CA FINAL – NOV 15

LAW AND AUDIT AMENDMENTS

05TH September 2015

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Companies (Auditors' Report) Order, 2015 [CARO]

1. What types of Companies are specifically exempted from application of CARO?

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

2. **Exceptions / Exemptions:** CARO **does not apply** to the following classes of Companies –
   (a) Banking Company as defined u/s 5(c) of the Banking Regulation Act, 1949,
   (b) Insurance Company as defined Insurance Act, 1938.
   (c) Company licensed to operate u/s 8 of the Companies Act, 2013 and
   (d) One percent Company as per Sec.2(62) and a Small Company as per Sec.2(85) of the Companies Act,
   (e) Private Limited Companies subject to the following conditions –
   - Aggregate of Paid Up Capital and Reserves should not exceed ` 50 Lakhs.
   - Loan outstanding from any Bank or Financial Institution should not exceed ` 25 Lakhs.
   - Turnover should not exceed ` 5 Crores.

2. Bring out the differences between compliance with the requirements of Sec. 143 of the Companies Act and CARO.

CARO Requirements are **supplemental** to the existing provisions of Sec.143 regarding the Auditor's Report. However, certain points of distinction between CARO and Sec.143 requirements are –

Requirements of Sec 143	Requirements of CARO
1. The provisions of sub–sections (1), (2), (3) and (4) of Sec.143 are applicable to **all Companies.**	1. Certain classes of Companies are exempt from CARO. (**Refer previous question**).
2. Sec.143 (1) requires the Auditor to make certain specific enquiries during the course of his audit. The Auditor is, however, not required to report on any of the matters specified in the sub–clauses, unless he has any special comments to make on the said matters, i.e. if he is satisfied with the results of his enquiries, he has **no further duty to report** that he is so satisfied.	2. CARO requires a **statement** on each of the matters specified therein, even if the Auditor has no comments to make on any of the matter(s) contained therein.

3. Bring out the professional necessity for complying CARO. Is it mandatory?

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

2. **Nature of CARO:** CARO is **not intended to limit the duties and responsibilities** of Auditors, but only requires a Statement to be included in the Audit Report in respect of the matters specified therein. For example, examination of the system of internal control is one of the basic audit procedures employed by the Auditor. The fact that CARO requires a statement regarding the internal control applicable to purchases of Inventories, Fixed Assets and Sale of Goods and Services, only is **no** justification for the Auditor to conclude that an examination of internal control regarding the other areas of a Company's business is not important or not required.

3. **Government Companies:** In case of Audit of Government Companies, CARO is **supplemental** to the Directions given by the C&AG of India. Therefore, in respect of such Companies, the matters specified in CARO will form part of the Auditor's Report.

4. List the matters to be reported under CARO, 2015.

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

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

2. **INVENTORIES [3(ii)]:**

(a) **Verification:** Whether Management has physically verified all the inventories at suitable intervals.

(b) **Adequacy of procedures:** Whether the procedures for physical verification of inventory are reasonable and adequate, having regard to the size of the Company and the nature of its business.

(c) **Adequacy of Records:**
- Whether the Company is maintaining proper records of inventory, and
- Whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account.

3. **LOANS TO DIRECTORS AND INTERESTED PARTIES [3(iii)]:**

LOANS GIVEN: Has the Company granted any loans, secured or unsecured, to Companies, Firms or other parties covered in the Register maintained u/s 189 of the Act.

(a) **Repayment:** Whether receipt of the Principal and the interest amount are regular.

(b) **Steps for recovery:** If overdue amount is more than ` 1,00,000, whether reasonable steps have been taken by the Company for recovery of Principal and Interest.

4. **INTERNAL CONTROL [3(iv)]:**

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

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

5. **DEPOSITS FROM PUBLIC [3(v)]:** If the Company has accepted Deposits from public, whether the following are complied with –

(a) Directives issued by the Reserve Bank of India,

(b) Provisions of Sec. 73 to 76 or any other relevant provision of the Companies Act, 2013 and its rules.

(c) Orders, if any, passed by the Company Law Board / NCLT / RBI / any Court / Tribunal.

(d) The nature of contraventions, if any, should be stated in the Report.

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

7. **STATUTORY DUES [3(vii)]:**

(a) Is the Company regular in depositing Undisputed Statutory Dues including Provident Fund, Employees' State Insurance, Income Tax, Wealth Tax, Service Tax, Sales Tax, Customs Duty, Excise Duty, Value Added Tax, Cess and any other Statutory dues with the appropriate authorities. If not paid regularly, the extent of the arrears of outstanding statutory dues as at the last day of the Financial Year concerned for a period of more than 6 months from the date they became payable, shall be indicated in the Report.

(b) If such non–payment of dues is on account of any dispute, then the amount involved and the forum where the dispute is pending should also be mentioned.

(c) Whether the amount required to be transferred to Investor Education and Protection Fund in accordance with the provision of Companies Act, 1956 has been transferred to such fund within time.

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

9. **REPAYMENT OF DUES [3(ix)]:**

(a) Has the Company paid the Principal and Interest dues to Financial Institutions, Banks or Debentureholders without default,

(b) In case of default, the period and the amount of default shall be reported.

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

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

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

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

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

5. Explain the applicability of CARO to Foreign Companies.

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

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

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

6. CA Vishwam is appointed as the Branch Auditor of VVK Ltd. Is he required to comply with the CARO when issuing his Branch Audit Report, or is CARO applicable only with respect to the Audit Report issued by the Principal Auditor?

1. Sec.143(8) specifies that a Branch Auditor has the same duties in respect of Audit as the Company's Auditor.

2. The Report submitted by the Branch Auditor should contain a statement on all the matters specified in CARO, to enable the Company's Auditor to consider the same. Hence, CARO is applicable for Branch Audits also.

7. Krishna Ltd is a registered Non–Banking Financial Company which does the business of Lease Financing. Comment whether CARO is applicable for this Company.

Refer to applicability and exemption from CARO in Q.1 above. CARO is applicable to **all Companies**. Banks are exempted from CARO. However, NBFCs are not exempt. Hence, CARO is applicable to Krishna Ltd.

8. BK Ltd, a Benefit Fund, registered under NBFC Regulations, is in existence for the past two decades. On 31st December 2014, this Company is converted into a Bank. You have been appointed as an Auditor for the Financial Year 2014–2015. Comment whether CARO is applicable for this Company.

Refer to applicability and exemption from CARO in Q.1 above.

As on the date of B/Sheet, the Company is a Banking Company. Hence, CARO is **not applicable**, irrespective of the fact that the Company was converted from NBFC during the year.

9. Mittal Pvt Ltd provides the following information for the Financial Year 2014–2015. Comment whether CARO is applicable for this Company: (a) Paid–up Share Capital and Reserves – ` 50 Lakhs, (b) Outstanding Loans from Banks – ` 24 Lakhs, (c) Turnover – ` 6 Crores.

Refer to applicability and exemption from CARO in Q.1 above.

To be exempt from CARO, a Private Limited Company must satisfy **all** the prescribed conditions **cumulatively**. Even if one of the conditions is not satisfied, the Private Limited Company's Auditor has to report on the matters specified in CARO. Hence, CARO is **applicable** in the above case, since Turnover condition is attracted.

10. CA Bhava is appointed as the Auditor BB Pvt Unlimited, a Company registered under Companies Act, with Unlimited Liability. For Financial Year 2014–2015, the Company had a Turnover of ` 3 Crores, Outstanding Loans from Banks and FI of ` 23 Lakhs and Paid–Up Capital with Reserves of ` 48 Lakhs. Explain whether his Audit Report must include CARO.

Refer to applicability and exemptions from CARO in Q.1 above.

1. The term "Private **Limited** Company", as used in the exemption from CARO, should be construed to mean a Company registered as a "Private Company" (as defined in Sec.2(68)) and which has a **Limited Liability**.

2. So, CARO would be **applicable to Private Unlimited Companies,** irrespective of the size of their Paid–Up Capital and Reserves, Turnover, Borrowings from Banks/Financial Institutions. Hence, in the present case, Turnover / Capital Base / Loan Criterion need not be considered for the Company and CARO is applicable directly.

11. Guru Pvt Ltd has 2 Branches – in Chennai and in Mumbai. Each Branch has a separate Statutory Auditor and the Company, as a whole, has a Central Statutory Auditor. Comment which of these Auditors must comply with CARO.

Details	Chennai Branch	Mumbai Branch	Total
Paid up Capital and Reserves (in ` Lakhs)	30	30	60
Outstanding Loans from Banks and FI (in ` Lakhs)	10	26	36
Turnover (in ` Crores)	3	6	9

1. Conditions to be satisfied for being exempt from CARO are laid down in respect of the Company **taken as a whole**.
2. So, if CARO is applicable to the Company as a whole, then **each and every Branch** of the Company will also be automatically covered under CARO (irrespective of the fact that the Branch's transactions are within the limits).
3. The Branch Auditor has the same reporting responsibilities in respect of the Branch as those of the Auditor appointed u/s 139 of the Act has in respect of the Company. The comments of the Branch Auditor in respect of the Branch are dealt with by the Central Statutory Auditor of the Company while finalizing his report under the Order.
4. Hence in this case, all the three Auditors must comply with CARO.

12. Explain the term "Paid–Up Capital" for the purpose of determining applicability of CARO to Private Limited Companies. Does it include Preference Share Capital?

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

13. Vayu Pvt Ltd has a Turnover of ` 4 Crores for the Financial Year 2014–2015. The Outstanding Balance of Loans from Banks and Financial Institutions is ` 24 Lakhs throughout the year. The Company had a Capital of ` 60 Lakhs at the beginning of the year and on 15.09.2014 the Company made a Buy Back of Shares worth ` 20 Lakhs resulting in a Share Capital of `40 Lakhs as on 31st March 2015. Comment whether CARO is applicable for the Company.

Refer to applicability and exemptions from CARO in Q.12 above.

1. CARO is applicable to a Private Company if, **at any point of time**, during the Financial Year covered by the Audit Report, the conditions relating to – (a) Paid–Up Capital & Reserves, or (b) Loan Outstanding, or (c) Turnover, are satisfied.

2. In the present situation, Vayu Pvt Ltd's Share Capital was ` 60 Lakhs at the **beginning** of the year, thus exceeding the limits laid down in CARO. Hence, CARO is applicable.

14. Explain the term "Reserves" for the purpose of determining applicability of CARO to Private Limited Companies.

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

15. Keshav Pvt Ltd has a balance of ` 15 Lakhs as Capital Reserve, ` 15 Lakhs as Revenue Reserves, ` 20 Lakhs as Revaluation Reserve and ` 10 Lakhs as Paid–Up Share Capital as on 31st March. Comment on the applicability of CARO to this Company.

Refer to Explanation for Paid–Up Share Capital and Reserves.

1. Reserves includes all types of Reserves (Capital Reserves, Revenue Reserves, Revaluation Reserve, etc)
2. Here, Paid–Up Capital + Reserves = ` 10 Lakhs (Paid–Up Capital) + ` 50 Lakhs (Capital Reserve + Revenue Reserve + Revaluation Reserve) = ` 60 Lakhs. Hence, CARO is applicable for this Company.

16. Mahath Pvt Ltd provides the following information for the financial year ending 31st March. Comment whether CARO is applicable for this Company. (amounts in ` Lakhs)

Paid Up Share Capital 35, Capital Reserve 7, Revaluation Reserve 10, General Reserve 10, Profit and Loss (Dr.) 15

Refer to Explanation for Paid–Up Share Capital and Reserves.

1. Debit balance of P&L A/c, should be **reduced from the figure of Revenue Reserves only**. So, if the Company does **not** have Revenue Reserves, Debit Balance of P&L A/c **cannot** be reduced from the figures of Paid–Up Capital, Capital Reserves and Revaluation Reserves.
2. In the present case,

(a)	Paid–Up Capital		= ` 35 Lakhs
(b)	Reserves	= 7 + 10 + 10	= ` 27 Lakhs
	Less: P&L (Dr) to the extent of Revenue Reserves (i.e. General Reserve)	= ` 10 Lakhs	= ` 17 Lakhs
	Paid up Capital + Reserves [(a) + (b)]		= ` 52 Lakhs

3. Hence, CARO is applicable for this Company.

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

17. A Private Limited reports the following position as on 31st March:
Paid Up Capital ` 30 Lakhs, Revaluation Reserve ` 10 Lakhs, Capital Reserve ` 11 Lakhs, P&L A/c [Dr.] ` 2 Lakhs
The Management of the Company contends that CARO is not applicable to it. Comment.

Refer discussion in previous question. P&L (Dr) can be deducted only from **Revenue Reserves**.

Total of Paid Up Capital and Reserves = 30 + 10 + 11 = ` 51 Lakhs. Hence, CARO is applicable.

18. Explain the term "Loans Outstanding" for the purpose of determining applicability of CARO to Private Ltd Companies.

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

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

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

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

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

19. H Private Ltd had taken Overdrafts from two Banks with a limit of ` 10 Lakhs each against the security of Fixed Deposit it had with those Banks and an Unsecured Overdraft from a Financial Institution of ` 9 Lakhs. The said loans were outstanding as at 31st March. The Paid Up Capital and Reserves of the Company as at that date was ` 40 Lakhs and its Turnover during the financial year ended on 31st March was ` 3 Crores. The Management of the Company is of the opinion that CARO 2015 is not applicable to it because Turnover and Paid–Up Capital were within the limits prescribed and Loans taken against the Fixed Deposit cannot be considered. The Company further contended that Loan Limit is to be reckoned per Bank or Financial Institution and not cumulatively. Comment.

Refer to applicability and exemption from CARO in Q.1 above.

1. **Applicability:** A Private Ltd Company must satisfy all the 3 specified conditions for claiming exemption.

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

3. **"Loan from any Bank":** Total Outstanding Balances from all Banks & Financial Institutions should be considered cumulatively, and not on "per Bank / FI basis". Thus, all loans (Secured or Unsecured) should be included.

4. **Conclusion:** CARO is applicable to the Company, since the Total Loan is (10 + 10 + 9) = ` 29 Lakhs.

20. Prithvi Pvt Ltd has Outstanding Payable balances of ` 15 Lakhs with SBI, ` 16 Lakhs HSBC and ` 17 Lakhs with ICICI as on 31st March. Comment on the applicability of CARO to this Company.

1. **"Any Bank or Financial Institution (FI)",** would refer to the Aggregate to all Loans and not with reference to each Bank or Financial Institution.

2. In the given case, the aggregate of Loans Outstanding = 15 Lakhs +16 Lakhs + 17 Lakhs = ` 48 Lakhs (exceeds the limit). Hence, CARO is applicable.

21. AP Pvt Ltd has borrowed ` 80 Lakhs on 15th June 2014 and repaid the entire loan before 31st March 2015. Comment on the applicability of CARO to this Company.

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

2. Where the Company had taken a Loan from a Bank in excess of ` **25 Lakhs** during the year, but the year–end balance of the same is NIL, the Company would be covered by CARO, notwithstanding that it fulfills all other conditions for exemption from the Order. In the present case, AP Pvt Ltd will be covered under CARO.

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

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

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

23. Explain the term "Financial Institution" under Companies Act.

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

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

24. Explain the term "Turnover" for the purpose of applicability of CARO.

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

2. **Inclusions & Exclusions:** For ascertaining the limit of ` 5 Crores –
   (a) Sales Tax Collected or Excise Duty Collected should **not** be included, if they are credited **separately** to Sales Tax Account or Excise Duty Account.
   (b) Trade Discounts should be **deducted** from the figure of Turnover.
   (c) Commission Allowed to third parties should **not** be deducted from the figure of Turnover.
   (d) Sales Returns should be **deducted** from the figure of Turnover, even if the Returns are from the Sales made in the earlier years. [As a corollary, any Sales Returns, etc. in respect of Sales made during the year under report, if received **after** the end of that year, would **not** be deductible from the figure of Turnover of such year.]
   (e) Income received by way of Rent or Dividend/Interest would **not** form part of "Turnover".

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

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

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

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

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

Hence, CARO **does not** apply to A Pvt Ltd, since all the conditions relating to exemption are satisfied.

26. T Pvt Ltd's Paid Up Capital and Reserves are less than ` 50 Lakhs and it has no Outstanding Loan exceeding ` 25 Lakhs from any Bank or Financial Institution. Its Sales are ` 6 Crores before deducting Trade Discount ` 10 Lakhs and Sales Returns ` 95 Lakhs. The services rendered by the Company amounted to ` 10 Lakhs. Comment on applicability of CARO to this Company.

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

1. Aggregate of Paid up Capital is less than ` 50 Lakhs
2. Loan from Banks and Financial Institutions is less than ` 25 Lakhs.
3. Turnover = [Sales ` 6 Crores – Trade Discount ` 10 Lakhs – Returns ` 95 Lakhs] + Services Income ` 10 Lakhs = Net ` 5.05 Crores.(more than the specified limit of ` 5 Crores)

Hence, CARO applies to T Pvt. Ltd, since the Turnover exceeds ` 5 crores.

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

Refer Para 3(i)(a) of CARO

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

2. **Coverage:** The FA Register must contain details in respect of the following assets –
   (a) Both Tangible or Intangible Assets.
   (b) Self–Financed or Acquired through Finance Lease.
   (c) Assets which are fully held for disposal, retired from active use, fully depreciated assets, period of useful life as per Schedule II of the Act.
   (d) Fully Impaired Assets.

3. **Form of Record:** FA Register can be maintained in manual form or in electronic form. The conditions relating to Electronic Form FA Register are –
   (a) It should be maintained such that it can be retrieved in a **legible form**.
   (b) It will have to be ensured that the information contained in the electronic records remains **accessible and unaltered** and its origin, destination, date, etc. can be identified.

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

4. **Special Points:**
   (a) In case of Fixed Assets with **changing locations** (e.g. a Construction Equipment which has to be moved to various sites), it is sufficient if records of movement / custody of the Equipment is maintained.
   (b) In case of Assets like Furniture, etc. located in the **residential premises of the Staff,** the FA Register should indicate the Name / Designation of the Staff.
   (c) Electrical Installations need not be shown as a separate asset. For purposes of identification, it is suggested that the initial sub–division may be made according to the User, e.g. Factory Buildings, Plant, Service Departments, Township Buildings, etc. A further sub–division can be made according to the sub–division already made for Buildings, Plant, etc.
   (d) For Furniture & Fittings, individual identification can be made for high–value items, and by groups for other items.

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

A Ltd, having Fixed Assets at 10 different locations, in total valuing ` 5,000 Crores, have been physically verifying the assets every third year. Auditor insists for yearly verification of the same – Comment.

Refer Para 3(i)(b) of CARO

1. **Outsourcing:** It is not necessary that only the Company's Staff should make the verification. It is also possible that the same may be verified by outside Expert Agencies engaged by the Management.

2. **Method of Verification:**
   (a) The Auditor should examine whether the method of verification is **reasonable,** in the circumstances relating to each asset. For example, in the case of certain process industries, verification by direct physical check may not be possible in the case of Assets which are in continuous use or which are concealed within larger units.
   (b) Also, it is not always possible to suspend manufacturing operations merely to conduct a physical verification of the Fixed Assets, unless there are compelling reasons which would justify such an extreme procedure. In such cases, indirect evidence of the existence of the Assets may suffice. For example, the very fact that an Oil Refinery is producing at normal levels of efficiency may be sufficient to indicate the existence of the various process units even where each such unit cannot be verified by physical or visual inspection.

3. **Reasonable Intervals:**
   (a) What constitutes "reasonable intervals" depends upon the **circumstances of each case**.
   (b) While an **annual** verification may be **reasonable**, it may be impracticable to carry out the same in some cases (due to nature of assets, difficulty in verification, spread, etc). Even in such cases, the verification programme should be such that all assets are verified at least once in **every 3 years**.
   (c) Where verification of all assets is not made during the year, it will be necessary for the Auditor to report that fact, but if he is satisfied regarding the frequency of verification he should also make a suitable comment to that effect.

4. **Material Discrepancies:** If a material discrepancy has been properly dealt with in the Books of Accounts (which may or may not imply a separate disclosure in the accounts), it is not necessary for the Auditor to give details of the discrepancy / its treatment in the Accounts. However, he is required to make a statement that a material discrepancy was noticed on the verification of Fixed Assets and that the same has been properly dealt with in the Books of Account.

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

1. **Reporting Responsibilities:** The Auditor's reporting duties can be analysed from two perspectives, i.e. in the Main Audit Report (where he expresses his opinion on the Financial Statements) and in the CARO Report.

2. **CARO Reporting:** Compliance with CARO requirements should be judged based on the **whole Accounting Year** and not merely with reference to the position existing at the Balance Sheet date, or the date on which the Auditor makes his Report. Hence, in the above case, the Auditor will make a negative remark in his CARO Report.

3. **Main Audit Report:**
   (a) In the Main Audit Report, the Auditor reports on the State of Affairs as they existed during the Accounting Year.
   (b) In deciding whether or not to make an Adverse Report, the Auditor should consider what detrimental effect, if any, has been caused by the failure to comply with the requirements of CARO, for any part of the year.
   (c) For example, if records for Fixed Assets were not properly maintained for some part of the year but were properly maintained at the Balance Sheet date and physical verification was made after the records were properly maintained, there is no detrimental effect on the Company. However, for example, if Internal Control with respect to the items specified in CARO Clauses was inadequate during a part of the year, there may be a detrimental effect on the Company.
   (d) Also, the Auditor cannot ignore the position existing at the Balance Sheet date or at the time at which he makes his Report. The Auditor might consider, in the light of the circumstances and provided he is able to satisfy himself regarding the facts, as to whether a reference to the State of Affairs existing at the BS Date or at the date when he makes his report would be necessary to give a more complete picture to the Members to whom he is reporting.

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

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

30. Bring out the requirements of CARO in relation to Physical Verification of Inventory.

Refer Para 3(ii)(a) of CARO

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

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

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

Refer Para 3(ii)(b) of CARO

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

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

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

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

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

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

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

1. **Principle: AS–2** requires that any change in the accounting policy relating to Inventories which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. When there is a change in accounting policy (which has a material effect in the current period) the amount by which any item in the Financial Statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

2. **Conclusion:**
   (a) Change in basis of Inventory Valuation amounts to a change in the basis of accounting. If the effect on profit is material, adequate disclosure should be made in the accounts or notes.

(b) The Auditor should ensure such change in method of valuation (including quantification of effect on the Financial Statements) should be disclosed in the Financial Statements or in the Notes. Else, he would not have satisfied the statutory reporting requirements.

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

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

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

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

Refer Para 3(ii)(c) of CARO

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

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

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

35. CA Shabd was appointed as the Auditor of Sparshi Ltd, which is subject to CARO reporting. As per Para 3(ii)(c) of CARO – the Auditor has to comment on material discrepancies on physical verification of Inventory by the Management. Sparshi Ltd does not maintain quantity details of Inventory because of which, material discrepancy (if any) could not be identified. Comment on the reporting responsibilities of the Auditor under this clause.

1. **Para 3(ii)(c) of CARO** requires the Auditor to examine whether material discrepancies have been noticed on verification of Inventories when compared with Book Records. Such an examination is possible when Quantitative Records are maintained for inventories.

2. In many cases, records of individual issues (particularly for Stores items) are not separately maintained, and the Closing Inventory is established only on the basis of a year–end Physical Verification.

3. If 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.

4. Where such reconciliation is not possible, the Auditor has to determine whether the item for which the discrepancy cannot be established is material or not. If such item is material, 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.

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

Refer Para 3(iii) of CARO

1. **Period of Review:**
   (a) The Auditor is required to disclose the requisite information in his report in respect of all parties covered in the Register maintained u/s 189 of the Act, **irrespective of the period** to which such loan relates.
   (b) The Clause covers not only Loans granted during the year, but all Loans **including Opening Balances**.
   (c) It may so happen that a Related Party u/s 189 may take a Loan from the Company and repay it back to the Company within the Financial Year concerned. So, while examining the loans, the Auditor should also take into consideration the loan **transactions that have been squared–up** / settled during the year, and report such transactions under this Clause.
2. **Loans in Kind:** Further, there is no stipulation regarding the loan being given in cash or in kind. In the absence of such stipulation, the Auditor is required to disclose the requisite information in his report in respect of all kind of Loans whether given in cash or in kind, to the parties covered in the Register maintained u/s 189 of the Act.

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

Refer Para 3 (iii)(a) of CARO

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

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

Refer Para 3(iii)(b) of CARO

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

39. ABC Private Ltd has granted Loan of ` 20 Crores to XYZ Ltd, a Sister Concern, and it remains outstanding at the year–end. How would you report the fact?

1. **Legal Compliance:** The Auditor should verify compliance with Sec.186 with respect to the above loan.

2. **Disclosure:** The Loan given should be shown in the Assets Side of the Balance Sheet, suitably classified as "Current" or "Non–current" Loans and Advances.
3. **AS Compliance:** Since ABC Private Ltd granted Loan to XYZ Ltd (Sister Concern), requirements of AS–18 should be followed by ABC Private Ltd. [Refer **Padhuka's** Students' Referencer on AS (AS 18 – Disclosure Requirements).]
4. **Inquiry:** Where the terms and conditions of the loan are prejudicial to the interest of the Company, the Auditor shall report u/s 143(1) of the Act.
5. **CARO:** The Auditor should also disclose the fact in his Report under Clause 3(iii).

If compliance with the above is ensured, the Auditor will issue an Unmodified Opinion.

40. What are the duties of an Auditor in relation to verification of Internal Controls? Explain with reference to CARO.

Refer Para 3(iv) of CARO

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

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

3. **Audit Procedures: –** The Auditor shall review the following to identify major weakness in internal controls:
   (a) Reports of Internal Auditor, if any,
   (b) Minutes of the Meetings of the Board of Directors and Audit Committee,
   (c) Previous years' Working Papers,
   (d) Follow–up actions taken by the Management in response to weaknesses communicated to the Management.

4. **Reporting Responsibilities:**
   (a) **Assessment:** The Auditor makes an assessment whether the major weakness noted by him has been **corrected** by the Management **as at the Balance Sheet date**.
   (b) **Weakness not corrected:** If the Auditor is of the opinion that the weakness has not been corrected, then he should report the fact while commenting under this Clause. Apart from stating that there has been a continuing failure to correct major weakness, the Auditor should report the weakness and the steps to be taken by the Management to correct the weakness, if any.
   (c) **Weakness Corrected:** It may also happen that the weakness is corrected by the date on which the Auditor issues the Audit Report. In such a case, the Auditor's Report should state the fact that although as at the Balance Sheet date, there was a continuing failure to correct a major weakness on the date of the Financial Statements, the weakness has been corrected by the date the Auditor issued his Report.
   (d) **Continuing Weakness:** Even if the Management has taken reasonable steps to correct the weakness but the weakness continues, the Auditor is required to report the same under this Clause.
   (e) **Impact on Main Audit Report:** If the Auditor is of the opinion that the major weaknesses in the internal control system have serious implications on the adequacy or reliability of the Books of Account of the Company, the Auditor should consider modifying his Audit Report on the Financial Statements.

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

1. The requirements in regard to adequacy of Internal Controls and Continuing Failure to correct major weakness(es) are not inter–related. These are two distinct aspects of the Clause.

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

42. Bring out the responsibilities of an Auditor under CARO in relation to verification of Deposits Received by the Company.

Refer Para 3(v) of CARO

1. **Scope:** This Clause requires the Auditors to report on compliance with the requirement of Sec.73 to 76, Rules made thereon and the directives of RBI relating thereto.
2. **Audit Procedures:**
   (a) **Understanding:** The Auditor should obtain an **understanding** of the requirements of Sec.73 to 76 and those of the relevant Rules and should verify their compliance.
   (b) **Audit Plan:** The Auditor should **plan** to test for compliance with the provisions of Sec.73 to 76 of the Act.
   (c) **Examining Controls:** The Auditor should examine the **efficacy of Internal Controls** instituted by the Company so that the Deposits accepted by the Company remain within the limits. It may be difficult for the Auditor to ascertain that Deposits accepted by the Company are within the limits **on each day** of the Accounting Year. He would, therefore, be justified in making a reasonable **test check** to ensure that the Company has not accepted Deposits during the year in excess of the limits.
   (d) **Check List:** The Auditor may also make a "Check List" to ensure that all the requirements of the Rules regarding the records to be maintained, returns to be filed, etc. are complied with.
   (e) **Verifying Documentation:** The Auditor should examine the system by which deposits are accepted and records are maintained and make a reasonable **test check** to ensure the correctness of the system.
   (f) **Special Consideration:** For Financial Companies, the Auditor should make a similar examination having regard to the RBI directives (e.g. Sec.45MA of RBI Act) in force from time to time.
   (g) **Verifying Default:** The Auditor has to determine whether there is a default in any repayment of Deposits. Non–compliance of provisions.
   (h) **Management Representation:** The Auditor should obtain a Management Representation to the effect whether the Company has complied Sec. 73 to 76, Rules thereon, Directives issued by RBI & any other relevant orders.
   (i) **Reporting:** If the Auditor is of the view that any kind of contravention of Sec.73 to 76 or any other relevant provisions of the Act or Rules, has taken place, he should state in his report that the provisions have not been complied with, along with the nature of contraventions.

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

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

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

Note: Students may also refer to **Sec.143(3)(g),** i.e. Reporting on Directors' Disqualification u/s 164(2).

44. Bring out the reporting responsibilities of an Auditor under CARO, in relation to maintenance of Cost Records.

Refer Para 3(vi) of CARO.

1. **Maintenance of Cost Records [Sec.148(1)]:**
   (a) **Requirement:** Companies notified by Central Government are required to maintain proper Books of Account showing particulars relating to utilization of material or labour or to other items of Cost as may be prescribed.
   (b) The Cost Accounting Records Rules issued for various industries contain requirements relating to two matters:
   - maintenance of proper **Books of Account** relating to Materials, Labour, and Other items of Cost, and
   - preparation of **Cost Statements** at the end of the Financial Year in accordance with the Industry Rules.

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

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

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

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

3. **Audit Considerations:**

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

45. Bring out the Auditor's responsibilities in relation to Statutory Dues of the Company under CARO.

Refer Para 3(vii)(a) of CARO

1. **Scope:**

(a) **Regular Levies:** The intention of this Clause is to ascertain how **regular** the Company is in depositing Statutory Dues with the appropriate authorities. Since the emphasis of the Clause is on the **regularity**, the scope of Auditor's inquiry is restricted to only those Statutory dues, which the Company is required to deposit regularly to an Authority.

(b) **Other Levies:** The Auditor is not required to ascertain whether the Company is regular in depositing amounts, which may be levied by an Appropriate Authority from time to time upon occurrence or non–occurrence of certain events and therefore are not required to be paid regularly.

2. **Meaning of Statutory Due:**

(a) Any sum, which is to be regularly **paid to an Appropriate Authority under a Statute** (whether Central, State or Local or Foreign) applicable to the Company, should be considered as a "Statutory Due". So, the **obligation** to pay a Statutory Due is created or **arises out of a Statute**, rather than being based on an Independent Contractual or Legal relationship.

(b) Where any dues are **recoverable as Arrears of Land Revenue** by the concerned Authority, the same shall be treated as a Statutory Due. **Examples:** Municipal Taxes, TDS, License Fees (for Cinema Halls, etc).

(c) Any sum payable to an Electricity Company as **Electricity Bill** would **not** constitute a Statutory Due, despite the fact that such a Company has been established under a Statute. This is so because the due has arisen on account of Contract of Supply of Goods or Services between the Parties.

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

4. **Reporting Format Examples:**
   (a) While the Auditor has to report upon the regularity of the deposit, he is not required to specify in detail each instance where there has been a delay or the extent of the delay. It should be sufficient if he indicates whether **generally** the deposits have been regular or otherwise.

   (b) **Reporting Examples –**
   - "Undisputed Statutory Dues including PF or ESI, IT, VAT, Wealth Tax, ST, Custom Duty, ED, Cess have been regularly deposited by the Company with the Appropriate Authorities in all cases during the year" (or)
   - "Undisputed Statutory Dues … Cess have generally been regularly deposited with the Appropriate Authorities though there has been a slight delay in a few cases" (or)
   - "Undisputed Statutory Dues……. Cess have not generally been regularly deposited with the Appropriate Authorities, though the delays in deposit have not been serious" (or)
   - "Undisputed Statutory Dues ……… Cess have not been regularly deposited with the Appropriate Authorities and there have been serious delays in a large number of cases".

   (c) In indicating the Arrears, the period to which the Arrears relate should also preferably be given and further, wherever possible, the fact of subsequent clearance or otherwise may also be indicated. The following is the format in which the Auditor may report the extent of the Arrears of Outstanding Statutory Dues:

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

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

5. **Other Points:**

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

46. Under CARO, an Auditor is required to report on the regularity of payment of Provident Fund and Employees' State Insurance dues. Give alternative drafts of the report on this Clause, mentioning the circumstances of reporting.

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

1. **Auditor's Duties:**
   (a) The Auditor has to report on the regularity of deposit of PF / ESI dues irrespective of the fact whether or not there are any arrears on the Balance Sheet date. There may be situations where a Company has deposited the relevant dues before the end of the year, while it has been in default in the matter for a significant part of the year.
   (b) While the Auditor has to report upon the **regularity** of the deposit, he is not required to specify in detail each instance where there has been a delay or the extent of the delay. However, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than 6 months from the date they became payable, should be indicated.

2. **Alternative Drafts for Reporting:** Some examples of wordings, which may be used, are given below –

(a) "Provident Fund / Employees' State Insurance dues have generally been regularly deposited with the appropriate authorities in all cases during the year".

(b) "Provident Fund / Employees' State Insurance dues have generally been regularly deposited with the appropriate authorities, though there has been a slight delay (less than 6 months) in a few cases".

(c) "Provident Fund / Employees' State Insurance dues have not generally been regularly deposited with the appropriate authorities though the delays in deposit have not been serious".

(d) "Provident Fund / Employees' State Insurance dues have not been regularly deposited with the appropriate authorities and there have been serious delays in a large number of cases. However, there are no arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than 6 months from the date they became payable".

(e) "Provident Fund / Employees' State Insurance dues relating to the period ...... and aggregating to ` ........... which had fallen due for deposit with the appropriate authorities had not been so deposited as at.......... Out of these, ` .... have been deposited subsequently".

(f) "Provident Fund / Employees' State Insurance dues relating to the period ...... and aggregating to ` .... which had fallen due for deposit with the appropriate authorities had not been so deposited as at.......... The details of amounts outstanding for a period exceeding **6 months** from the date they became payable are given below:"

47. A Company having several departments with separate payrolls and where payments of wages are spread over several days, makes lump–sum deposits of estimated amounts of Provident Fund and Employees State Insurance dues and adjusts the excess or deficit against the following month's deposit. Comment on the above.

Garuthman Steels Ltd is a Manufacturing Company with more than 500 Employees. The monthly payroll calculation is finalized on 10^{th} of the succeeding month and the Salary is disbursed on the 12^{th} of the succeeding month. Hence for the purpose of ESI & EPF the Company makes an estimate of Salary at the end of every month and the same is paid on the due date. Later on when the payroll is finalized, the differential amount of ESI & EPF is paid. Does it amounts to irregularity in depositing Statutory Dues?

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

1. In case of a large Company where there are a number of departments with separate payrolls and where payments are spread over a number of days, the collection of data regarding the PF / ESI collection and the Company's contribution thereto may take some time.

2. To avoid delayed payments, the Company may make lumpsum deposits of estimated amounts and adjust the excess or deficit against the following month's deposit.

3. If this method is consistently followed and the difference between the total dues and the lumpsum deposit is not material, it can be deemed as regularly deposited and hence, no adverse comment is necessary.

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

1. **Accrual:** Provident Fund contributions should be accounted in the books on accrual basis, whether paid or not. As per Sec.128(1) a Company has to maintain proper books of account, on accrual basis of accounting.

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

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

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

49. During the course of audit of ABC Ltd, it is noticed that out of ` 12 Lakhs of PF Contributions accounted in the books, only ` 2 Lakhs has been remitted to the authorities during the year. On enquiry, the Chief Accountant informed that due to financial problems they have not remitted but will remit the same as and when the position improves. As a Statutory Auditor, how would you deal with the above situation?

Note: Refer to Clause 3(vii) Point 9 of CARO.

Conclusion: In the given case, the Company has not complied with the requirements as to deposit of PF contributions, to the tune of ` 10 Lakhs. Financial problems do not constitute sufficient reason for non–compliance. Hence, the Auditor shall report the non–compliance under Clause 3(vii) of CARO in his report.

50. B Ltd, manufacturing cycles, has 150 employees. Auditors observe that it has not registered itself for Provident Fund and ESI purposes, not remitting the dues in time and Auditor insists for qualifying the Report. Management contends that in the absence of registration, it cannot be construed that the Company is in default of statutory dues on regular basis. Comment.

Note: Refer to Clause 3(vii) Point 9 of CARO.

Management's contention that it has not registered and so not paid the statutory due is not a valid reason for non–payment. Auditor is required to verify legal compliance as per **SA–250**. Hence, the Auditor shall report the non–compliance under Clause 3(vii) of CARO in his report, and also consider the effect of non–compliance with applicable Laws and Regulations.

51. Adhvaryu Ltd has not paid ESI and EPF on a monthly basis. However, the entire arrears are paid on the month of March (along with respective interest) and as on the Balance Sheet date, no amount is due to be paid in respect of EPF and ESI. Bring out the Auditor's responsibilities under CARO.

1. The Auditor has to report on the regularity of deposit of Statutory Dues **irrespective of** the fact whether or not there are any **arrears on the Balance Sheet date**.
2. There may be situations where a Company has deposited the relevant dues before the end of the year while it has been in default in the matter for a significant part of the year.
3. In cases where there are no arrears on the Balance Sheet date, but the Company has been irregular during the year in depositing the Statutory Dues, the Auditor should **state this fact** in his Audit Report.

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

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

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

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

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

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

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

1. **First View:** The Statutory Dues referred to in this Clause become payable on the last date by which payment can be made without attracting penalty and/or interest under the relevant law. Hence, in the above case, there is an irregularity in relation to the first 5 months Service Tax due.
2. **Second View:** It can also be argued that the amounts referred to in the clause become so payable as at the date of the expiry of the stay granted by the Authorities or, where instalments have been granted for the payment of Statutory Dues referred to in the Clause, the date on which the default occurs and the amount becomes payable to the Authorities. If this view is taken, in the above case, there is no irregularity in remittance of Service Tax.
3. **Conclusion:** As the purpose of this Clause is to indicate the amounts which have become actually payable & are outstanding as at the Balance Sheet date for a period of more than 6 months from the date they became payable, the latter view conforms more closely to the requirements of CARO. Hence it can be concluded that the Company is not irregular in depositing Statutory Dues.

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

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

2. **Disputed Due:**

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

(f) **Cases Pending Appeal**	Where the amount under the dispute is pending for an Appeal to be filed and the time limit for filing the Appeal has **lapsed**, the disputed amount would become a **Statutory Due.** The reporting responsibilities of the Auditor as are applicable to any other Undisputed Statutory Due under Clause 3(vii) of CARO.

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

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

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

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

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

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

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

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

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

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

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

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

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

60. Bring out the reporting requirements of the Auditor under Clause 3(vii)(c) of CARO.

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

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

61. Write short notes on Investors Education and Protection Fund as per Companies Act, 1956

1. **Transfer of Unpaid / Unclaimed Dividend:** Any money transferred to the Unpaid Dividend Account of a Company and which remains unpaid / unclaimed for a period of **7 years** from the date of such transfer, shall be transferred by the Company to the **"Investor Education and Protection Fund"** established by the Central Government **u/s 205C of the Companies Act, 1956.**
2. **Moneys due to the Fund:** The following amounts shall be credited to the "Investor Education and Protection Fund" established u/s 205C –
   (a) Amounts in the Unpaid Dividend Accounts of Companies.
   (b) Application moneys received by Companies for allotment of any securities and due for refund.
   (c) Matured Deposits with Companies.
   (d) Matured Debentures with Companies.
   (e) Interest accrued on amounts referred above.
   (f) Grants and Donations given by Government, Companies and Other Institutions.
   (g) Interest or other income received out of investments made from the Fund.

   Note: The first 4 items shall form part of the Fund only after the expiry of 7 years from the date they became due for payment.
3. **Objectives of Fund:** No claim for payment of any moneys from the Fund can be entertained. The Fund shall be utilised for – (i) Promotion of Investor Awareness, and (ii) Protection of the interests of Investors, in accordance with the prescribed Rules.
4. **Details to be furnished:** When Unclaimed Dividends are transferred to the Fund Account, the Company must furnish the following details to the prescribed authority – (i) Nature of sum transferred, (ii) Name and last known address of the rightful recipients, (iii) Amount to which each person is entitled, (iv) Nature of his claim thereto, and (v) Other prescribed particulars.

62. USA Industries Limited has constituted "Investor Education and Protection Fund" as required under the Companies Act, but so far no amounts have been deposited into the said account. Whether the Auditor should report the same in CARO.

1. **Creation of Fund:** "Investor Education and Protection Fund" can be established only by Central Government. The Company shall only transfer the Unclaimed Dividend, Unclaimed Deposits, etc. from the Special Bank Account to the Investor Education and Protection Fund established by CG.
2. **Reporting under CARO:** Auditor shall determine the amount to be transferred to Investor Education and Protection Fund. In case of delay in transferring the same, he should report the delay under Clause 3(vii)(c) of CARO.

63. Bring out the reporting requirements of the Auditor under Clause 3(viii) of CARO.

Refer Clause 3(viii) of CARO

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

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

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

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

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

Kapalinath Ltd had taken a Term Loan from a Nationalized Bank in 2011 for ` 200 Lakhs repayable in 5 equal instalments of ` 40 Lakhs from 31st March 2012 onwards. It had repaid the loan instalments due in 2012 & 2013, but defaulted in 2014, 2015 & 2016. What is the responsibility of the Company Auditor, assuming that Company has sought re–schedulement of loan? Explain. **M 11**

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

Refer Clause 3(ix) in CARO.

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

65. Bring out the verification aspects and duties of an Auditor under CARO in relation to Guarantees issued by a Company.

Refer Para 3(x) of CARO.

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

66. Bring out the reporting responsibilities of an Auditor in relation to Term Loans availed by Companies.

Refer Para 3(xi) of CARO

1. **Applicability:** This Clause is applicable in respect of Term Loans availed from **any person** (Banks, Financial Institutions, Directors, Subsidiaries, etc.)
2. **Audit Process:** The Auditor should examine the loan proposal, loan document with the Terms and Conditions, Sanction Letter (for understanding the purpose of Loan) and should also compare it with the actual utilisation of the loans.
3. **Deposit in Common Pool:** It is **not** necessary to establish a one–to–one relationship with the amount of Term Loan & its utilisation. For example, if the amount of Term Loan disbursed by the Bank is deposited in the Common A/c of the Company from which subsequently the utilisation is made, it should not be construed as a mis–application.
4. **Better Utilisation:** Where a Company applies a Term Loan for buying an Asset and if the same has been used for buying an improved version / model of that Asset, it is not considered as a mis–application.
5. **Temporary Deposits during Construction Period:** During Construction Phase, Companies, temporarily invest the surplus funds in Deposits, to reduce the Cost of Capital or for other business reasons. However, subsequently the same are utilised for the stated objectives. In such cases, the Auditor should **mention the fact** that pending utilisation of the Term Loan for the stated purpose, the funds were temporarily used for the purpose other than for which the loan was sanctioned but were ultimately utilised for the stated end–use.
6. **Year–end Disbursement:** It may so happen that the Term Loans taken during the year might not have been applied for the stated purpose during the year (e.g. Loan disbursed at the 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.
7. **Loans Disbursed in Previous Year:** Based on the above point, it is clear that the Auditor, while making inquiry in respect of this clause, should also consider the Term Loans which although were taken in the previous accounting period but have been actually utilised during the current accounting period and report accordingly.

8. **Purpose of Loan not specified:** In case of Term Loans from Banks, raised against Title Deeds, Long Term FDRs, NSCs, etc. where the Bank is not concerned with the purpose for which it is being obtained, the Auditor should clearly **mention the fact,** that in the absence of any stipulation regarding the utilization of loans from the Lender, he is unable to comment as to whether the Term Loans have been applied for the purposes for which they were obtained. It may, however, be noted that the Auditor, in such cases, should verify that the Company has not invested or utilized the money for purposes that are **prohibited** under law.

9. **Reporting:** If the Auditor finds that the Term Loans have **not** been utilized for the purpose for which they were obtained, the Auditor's Report should **state the fact**, and mentions in his Report, the amount of such Term Loan.

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

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

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

Refer Para 3(xii) Point 12 of CARO

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

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

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

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

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

2. **Observations:**
   (a) Since the quantum of Scrap and By–Products is considerable, it appears that maintenance of records for generation as well as records for sale of Scrap/ By–Products is necessary, but the Company has not maintained such records.

(b) The Auditor has to evaluate and consider the effect of non–maintenance of records for Scrap & By–Products in the light of – (a) effectiveness of internal control system, (b) compliance with Cost Accounting (Records) Rules, where applicable, & (c) possibility of frauds in relation to such Scrap & By–Products.

(c) The Auditor will have to issue an adverse comment on non–maintenance of reasonable records for sale of Scrap/ By–Products and decide on the aspect of records on generation, on the basis of facts and circumstances of the case.

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

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

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

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

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

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

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

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

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

Clause	Auditors' Duties
Loss Making Co.3(vii)	**Note:** Refer to reporting requirements under **Clause 3(viii) of CARO,** given above. Assuming that the Company is in existence for more than 5 years, the Auditor should report on the lines specified above.

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

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

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

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

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

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

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

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

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

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

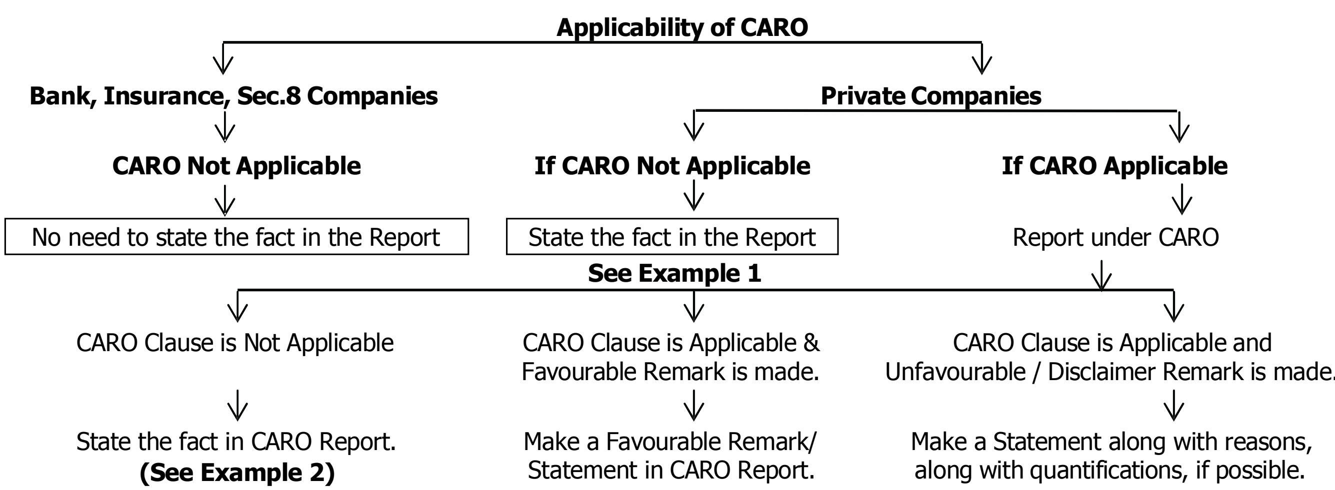
Note:

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

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

1. **Responsibilities of BOD:** Sec.314 of the Act requires that the Board shall be bound to give in its Report, the fullest information & explanations regarding every reservation, qualification or adverse remark contained in the Auditor's Report. In this regard, Audit Report includes CARO and hence the Board's responsibility is extended to this.
2. **Consensus–ad–idem:** The Auditor's comments in CARO may be in respect of Matters of Fact or they may be an Expression of Opinion. It is necessary that there should be no inconsistency in the facts as stated by the Auditor and as explained in the Board's Report. It is, therefore, suggested that wherever possible, a Draft Report should be submitted to the Board to verify and confirm the facts stated therein.
3. **Difference of opinion:** It is, however, possible that, on the same facts, there may be a genuine difference of opinion between the Auditor and the Board. In such a case, each is entitled to hold his or its view. Therefore, the expression of a different opinion in the Board's Report should not be regarded as any reflection on the Opinion expressed by Auditor.
4. **Inclusion in Audit Report:** It is not necessary that the Management's Explanation for any matter on which he makes an Adverse Comment be included in the Audit Report. However in the following cases, the same may be included–
   (a) **To make the comment more meaningful and complete**. (e.g. Physical Verification of Inventories, though planned, may not have been carried out because of a Strike or a Lockout. An Adverse Comment without this explanation would be misleading.)
   (b) **To explain the fact** why in spite of an Adverse Comment, the **True and Fair view** of the Financial Statements is **not vitiated** (e.g. Physical Verification of a part of the Inventories at the year–end may not have been carried out, but there is sufficient other evidence produced by the Management which satisfies the Auditor regarding the existence, condition and value of the Inventories).

75. Summarise the reporting requirements in case of CARO Applicability and its Clause Applicability or Non–Applicability.



Example 1 Format: This Report does not include a Statement on the matters specified in Para 3 of CARO, 2015, issued by the Department of Company Affairs, in terms of Sec.143(11) of the Companies Act, 2013, since in our opinion & according to the information and explanations given to us, the said Order is not applicable to the Company.

Example 2 Format: The Central Government has not prescribed maintenance of Cost Records u/s 148(1) of the Companies Act, 2013 for any of the products of the Company.

READER'S NOTES

DEFINITIONS

Associate Company [Section 2(6) of the Companies Act, 2013]

The shares held by a company in another company in a 'fiduciary capacity' shall not be counted for the purposes of determining the relationship or 'associate company' u/s 2(6) of the Companies Act, 2013.

Related Party [Section 2(76) of the Companies Act,2013]

Related party-with reference to a company, means—

(i) a director or his relative;

(ii) a key managerial personnel or his relative;

(iii) a firm, in which a director, manager or his relative is a partner;

(iv) a private company in which a director or manager or his relative is a member or director;

(v) a public company in which a director or manager is a director and holds along with his relatives, more than two per cent of its paid-up share capital;

(vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

(vii) any person on whose advice, directions or instructions a director or manager is accustomed to Act:
Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

(viii) any company which is—

- a holding, subsidiary or an associate company of such company; or
- a subsidiary of a holding company to which it is also a subsidiary;

(ix) such other person as may be prescribed.

Rule 3 of the *Companies (Specification of Definitions Details) Rules, 2014* provides that for the purposes of sub-clause (ix) of clause (76) of section 2 of the Act, a director other than an independent director or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party.

Final Course

Corrigendum to Study Material, Practice Manual (January, 2015 Edition) and Compiler applicable for May and November, 2015 Examination

Group-I: Paper 3-Advanced Auditing and Professional Ethics

(A) **Study Material – Module I (January, 2015 Edition)** In Chapter 6 on The Company Audit, at Page No. 6.20, Para No. (c) "Right to receive notices and to attend general meeting" should be replaced with-

"**Auditor to attend General Meeting**: Section 146 of the Companies Act, 2013 discusses right as well as duty of the auditor. According to the section 146:

"all notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and the auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorised representative, who shall also be qualified to be an auditor, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor."

Thus, it is right of the auditor to receive notices and other communications relating to any general meeting and to be heard at such meeting, relating to the matter of his concern, however, it is duty of the auditor to attend the same or through his authorised representative unless otherwise exempted."

(B) **Practice Manual (January, 2015 Edition)**

1. At Page No. 6.3, in table, under heading "Equity & Liabilities" of Question No. 4(a), following sub-heads need to be added, corresponding to the data given:

   Share Capital Reserves & Surplus

   Employee Stock Option Outstanding Share Application Money

2. At Page No. 1.24, in Answer to Question No. 3(d); and at Page No. 1.66, in Answer to Question No. 39, the word "SA 4410" need to be replaced with the word "SRS 4410".

3. **Chapter 22- Professional Ethics:**

   (i) At Page No. 22.7, Answer to Question No. 1(d), should be read as under:

Partnership with Non-Chartered Accountants: As per clause 4 of Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant will be guilty of professional misconduct if he enters into partnership, in or outside India, with any person other than Chartered Accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (V) of sub-section (1) of section 4 or whose qualifications are recognized by the Central Government or the Council for the purpose of permitting such partnerships.

However, for the purpose of Limited Liability Partnership, Regulation 53B of the Chartered Accountants

Regulations 1988 permits a Chartered Accountant in practice to enter into partnership with other prescribed Professional Bodies which includes an Advocate, a member of Bar Council of India.

In the instant case, Mr. P, a Chartered Accountant, has entered into partnership with Mr. L, an advocate. Thus, he would not be guilty of professional misconduct as per Clause 4 of Part I of First Schedule read with Regulation 53B.

(i) At Page No. 22.34, Answer to Question No. 21(b), should be read as under:

"As per Section 141(3)(d)(ii) of the Companies Act, 2013, a person who, or his relative or partner is indebted to the company, or its subsidiary, or its holding or associate company, or a subsidiary of its holding company, for an amount exceeding ` 5,00,000 then he is not qualified for appointment as an auditor of a company. There is no such similar provisions in the Income Tax Act.

Further, the Research Committee of the ICAI has expressed the opinion that where in accordance with the terms of his engagement by a client the auditor recovers his fees on a progressive basis as and when a part of the work is done without waiting for the completion of the whole job, he cannot be said to be indebted to the company at any stage.

However, as per Chapter X of Council General Guidelines, 2008 a member of the Institute in practice or a partner of a firm in practice or a firm shall not accept appointment as auditor of a concern while indebted to the concern or given any guarantee or provided any security in connection with the indebtedness of any third person to the concern, for limits fixed in the statute and in other cases for amount exceeding ` 10,000/-.

In the instant Case, Mr. D is appointed to conduct a tax audit u/s 44AB of the Income Tax Act, 1961.He has received the entire audit fees of ` 25,000 in April, 2014 in respect of the tax audit for the year ended 31.3.2014 which is not on progressive basis. Furthermore, the monetary limit is also exceeding the limit of ` 10,000 as per Council General Guidelines. Therefore, Mr. D will be held guilty for misconduct."

(ii) At Page No. 22.12, additional provisions to be inserted in Answer to Question No. 6(b):

"This is also a contravention of section 141(3)(f) of the Companies Act, 2013, which requires that a person shall not be eligible for appointment as an auditor of a company whose relative is a director or is in the employment of the company as a director or key managerial personnel.

In the given case, Mr. Shah, Chartered Accountant, has certified the financial statements of a company in which his wife is a director with substantial interest. Hence, this amounts to professional misconduct which attracts clause (4) of Part I of Second Schedule to the Chartered Accountants Act, 1949 and Mr. Shah has to vacate the office accordingly.

At Page No. 22.50, last part i.e. Conclusion part of Answer to Question No. 31(a), word "Professional Misconduct" should be read as "Other Misconduct"

Corrigendum in the Practice Manual of Paper No. 4, Corporate and Allied Laws (Final Level) in the printed copy (Edition: December, 2014)

1. Students are advised to delete question no. 2(iii) on page 1.1 and question no. 3(iii) on page no. 3.2 and the respective corresponding answers.

2. With respect to question no. 19, answer to Part (i) on page no. 3.17, para 3 stating "The disqualification of Mr. Kishore……..office of director in AB Ltd." be substituted with the below mentioned para-

"As per section 167(1)(a) of the Companies Act, 2013, the office of a director shall become vacant in case he incurs any of the disqualifications specified under section 164(2) of the Companies Act, 2013. Since, Mr. Kishore has attracted disqualification under section 164(2) of the Companies Act, 2013, he has to vacate office of a director in AB Ltd."

3. Question no. 29 along with its answer given on page no. 3.24, be deleted.

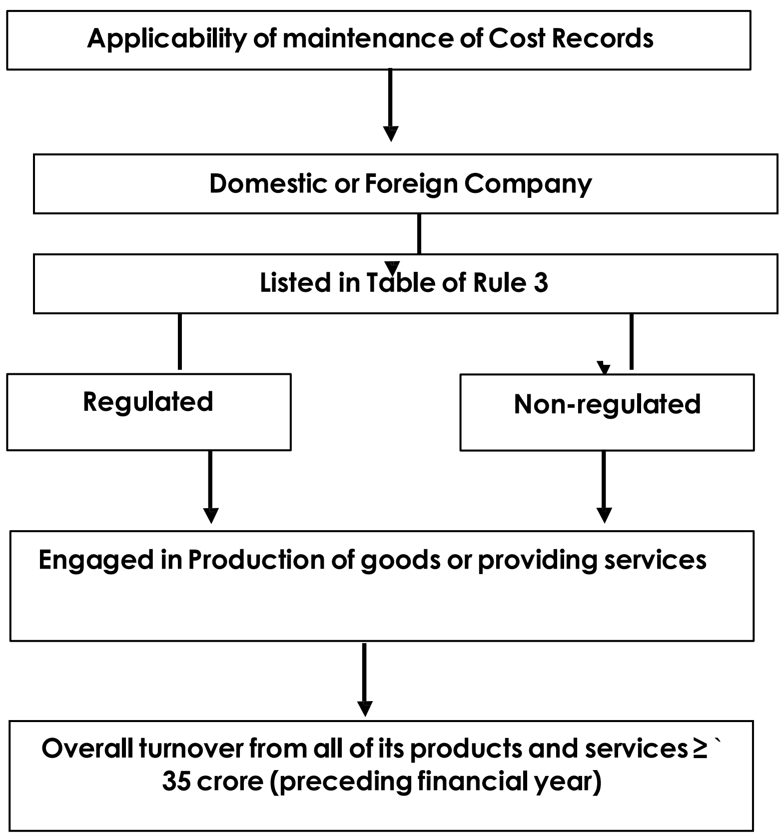
4. Question no. Q16 (ii) and Q23 (ii) on page nos. 19.19 and 19.26 respectively, along with their respective corresponding answers be deleted.

IMPORTANT AMENDMENTS FOR NOV 15

Rule-3: Application of Records

Two categories (regulated sectors and non-regulated sectors) have been retained and a general threshold of turnover of ` 35 crores or more has been prescribed for companies covered. Micro enterprise or a small enterprise as per MSMED Act, 2006 have been taken out of the purview.

Rule 3: Diagrammatic Representation



Rule-4: Applicability for Cost Audit	Even for regulated sectors like Telecommunication, Electricity, Petroleum and Gas, Drugs and Pharma, Fertilizers and Sugar, Cost audit requirement has been made subject to a turnover based threshold of ` 50 crores for all product and services and ` 25 crores for individual product or services. For Non-regulated sector the threshold is ` 100 crores and ` 35 crores respectively.

- No cost Accounting records will be required to maintained by the companies which is classified as a Micro enterprise or a small enterprise including as per the turnover criteria under sub section 9 of section 7 of MSMED ACT 2006
- The requirement for cost audit under these rules shall not apply to a company which is covered in rule 3, and –
- whose revenue from exports, in foreign exchange, exceed, seventy five per cent of its total revenue; or
- which is operating from special economic zone (SEZ)

Maintenance of Records [Rule 5]

(1) Every company under these rules including all units and branches thereof, shall, in respect of each of its financial year commencing on or after the 1st day of April, 2014, maintain cost records in **form CRA-1.**

Provided that in case of company covered in serial number 12 and serial numbers 24 to 32 of item (B) of rule 3, the requirement under this rule shall apply in respect of each of its financial year commencing on or after 1st day of April, 2015.

(2) The cost records referred to in sub-rule (1) shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

(3) The cost records shall be maintained in such manner so as to enable the company to exercise, as far as possible, control over the various operations and costs to achieve optimum economies in utilisation of resources and these records shall also provide necessary data which is required to be furnished under these rules.

Cost Audit [Rule 6]

(1) The category of companies specified in rule 3 and the thresholds limits laid down in rule 4, shall within one hundred and eighty days of the commencement of every financial year, appoint a cost auditor.

(2) Every company referred to in sub-rule (1) shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in **Form CRA-2**, alongwith the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

(3) Every cost auditor appointed as such shall continue in such capacity till the expiry of one hundred and eighty days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

(3A) Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.

(4) Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in **Form CRA-3.**

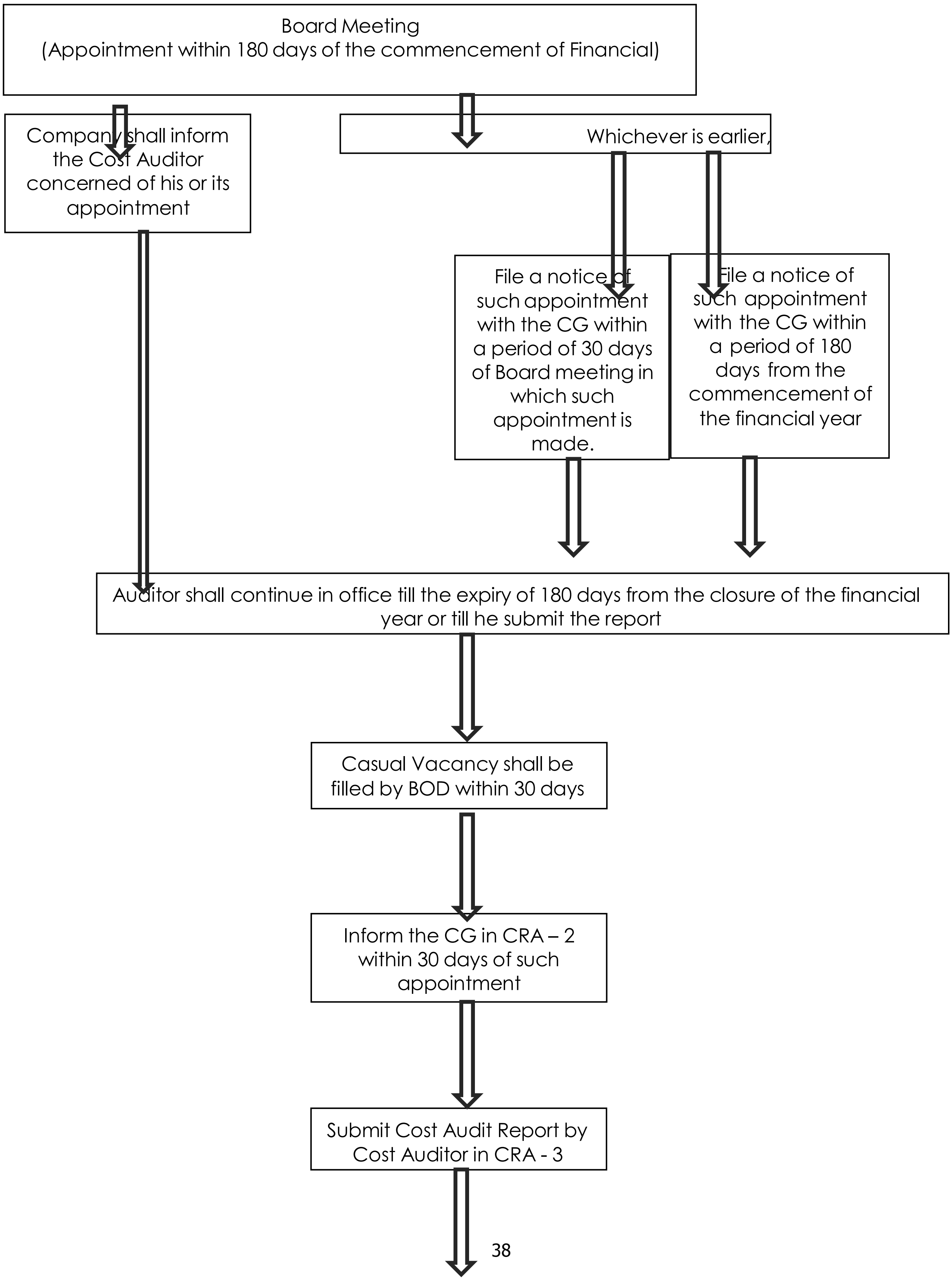
(5) Every cost auditor shall forward his report to the Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of directors shall consider and examine such report particularly any reservation or qualification contained therein.

(6) Every company covered under these rules shall, within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report alongwith full information and explanation on every reservation or qualification contained therein, in Form CRA-4 alongwith fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

(7) The provisions of sub-section (12) of section 143 of the Act and the relevant rules made thereunder shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules.

Procedure for appointment of Cost Auditor [Rule 14] – Refer Company Audit Sheet Sec 148

Cost Audit (Rule 6)



Cost Audit Report submitted to BOD within 180 days

⇓

Company within 30 days from the date of receipt of a copy of Cost Audit Report, furnish to the CG in CRA - 4

***

(27) SA 700: Forming an opinion and Reporting on Financial Statements

1) OPINION

UNMODIFIED

When Auditor concludes that Financial Statement are prepared as per Applicable FRF

MODIFIED

If he concludes that Financial Statement are not free from material misstatement.

OR

Unable to obtain SAAE

2) CONTENTS OF REPORT:

a) Title

b) Adresses

c) Introduction

d) Management responsibility for Financial Statement

→ As per FRF

→ ICS for preparation of Financial Statement

e) Auditor's Responsibility

→ To express opinion

→ Compliance with SA

→ Reasonable Assurance

→ Evidences → A/c Policy

→ A/c Estimate

→ Overall Presentation

f) Auditor's opinion:-

The Financial Statement present fairly / give a true & fair view in accordance with applicable FRF

g) Report on other legal & regulatory requirement

h) Date

i) Place

j) Signature.

Example on Auditor's Report:-

→ Report is unmodified and does not include Emphasis of Matter para or an other matter para

→ INDEPENDENT AUDITOR'S REPORT (IAR)

TO, THE MEMBERS OF ABC COMPANY LTD.

Report on Financial Statement

We have audited the accompanying financial statement of AC company Ltd, which comprises of the Balance Sheet as at March 31, 20XX and the statement of Profit & Loss and cash flow statement for the year ended and a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENT

Management is responsible for the preparation of Financial Statement in accordance with accounting standards as per section 133 of Companies Act., 2013.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit is accordance with SAs issued by ICAI. Those standards require that we comply with ethical requirements, plan and performance the audit to obtain reasonable assurance whether Financial Statement are free from material misstatements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

OPINION

In our opinion and to the best of our information and according to the explanation given to us, the Financial Statement give a true and fair view in conformity with the a/c principals generally accepted in India.

a) In case of Balance Sheet, the state of affairs of company as on 31.3.20XX

b) In case of Profit & Loss , the P/L for the year ended 31.3.20XX

c) In case of CFS, the cash flows for the year ended 31.3.20XX

REPORT ON OTHER LEGAL AND REGULATORY REQUIRMENTS

a) As required by CARO, 2015, we give in the Annexure a statement on matters specified in para 4 & 5 of the order.

b) As per 143(3), we report that

→ We have obtained all information & explanation.

→ BOA have prepared in accordance with law

→ B/S, P/L, CFS are in accordance with law

→ None of the Director are disqualified as per 164(2)

For ABC and Co.
Chartered Accountants
Firm's Registration No.
Signature
(Name of Member Signing)
(Designation)
Membership No

Place of Signature
Date

(28) SA 705: Modification to the Opinion in the Independent Auditor's Report

Summary of SA – 705 (w.e.f. 1st April 2011)

If he has evidence that financial statement are misstated

- Material + Pervasive → Adverse
- Material but not pervasive → Qualified

Unable to obtain sufficient and appropriate evidences

- Material + Pervasive → Disclaimer
- Material but not pervasive → Qualified

Material → Qualified
Material → Adverse
Material → Disclaimer

Inability to obtain sufficient and appropriate evidences due to limitations imposed by management after accepting engagement

↓

Request management to remove the same

- Accept
- Refuses → Tell TCWA + Alternate Procedures → Still unable
  - Material not Pervasive → Qualified
  - Material + pervasive → Resign / Disclaimer

→ Report shall contain BASIS FOR MODIFICATION

→ Opinion para shall have heading → Qualified opinion
→ Adverse Opinion
→ Disclaimer of Opinion

→ Change wordings of Auditors responsibility paragraph in case of adverse / Disclaimer

Example for Qualified Opinion Report:

"IAR"

To, The Members of ABC CO. LTD
Report on Financial Statement
Management's Responsibility
Auditor's Responsibility

AS PER SA 700

Basis for Qualified Opinion:

The CO's inventories are carried in Balance Sheet at Rs. Management has not stated the inventories at lower of cost and not realisable value but has stated them solely at cost, which constitute a departure as per AS – 2. Because of which an amount of Rs. would have been required to write the inventory down to their NRV. Accordingly, cost of sales would have been reduced by Rs. XXX, XXX and XXX respectively.

OPINION:

In our opinion and to best of our information and explanation given to us, except for the effects of the matter describe in Basis for Qualified Opinion para, the Financial Statement give the true & fair view…..SA 700

REPORT ON OTHER LEGAL AND REGU. REQ.
SIGNATURE
MEMBERSHIP NO

As per SA 700.

Example for Adverse Opinion Report:-

To the Members of ABC Co. Ltd
Report on Financial Statement
Management Responsibility
Auditor's Responsibility

As per SA 700

Basis for Adverse Opinion:-

The company has not consolidated the Financial Statement of subsidiary XYZ Co. it acquired during 20XX because it has not yet been able to ascertain fair values of certain assets and liabilities of the subsidiary. Had XYZ been consolidated many elements in accompanying financial statements would have been materially affected.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in Basis for Adverse Opinion Para, the consolidated Financial Statements does not give a true & fair view in conformity………..SA 700

For ABC Co Ltd.
Signature
Membership No

As per SA 700

(29) SA 706: Emphasis of Matter Paragraph and other Paragraph in the Independent Auditor's Report

1) <u>What is EOM?</u>

→ Para included in AR
→ Refers to a matter appropriately disclosed in Financial Statement
→ In the auditor's judgement is of such importance that
→ It is fundamental to user's understanding of Financial Statement.

2) <u>What is OM?</u>

→ Para included in AR
→ Refers to a matter other than those disclosed in Financial Statement
→ In auditor's Judgement is of such importance that
→ Is relevant to users understanding of audit, auditor's responsibility or auditor's report.

3) <u>Circumstances where EOM may be necessary "USES"</u>

a) Uncertainty relating to a pending litigation, properly disclosed in Financial Statement.
b) Substantial doubt about going concern proper disclosed in Financial Statement.
c) Early application of a new accounting standards
d) Substantial change in accounting policy.

4) <u>Circumstances where OM may be necessary</u>:

a) Other reporting responsibilities in case of audit of company
b) LFAR in case of audit of a bank.

5) <u>Note</u>:-

If auditor expects to includes an EOM from para he shall communicate the same with TCWG.

<u>Example for EOM Para:-</u>

<u>Situation</u>:- Inventories are misstated. It is material but not pervasive. The Audit opinion is qualified for this misstatement. There is uncertainty relating to pending exceptional litigation matter. It is highlighted in EOM para.

"IAR"

→

To
Management Responsibility
Auditor's Responsibility
Basis for Qualified opinion — SA 700 & 705
Opinion

<u>EOM</u>:

We draw attention to note X to the Financial Statement which describe the uncertainty related to the outcome of lawsuit filed against the company by XYZ Co. Our opinion is not qualified in respect of this matter
Report on other legal & Reg. Req.
For ABC Co — SA 700
Signature

<u>Example for OM Para</u>:

<u>Situation</u>:- Report concludes OM para in respect of audit responsibility in respect of subsidiary not auditor by him but which forms part of consolidated Financial Statement.

"IAR"

→

To

Management Responsibility

Auditor's Responsibility

Opinion

<u>Other Matter</u>

We did not audit the Financial Statement of certain subsidiaries whose Financial Statement reflect total assets (net) of Rs. XXX as at March 31st, 20XX, total revenues of Rs. XXX and net cash outflows amounting to Rs. XXX for the year ended. The Financial Statement have been audited by other auditors whose reports have been furnished to us by the management and our opinion is solely based on reports of other auditors. Our opinion is not qualified in respect of this matter

For ABC Co LTD
Chartered Accountant
Signature
Member No

(30) SA 710: Comparative Information – Corresponding Figures and Comparative Financial Information

* Comparative Financial Statements:

Auditor's opinion refers to each period for which financial statements are prepared.

* Corresponding Figures:

Auditors opinion on Financial Statement refers to current period only.

* Audit Procedures:- "DESPO"
  - **a)** Determine as to whether Financial Statement include comparative Information required and is classified properly.
  - **b)** Evaluate whether comparative into agrees with the amounts and other disclosures presents in prior periods.
  - **c)** Significant a/c policies have been followed or not.
  - **d)** Maintain Professional skepticism to obtain SAAE
  - **e)** Obtain WR for all periods referred to in his opinion.

* Prior Period Financial Statement are
  - **a)** Audited by another Auditors:-
    - → State in OTHER MATTERS PARA
      - That Financial Statement of prior period are audited by predecessor auditor.
      - Type of opinion expressed by him
      - Date of that report.
      - If it contains material misstatements, communicate with TCWG.
  - **b)** Are unaudited:-
    - → State in OTHER MATTERS PARA that corresponding Financial Statement are unaudited.
      (This statement does not relieve auditors o obtain SAAE AFFECTING CURRENT Financial Statement)

(31) SA 720: The Auditor's Responsibility in relation to other information in documents containing Audited Financial Statement.

1) The Auditor shall read the other information inconsistencies if any, with the audited Financial Statement.

2) If on reading other information, material inconsistencies are found he shall determine whether Financial Statement needs to be revised.

3) If Material Inconsistencies are identified in other information obtained prior to the date of Auditor's Report then,

→ Auditor shall revise the Financial Statement.

→ If Management refuses to revise, qualify the report

→ If revision is necessary and management still refuses, he shall communicate with TCWG and include in OTHER MATTERS PARA, describing the inconsistency.

4) If material inconsistency is identified in other information obtained subsequent to the date of Auditor's report then,

→ Auditors shall receive Financial Statement & follow SA 560

→ Revision is necessary and management agreement then carry additional procedures,

→ Revision of other information is necessary, but management, refuses, then he should discuss with TCWG and take appropriate action.

5) If there is material misstatements of fact, then auditor should consult with entity's legal council and shall consider the advice received.

6) If management refuses to correct the misstatements, the shall commincate with TCWG and take appropriate action.

Common Answer for SA 240,315,330,450

1. Misstatement in the Financial Statement can arise either from

Fraud (Intentional) or Errors (Unintentional)

The auditor is concerned with fraud that causes material misstatement in the Financial Statement.

2. The primary responsibility for the prevention & detection of fraud is of TCWG + management.The responsibility of auditor is obtaining reasonable assurance that the Financial Statement are free from material misstatement.

3. Duty of the auditor:
- Obtain reasonable assurance that financial statements and free from frauds
- But he can't detect all misstatements
- Risk of non detection of fraud is high (Concealment)
- Maintain professional skepticism
- Discuss within team (doubt of fraud)
- Obtain WR w.r.t their
- Responsibility,
- Assessment of risk
- Doubt of fraud.

4. If he finds misstatement, consider whether it is fraud.
If it is fraud, then
- ➢ Consider reliability of WR & Revise the risk

5. Auditor shall obtain understanding of:

(a) Relevant Industry, Regulatory and other External Factors

(b) Nature of Entity including.
- Its Operations
- Ownership & Governance structure
- Types of investments
- The way Entity is structured & how it is financed

(c) Selection and Application of Accounting Policies & reasons for changes thereto.

(d) Entity objectives & Strategies & those business risks that may result in increase risk of material misstatements.

(e) Measurement & review of Financial Performance.

Internal control relevant to audit.

6. Procedure designed to detect material misstatements at assertion level. It comprises of:

(a) Test of details (or classes of transactions, Account Balances and Disclosure); and

(b) Substantive Analytical Procedures

7. If material, communicate uncorrected misstatement and their effect on his opinion to TCWG with a request that uncorrected misstatements be corrected.
Obtain a written representation from management/ TCWG w.r.t their believing that effect of uncorrected misstatements is immaterial

AMENDMENTS IN ALLIED LAW
FOREIGN EXCHANGE MANAGEMENT ACT, 1999

A. CURRENT ACCOUNT TRANSACTIONS: (SECTION 5)

Transactions permissible with approval of Reserve Bank (Schedule – III)

1. Release of exchange exceeding US$ 25,000 ***(LATEST AMENDMENT IN JUNE 2014)*** or its equivalent in one financial year, for **one or more private visits to any country** (except Nepal & Bhutan).

B. LIBERALISED REMITTANCE SCHEME

The Reserve Bank of India had announced a LRS in February 2004 as a step towards further simplification and liberalization of the foreign exchange facilities available to Resident Individuals.

As per the Scheme, resident individuals may remit up to USD 125,000/- per financial year *[LATEST AMENDMENT IN JUNE 2014*] for any permitted capital and current account transactions or a combination of both.

SCHEDULE VII AMENDMENTS

GOVERNMENT OF INDIA
MINISTRY OF CORPORATE AFFAIRS
NEW DELHI

Dated: October 24, 2014

NOTIFICATION

G.S.R.741 (E) In exercise of the powers conferred by sub-section (1) of section 467 of the Companies Act, 2013 (18 of 2013), the Central Government hereby makes the following further amendments to Schedule VII of the said Act, namely:-

(i) In item (i), after the words "and sanitation", the words "including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation" shall be inserted;

(ii) In item (iv), after the words "and water", the words "including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga;" shall be inserted.

2. This notification shall come into force on the date of its publication in the Official Gazette

MINISTRY OF CORPORATE AFFAIRS NOTIFICATION

New Delhi, the 19th January, 2015

1. In the Companies (Appointment and Qualification of Directors) Rules, 2014, in rule 16, the following proviso shall be inserted, namely:—

"Provided that in case a company has already filed Form DIR-12 with the Registrar under rule 15, a foreign director of such company resigning from his office may authorise in writing a practising chartered accountant or cost accountant in practice or company secretary in practice or any other resident director of the company to sign Form DIR-11 and file the same on his behalf intimating the reasons for the resignation.

NOTIFICATION

New Delhi, the 25th July, 2014

S. O. 1913(E).—In exercise of the powers conferred by the second proviso to sub-section (1) of Section 203 of the Companies Act, 2013 (18 of 2013), the Central Government hereby notifies that public companies having paid-up share capital of rupees one hundred crore or more and annual turnover of rupees one thousand crore or more which are engaged in multiple businesses and have appointed Chief Executive Officer for each such business shall be the class of companies for the purposes of the second proviso to sub-section (1) of Section 203 of the said Act.

Explanation.—For the purposes of this notification, the paid-up share capital and the annual turnover shall be decided on the basis of the latest audited balance sheet.

Clarification on matters relating to Consolidated Financial statements

Vide General Circular No, 39/2014, dated 14th October, 2014, clarifications has been issued on the manner of presentation of notes in Consolidated Financial Statement (CFS) to be prepared .Circular clarified that Schedule III to the Act read with the applicable Accounting Standards does not envisage that a company while preparing its CFS merely repeats the disclosures made by it under stand-alone accounts being consolidated. In the CFS, the company would need to give all disclosures relevant for CFS only.

Right of persons other than retiring director to stand for directorship - Refund of deposit under section 160 of the Companies Act, 2013 in certain cases.

It has been bought by companies registered under section 8 of the Companies Act, 2013 about the manner in which the amount of deposit of rupees one lakh received by them under section 160(1) of the Companies Act, 2013 is to be handled if the depositor fails to secure more than twenty five have per cent of the total valid votes.

It has been clarified that in such cases, the Board of directors of a section 8 company is to decide as to whether the deposit made by or on behalf of the person failing to secure more than twenty-five percent of the valid votes is to be forfeited or refunded.

Clarification with regard to section 185 and 186 of the Companies Act 2013 - loans and advances to employees.

Vide General Circular No, 04/2015, dated 10/3/2015 clarification has been issued on the applicability of provisions of section
186 of the Companies Act, 2013 relating to grant of loans and advances by Companies to their employees.

It has been clarified that loans and/or advances made by the companies to their employees, other than the managing or whole time directors (which is governed by section 185) are not governed by the requirements of section 186 of the Companies Act, 2013.

This clarification will, however, be applicable if such loans/advances to employees are in accordance with the conditions of service applicable to employees and are also in accordance with the remuneration policy, in cases where such policy is required to be formulated.

FOR ANY DOUBTS REGARDING LAW AND AUDIT,

PLEASE MAIL ME: elitevision555@gmail.com

#VIDEO LECTURES WILL BE OUT SOON

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