non-performing and which remains unrealised in a year shall be reversed in the profit and loss account of the immediately succeeding year.

(3) (a) In respect of mortgage loans, the classification of assets and the provisioning required shall be as under:

NATURE OF ASSET	PROVISION REQUIRED
Standard Asset	No provision
Sub-standard Asset	10% of the aggregate outstanding amount
Doubtful Asset	25% of the aggregate outstanding amount
Loss Asset	100% of the aggregate outstanding amount

Provided that a Nidhi may make provision for exceeding the percentage specific herein.

(b) The estimated realisable value of the collateral security to which a Nidhi has valid

recourse may be reduced from the aggregate outstanding amount, if the proceedings for the sale of the mortgaged property have been initiated in a court of law within the previous two years of the interest, income or instalment remaining unrealised.

(4) In case of companies which were incorporated on or before 26-07-2001, such companies shall make provisions in respect of loans disbursed and outstanding as on 31-03-2002 for income reversal and non-performing assets as per table given below:

For the year ended	Extent of provision
31-03-2015	Un-provided balance on equal basis over the three years as specified in the preceding column.
31-03-2016	
31-03-2017	

(5) (a) The Notes on the financial statements of a year shall disclose-

(i) the total amount of provisions, if any, to be made on account of income reversal and non-performing assets remaining unrealised;

(ii) the cumulative amount provided till the previous year;

(iii) the amount provided in the current year; and

(iv) the balance amount to be provided.

(b) Such disclosure shall continue to be made until the entire amount to be provided has been provided for.

(6) In respect of loans against gold or jewellery—

(a) the aggregate amount of loan outstanding against the security of gold or jewellery shall either be recovered or renewed within three months from the due date of repayment;

(b) if the loan is not recovered or renewed and the security is not sold within the aforesaid period of three months, the company shall make provision in the current year's financial statements to the extent of unrealised amount or the aggregate outstanding amount of loan including interest as applicable;

(c) no income shall be recognised on such loans outstanding after the expiry of the three months period specified in (a) above or sale of gold or jewellery, whichever is earlier; and

(d) the loan to value ratio shall not exceed 80 per cent.

Explanation.- For the purposes of this rule, the term 'loan to value ratio' means the ratio between the amount of loan given and the value of gold or jewellery against which such loan is given.

21. Filing of half yearly return.—Every company covered under rule 2 shall file half yearly return with the Registrar in Form NDH-3 along with such fee as provided in Companies (Registration Offices and Fees) Rules, 2014 within thirty days from the conclusion of each half year duly certified by a company secretary in practice or chartered accountant in practice or cost accountant in practice.

22. Auditor's certificate.—The Auditor of the company shall furnish a certificate every year to the effect that the company has complied with all the provisions

contained in the rules and such certificate shall be annexed to the audit report and in case of non-compliance, he shall specifically state the rules which have not been complied with.

23. Power to enforce compliance.—(1) For the purposes of enforcing compliance with these rules, the Registrar of companies may call for such information or returns from Nidhi as he deems necessary and may engage the services of chartered accountants, company secretaries in practice, cost accountants, or any firm thereof from time to time for assisting him in the discharge of his duties.

(2) In respect of any Nidhi which has violated these rules or has failed to function in terms of the Memorandum and Articles of Association, the concerned Regional Director may appoint a Special Officer to take over the management of Nidhi and such Special Officer shall function as per the guidelines given by such Regional Director:

Provided that an opportunity of being heard shall be given to the concerned Nidhi by the Regional Director before appointing any Special Officer.

24. Penalty for non-compliance.- If a company falling under rule 2 contravenes any of the provisions of the rules prescribed herein, the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees, and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first during which the contravention continues.

Appendix IX

Text of Section 42 of the Companies Act, 2013

42. Offer or invitation for subscription of securities on private placement[15].

(1) Without prejudice to the provisions of section 26, a company may, subject to the provisions of this section, make private placement through issue of a private placement offer letter.

(*2*) Subject to sub-section (*1*), the offer of securities or invitation to subscribe securities, shall be made to such number of persons not exceeding fifty or such higher number as may be prescribed, [excluding qualified institutional buyers and employees of the company being offered securities under a scheme of employees stock option as per provisions of clause (*b*) of sub-section (*1*) of section 62], in a financial year and on such conditions (including the form and manner of private placement) as may be prescribed.

Explanation I.—If a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an offer to the public and shall accordingly be governed by the provisions of Part I of this Chapter.

Explanation II.— For the purposes of this section, the expression—

(*i*) "qualified institutional buyer'' means the qualified institutional buyer as defined in the Securities

[15] Ministry of Corporate Affairs vide its notification no. GSR 465(E) dated 5th June, 2015 has specified that Section 42 except sub-section (I), explanation (II) to sub-section (2), sub-sections (4), (6), (t), (9) and (10) shall not apply Nidhis.

and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 as amended from time to time.

(*ii*) *"*private placement" means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in this section.

(*3*) No fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company.

(*4*) Any offer or invitation not in compliance with the provisions of this section shall be treated as a public offer and all provisions of this Act, and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be required to be complied with.

(*5*) All monies payable towards subscription of securities under this section shall be paid through cheque or demand draft or other banking channels but not by cash.

(*6*) A company making an offer or invitation under this section shall allot its securities within sixty days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within fifteen days from the date of completion of sixty days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of twelve per cent. per annum from the expiry of the sixtieth day:

Provided that monies received on application under this section shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—

(*a*) for adjustment against allotment of securities; or

(*b*) for the repayment of monies where the company is unable to allot securities.

(*7*) All offers covered under this section shall be made only to such persons whose names are recorded by the company prior to the invitation to subscribe, and that such persons shall receive the offer by name, and that a complete record of such offers shall be kept by the company in such manner as may be prescribed and complete information about such offer shall be filed with the Registrar within a period of thirty days of circulation of relevant private placement offer letter.

(*8*) No company offering securities under this section shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer.

(*9*) Whenever a company makes any allotment of securities under this section, it shall file with the Registrar a return of allotment in such manner as may be prescribed, including the complete list of all security-holders, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

(*10*) If a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the amount involved in the offer or invitation or two crore rupees, whichever is higher, and the company shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty.

Appendix X

Rule 14 of the Companies (Prospectus & Allotment of Securities) Rules, 2014

Rule 14 of The Companies (Prospectus and Allotment of Securities) Rules, 2014, as amended by notification dated 30.6.2014

14. Private Placement.—

(1) (a) For the purposes of sub-section (1) of section 42, a company may make an offer or invitation to subscribe to securities through issue of a private placement offer letter in Form PAS-4.

(b) A private placement offer letter shall be accompanied by an application form serially numbered and addressed specifically to the person to whom the offer is made and shall be sent to him, either in writing or in electronic mode, within thirty days of recording the names of such persons in accordance with sub-section (7) of section 42:

Provided that no person other than the person so addressed in the application form shall be allowed to apply through such application form and any application not conforming to this condition shall be treated as invalid.

(2) A company shall not make a private placement of its securities unless –

(a) the proposed offer of securities or invitation to subscribe securities has been previously approved by the shareholders of the company, by a Special Resolution, for each of the Offers or Invitations:

Provided that in the explanatory statement annexed to the notice for the general meeting the basis or justification for the price (including premium, if any) at

which the offer or invitation is being made shall be disclosed:

Provided further that in case of offer or invitation for non-convertible debentures, it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitation for such debentures during the year.

Provided also that in case of an offer or invitation for non convertible debenture referred to in the second proviso, made within a period of six months from the date of commencement of these rules, the special resolution referred to in the second proviso may be passed within the said period of six months from the date of commencement of these rules.

(b) such offer or invitation shall be made to not more than two hundred persons in the aggregate in a financial year:

Provided that any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62 shall not be considered while calculating the limit of two hundred persons;

Explanation.– For the purposes of this sub-rule, it is hereby clarified that –

(i) the restrictions under sub-clause (b) would be reckoned individually for each kind of security that is equity share, preference share or debenture;

(ii) the requirement of provisions of sub-section (3) of section 42 shall apply in respect of offer or invitation of each kind of security and no offer or invitation of another kind of security shall be made unless allotments with respect to offer or invitation made earlier in respect of any other kind of security is completed;

(c) the value of such offer or invitation per person shall be with an investment size of not less than twenty thousand rupees of face value of the securities;

(d) the payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep the record of the Bank account from where such payments for subscriptions have been received:

Provided that monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application.

(3) The company shall maintain a complete record of private placement offers in Form PAS-5:

Provided that a copy of such record along with the private placement offer letter in Form PAS-4 shall be filed with the Registrar with fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and where the company is listed, with the Securities and Exchange Board within a period of thirty days of circulation of the private placement offer letter.

Explanation.- For the purpose of this rule, it is hereby clarified that the date of private placement offer letter shall be deemed to be the date of circulation of private placement offer letter.

(4) A return of allotment of securities under section 42 shall be filed with the Registrar within thirty days of allotment in Form PAS-3 and with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 along with a complete list of all security holders containing-

(i) the full name, address, Permanent Account Number and E-mail ID of such security holder;

(ii) the class of security held;

(iii) the date of allotment of security ;

(iv) the number of securities held, nominal value and amount paid on such securities; and particulars of consideration received if the securities were issued for consideration other than cash.

(5) The provisions of clauses (b) and (c) of sub-rule (2) shall not be applicable to –

(a) non-banking financial companies which are registered with the Reserve Bank of India under Reserve Bank of India Act, 1934; and

(b) housing finance companies which are registered with the National Housing Bank under National Housing Bank Act, 1987,

if they are complying with regulations made by Reserve Bank of India or National Housing Bank in respect of offer or invitation to be issued on private placement basis:

Provided that such companies shall comply with sub-clauses (b) and (c) of sub-rule (2) in case the Reserve Bank of India or the National Housing Bank have not specified similar regulations.

Appendix XI

Text of Section 45-IA of the Reserve Bank of India Act, 1934

45-IA. Requirement of Registration and Net Owned Fund

(1) Notwithstanding anything contained in this Chapter or in any other law for the time being in force, no non-banking financial company shall commence or carry on the business of a non-banking financial institution without–

(a) obtaining a certificate of registration issued under this Chapter; and

(b) having the net owned fund of twenty-five lakh rupees or such other amount, not exceeding two hundred lakh rupees, (Rs. 200 Lakhs since April 1999) as the Bank may, by notification in the Official Gazette, specify.

(2) Every non-banking financial company shall make an application for registration to the Bank in such form as the Bank may specify:

Provided that a non-banking financial company in existence on the commencement of the Reserve Bank of India (Amendment) Act, 1997 shall make an application for registration to the Bank before the expiry of six months from such commencement and notwithstanding anything contained in sub-section (1) may continue to carry on the business of a non-banking financial institution until a certificate of registration is issued to it or rejection of application for registration is communicated to it.

(3) Notwithstanding anything contained in sub-section (1), a non-banking financial company in existence on the commencement of the Reserve Bank of India (Amendment) Act, 1997 and having a net owned fund

of less than twenty-five lakh rupees may, for the purpose of enabling such company to fulfil the requirement of the net owned fund, continue to carry on the business of a non-banking financial institution–

(i) for a period of three years from such commencement; or

(ii) for such further period as the Bank may, after recording the reasons in writing for so doing, extend, subject to the condition that such company shall, within three months of fulfilling the requirement of the net owned fund, inform the Bank about such fulfilment:

Provided that the period allowed to continue business under this sub-section shall in no case exceed six years in the aggregate.

(4) The Bank may, for the purpose of considering the application for registration, require to be satisfied by an inspection of the books of the non-banking financial company or otherwise that the following conditions are fulfilled:–

(a) that the non-banking financial company is or shall be in a position to pay its present or future depositors in full as and when their claims accrue;

(b) that the affairs of the non-banking financial company are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;

(c) that the general character of the management or the proposed management of the non-banking financial company shall not be prejudicial to the public interest or the interest of its depositors;

(d) that the non-banking financial company has adequate capital structure and earning prospects;

(e) that the public interest shall be served by the grant of certificate of registration to the non-banking financial company to commence or to carry on the business in India;

(f) that the grant of certificate of registration shall not be prejudicial to the operation and consolidation of the financial sector consistent with monetary stability, economic growth and considering such other relevant factors which the Bank may, by notification in the Official Gazette, specify; and

(g) any other condition, fulfilment of which in the opinion of the Bank, shall be necessary to ensure that the commencement of or carrying on of the business in India by a non-banking financial company shall not be prejudicial to the public interest or in the interest of the depositors.

(5) The Bank may, after being satisfied that the conditions specified in sub-section (4) are fulfilled, grant a certificate of registration subject to such conditions which it may consider fit to impose.

(6) The Bank may cancel a certificate of registration granted to a non-banking financial company under this section if such company–

(i) ceases to carry on the business of a non-banking financial institution in India; or

(ii) has failed to comply with any condition subject to which the certificate of registration had been issued to it; or

(iii) at any time fails to fulfil any of the conditions referred to in clauses (a) to (g) of sub-section (4); or

(iv) fails–

(a) to comply with any direction issued by the Bank under the provisions of this chapter; or

(b) to maintain accounts in accordance with the requirements of any law or any direction or order issued by the Bank under the provisions of this Chapter; or

(c) to submit or offer for inspection its books of account and other relevant documents when so demanded by an inspecting authority of the Bank; or

(v) has been prohibited from accepting deposit by an order made by the Bank under the provisions of this Chapter and such order has been in force for a period of not less than three months:

Provided that before cancelling a certificate of registration on the ground that the non-banking financial company has failed to comply with the provisions of clause (ii) or has failed to fulfil any of the conditions referred to in clause (iii) the Bank, unless it is of the opinion that the delay in cancelling the certificate of registration shall be prejudicial to public interest or the interest of the depositors or the non-banking financial company, shall give an opportunity to such company on such terms as the Bank may specify for taking necessary steps to comply with such provision or fulfillment of such condition;

Provided further that before making any order of cancellation of certificate of registration, such company shall be given a reasonable opportunity of being heard.

(7) A company aggrieved by the order of rejection of application for registration or cancellation of certificate of registration may prefer an appeal, within a period of thirty days from the date on which such order of rejection or cancellation is communicated to it, to the Central Government and the decision of the Central Government where an appeal has been preferred to it,

or of the Bank where no appeal has been preferred, shall be final:

Provided that before making any order of rejection of appeal, such company shall be given a reasonable opportunity of being heard.

Explanation.– For the purposes of this section,–

(I) "net owned fund" means–

(a) the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance-sheet of the company after deducting therefrom–

(i) accumulated balance of loss;

(ii) deferred revenue expenditure; and

(iii) other intangible assets; and

(b) further reduced by the amounts representing–

(1) investments of such company in shares of–

(i) its subsidiaries;

(ii) companies in the same group;

(iii) all other non-banking financial companies; and

(2) the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with,–

(i) subsidiaries of such company; and

(ii) companies in the same group,

to the extent such amount exceeds ten per cent of (a) above.

(II) "subsidiaries" and "companies in the same group" shall have the same meanings assigned to them in the Companies Act, 1956.

Appendix XII

Text of Sections 73 to 76 of the Companies Act, 2013

Prohibition on acceptance of deposits from public

73. (*1*) On and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under this Chapter:

Provided that nothing in this sub-section shall apply to a banking company and non-banking financial company as defined in the Reserve Bank of India Act, 1934 and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

(*2*) A company may, subject to the passing of a resolution in general meeting and subject to such rules as may be prescribed in consultation with the Reserve Bank of India, accept deposits from its members on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest, as may be agreed upon between the company and its members, subject to the fulfilment of the following conditions, namely:—

(*a*) issuance of a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in such form and in such manner as may be prescribed;

(*b*) filing a copy of the circular along with such statement with the Registrar within thirty days before the date of issue of the circular;

(*c*) depositing such sum which shall not be less than fifteen per cent of the amount of its deposits maturing during a financial year and the financial year next following, and kept in a scheduled bank in a separate bank account to be called as deposit repayment reserve account;

(*d*) providing such deposit insurance in such manner and to such extent as maybe prescribed;

(*e*) certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits; and

(*f*) providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company:

Provided that in case where a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as ‘‘unsecured deposits’ and shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.

(*3*) Every deposit accepted by a company under sub-section (*2*) shall be repaid with interesting accordance with the terms and conditions of the agreement referred to in that sub-section.

(*4*) Where a company fails to repay the deposit or part thereof or any interest thereon under sub-section (*3*), the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.

(5) The deposit repayment reserve account referred to in clause (*c*) of sub-section (*2*) shall not be used by the company for any purpose other than repayment of deposits.

Repayment of deposits, etc., accepted before commencement of this Act

74. (*1*) Where in respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall—

(*a*) file, within a period of three months from such commencement or from the date on which such payments, are due, with the Registrar a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment, notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law; and

(*b*) repay within one year from such commencement or from the date on which such payments are due, whichever is earlier.

(*2*) The Tribunal may on an application made by the company, after considering the financial condition of the company, the amount of deposit or part thereof and the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit.

(*3*) If a company fails to repay the deposit or part thereof or any interest thereon within the time specified in sub-section (*1*) or such further time as may be allowed by the Tribunal under sub-section (*2*), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.

Damages for fraud

75. (*1*) Where a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified in sub-section (*1*) of that section or such further time as may be allowed by the Tribunal under sub-section (*2*) of that section, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in sub-section(*3*) of that section and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

(*2*) Any suit, proceedings or other action may be taken by any person, group of persons or any association of persons who had incurred any loss as a result of the failure of the company to repay the deposits or part thereof or any interest thereon.

Acceptance of deposits from Public by certain companies

76. (*1*) Notwithstanding anything contained in section 73, a public company, having such net worth or turnover as may be prescribed, may accept deposits from persons other than its members subject to compliance with the requirements provided in sub-section (*2*) of section 73 and subject to such rules as the Central Government may, in consultation with the Reserve Bank of India, prescribe:

Provided that such a company shall be required to obtain the rating (including its net worth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency for informing the public the rating given to the company at the time of invitation of deposits from the public which ensures adequate safety and the rating shall be obtained for every year during the tenure of deposits:

Provided further that every company accepting secured deposits from the public shall within thirty days of such acceptance, create a charge on its assets of an amount not less than the amount of deposits accepted in favour of the deposit holders in accordance with such rules as may be prescribed.

(*2*) The provisions of this Chapter shall, *mutatis mutandis*, apply to the acceptance of deposits from public under this section.

Appendix XIII

Text of the Companies (Acceptance of Deposits) Rules, 2014

1. Short title, commencement and application.- (1) These rules may be called the Companies (Acceptance of Deposits) Rules, 2014.

(2) They shall come into force on the 1st day of April, 2014.

(3) These rules shall apply to a company other than –

(i) a banking company;

(ii) a non-banking financial company as defined in the Reserve Bank of India Act, 1934 (2 of 1934) registered with the Reserve Bank of India;

(iii) a housing finance company registered with the National Housing Bank established under the National Housing Bank Act, 1987 (53 of 1987); and

(iv) a company specified by the Central Government under the proviso to sub-section (1) of section 73 of the Act.

2. Definitions.- (1) In these rules, unless the context otherwise requires, ___

(a) "Act" means the Companies Act, 2013 (18 of 2013);

(b) "Annexure" means the Annexure attached to these rules;

(c) "deposit" includes any receipt of money by way of deposit or loan or in any other form, by a company, but does not include –

(i) any amount received from the Central Government or a State Government, or any amount received from any other source whose repayment is guaranteed by the Central Government or a State Government, or any amount received from a local authority, or any amount received from a statutory authority constituted under an Act of Parliament or a State Legislature ;

(ii) any amount received from foreign Governments, foreign or international banks, multilateral financial institutions (including, but not limited to, International Finance Corporation, Asian Development Bank, Commonwealth Development Corporation and International Bank for Industrial and Financial Reconstruction), foreign Governments owned development financial institutions, foreign export credit agencies, foreign collaborators, foreign bodies corporate and foreign citizens, foreign authorities or persons resident outside India subject to the provisions of Foreign Exchange Management Act, 1999 (42 of 1999) and rules and regulations made there under;

(iii) any amount received as a loan or facility from any banking company or from the State Bank of India or any of its subsidiary banks or from a banking institution notified by the Central Government under section 51 of the Banking Regulation Act, 1949 (10 of 1949), or a corresponding new bank as defined in clause (d) of section 2 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970) or in clause (b) of section (2) of the Banking

Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980) , or from a co-operative bank as defined in clause (b-ii) of section 2 of the Reserve Bank of India Act, 1934 (2 of 1934) ;

(iv) any amount received as a loan or financial assistance from Public Financial Institutions notified by the Central Government in this behalf in consultation with the Reserve Bank of India or any regional financial institutions or Insurance Companies or Scheduled Banks as defined in the Reserve Bank of India Act, 1934 (2 of 1934);

(v) any amount received against issue of commercial paper or any other instruments issued in accordance with the guidelines or notification issued by the Reserve Bank of India;

(vi) any amount received by a company from any other company;

(vii) any amount received and held pursuant to an offer made in accordance with the provisions of the Act towards subscription to any securities, including share application money or advance towards allotment of securities pending allotment, so long as such amount is appropriated only against the amount due on allotment of the securities applied for;

Explanation.- For the purposes of this sub-clause, it is hereby clarified that –

(a) Without prejudice to any other liability or action, if the securities for which application money or advance for such securities was received cannot be

allotted within sixty days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within fifteen days from the date of completion of sixty days, such amount shall be treated as a deposit under these rules.

"Provided that unless otherwise required under the Companies Act, 1956 (I of 1956) or the Securities and Exchange Board of India Act, 1992 (15 of 1992) or rules or regulations made there under to allot any share, stock, bond, or debenture within a specified period, if a company had received any amount by way of subscriptions to any shares, stock, bonds or debentures before the 1st April,2014 and disclosed it in the balance sheet for the financial year ending on or before the 31st March, 2014 against which the allotment is pending on the 3lst March, 2015, the company shall, by the 1st June 2015, either return such amounts to the persons from whom these were received or allot shares, stock, bonds or debentures or comply with these rules."

(b) any adjustment of the amount for any other purpose shall not be treated as refund.

(viii) any amount received from a person who, at the time of the receipt of the amount, was a

director of the company: or a relative of the director of the private company

Provided that the director of the company or relative of the director of the private company, as the case may be from whom money is received, furnished, to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others and the company shall disclose the details of money so accepted in the Board's Reports;

(ix) any amount raised by the issue of bonds or debentures secured by a first charge or a charge ranking *pari passu* with the first charge on any assets referred to in Schedule III of the Act excluding intangible assets of the company or bonds or debentures compulsorily convertible into shares of the company within five years:

Provided that if such bonds or debentures are secured by the charge of any assets referred to in Schedule III of the Act, excluding intangible assets, the amount of such bonds or debentures shall not exceed the market value of such assets as assessed by a registered valuer;

(x) any amount received from an employee of the company not exceeding his annual salary under a contract of employment with the company in the nature of non-interest bearing security deposit;

(xi) any non-interest bearing amount received or held in trust;

(xii) any amount received in the course of, or for the purposes of, the business of the company,

(a) as an advance for the supply of goods or provision of services accounted for in any manner whatsoever provided that such advance is appropriated against supply of goods or provision of services within a period of three hundred and sixty five days from the date of acceptance of such advance:

Provided that in case of any advance which is subject matter of any legal proceedings before any court of law, the said time limit of three hundred and sixty five days shall not apply:

(b) as advance, accounted for in any manner whatsoever, received in connection with consideration for an immovable property under an agreement or arrangement , provided that such advance is adjusted against such property in accordance with the terms of agreement or arrangement;

(c) as security deposit for the performance of the contract for supply of goods or provision of services;

(d) as advance received under long term projects for supply of capital goods except those covered under item (b) above:

Provided that if the amount received under items (a), (b) and (d) above becomes refundable (with or without interest) due to the reasons that the

company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then the amount received shall be deemed to be a deposit under these rules:

Explanation.- For the purposes of this sub-clause the amount referred to in the proviso shall be deemed to be deposits on the expiry of fifteen days from the date they become due for refund.

(xiii) any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to fulfillment of the following conditions, namely:

(a) the loan is brought in pursuance of the stipulation imposed by the lending institutions on the promoters to contribute such finance;

(b) the loan is provided by the promoters themselves or by their relatives or by both; and

(c) the exemption under this sub-clause shall be available only till the loans of financial institution or bank are repaid and not thereafter;

(xiv) any amount accepted by a Nidhi company in accordance with the rules made under section 406 of the Act.

Explanation.- For the purposes of this clause, any amount.

(a) received by the company, whether in the form of instalments or otherwise, from a person with promise or offer to give returns, in cash or in kind, on completion of the period specified in the promise or offer, or earlier, accounted for in any manner whatsoever, or

(b) any additional contributions, over and above the amount under item (a) above, made by the company as part of such promise or offer, shall be treated as a deposit;

(d) ‘‘depositor’’ means,

(i) any member of the company who has made a deposit with the company in accordance with the provisions of subsection (2) of section 73 of the Act, or

(ii) any person who has made a deposit with a public company in accordance with the provisions of section 76 of the Act;

(e) “eligible company” means a public company as referred to in sub-section (1) of section 76, having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies before making any invitation to the Public for acceptance of deposits:

Provided that an eligible company, which is accepting deposits within the limits specified under clause (c) of subsection (1) of section 180, may accept deposits by means of an ordinary resolution;

(f) "fees" means fees as specified in the Companies (Registration Offices and Fees) Rules, 2014;

(g) "Form" or 'e-Form" means a form set forth in Annexure to these rules which shall be used for the matter to which it relates;

(h) "section" means section of the Act;

(i) "trustee" means the trustee as defined in section 3 of the Indian Trusts Act, 1882 (12 of 1882).

(2) Words and expressions used in these rules but not defined and defined in the Act or in the Reserve Bank of India Act, 1934 (2 of 1934) or in the Companies (Specification of definitions details) Rules, 2014, shall have the meanings respectively assigned to them in the said Acts or in the said rules.

3. Terms and conditions of acceptance of deposits by companies.- (1) On and from the commencement of these rules,—

(a) no company referred to in sub-section (2) of section 73 and no eligible company shall accept or renew any deposit, whether secured or unsecured, which is repayable on demand or upon receiving a notice within a period of less than six months or more than thirty-six months from the date of acceptance or renewal of such deposit:

Provided that a company may, for the purpose of meeting any of its short-term requirements of funds, accept or renew such deposits for repayment earlier than six months from the date of deposit or renewal, as the case may be, subject to the condition that
(a) such deposits shall not exceed ten per cent. of the aggregate of the paid up share capital, free

reserves and securities premium account of the company, and

(b) such deposits are repayable not earlier than three months from the date of such deposits or renewal thereof.

(2) Where depositors so desire, deposits may be accepted in joint names not exceeding three, with or without any of the clauses, namely, “Jointly”, “Either or Survivor”, “First named or Survivor”, “Anyone or Survivor”.

(3) No company referred to in sub-section (2) of section 73 shall accept or renew any deposit from its members, if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal of such deposits exceeds twenty five per cent. of the aggregate of the paid up share capital, free reserves and securities premium account of the company.

(4) No eligible company shall accept or renew

(a) any deposit from its members, if the amount of such deposit together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members exceeds ten per cent of the aggregate of the paid up share capital, free reserves and securities premium account of the company;

(b) any other deposit, if the amount of such deposit together with the amount of such other deposits, other than the deposit referred to in clause (a), outstanding on the date of acceptance or renewal exceeds twenty-five per cent. Of aggregate of the paid up share capital, free reserves and securities premium account of the company.

(5) No Government company eligible to accept deposits under section 76 shall accept or renew any deposit, if

the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal exceeds thirty five per cent of the aggregate of its paid up share capital, free reserves and securities premium account of the company.

(6) No company referred to in sub-section (2) of section 73 or any eligible company shall invite or accept or renew any deposit in any form, carrying a rate of interest or pay brokerage thereon at a rate exceeding the maximum rate of interest or brokerage prescribed by the Reserve Bank of India for acceptance of deposits by non-banking financial companies.

Explanation:- For the purposes of this sub-rule, it is hereby clarified that the person who is authorised, in writing, by a company to solicit deposits on its behalf and through whom deposits are actually procured shall only be entitled to the brokerage and payment of brokerage to any other person for procuring deposits shall be deemed to be in violation of these rules.

(7) The company shall not reserve to itself either directly or indirectly a right to alter, to the prejudice or disadvantage of the depositor, any of the terms and conditions of the deposit, deposit trust deed and deposit insurance contract after circular or circular in the form of advertisement is issued and deposits are accepted.

(8) Every eligible company shall obtain, at least once in a year, credit rating for deposits accepted by it in the manner specified herein below and a copy of the rating shall be sent to the registrar of the companies along with the return of the deposits in form DPT-3.

Name of the agency	Minimum investment grade rating
(a) The credit rating	FA- (FA Minus)

information services of India Ltd.	
(b)ICRA Ltd.	MA- (MA Minus)
© Credit Analysis and Research Ltd.	CARE BBB(FD)
(d) Fitch Rating India Private Ltd.	tA(ind)(FD)
(e) Brickwork Rating India Private Ltd.	BWR FBBB]
(f) SME Rating Agency of India Ltd.	SMERAA

4. Form and particulars of advertisements or circulars.- (1) Every company referred to in sub-section (2) of section 73 intending to invite deposit from its members shall issue a circular to all its members by registered post with acknowledgement due or speed post or by electronic mode in Form DPT-1:

Provided that in addition to issue of such circular to all members in the manner specified above, the circular may be published in English language in an English newspaper and in vernacular language in a vernacular newspaper having wide circulation in the State in which the registered office of the company is situated.

(2) Every eligible company intending to invite deposits shall issue a circular in the form of an advertisement in Form DPT-1 for the purpose in English language in an English newspaper and in vernacular language in one vernacular newspaper having wide circulation in the State in which the registered office of the company is situated.

(3) Every company inviting deposits from the public shall upload a copy of the circular on its website, if any.

(4) No company shall issue or allow any other person to issue or cause to be issued on its behalf, any circular or a circular in the form of advertisement inviting deposits, unless such circular or circular in the form of advertisement is issued on the authority and in the name of the Board of directors of the company.

(5) No circular or a circular in the form of advertisement shall be issued by or on behalf of a company unless, not less than thirty days before the date of such issue, there has been delivered to the Registrar for registration a copy thereof signed by a majority of the directors of the company as constituted at the time the Board approved the circular or circular in the form of advertisement, or their agents, duly authorised by them in writing.

(6) A circular or circular in the form of advertisement issued shall be valid until the expiry of six months from the date of closure of the financial year in which it is issued or until the date on which the financial statement is laid before the company in annual general meeting or, where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the Act, whichever is earlier, and a fresh circular or circular in the form of advertisement shall be issued, in each succeeding financial year, for inviting deposits during that financial year.

Explanation: For the purpose of this rule, the date of the issue of the newspaper in which the advertisement appears shall be taken as the date of issue of the advertisement and the effective date of issue of circular shall be the date of dispatch of the circular.

5. Manner and extent of deposit insurance.- (1) Every company referred to in sub-section (2) of section 73 and every other eligible company inviting deposits shall enter into a contract for providing deposit insurance at least thirty days before the issue of circular or advertisement or at least thirty days before the date of renewal, as the case may be.

"Provided that the companies may accept deposit without deposit insurance contract till the 31st March, 2016 or till the availability of a deposit insurance product, whichever is earlier."

Explanation- For the purposes of this sub-rule, the amount as specified in the deposit insurance contract shall be deemed to be the amount in respect of both principal amount and interest due thereon.

(2) The deposit insurance contract shall specifically provide that in case the company defaults in repayment of principal amount and interest thereon, the depositor shall be entitled to the repayment of principal amount of deposits and the interest thereon by the insurer up to the aggregate monetary ceiling as specified in the contract:

Provided that in the case of any deposit and interest not exceeding twenty thousand rupees, the deposit insurance contract shall provide for payment of the full amount of the deposit and interest and in the case of any deposit and the interest thereon in excess of twenty thousand rupees, the deposit insurance contract shall provide for payment of an amount not less than twenty thousand rupees for each depositor.

(3) The amount of insurance premium paid on the insurance of such deposits shall be borne by the company itself and shall not be recovered from the depositors by deducting the same from the principal amount or interest payable thereon.

(4) If any default is made by the company in complying with the terms and conditions of the deposit insurance contract which makes the insurance cover ineffective, the company shall either rectify the default immediately or enter into a fresh contract within thirty days and in case of non-compliance, the amount of deposits covered under the deposit insurance contract and interest payable thereon shall be repaid within the next fifteen days and if such a company does not repay the amount of deposits within said fifteen days it shall pay fifteen per cent. interest per annum for the period of delay and shall be treated as having defaulted and shall be liable to be punished in accordance with the provisions of the Act.

6. Creation of security.- (1) For the purposes of providing security, every company referred to in sub-section (2) of section 73 and every eligible company inviting secured deposits shall provide for security by way of a charge on its assets as referred to in Schedule III of the Act excluding intangible assets of the company for the due repayment of the amount of deposit and interest thereon for an amount which shall not be less than the amount remaining unsecured by the deposit insurance:

Provided that in the case of deposits which are secured by the charge on the assets referred to in Schedule III of the Act excluding intangible assets, the amount of such deposits and the interest payable thereon shall not exceed the market value of such assets as assessed by a registered valuer.

Explanation. I – For the purposes of this sub-rule it is clarified that the company shall ensure that the total value of the security either by way of deposit insurance or by way of charge or by both on company's assets shall not be less than the amount of deposits accepted and the interest payable thereon.

Explanation. II- For the purposes of proviso to sub-clause (ix) of clause (c) of sub-rule (1) of rule 2 and this sub-rule, it is hereby clarified that pending notification of sub-section (1) of section 247 of the Act and finalisation of qualifications and experience of valuers, valuation of stocks, shares, debentures, securities etc. shall be conducted by an independent merchant banker who is registered with the Securities and Exchange Board of India or an independent chartered accountant in practice having a minimum experience of ten years.

(2) The security (not being in the nature of a pledge) for deposits as specified in sub-rule (1) shall be created in favour of a trustee for the depositors on:

(a) specific movable property of the company, or

(b) specific immovable property of the company wherever situated, or any interest therein.

7. Appointment of trustee for depositors.- (1) No company referred to in sub-section (2) of section 73 or any eligible company shall issue a circular or advertisement inviting secured deposits unless the company has appointed one or more trustees for depositors for creating security for the deposits:

Provided that a written consent shall be obtained from the trustee for depositors before their appointment and a statement shall appear in the circular or circular in the form of advertisement with reasonable prominence to the effect that the trustees for depositors have given their consent to the company to be so appointed.

(2) The company shall execute a deposit trust deed in Form DPT-2 at least seven days before issuing the circular or circular in the form of advertisement.

(3) No person including a company that is in the business of providing trusteeship services shall be appointed as a trustee for the depositors, if the proposed trustee –

(a) is a director, key managerial personnel or any other officer or an employee of the company or of its holding, subsidiary or associate company or a depositor in the company;

(b) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(c) has any material pecuniary relationship with the company;

(d) has entered into any guarantee arrangement in respect of principal debts secured by the deposits or interest thereon;

(e) is related to any person specified in clause (a) above.

(4) No trustee for depositors shall be removed from office after the issue of circular or advertisement and before the expiry of his term except with the consent of all the directors present at a meeting of the board.

Provided that in case the company is required to have independent directors, at least one independent director shall be present in such meeting of the Board

8. Duties of trustees.- It shall be the duty of every trustee for depositors to

(a) ensure that the assets of the company on which charge is created together with the amount of deposit insurance are sufficient to cover the repayment of the principal amount of secured deposits outstanding and interest accrued thereon;

(b) satisfy himself that the circular or advertisement inviting deposits does not contain any information which is inconsistent with the terms of the deposit scheme or with the trust deed and is in compliance with the rules and provisions of the Act;

(c) ensure that the company does not commit any breach of covenants and provisions of the trust deed;

(d) take such reasonable steps as may be necessary to procure a remedy for any breach of covenants of the trust deed or the terms of invitation of deposits;

(e) take steps to call a meeting of the holders of depositors as and when such meeting is required to be held;

(f) supervise the implementation of the conditions regarding creation of security for deposits and the terms of deposit insurance;

(g) do such acts as are necessary in the event the security becomes enforceable;

(h) carry out such acts as are necessary for the protection of the interest of depositors and to resolve their grievances.

9. Meeting of depositors.- The trustee for depositors shall call a meeting of all the depositors on

(a) requisition in writing signed by at least one-tenth of the depositors in value for the time being outstanding;

(b) the happening of any event, which constitutes a default or which, in the opinion of the trustee for depositors, affects the interest of the depositors.

10. Form of application for deposits.- (1) On and from the commencement of these rules, no company shall accept, or renew any deposit, whether secured or unsecured, unless an application, in such form as specified by the company, is submitted by the intending depositor for the acceptance of such deposit.

(2) The form of application referred to in sub-rule (1) shall contain a declaration by the intending depositor to the effect that the deposit is not being made out of any money borrowed by him from any other person.

11. Power to nominate.- Every depositor may, at any time, nominate any person to whom his deposits shall vest in the event of his death and the provisions of section 72 shall, as far as may be, apply to the nomination made under this rule.

12. Furnishing of deposit receipts to depositors.- (1) Every company shall, on the acceptance or renewal of a deposit, furnish to the depositor or his agent a receipt for the amount received by the company, within a period of twenty one days from the date of receipt of money or realisation of cheque or date of renewal.

(2) The receipt referred to in sub-rule (1) shall be signed by an officer of the company duly authorised by the Board in this behalf and shall state the date of deposit, the name and address of the depositor, the amount received by the company as deposit, the rate of interest payable thereon and the date on which the deposit is repayable.

13. Maintenance of liquid assets and creation of deposit repayment reserve account.- Every company referred to in sub-section (2) of section 73 and every eligible company shall on or before the 30th day of April of each year deposit the sum as specified in clause (c) of the said sub-section with any scheduled bank and the amount so deposited shall not be utilised

for any purpose other than for the repayment of deposits:

Provided that the amount remaining deposited shall not at any time fall below fifteen per cent. of the amount of deposits maturing, until the end of the current financial year and the next financial year.

14. Registers of deposits.- (1) Every company accepting deposits shall maintain at its registered office one or more separate registers for deposits accepted or renewed, in which there shall be entered separately in the case of each depositor the following particulars, namely:

(a) name, address and PAN of the depositor/s;

(b) particulars of guardian, in case of a minor;

(c) particulars of the nominee;

(d) deposit receipt number;

(e) date and the amount of each deposit;

(f) duration of the deposit and the date on which each deposit is repayable;

(g) rate of interest or such deposits to be payable to the depositor;

(h) due date for payment of interest;

(i) mandate and instructions for payment of interest and for non-deduction of tax at source, if any;

(j) date or dates on which the payment of interest shall be made;

(k) details of deposit insurance including extent of deposit insurance;

(l) particulars of security or charge created for repayment of deposits;

(m) any other relevant particulars;

(2) The entries specified in sub-rule (1) shall be made within seven days from the date of issuance of the receipt duly authenticated by a director or secretary of the company or by any other officer authorised by the Board for this purpose.

(3) The register referred to in sub-rule (1) shall be preserved in good order for a period of not less than eight years from the financial year in which the latest entry is made in the register.

15. General provisions regarding premature repayment of deposits.- Where a company makes a repayment of deposits, on the request of the depositor, after the expiry of a period of six months from the date of such deposit but before the expiry of the period for which such deposit was accepted, the rate of interest payable on such deposit shall be reduced by one per cent from the rate which the company would have paid had the deposit been accepted for the period for which such deposit had actually run and the company shall not pay interest at any rate higher than the rate so reduced :

Provided that nothing contained in this rule shall apply to the repayment of any deposit before the expiry of the period for which such deposit was accepted by the company, if such repayment is made solely for the purpose of—

(a) complying with the provisions of rule 3; or

(b) providing war risk or other related benefits to the personnel of the naval, military or air forces or to their families, on an application made by the associations or societies formed by such personnel, during the period of emergency declared under article 352 of the Constitution :

Provided further that where a company referred to in under sub-section (2) of section 73 or any eligible

company permits a depositor to renew his deposit, before the expiry of the period for which such deposit was accepted by the company, for availing of a higher rate of interest, the company shall pay interest to such depositor at the higher rate if such deposit is renewed in accordance with the other provisions of these rules and for a period longer than the unexpired period of the deposit.

Explanation: For the purposes of this rule, where the period for which the deposit had run contains any part of a year, then, if such part is less than six months, it shall be excluded and if such part is six months or more, it shall be reckoned as one year.

16. **Return of deposits to be filed with the Registrar**.- Every company to which these rules apply, shall on or before the 30th day of June, of every year, file with the Registrar, a return in Form DPT-3 along with the fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and furnish the information contained therein as on the 31st day of March of that year duly audited by the auditor of the company.

17. **Penal rate of interest**.- Every company shall pay a penal rate of interest of eighteen per cent. per annum for the overdue period in case of deposits, whether secured or unsecured, matured and claimed but remaining unpaid.

18. **Power of Central Government to decide certain questions**. If any question arises as to the applicability of these rules to a particular company, such question shall be decided by the Central Government in consultation with the Reserve Bank of India.

19. **Applicability of sections 73 and 74 to eligible companies**.- Pursuant to provisions of sub-section (2) of section 76 of the Act, the provisions of sections 73 and 74 shall, mutatis mutandis, apply to acceptance of deposits from public by eligible companies.

Explanation.- For the purposes of this rule, it is hereby clarified that in case of a company which had accepted or invited public deposits under the relevant provisions of the Companies Act, 1956 and rules made under that Act (hereinafter known as "Earlier Deposits") and has been repaying such deposits and interest thereon in accordance with such provisions, the provisions of clause (b) of sub-section (1) of section 74 of the Act shall be deemed to have been complied with if the company complies with requirements under the Act and these rules and continues to repay such deposits and interest due thereon on due dates for the remaining period of such deposit in accordance with the terms and conditions and period of such Earlier Deposits and in compliance with the requirements under the Act and these rules;

Provided further that the fresh deposits by every eligible company shall have to be in accordance with the provisions of Chapter V of the Act and these rules;

20. **Statement regarding deposits existing as on the date of commencement of the Act**.- For the purposes of clause (a) of sub-section (1) of section 74, the statement shall be in Form DPT-4.

21. **Punishment for contravention**.- If any company referred to in sub-section (2) of section 73 or any eligible company inviting deposits or any other person contravenes any provision of these rules for which no punishment is provided in the Act, the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first day during which the contravention continues.