

AUDIT REPORT

Question 1

The Statutory auditors of Getwell Ltd. included certain comments in his report u/s 227 of the Companies Act, 1956. Since the company requested the auditors to drop the above comments, as otherwise it will affect their future business, as a compromise the auditor included the comment in the report in ordinary type. Comment. (5 Marks) (November 2008)

Answer

As per Section 227(3) (e) of the Companies Act, 1956, one of the issues relating to audit report is that the report shall indicate in Bold or in Italics the observations as comments of the auditor which have any adverse effect on the functioning of the company. According to the Guidance Note issued on section 227(3) (e) and (f) of the Companies Act, creates a requirement for the auditor to consider any matter leading to the modification of the auditor report on financial statements is likely to have an adverse effect on the functioning of the company and if so the auditors is required to highlight such matter in Bold or in Italics.

In the instant case, the auditor's action in having printed certain comments in ordinary type is contrary to the provision of the Act and Guidance Note. He will be deemed to have discharged his duties negligently.

Question 2

A Private Limited reports the following position as on 31st March, 2010 :

<i>Paid up capital</i>	<i>30 lacs</i>
<i>Revaluation reserve</i>	<i>10 lacs</i>
<i>Capital reserve</i>	<i>11 lacs</i>
<i>P&T A/c [Dr. Balance]</i>	<i>2 lacs</i>

The Management of the Company contends that CARO 2003 is not applicable to it. Comment.

(5 Marks) (May 2010)

Answer

As per the Statement on CARO, 2003 issued by ICAI, for determining the applicability of the CARO, 2003 to a private limited company, both capital as well as the revenue reserves shall be taken into consideration while computing the limit of rupees fifty lacs prescribed for paid up capital and reserves. 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. The credit balance in the profit and loss account should also be considered as a part of reserve since the balance in the profit and loss account is available for general purposes like declaration of dividend. The debit balance in the profit and loss account, if any, should be reduced from the figure of revenue reserves only. If the company does not have revenue reserves, debit balance of profit and loss account cannot be reduced from the figures of paid up capital, capital reserve and revaluation reserve.

Accordingly the profit and loss account (Dr Balance) of ₹ 2 lacs cannot be deducted and hence CARO, 2003 is applicable to the Company.

Question 3

PQR Ltd., a listed company and having an average annual turnover of more than ₹ 5 crores has no Internal Audit System. Give your views. (5 Marks) (November 2010)

Answer**Internal Audit System and CARO 2003.**

The Companies Act, 1956 does not require a company to necessarily have an internal audit system. As per Para 4(vii) of CARO, 2003, statutory auditor is required to comment on whether the auditee company has an internal audit system commensurate with its size and nature of its business.

The clause has a mandatory application in respect of listed companies irrespective of the size of paid-up capital and reserves or turnover. For other companies, it is applicable if either of the following conditions is satisfied:

- (a) The company has a paid-up capital and reserves exceeding ₹ 50 lakhs at the commencement of the financial year, or
- (b) The company has an average annual turnover of ₹ 5 crores or more for a period of 3 consecutive financial years immediately preceding the financial year concerned.

In the instant case, PQR Ltd is a listed company and having an average annual turnover of more than ₹ 5 crores. Hence, the auditor will have to mention in his report the fact of not having such internal audit system by the Company.

Question 4

- (a) *OK Ltd. has taken a term loan from a nationalized bank in 2006 for ₹ 200 lakhs repayable in five equal instalments of ₹ 40 lakhs from 31st March, 2007 onwards. It had repaid the loans due in 2007 & 2008, but defaulted in 2009, 2010 & 2011. As the auditor of OK Ltd. what is your responsibility assuming that company has sought reschedulement of loan?* (4 Marks)
- (b) *Big and Small Ltd. received a show cause notice from central excise department intending to levy a demand of ₹ 25 lakhs in December 2010. The company replied to the above notice in January 2011 contending that it is not liable for the levy. No further action was initiated by the central excise department upto the finalization of the audit for the year ended on 31st March, 2011. As the auditor of the company, what is your role in this?* (4 Marks)
- (c) *Director of T Ltd. draws an advance of US\$ 200 per day in connection with the foreign trip undertaken on behalf of the company. On his return he files a declaration stating that entire advance was expended without any supporting or evidence. T Ltd. books the entire expenses on the basis of such declaration. As the auditor of T Ltd. how do you deal with this?* (8 Marks) (May 2011)

Answer

- (a) As per Para 4 (xi) of CARO, 2003 the auditors of a company has to state in his report that whether the Company has defaulted in repayment of its dues to financial institutions or bank or debentures holders and if yes the period and amount of default to be reported.

In this case OK Ltd has defaulted in repayment of dues for three years. Application for rescheduling will not change the default position. Hence the auditor has to report in his audit report that the Company has defaulted in its repayment of dues to the bank to the extent of ₹ 120 lakhs.

- (b) The auditor's report under section 227 the Companies Act, 1956 has to specifically include certain matters specified in Para 4 and Para 5 of CARO 2003.

One of such matter is payment of dues to Government. As per Para 4 (ix)(b) of CARO, 2003, "In case dues of Income Tax/ Sales Tax/ Service Tax/ Customs Duty/ Wealth Tax/ Excise Duty/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 Department shall not constitute the dispute."

In the present case issuance of show cause notice by Excise Department does not tantamount to demand payable by the Company. In as much as the Company has replied

to the notice and no further correspondence was received from the Department, it has to be construed that there is no demand. The auditor needs not to report on this.

- (c) SA 500 "Audit Evidence" states that an auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base his opinion.

Section 227 (IA) (e) the Companies Act, 1956 requires an auditor to report when personal expenses have been charged to revenue account.

In the context of the facts of case, ascertain whether the payment made by the company for the foreign trip form an "allowance" or "reimbursement". An allowance is a fixed sum of money allowed on the basis of specified criteria. No evidence supporting the expenditure is required for payment of allowance to the director. On the other hand, if the payment is reimbursement should be against actual expenditure.

The director concerned should provide proof of expenditure. Since the director has given only a declaration, the auditor should ascertain other relevant facts as to whether the advance paid is pursuant to the policy of the company which is based on approximate estimation of the expenditure normally incurred by a person of the status of a director and the same is applicable to persons of a similar status within the company. If the auditor considers the advance taken is reasonable then the declaration can be considered adequate, otherwise he may have to call for additional documentary evidences.