INDEX Amendments 'IPC'

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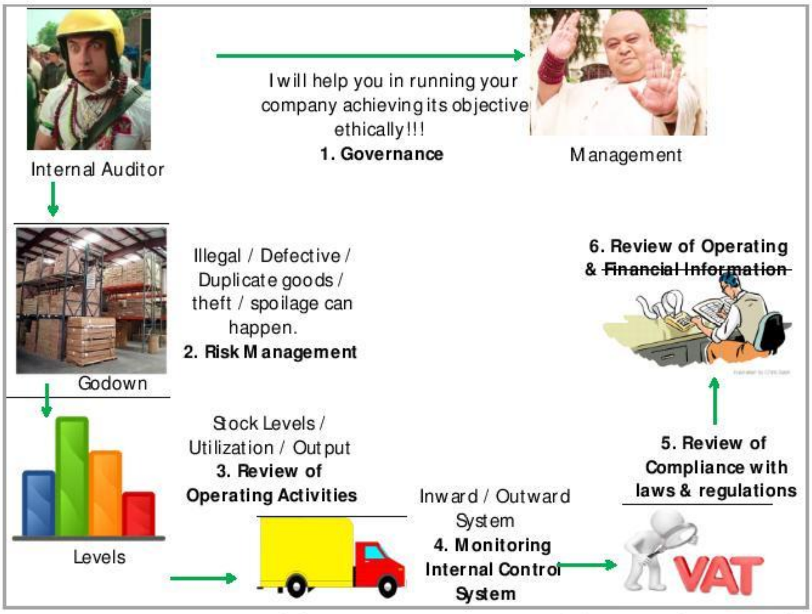
SA 610 (Revised)
USING THE WORK OF INTERNAL AUDITORS

SA 610-MAP

- Scope and Objectives of the Internal Audit Function
- Objectives of SA 610
- Relationship between the Internal Audit Function and the External Auditor
- Can we use work of internal auditor?
- How to use work of Internal Auditor?
- Can we take direct assistance of internal auditor?
- How to use direct assistance of internal auditor?

Scope and Objectives of the Internal Audit Function



Internal audit function – A function of an entity that performs assurance and Consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.

The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the following:

<u>Activities Relating to Governance</u>

- The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

<u>Activities Relating to Risk Management</u>

- The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process).
- The internal audit function may perform procedures to assist the entity in the detection of fraud.

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Activities Relating to Internal Control

- Evaluation of internal control. The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal control, including those controls that are relevant to the audit.
- Examination of financial and operating information. The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
- Review of operating activities. The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including nonfinancial activities of an entity.
- Review of compliance with laws and regulations. The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

Objectives of SA 610

The objectives of the external auditor, where the entity has an internal audit function and the external auditor expects to use the work of the function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor, or to use internal auditors to provide direct assistance, are:

(a) To determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and if so, in which areas and to what extent; and having made that determination:

(b) If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit; and

(c) If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work.

Relationship between the Internal Audit Function and the External Auditor

Particulars	Internal Audit	External Audit
Definition	It is a **review of activities, as a service to all levels of Management.**	**Audit of financial or other quantitative information of any entity** with a view to express an opinion thereon.
Objective	**Report upon the effectiveness of Internal Controls,** financial and others, as a contribution to the efficient use of resources within an organization.	To **express an opinion on the true and fair view** presented by Financial Statements.
Necessity	It is **voluntary. Compulsory to some companies U/S 138**	It is normally **compulsory. U/S 143**

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Auditor	Generally an **employee of the Organization.**	The External or Statutory Auditor is **not part of the organization.**
Appointment	By the **Management (BOD)** of the enterprise.	By the **owners (Shareholders)** of the enterprise.
Scope of work	It is **determined by the Management** and ranges from the pure review of accounting functions to the review of various operational services in the organization.	It **arises from the** responsibilities placed on him by the statute or the terms of engagement.
Submission of Report	To the **Management.**	To the **Shareholders.**
Format of Report	**No format** is prescribed. Guidelines in SIA 4	The aspects to be covered in the **Report are prescribed by law. SA 700**
Orientation	**Management** Oriented.	Oriented to the **needs of the users of Financial Statements** and also Management.

The role and objectives of the internal audit function are determined by management and, where applicable, those charged with governance. While the objectives of the internal audit function and the external auditor are different, some of the ways in which the internal audit function and the external auditor achieve their respective objectives may be similar.
Irrespective of the degree of autonomy and objectivity of the internal audit function, such function is not independent of the entity as is required of the external auditor when expressing an opinion on financial statements. The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal auditors.

Can we use work of Internal Auditor?

1. Evaluate Internal Audit Function ?

2. Which work can be used ?

1. Evaluate Internal Audit Function?

1. Technical Competence	
Team is Appropriately Resourced	10 CAs + 20 Articles + 2 CWAs
Established policies for hiring / training / assigning	Every 3 months / No graduates / Pre audit 9 day training / assigning as per talent
Qualification	CA / CPA / CIMA / CIA
Technical Training & Proficiency	Trained for AS / Ind AS / IFRS / SOX

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Membership of Professional Bodies (Compliance to Standards & Continuing Professional Development)	Majority governed by CA Act which require compliance to SAs & also Continuing Professional Education Programme
Knowledge of entity's FR & FRF	Team worked in same industry for past 10 years & working on same client for past 4 years
2. Objectivity	
Conflict of Interest	Not holding any post other than internal auditor in current & past.
Appointment	Audit Committee / BOD
Staff Appointments	Always in consultation with AC / BOD
Scope	No restrictions
Status	In line with directors
Authority	All the powers like director for internal auditor.
Accountability	Quarterly presentations & performance report.
Recommendations	Full Compliance
Membership obligation towards objectivity	As per CA Act & Regulations
3. Systematic and Disciplined Approach	
Documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting	There are 3 volumes of 1000 page each giving principles / formats / guidance on planning / risk assessment / procedures / reporting of Internal Audit.
Quality control policies and procedures	Internal Audit Firm is governed by Quality Control Procedures established under Internal Auditing Standards & SQC 1

The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by evaluating the following:

(a) The extent to which the internal audit function's organizational status and relevant policies and procedures support the **objectivity** of the internal auditors;

(b) The **level of competence** of the internal audit function; and

(c) Whether the internal audit function applies **a systematic and disciplined approach**, including quality control.

The external auditor **shall not** use the work of the internal audit function if the external auditor determines that:

(a) The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;

(b) The function lacks sufficient competence; or

(c) The function does not apply a systematic and disciplined approach, including quality control.

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2. Which work can be used?

As a basis for determining the areas and the extent to which the work of the internal audit function can be used, the external auditor shall consider the **nature and scope of the work that has been performed, or is planned to be performed, by the internal audit function** and its relevance to the external auditor's overall audit strategy and audit plan.

The external auditor shall make all significant judgments in the audit engagement and, **to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the function and perform more of the work directly**:

(a) The **more judgment** is involved in:

(i) Planning and performing relevant audit procedures; and

(ii) Evaluating the audit evidence gathered;

(b) The **higher the assessed risk of material misstatement** at the assertion level, with special consideration given to risks identified as significant;

3. How to use work of Internal Auditor?

If the external auditor plans to use the work of the internal audit function, the external auditor shall **discuss the planned use of its work with the function as a basis for coordinating their respective activities.**

The external auditor shall **read the reports of the internal audit function** relating to the work of the function that the external auditor plans to use to obtain an **understanding of the nature and extent of audit procedures** it performed and the related findings.

The external auditor shall **perform sufficient audit procedures on the body of work of the internal audit function** as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit, including evaluating whether:

(a) The work of the function had been **properly planned, performed, supervised, reviewed and documented**;

(b) **Sufficient appropriate evidence had been obtained** to enable the function to draw reasonable conclusions; and

(c) **Conclusions reached are appropriate** in the circumstances and the reports prepared by the function are consistent with the results of the work performed.

The nature and extent of the external auditor's audit procedures shall be responsive to the external auditor's evaluation of:

(a) The **amount of judgment involved**;

(b) The **assessed risk of material misstatement**;

(c) The extent to which the internal audit function's **organizational status** and relevant policies and procedures support the **objectivity of the internal auditors**; and

(d) The level of competence of the function; and **shall include re-performance of some of the work**

The external auditor shall also evaluate whether the external auditor's conclusions regarding the internal audit function and the determination of the nature and extent of use of the work of the function for purposes of the audit remain appropriate.

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4. Can we take direct assistance of internal auditor ?

The external auditor **may be prohibited by law or regulation** from obtaining direct assistance from internal auditors. If so then corresponding paragraphs of this SA will not be applicable.

If using internal auditors to provide direct assistance is **not prohibited by law or regulation**, and **the external auditor plans to use internal auditors to provide direct assistance** on the audit, the external auditor shall evaluate the existence and **significance of threats to objectivity and the level of competence of the internal auditors who will be providing such assistance.** The external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity shall include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity.

The external auditor shall not use an internal auditor to provide direct assistance if:

a) There are significant threats to the objectivity of the internal auditor; or (b) The internal auditor lacks sufficient competence to perform the proposed work.

Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:

a) Obtain **written agreement** from an authorized representative of the entity that the internal auditors will be allowed **to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor** performs for the external auditor; and
b) Obtain **written agreement** from the internal auditors that they will **keep confidential specific matters** as instructed by the external auditor and **inform the external auditor of any threat to their objectivity**.

The external auditor shall **direct, supervise and review** the work performed by internal auditors on the engagement in accordance with SA 220.

In so doing:

(a) The **nature, timing and extent of direction, supervision, and review** shall recognize that the internal auditors **are not independent** of the entity and be responsive to the outcome of the evaluation of the factors (Judgment / RMM / Competence etc.) ; and
(b) The review procedures shall include the external auditor **checking back to the underlying audit evidence for some of the work performed** by the internal auditors.

The direction, supervision and review by the external auditor of the work performed by the internal auditors shall be sufficient in order for the external auditor to be satisfied that the internal auditors have obtained sufficient appropriate audit evidence to support the conclusions based on that work.

In directing, supervising and reviewing the work performed by internal auditors, the external auditor **shall remain alert** for indications that the external auditor's evaluations "whether to use internal auditor for direct assistance" are no longer appropriate.

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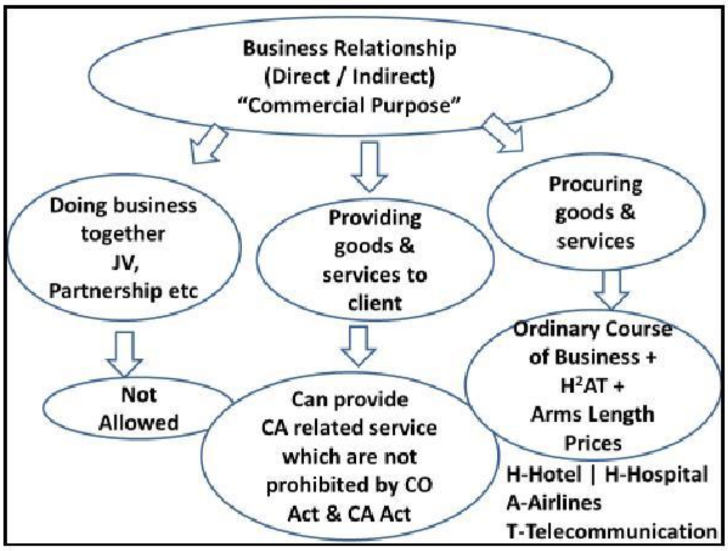
Addition to Company Audit Lectures

1. Additional explanation to concept of Business Relationship



2. Associate includes Joint Venture

Sec 2 (6)"associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation.—For the purposes of this clause, "significant influence" means control of at least twenty per cent of total share capital, or of business decisions under an agreement

3. Director of holding

As per company's act director of holding / subsidiary / associate are not disqualified to do audit of company, which is a loop hole in company's act. But ICAI has plugged on loop hole as per announcement Director of holding company cannot do audit of company so this one loop hole is plugged.

4. In exemptions to relatives there is small controversy: - if you read language carefully then as per literal interpretation you will notice that relatives can hold securities only in "that company" and not subsidiaries, associate.

   But as per reasonable interpretation if holding is allowed in that company where audit is being conducted other companies such as subsidiaries and associate should be covered.

   I will suggest give both the point of views in exams.

5. Exemptions while counting OPC / Dormant Co / Small Co / Pvt Co paid up capital below 100 crores.

   Further there are ICAI Guidelines 2008, which says ceiling limit should be 30 including all types of companies. So if we take combined interpretation, then CA can do 20 audits

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excluding 4 types of companies specified above and 30 companies including 4 types companies specified. But this point can be given at the end as additional knowledge. Solve problems as per limit of 20 only, unless specifically mentioned about guidelines.

Little controversy here regarding foreign company, foreign company is considered as body corporate and not company as per companies act. Now while counting we should only take companies and not body Corporates such as foreign company. This view is supported by some authors but PM sometimes considers foreign company while counting. So express both views while answering a question.

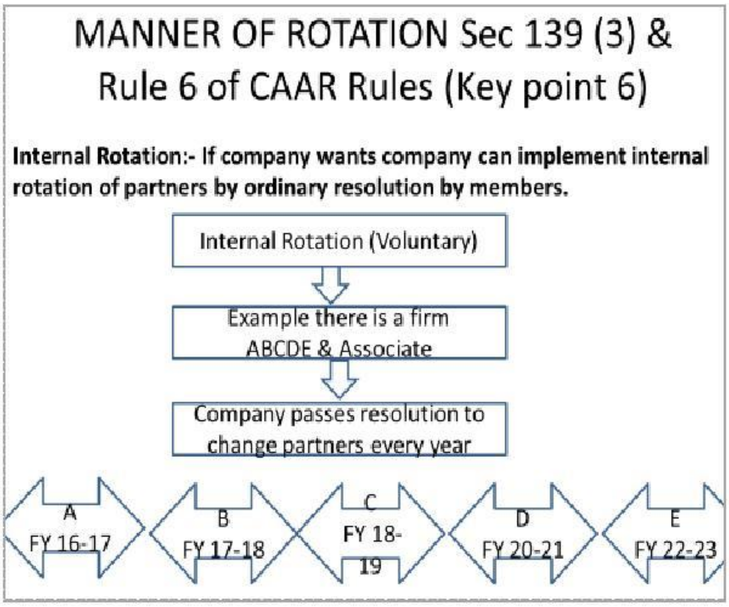
6. Other Disqualifications

If CA is doing equity share valuation for unlisted / unquoted company then he cannot do statutory and tax audit of such company

7. Appointing auditor of government company

Subsection covers company owned or controlled directly or indirectly by central / state or partly by both. As per General circular issued on 26th Mar 2014 it is further clarified that concept of deemed government company of old companies act 1956 will be covered here that means 51% holding by CG / SG / Government Companies by one of them or in any combination.

8. Rotation



MANNER OF ROTATION Sec 139 (3) & Rule 6 of CAAR Rules (Key point 7)

If company wants company can keep joint auditors.

Where a company has appointed two or more individuals or firms or a **combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors,** as the case may be, **do not complete their term in the same year.**

For example Firm A is auditor then appoint Firm B as auditor from 9th year so that when Firm A goes under rotation Firm B is well settled.

9. Rotation

Rotation of Auditor 139(2) & Rule 6 of CAAR

CLASS OR CLASSES OF COMPANIES (APPLICABLE)	OTHER THAN CLASS OR CLASSES OF COMPANIES (NOT APPLICABLE)
1. LISTED COMPANY; 2. PUBLIC COMPANY WHOSE PAID UP SHARE CAPITAL IS Rs. 10 Cr. OR MORE ; OR 3. PRIVATE COMPANY WHOSE PAID UP CAPITAL IS Rs. 20 Cr. OR MORE ; OR 4. ANY COMPANY HAVING PUBLIC BORROWINGS FROM FI, BANK OR PUBLIC DEPOSIT OF RS. 50 CRORES OR MORE	1. ONE PERSON COMPANY; OR 2. SMALL COMPANY; OR 3. DORMANT COMPANY *Nothing is specified regarding when to check these conditions. None of the authors have taken any firm stand. We will also take logical view. Rotations means to change auditors, which happens on AGM. So we have to check these conditions as on date of AGM. This is in line with interpretation in old company act 1956.*

10. Adverse impact on functioning of company

Duty to report 143 (2) / (3) / (4)

Step 4 :- Meeting with Employee

→All the information and explanations is obtained, if not give details.

→ Whether he has received branch report & manner in which report is dealt.

→ the observations or comments (Qualification / Adverse / Disclaimer / EMP / OPM) of the auditors on financial transactions or matters which have **any adverse** effect on the **functioning** of the company (Affects going concern / Non Determination of Obsolete Stock / Significant Impairments of Assets in short significant expenses / losses not reported or Incomes or Profits Overstated)

→ If there is any negative comment or qualification, reason should be stated in report.

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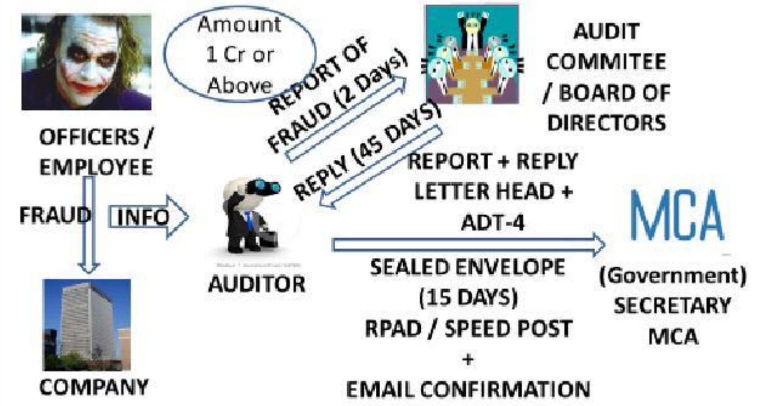
11. Fraud Reporting

Fraud Reporting Sec 143 (12) / (13) / (14) / (15)



***Reason to believe that fraud is being committed / already committe

*** Also applicable to Cost Auditor (CMA) & Company Secretary (CS)

*** Will not be considered as breach of principle of confidentiality

*** Fine:- Min 1,00,000 Max 25,00,000

AMOUNT OF FRAUD OR EXPECTED FRAUD LESS THAN RS 1 CRORE

→The auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:—

(a) Nature of Fraud with description;
(b) Approximate amount involved; and
(c) Parties involved

→The following details of each of the fraud reported to the Audit Committee or the Board as reported above during the year shall be disclosed in the Board's Report:—

(a) Nature of Fraud with description;
(b) Approximate Amount involved;
(c) Parties involved, if remedial action not taken; and
(d) Remedial actions taken.

Guidance Note on Fraud Reporting

→Auditors appointed under the following statutes **not covered under** Sec 143(12) for reporting under Fraud

Tax Audit under Income Tax Act 1961 / Sales Tax Audit / Vat Audit / Internal Auditors under Sec 138

→Reporting of fraud by auditor- **only if auditor is the first person** to identify/note such instance in the course of performance of his duties as an auditor.

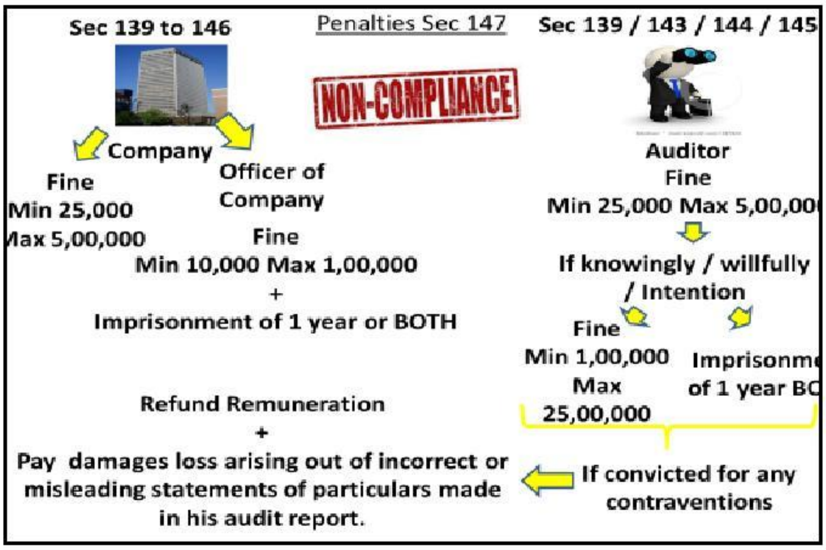
→The requirements for reporting by auditors under Section 143(12) would apply **even if the fraud is required to be/has been reported under any other statute or to any other Regulator***(Like reporting to RBI)*

→Reporting of fraud by an auditor relating to prior period-

Fraud of previous year found during the FY beginning on or after April 1, 2014 which was not dealt with in the prior financial years in the financial statements/ audit report/ board's report should also be reported.

→No need to report to CG if auditor is satisfied that fraud has not taken place have persuasive evidence for the same.

12. Penalities



→The Central Government shall, by notification, **specify any statutory body or authority or an officer** for ensuring **prompt payment of damages** to the company or the persons and such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

→Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act **shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.**

→In case of **criminal liability** of any audit firm, the liability other than fine, shall devolve **only on the concerned partner or partners**, who acted in a fraudulent manner or abetted or, as the case may be,

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13. Sec 129 Consolidation

SECTION 129(4) FINANCIAL STATEMENT

CONSOLIDATED FINANCIAL STATEMENT

PREPARATION

AUDIT

ADOPTION

AS SIMILAR AS FST

1.To intermediate wholly-owned subsidiary, other than a wholly-owned subsidiary whose immediate parent is a company incorporated outside India.
2.Exemption for FY 14-15 :- In case of a company which does not have a subsidiary or subsidiaries but has one or more associate companies or joint ventures or both, for the consolidation of financial statement in respect of associate companies or joint ventures or both, as the case may be.
3.Exemption for FY 14-15:- To consolidation of financial statement by a company having subsidiary or subsidiaries incorporated outside India.

Even if no consolidation is done following should be done for all subsidiaries 1.As per Sec 129 Attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries in such form as may be prescribed (FORM AOC 1)

2. As per rule 6 follow requirements of Schedule III, which means show % contribution of subsidiaries / associates / JVs Indian & foreign separately in consolidated Balance Sheet & consolidated P&L. An entity shall disclose the list of subsidiaries or associates or joint ventures which have not been consolidated in the consolidated financial statements along with the reasons of not consolidating.

3.As per Sec 136 provided also that every company having a subsidiary or subsidiaries shall,— *(Here subsidiary means only subsidiary not associate & JVs)*
(a)Place separate audited accounts in respect of each of its subsidiary on its website, if any;
(b)Provide a copy of separate audited financial statements in respect of each of its subsidiary, to any shareholder of the company who asks for it.

1. As per Sec 137 financial statements a company shall attach along with its financial statements to be filed with the Registrar, the accounts of its subsidiary(ies) which have been incorporated outside India and which have not established their place of business in India.

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14. Sec 135

CONTINUITY CLAUSE

- For a company to get out of the requirement it has to cease to be covered under S 135(1) for 3 consecutive years! (rule 3(2))

Year	Net-worth >= 500 Crore	Turnover >= 1000 Crore	Profit >=5 Crore	Applicable
14-15	Yes	No	No	Yes
15-16	No	No	No	Yes (1st Year)
16-17	No	No	No	Yes (2nd Year)
17-18	No	No	No	Yes (3rd Consecutive year completed)
18-19	No	No	No	No (Exemption from 4th Year)
19-20	Yes	No	No	Yes

15. CSR is not allowed under income tax

16. Nidhi Company

Exemption for Nidhi Company

Shall apply, subject to the modification that, in the case of members who do not individually or jointly hold shares of more than one thousand rupees in face value or more than one per cent, of the total paid-up share capital whichever is less, it shall be sufficient compliance with the provisions of the section if an intimation is sent by public notice in newspaper circulated in the district in which the Registered Office of the Nidhi is situated stating the date, time and venue of Annual General Meeting and the financial statement with its enclosures can be inspected at the registered office of the company, and the financial statement with enclosures are affixed in the Notice Board of the company and a member is entitled to vote either in person or through proxy.

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17. Unaudited Foreign Subsidiary

Clarification on foreign subsidiaries

Ministry in consultation with ICAI and it is clarified that in case of a foreign subsidiary, which is not required to get its accounts audited as per legal requirements prevalent in the country of its incorporation and which does not get such accounts audited, the holding/parent Indian may place/file such unaudited accounts to comply with requirements of sections 136(1) and 137(1) as applicable. These, however, would need to be translated in English, if the original accounts are not in English. Further, the format of accounts of foreign subsidiaries should be, as far as possible, in accordance with requirements under Companies Act, 2013. In case this is not possible, a statement indicating the reasons for deviation may be placed/filed along with such accounts.

18. XBRL

XBRL REPORTING

The following class of companies shall file their financial statement and other documents under section 137 of the Act, with the Registrar in e-form AOC-4 XBRL given in Annexure-I for the financial years commencing on or after 1st April, 2014 using the XBRL taxonomy given in Annexure II, namely:—

(i) all companies listed with any Stock Exchange(s) in India and their Indian subsidiaries; or

(ii) all companies having paid up capital of rupees five crore or above;

(iii) all companies having turnover of rupees hundred crore or above; or

(iv) all companies which were hitherto covered under the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011:

Provided that the companies in banking, insurance, power sector, non-banking financial companies and housing finance companies need not file financial statements under this rule.

19. Internal Audit

Who can become Internal Auditor?

CHARTERED ACCOUNTANT
(May or may not be in practice)

COST ACCOUNTANT

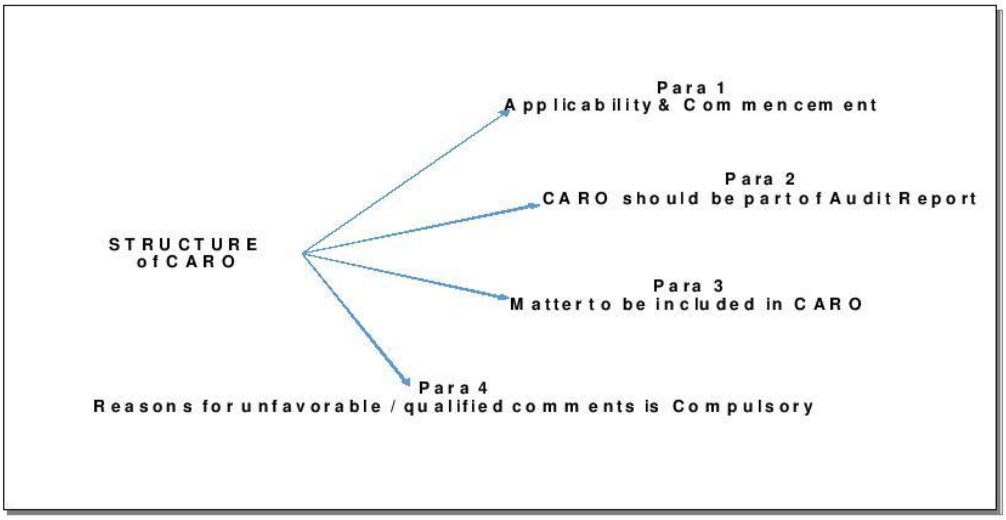
SUCH OTHER PROFESSIONAL

He may or may not be employee of company

CARO 2016

Contents

1. Origin of CARO-Sec 143(11)
2. Applicability of CARO
3. Cases on applicability of CARO
4. Shortcut to remember CARO
5. Sequence wise clauses in CARO
6. Cases on Clauses



Applicability of CARO

It shall apply to every company including a foreign company as defined under Sec 2 (42).

Exemptions (IB-COPS)[Each exemption is discussed in detail along with Cases]

1. Insurance Company
2. Banking Company
3. Section 8 Company (Charitable Purpose)

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4. One Person Company
5. Private Limited Company (All conditions below should be satisfied)
   Not Subsidiary / Holding of Public Company
   (i.e Holding / Subsidiary should not be public)
   Paid up capital + Reserves not exceeding 1 Crore
   Loan from Banks & FIs not exceeding 1 Crore -- At any point of time during the year
   Total Revenue not exceeding 10 crores -- During the Financial Year
   (As disclosed in Schedule III)

6. Small Company (Other than Public Company)

- Paid-up share capital of which does not exceed 50 Lakhs or such higher amount as may be prescribed which shall not be more than 5 Crores;
- Turnover of which as per its last profit and loss account does not exceed 2 crore or such higher amount as may be prescribed which shall not exceeding 20 crore:

Provided that nothing in this clause shall apply to—

a) A holding company or a subsidiary company; (In short there should be no holding or subsidiary company)
b) A company registered under section 8; or
c) A company or body corporate governed by any special Act (ICAI / RBI / NABARD etc)

CASE	EXEMPTION
GENERAL CASES	
This order is on the company or auditors of the company?	This order is issued by CG on the auditors of the company, which they have to follow while doing there audit and preparing audit report. It is a reporting order. Company Auditor Report Order.
Is a consolidated financial statement exempt from CARO?	Yes they are exempt. The Order specifically provides that it shall not apply to the auditor's report on consolidated financial statements.
Are branch audit reports exempt from CARO?	No they are not exempt. It is applicable to branch auditors while preparing their report. As there reports will be studied and merged to make final audit report of the company.
INSURANCE COMPANIES	
Is exemption available for both life insurance & general insurance?	Yes, exemption is for both.
BANKS	
Will co-operative bank get exemption?	Yes, it is not a company not governed by company act, it is co-operative society, so CARO is as such not applicable

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Will NBFC get exemption?	No, Exemption is only to Banks.
In December NBFC was converted into Bank?	Yes, we have to see status as on year end and it is a bank at year end.
In December Bank was converted into NBFC?	No, we have to see status as on year end and it is a NBFC at year end.
SECTION 8	
Company was licensed under Sec 25 of company Act 1956, will it get exemption	Yes, they will get exemption as specified in Guidance Note on CARO 2016
When to check status of Insurance Company / Banking Company / Section 8 Company / Small Company for exemption?	Unless specifically provided, We have to check status of these companies at the year end on balance sheet date.
PRIVATE COMPANY	
Private company satisfies all conditions except one will they get exemption?	No, all conditions should be satisfied to get exemption.
75% equity shares of private company were held by public company till 15th Jan, on this date 30% were sold in open market, Will such private company get exemption.	Yes, we have to see status as on balance sheet date, here as on balance sheet date percentage holding will be 45%, so it is not subsidiary of public company, so they will get exemption.
Private unlimited company has paid up capital of 90 lakhs, outstanding loans 85 lakhs, turnover of 7 crores and it is not subsidiary or holding of public company?	Yes they will get exemption, as per guidance not "Private Limited Company" should be construed to mean a company registered as a "private company" {as defined in sub-section (68) of section 2 of the Act} So private limited as well as unlimited both will get exemption. This is exactly opposite of the point of view taken by earlier Statement on CARO. (Very important for exams)
Private company is subsidiary of public foreign company or it holding company of public foreign company, will they get exemption?	CARO just says no to public company, it doesn't specify whether domestic or foreign or both. As per literal interpretation it means only domestic, Indian registered public company but as per reasonable interpretation that we don't want to exempt private company where public at large can be involved directly or indirectly. So specify both the view. As on today as there is lack of clarity, I support second view.
Private limited company has equity share	Computation of paid up capital &

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capital of 20 lakhs, preference share capital of 10 lakhs, general reserves of 30 lakhs, P&L debit balance (60) lakhs, Securities Premium of 10 lakhs, Capital Reserve of 15 Lakhs, Share Application 20 lakhs, Share Forfeiture 5 lakhs, Revaluation Reserve 8 lakh, Capital Redepmtion Reserve 3 lakhs, Share Option Outstanding Account 6 lakhs will this company get exemption?	reserves:- Eq 60 + Pref 10 + Gen Res 30 – Debit bal of P&L (60) + Sec Premium 10 + Capital Reserve 15 + Share Forfeiture 5 + Revaluation Reserve 8 + Capital Redemptin Reserve 3 + Share Option Outstanding 6 = 88, As it is not crossing 1 crore and if other conditions satisfied company can get exemption.
Equity Shares issued for CASH 1,000. For consideration other than cash 200. Bonus Shares Issued 300. Face Value Rs 10, Issue Price Rs 25 , Calls in Arrears Rs 1500, Share Forfeiture Amount Rs 3000, Calls in advance 500. Pref Shares 1000, FV 100. Debenture 500, FV 100 Compute Paid up Share Capital	Paid up capital includes money received for paid up capital and ANY AMOUNT CREDITED AS PAID UP CAPITAL so receiving money is not sole criteria for paid up capital. Hence shares issued for consideration other than cash and shares issued free of cost "Bonus Shares" should also be included. Further both equity & preference share both should be included. Equity Share Capital -->CASH 1,000 X 10 = 10,000 (Ignore securities premium) -->Other than CASH 200 X 10 = 2,000 -->Bonus Shares 300 X 10 = 3,000 -->Preference Shares 1,000 x 100= 1,00,000 Total -------------------------> 1,15,000 --> (-) Calls in arrears (1500) (Should be deducted from face value) -->(+) Share forfeiture 3000 --> Ignore Calls in Advance & Debentures ---> Grand Total (Paid Up Capital)--->1,16,500
Loan 40 lakhs, Interest Accrued as on balance sheet date 8 lakhs, Interest due and unpaid 12 lakhs , How much will be counted for the purpose of exemption ?	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. So 40 + 12 = 52 lakhs will be counted.
Fund based facilities from bank Rs 20 lakhs and non fund based facilities Rs 10 lakhs which are not yet devolved, How much should be counted in borrowings?	Non-fund based credit facilities (Eg Letter of Credit / Guarantee etc), to the extent such facilities have devolved and have been converted into fund-based credit facilities, should also be considered as

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	outstanding borrowings. That means 20 will be considered and 10 will be left as no money is taken till date under it.
Out of loan 30 lakhs, 5 lakh is due within 12 months from date of balance sheet hence it is shown in current liability as current maturity of long term loan. So how much loan should be considered 30 lakhs or 25 lakhs?	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. So here we will consider 25+5=30 whole loan amount outstanding irrespective of where it is shown in balance sheet.
Will borrowing cover short term loans?	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.
Overdraft facility fully covered by FD will it be covered in borrowing?	Notwithstanding the fact that the company has been granted an overdraft facility against, say, fixed deposits, of the company with the concerned bank, we will include whole overdraft amount in borrowing.
Private limited company has following borrowings from Mr Mukesh Ambani 20 Lakhs, Mr Vijay Malaya 5 lakhs, ICICI Bank 5 lakhs, IFCI 10 lakhs is exemption available?	We have to consider borrowings only from Banks & FIs so total is ICICI 5 + IFCI 10 = 15 lakhs, it is below 25 lakhs so exemption is available.
Will loan from NBFC will be counted?	Yes, the term “financial institution” shall also cover a non-banking financial company (NBFC)
Private Limited company has taken CC of 30 lakhs and balance outstanding as on date is 10 lakhs?	We don’t have to see limit, we have to see actual amount outstanding, it is not exceeding 25 lakhs, Exemption is available.
Loan during they year rose to 1.6 crore but it was repaid regularly and as on balance sheet date it has reduced to nil, will such private company get exemption?	No, in case of loan outstanding we have to see balance during the year and if any time it exceeds 1 crore condition required for exemption will be broken.
Whether revenue will include other income?	The term, “revenue”, has been defined by the Order as total revenue disclosed in Schedule III of the Act.

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	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.
Private limited company has Sale of goods Rs 4 Crore , Sale of services Rs 2 Crore, Sales return Rs 1.5 Crore (Including 0.5 Crore from previous year) Excise Duty included in sale of goods Rs 75 lakhs, Interest on Investment 20 lakhs, Profit on sale on Investments 30 lakhs, Scrap Sales Rs 40 lakhs, VAT on sales included above 20 lakhs is CARO applicable?	Computation of Turnover Sale (Goods) 4 crore + Sale (Services) 2 Crore – Sales Return (1.5 Crore) – *Excise Duty 75 lakhs – *VAT on Sales 20 lakhs + Interest on Investments 0.2 + Profit on sale of Investments 0.3 + Scrap sales 0.4 = 4.45 Crores *If excise and VAT are accounted separately then they will not be included. We has assumed that accounting will be on separate basis and hence they are excluded. *In problem it is said that excise and vat amount are included in given sales they doesn't comment on method of accounting, so we have to take popular assumption and solve the case. As Turnover is below 5 Crores CARO not applicable.
SMALL COMPANY	
A Ltd is small company but it does not fulfil conditions of private company?	Yes such company will get exemption. 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 doesn't fulfil conditions of exemption for private company.
What is difference between exemption of private company and exemption of small company ?	In small company there should not be holding or subsidiary but in private company holding or subsidiary should not be public company. In small company we see only paid up capital but in private company we see both paid up capital and reserves. In small company we see TURNOVER of last year, in private company we see TOTAL Revenue during the year.

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SLIDE 1 (After Passing CA)

(Flipkart to buy professional accessories) | Cl 1 | Fixed Assets

(Indian Airlines to book flight tickets) | Cl 2 | Invento

(LinkedIn to search contacts for job application) | Cl 3 | Loans given to Sec 189 Parties

(Live.com to send emails for jobs) | Cl 4 | Loans given under Sec 185 186 (Directors & Others)

(Dropbox to get soft copy of his documents) | CL 5 | Deposits Taken

(CNN to get updated about current affairs) | Cl 6 | Cost Records

SLIDE 2 (Job Interviews)

(SBI biggest bank of India) | Cl 7 | Statutory Dues

(LIC biggest insurance company of India) | Cl 8 | Loan Repayment

(Infosys India's Biggest Software Company) | Cl 9 | Application of funds from IPO / FPO

(Finolex biggest cable company of India) | Cl 10 | Fraud

(Micromax India's biggest Mobile Company) | Cl 11 | Managerial Remuneration

(India's biggest network, Network 18) | Cl 12 | Nidhi Company

Slide 3 (Fruits between interviews)

(Raisin) | Cl 13 | Related Party Transactions

(Pineapple) | Cl 14 | Private Placement

(Nuts) | Cl 15 | Non Cash Transaction

(Carrot) | Cl 16 | Certificate of Registrations by RBI

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Clause I / 1 (Flipkart)

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

1st Comment→ Maintenance of proper records including Quantity & Situation of FA
2nd Comment→Reasonableness of physical verification
3rd Comment→If there are material discrepancies is it properly adjusted in books of accounts
4th Comment→Whether title deed of immovable properties is in name of the company if not details should be given

Important Points

→Reason

1. Negligence in maintaining fixed assets records has led to weak internal control system, massive losses and closure of companies in past, hence companies should be carefully while dealing with fixed assets records as they are helpful in keeping control over fixed assets.

→Record Maintenance

1. Go and inspect fixed asset register of the company it should have following details Unique Identification Code, Description of Fixed Asset, Classification of Assets, Component wise break where applicable, Date of Acquisition or Year of Purchase, Original Cost, Useful life, Residual Value, Revaluation or Adjustments to Cost or Impairment, Depreciation, Book Value, Present Situation / Location etc
2. If some assets are moving like cranes in construction contracts, then its fine if separate records are kept for movements.
3. 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***.
4. Above details should be there irrespective whether asset is constructed / acquired / taken on finance lease***.
5. Records should contain details of all assets with company irrespective of whether they are retired from active use or fully depreciated or amortised or impaired***
6. These records should agree with fixed assets shown in books of accounts.
7. Fixed assets register can be in electronic form provide these 2 conditions are required else printouts will be required 1. Once FA register are finalised it should not be altered without authorisation & proper audit trail 2. It should retrieval in legible form and can be read easily.***

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→Physical Verification

1. 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.
2. 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.
3. The auditor should examine whether the method of verification was reasonable in the circumstances relating to each asset.
4. 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.

→Title Deeds

1. Identify immovable properties and verify the title deeds of such immovable properties.
2. TDRs(Transfer Development Rights), Plant and Machinery embedded in land etc., are not considered as an immovable property.***
3. 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.***
4. 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.***
5. 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

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Key to remember Reason Record maintenance Go and Inspect→Moving Assets→Assets at residence of Staff→ Constructed / Acquired / Finance Lease→Depreciated / Impaired / Retired from active use→Electronic Records Physical Verification Responsibility of Management→Audit should observe→ Also Instructions of Verification & Working Papers→Method of Verification→Annual is reasonable but interval can be more but not more than 3 years→Specify Title Deeds Identify immovable assets→ TDR / P&M not immovable→Conversions & Corporate restructuring→Accidental Loss or Otherwise

Clause II / 2(Indian Airlines)

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.

1st Comment→Reasonableness of physical verification of inventory 2nd Comment→Any material discrepancies observed 3rd Comment→Adjustment in books

Important Points

→Reason

1. Physical verification is very important part of internal control system; it ensures accuracy of quantity / physical condition which helps in valuation so auditor is asked to comment on this part of internal control system.

→Physical Verification

1. Inventory 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

2. 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

3. What constitutes "reasonable intervals" depends on circumstances of each case. The periodicity of the physical verification of inventories depends upon the nature of

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inventories, their location and the feasibility of 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.***

4. 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.

Key to remember Reason→Inclusions in Inventory→Consumables /loose tools /packing material /spare parts (regularly used)→Reasonable interval of time→Once in a year and frequency can increase depending on ABC analysis→Day to day records not available→ Get reconciliation→If not possible & material then report

Clause III / 3(LinkedIn)

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.

1st Comment→ Applicable to those companies who has given loan to parties covered in register maintained under Sec 189 2nd Comment→ Whether terms of condition are prejudicial 3rd Comment→ Whether schedule of repayment is specified 4th Comment→ Whether repayment or receipt is regular 5th Comment→ Total amount overdue for more than 90 days 6th Comment→ Reasonableness of steps taken for recovery

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Important Points

1. Reason: -Outflow of money to related parties through loan can lead to massive losses hence auditors are supposed to comment on such loans.

2. There is no stipulation regarding the loan being given in cash or in kind, so it is applicable to both***

3. 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 (Entities in which director is interested) or section 188 (All transactions with related parties) of the Act applies. Maintained by every company in Form MBP-4.

4. 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.***

5. 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.

6. 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.

7. 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.***

8. 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

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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.

Key to remember Reason→ Requirements of Sec 189→ Form MBP 4→Terms & Conditions→ Concessional loans to employees→ Regular recovery→ Not specified in agreement→Reasonable Steps need not mean legal steps

Clause IV / 4(Live.Com)

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.

1st Comment→Compliance with Sec 185 & 186 2nd Comment→If non compliance then concerned details

Important Points

1. Reason:- Company may suffer losses because of loans given to directors , corporates & other persons

Sec 185→ Regarding loans to Directors
Sec 186→ Regarding Inter corporate Loans & Others

2. Section 185

   Take list of directors & persons in whom director is interested, match it with Form MBP-1 & Register maintained in Sec 189 (MBP -4)

   Check transactions with these parties and determine whether Sec 185 is applicable which prohibits direct or indirect loan to directors, if it is covered in exceptions take evidence for same

   Report the nature of noncompliance, 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).

3. Section 186

Collecting information

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

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otherwise, made during the year as well as the outstanding balances as at the beginning of the year.

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.

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.

Requirements

The section also prohibits a company from making investments through more than two layers of investment companies.***

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.***

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.***

Exemptions

Section 186 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.

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.

SEBI

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.

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	Name of \ Company/ Party	Amount Involved	Balance as at Balance Sheet
Investment through more than two layers of investment companies			
Loan given or guarantee given or Security provided or Acquisition of securities exceeding the limits without prior approval by means of a special resolution			
Loan given at rate of Interest lower than Prescribed			
Any other default			

Key to remember
Reason→Sec 185→Collect information in the form of lists / MBP 1/ Sec 189 Register→Check whether 185 is applicable & Followed→Report if default→Sec 186→Collect information→Obtain list→ MBP 1→ Sec 189 register→ Financial Statements→Requirements→ 2 layers→ 60% of (paid up capital + free reserves + sec premium) or 100% of free reserves whichever is higher if exceeding take prior approval in the form of special resolution→Rate should not be less than government yield→Exemptions→SEBI requirement

Clause V / 5(Dropbox)

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 there under, 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?

→Only applicable if company has accepted deposits
1st Comment→Compliance with RBI Circulars + Sec 73 to 76 & other relevant sections of company act 2013
2nd Comment→ If non compliance explain nature of non-compliance
3rd Comment→ if order is passed by CLB / NCLT / RBI / Court / Any Other Tribunal compliance with the same

Important Points

1. Reason: -To protect rights of depositors
2. The auditor should also obtain an understanding of the requirements of sections 73 to 76 and rules there under.

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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.
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 subsection (1) of section 73 of the Act.***

3. The auditor should plan to test for compliance with the provisions of sections 73 to 76 of the Act and the Rules made there under i.e. the Companies (Acceptance of Deposits) Rules, 2014.

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.
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

4. The auditor should obtain management representation

Key to remember Reason→Check whether deposits are accepted? -->Understand Sec 73 to 76 / RBI requirements → only some companies having adequate net worth-->Prepare checklist→Do enquiry→Obtain management representation

Clause VI / 6(CNN)

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.

1st Comment →Whether cost records are applicable
2nd Comment→Whether such records are made and maintained

Important Points

1. The auditor should also obtain a list of books/records made and maintained in this regard.
2. 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.
3. The auditor should obtain a written representation from the management.
4. 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."***

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Key to remember Obtain list of books/ records maintained→General review no detailed examination→Management representation→Disclose extent of checking in report (Broadly reviewed / prima facie)

Clause VII / 7(SBI)

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.}

1st Comment→Regularity in depositing undisputed statutory dues including (PF / ESIC / Direct Taxes / Indirect Taxes etc 2nd Comment→ Arrears of outstanding statutory dues outstanding more than 6 months as on balance sheet date 3rd Comment→ Details of taxes not been deposited on account of any dispute, specify amount & forum

Important Points

1. Expose defaulters, so that government can take action and they fear of default.
2. Only amount covered by statue will come here amount covered by agreements won't be covered here. 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.

3. 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.(For example no need to comment on regularity of payment of custom duties as it is not a regular payment) 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 regularity clause. 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.

4. 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

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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 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***.

5. 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 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.***

6. 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 ofa 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.***

7. 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 instalments have been granted for the payment of statutory dues. Latter view seems to conform more closely to the requirements of the Order.***

8. 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

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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.

9. It may be noted that penalty and/or interest levied under the respective laws would be covered within the term "amounts payable***

Key to remember
Important Points
Reasons→Only amounts payable under law or covered not amount payable under contract for goods & service to government Eg Electricity / Gas etc.→ Only those payments which are supposed to be deposited periodically such as monthly, quarterly etc. should be seen for regularity of deposits→ Interesting case of customs duty on goods in bonded warehouse, it is not periodical payment and not due for payment but Rent & Interest on Custom Duty is covered by law is covered for regularity of payment→ Interesting case of advance tax , if company was aware of income but did not pay advance tax will be reported but if it is due to unexpected, windfall gains after payment date then it will not be reported→Dispute:- Mere representation to department will not be dispute there should proper appeal or time should be available to appeal with positive evidence that appeal will be accepted→No need to see sustainability of appeal→ Application for rectification of mistake U/S 154 will be considered as dispute→Disclosure should be made only if amount is not deposited irrespective of whether provision is made or not→If amount is paid it can be specified by auditor but it is not compulsory→Amount payable should include interest and penalty

Clause VIII / 8(LIC)

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).

1st Comment→ If there is default of loan from FIs / Bank / Govt or Debenture Holders
2nd Comment→If there is default then period & amount of default

Important Points

1. Reason: - Defaulter companies should be exposed so that other don't deal with them
2. Defaults during the year& defaults of last year continuing as on balance sheet date both should be covered.***

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3. 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.***

FIs include Public Financial Institutions / NBFCs
Government" does not include Government Company/ Public Sector Undertaking/Boards/Authority/Corporation and Foreign Government.***

4. The auditor should obtain the schedule of repayments to banks, financial institutions, government and debenture holders from the management of the company.
The auditor should examine the agreement or other documents containing the terms and conditions of the loans and borrowings including debenture trust deed.
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
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

5. If there is default

Particulars (Banks / FIs / Debenture)	Amount of default as at the balance sheet date	Period of default	Remarks, if any.

Special Circumstances
6. 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. ***
7. Submission of application for reschedulement / restructuring does not mean that no default has occurred. ***
8. 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.

Key to remember Reason→CY defaults & continuing defaults of previous year→Repayment means only principal amount→FIs include PFI / NBFC→Government doesn't include government company / Foreign Government Take Repayment schedule→Segregate Banks/ FIs/ Govt / Debenture Holders→Match it with loan agreements / debenture trust deeds→See repayment from books of accounts→Check confirmation also for the same→if there is default report it Special circumstances Dispute→Continue old terms→Reschedulement application doesn't mean no default→if Reschedulement is successful check compliance to new terms

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Clause IX / 9(Infosys)

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

→Applicable for IPO / FPO of all kind of securities also TERM Loans 1st Comment→ Application for purpose for which they were raised 2nd Comment→IF not applied for proper purpose Delays / Defaults / Subsequent Rectification should be specified

Important Points

1. Reason: - Many companies run into losses and lot of troubles when they divert fortheir objective, when they utilise money from the purpose other than they were obtained hence auditors are asked to comment on it.
2. Obtain offer documents / prospectus for IPO / FPO / sanction letter or documents containing the terms and conditions of the loan. Read them and obtain understanding of intended end use.
3. 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 such case verify whether the company has invested or utilized the money for purposes other than objects of the company
4. Issuance of Global Depository Receipts and American Depository Receipts may not fall within the scope of reporting under this clause. Because it is offer for sale not public offer.***
5. 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".***
6. 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.
7. 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. In such cases, it should not be construed that the loan has not been applied for the purpose for which it was raised.***
8. 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.***
9. Obtain a representation from the management as to the actual end utilization of money raised.
10. Suggested reporting format under this cause is as follows:

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

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Key to remember
Reason→Obtain prospectus / offer documents of IPO or FPO / agreements & sanction letter of term loans and understand purpose for which money can be used→If purpose is not specified mention it in report and check whether money is used at least as per objects of the company→ Not applicable to ADR / GDR because offer for sale→Term loans are 36 months or more→ No need to see one to one utilisation, see overall inflow and utilization for purpose → Utilisation for different improved machine is acceptable→ If not utilised or kept in short term funds then it should be reported→Obtain written representation→Reporting format if there is non compliance

Clause X / 10 (Finolex Cable)

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.

→2 types of fraud are covered by the company or fraud on the company by officers or employees
1st Comment→Whether any fraud is noticed or reported
2nd Comment→If yes nature & amount involved

Important Points

1. Reason: - Frauds are serious issues in any organisation, companies may try to suppress it and keep shareholders unaware about it hence auditors are asked to report on it.
2. Follow SA 240 can be presented – Auditor Responsibility / Risk Assessment Procedures / Management Representation
3. Take Management representation on frauds
4. Identify only those which are by the company or on the company by employees or officers
5. The clause does not require the auditor to discover such frauds. These can be reported or noticed apart from statutory auditor by anyone management / internal auditor / cost auditor***
6. It doesn't mean other frauds should not be detected we should detect with reasonable assurance all material frauds & errors as per SA 200 & 24
7. Reporting under this clause is in addition to reporting under Sec 143(12)

Key to remember
Reason→Follow SA 240 to collect information about fraud→Take management representation→Identify only 2 types of frauds→No change in objective, no guarantee to detect all frauds→ Only material frauds with reasonable assurance→It is additional reporting apart from Sec 143(12)

Clause XI / 11 (Micromax)

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

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1st Comment→ Whether managerial remuneration is approved & paid within limits as per Sec 197 & Schedule V 2nd Comment→If there is unauthorised or over payment then what are steps taken for refund of such amount

Important Points

1. Reason:- Managers may take away excessive remuneration and fool shareholders hence auditors are called to report.
2. Obtain agreements / resolutions for MR Company Policy
3. Obtain list of payments made
4. Understand requirements of Sec 197 & Schedule V

→Sec 197 is applicable only to <u>public company</u> that means this clause is only for public company

→Remuneration = Salary + Perquisites + Commission → Doesn't include sitting fees (Director Fees) & Payment for other professional nature services (For example payment for factory valuation)

→Limits (% of Net Profits computed as per Sec 198)

All Directors + Manager – 11% --> CG approval + Ordinary Resolution to Exceed Limit

1 MD / WTD Manager -- 5%
MD+WTD+Manager—2 or more→10% (Total)
Part Time Director & With MD / WTD / Manager→1%
Part Time Director & No MD / WTD / Manager→3%

*Director sitting fees is not included while applying %

Only Ordinary Resolution to Exceed Limit

→If there are inadequate profits or no profits→ Payment as per limits in Schedule V

→ 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.

5. Compute maximum limit as specified in Sec 197 & Schedule V

6. The default may be reported incorporating the following details:-
   a) Payment made to Director/Whole time Director/Managing Director/ Manager.
   b) Amount paid/ provided in excess of the limits prescribed.
   c) Amount due for recovery as at Balance Sheet date.
   d) Steps taken to secure the recovery of the amount.
   e) Remarks, if any

Key to remember Reason→Obtain policy / resolutions / agreements→List of payments and expense booked→Understand requirements of Sec 197 / Sec 198 / Schedule V→Compute maximum limit→Check compliance—Report Default

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Clause XII / 12(Network 18)

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.

→Applicable only to Nidhi Company 1st Comment→ Maintaining Net Owned Funds: Deposits → 1:20 2nd Comment→ 10% Unencumbered Term Deposits

Important Points

1. Reason: - Hard earned money of middle class people is deposited in Nidhi Company, if they collapse it is big loss to society so auditors are called to report on it.

2. Nidhi Company: -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.

3. Requirements of Rules applicable to Nidhi Company: - Auditor should know Rule 5(1) which prescribes that Nidhi company shall within 1 years

→Have not less than 200 members

→Net owned funds 10 lakhs or more

→Ratio of net owned funds to deposits should not exceed 1:20***

→Unencumbered deposit 10% or more***

Net Owned funds= Paid up Equity Share Capital + Free Reserves – Accumulated Losses-- Intangible Assets

Furthermore as per Rule 14, every Nidhi is to 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, which needs to be examined.

4. Ask management to provide computation of deposit liability & net owned fund.

Verify this statement as per records of Nidhi Company

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 theamount thereof.

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Key to remember
Reason→What is Nidhi Company? -->Requirements of Rule 5 & Rule 14 → How to compute net owned funds? --> Workings & Statements from management→Check compliance →if there is shortfall then report

Clause XIV / 13(Raisin)
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

1st→Its only about transactions with related parties
2nd→We have to comment on compliance with Sec 177 & Sec 188
3rd→We have to comment on disclosures of related party in financial statement

Important Points
1. Reason: - Related parties can control / influence company or company can control / influence them, because of this terms can be manipulated to take or give unjustified benefits, as there is high risk of manipulation auditors are supposed to comment on them.
2. Understand requirement of Sec 2(74) defines related parties(Given in Annexure 1)
3. How to get information about the transactions?

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
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
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

Obtain written representations
a) They have disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions &
b) They have accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.

Apply requirements of SA 550
4. Understand requirements of Sec 177
→Sec 177 is applicable only to listed companies & certain public companies
→As per Section 177 Audit Committee approval is required for related party transactions further omnibus approval can be taken for repetitive truncations

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→Sec 188 is applicable to all companies which require BOD approval for related party transactions. Such transactions include

1. Goods / Material—Sales / Purchases
2. Service—Rendering / Availing
3. Property—Buying / Selling
4. Property—Giving / Taking on lease
5. Goods / Service / Property – Purchase / Sale – Agent Appointment

6. Related party's appointment to any office or place of profit in company / subsidiary / associate
7. Underwriting of any security or derivatives thereof

Further ordinary resolution is required in general meeting if it crosses prescribed limit.

Exemption from ordinary resolution: -

1. Transaction between holding company & wholly owned subsidiary where it is consolidated with holding.
2. BOD approval & Ordinary resolution is not required if transaction is in ordinary course of business & on arm's length basis.
3. Check requirements of AS 18

4. 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 noncompliance may be given)

Key to remember Reason→Understand related parties Sec 2 (76)→Collect information about related party transactions→Prior period documents→Entities identification process→Obtain list of parties & transactions→ Section 189 register→Verify with form MBP-1→Obtain written representation→Apply SA 550→Understand Sec 177 & 188→Exemptions→Requirements of AS 18→If there is non-compliance then report

(Clause XV / 14(Pineapple)

Whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debenturesduring 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

1st Comment→Whether there is preferential allotment / private placement of shares / convertible debentures. 2nd Comment→Whether requirements of section 42 of company act 2013 are fulfilled.

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3rd Comment→Whether money is used for the purpose for which it was raised. 4th Comment→ Give details of non-compliance & non-utilisation for proper purpose.

Important Points

1. Reason: - Public offer is governed by strict rules and regulations, people may fool authorities by saying that it is private placement. Further such money raised may be mutualised hence reporting is required under CARO.

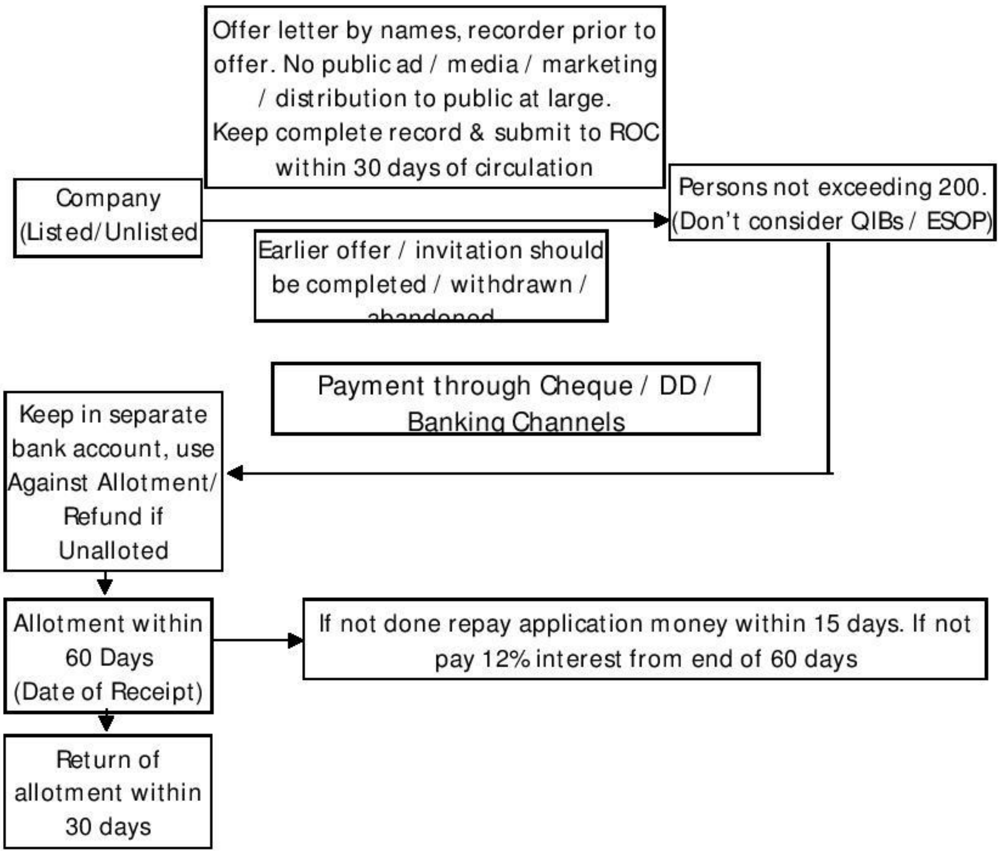
2. Inquire about changes in share capital (equity & preference) and convertible debentures during the year.

Check if there is any preferential allotment / private placement during the year.

Private placement means offer / invitation to subscribe to select group of people through issue of a private placement offer letter with their names which cannot be transferred and number of such people should not exceed 200 (while calculating 200 QIBs & Issue under ESOP scheme is not considered)

Preferential allotment is not defined in act and this clause talks about compliance of Sec 42 which is applicable to private placement only that indicated here preferential allotment is same as private placement.

3.Check compliance of requirements of Sec 42



If the

4. If there is non-compliance of section 42 details will be given

Nature of securities viz. Equity shares / Preference Shares / Convertible Debentures	Amount Involved	Nature of noncompliance

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5. Take for form PAS-4 which specifies purpose / object for which such shares were issued. It is not necessary to establish one-to-one relation from money received to money spent. Statement should be obtained with proofs of total money obtained & utilised with proofs.
6. If money is not yet utilised specify that, if it is invested in short term funds specify that, it is not non-compliance. Whenever final utilization is made specify in that year about this fact.***

7. The auditor may report the non-compliances incorporating the following details:

Nature of Securities viz. Equity shares /Preference shares /Convertible debentures	Purpose forwhich funds received	Total Amount Raised /opening unutilizd balance	Amount utilized for the other purpose	Unutilized balance as at Balance sheet date	Remarks, if any

Key to remember
Reason→Inquire about changes during the year→Identify private placement →Understand whether requirements of Sec 42 are applied→ Take form PAS 4 to understand purpose→Check utilisation for purpose→One to on relation not required→Statement for total money received and utilisation for specified purpose should be obtained→Report unutilised amount / temporary investments / subsequent year utilisation→Reporting format

Clause XIV / 15

Whether the company has entered into any noncash 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.

1st Comment→Whether there is non-cash transactions with directors or persons connected with him
2nd Comment→If answer to first question is yes then whether there is compliance of section 192

1. Reason: - In non-cash transactions lot of subjectivity is involved & it is not regular transaction hence it is prone to manipulations & frauds hence auditor is supposed to comment on its legal compliance to deter people to do wrong things.

2. Non Cash Transaction
If assets are transferred for cash or cash equivalent(highly liquid, convertible in known amount of cash, insignificant risk having maturity 3 months or less at the time of acquisition)then it will not be covered above.***
Acquisition of the asset takes place in one year and the corresponding liability is created, the corresponding settlement take place in next year. Such transaction will not be considered as non-cash transaction.

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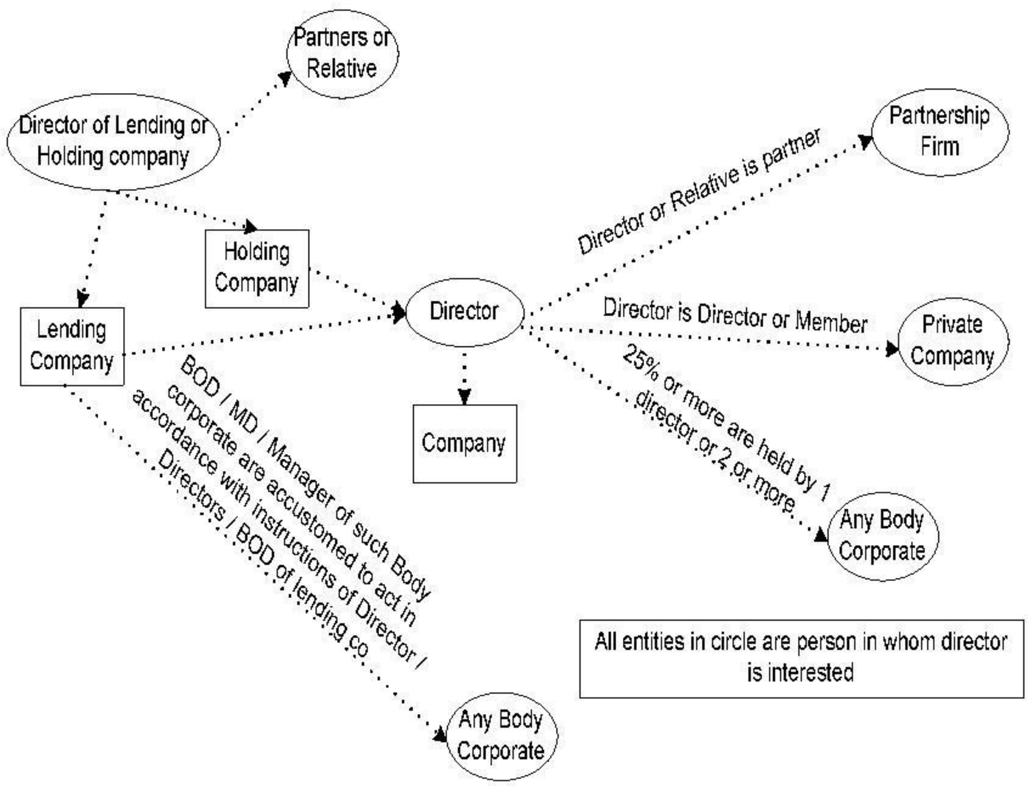
Further, mergers under Court schemes would be entered into subject to requisite approvals of Court etc., would not be considered non-cash transactions. (In short Sec 192 and this clause won't be applicable)

3. 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***
4." Person connected with the director" has not been defined in the Act, or the Rules there under. Instead, the term "to any other person in whom the director is interested" is defined in Sec 185, so this can be used as reference point as per guidance note

Definition of relative is same as we have studied in company audit
5. Documents which can give this information
--Take Form MBP-1 "Notice of Interest by Director"
--Take form MBP-2 "Register of Loans, Guarantee, Security and Acquisition Made by the Company"
--Take Form No. MBP-4, Register of Contracts with Related Party and Contracts and Bodies etc in which Directors are Interested
--Fixed Asset Movement Register



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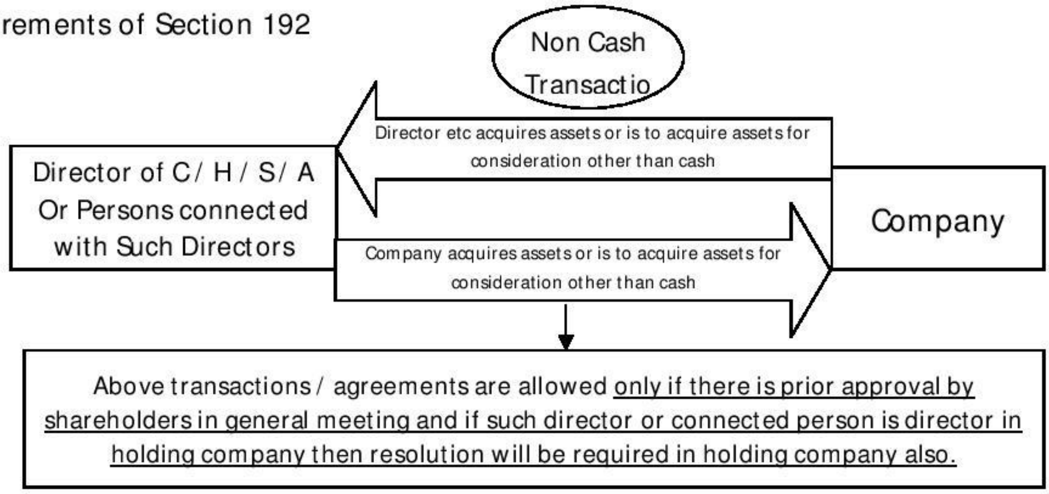
6. Obtaining a management representation as to whether the company has undertaken any non-cash transactions with the directors or persons connected with the directors, as envisaged in section 192(1)

7. Requirements of Section 192



To check resolutions following documents can be inspected.
--Minutes of AGM / Board of Directors Meeting
--Report on AGM

8. The language of section 192(1) also uses the term <u>"is to acquire", indicating the existence of intention to acquire.</u> 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.***

9. 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 <u>for which approval has not yet been obtained in a general meeting of the Company.</u>

Key to remember Reason→Non Cash Transactions→Which directors→Person Connected to directors→Documents which can give this information→Requirements of Sec 192→Concept of "Is to acquire"→Paragraph for reporting

Clause XVI / 16
Whether the company is <u>required to be registered under section 45-IA</u> of the Reserve Bank of India Act, 1934 and <u>if so, whether the registration has been obtained.</u>

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1st Comment→Whether company supposed to get registered as per requirements of RBI 2nd Comment→If answer to first question is yes then we are supposed to comment whether registration is obtained and if it is not obtained reason for the same should be specified

Important Points

1. Reason: - In financing companies without RBI registration is dangerous for society , in India many frauds have taken place hence auditors are supposed to comment on their registration status.

2. Check requirements of Sec 45-IA, is there any recent change in registration requirement.
3. As on today company should be registered if it is 1st NBFC and 2nd Net Owned fund is 2 Crores or more.***

4. NBFC→means a company whose principal business is financing like 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.
It can do other activities such as agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property but is should not be its principle business.

5. Now we have to determine whether financing in principle business, as per FAQ issued by RBI we will have to apply 50-50 test. As per this test if financial assets constitute more than 50% of total assets **AND** financial income constitutes more than 50% of total income then principle business is financing. ***
(No need to specify this example in answer unless specifically asked.)
Eg Fixed Assets 50 lakhs, Non Current Investments 80 lakhs, Current Investments 40 lakhs, Stock 20 lakhs, Debtor 10 lakhs, Cash 45 lakhs, Bank 25 Lakhs, Loans given 200 lakhs.
Sales 10 lakhs, Interest Income 20 Lakhs, Commission earned through financing 15 lakhs.
Answer
Total Assets→ 50 + 80 + 40 + 20 + 10 + 45 + 25 + 200= 674
Financial Assets→80 + 40 + 45 + 25 + 200 = 390
% of financial assets in total assets is 390 / 674 X 100 = 57.86 %

Total Income →10 + 20 + 15 = 45
Financial Income→ 20+15=35
% of financial income in total income is 35/45 X 100 = 77.77%
As both conditions are satisfied it is a NBFC.

6. Now we should compute net owned fund as per latest balance sheet
Eg Figures in lakhs***

PAID UP SHARE CAPITAL	
"Equity" Share Capital	400
(-) Calls in Arrears	(20)
Paid up "Equity" share capital	380

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FREE RESERVES	
(+)General Reserves	40
	420
FCITICIOUS ASSETS	
(-)Debit balance of P& L	(10)
(-)Deferred Revenue Expenditure	(5)
(-)Intangible Assets (Eg Goodwill / Patent etc)	(8)
	397
INVESTMENT IN SHARES	
(-) Subsidiary	(15)
(-)Companies of same group	(25)
(-)Other NBFCs	(35)
	322
"Book Value" of DEBENTURES, BONDS, OUTSTANDING LOANS & ADVANCES (INCLUDING HIRE PURCHASE & FIANANCE LEASE) & DEPOSITS→	
Subsidiary 50	
Companies 20	
Total 70	
(Please note Other NBFCs not covered as like given above in investment of shares)	
To the extent such amount exceed 10% of (Paid up Capital + Free Reserves)	
i.e 70 – 10 % (420) = 70 – 42 = 28	(28)
NET OWNED FUNDS	294

As it is above 200 lakhs / 2 cores registration will be required

7. If conditions of registrations are satisfied, then check whether certificate of registrations is obtained from RBI

8. If registration not obtained, then specify the reason Eg Management not aware about such requirement / Management feel it doesn't have much importance hence not obtained / application is in progress / RBI cancelled it for violation of same conditions etc.)

9. NBFCs which are governed by other regulators are supposed to take certificate of registrations here, for example regulated by SEBI / IRDA / MCA / National Housing Board etc.

Key to remember
Reason→Recent changes in registration requirements→Requirements as on today 1st NBFC & Net Owned funds 2 crores or more→ NBFC means principle business of finance → 50-50 test→ More than 50% income & More than 50% assets should be financial in nature→Net owned funds calculations→ Check registration certificate→If not obtained specify details→No need to comment on other NBFCs governed by other regulators

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