

The CARO Report for Companies:

Enhances alertness of Audit Team & a new standard of Transparency



By



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 Passionate to make anyone Speaker, Writer, Acquiring New Knowledge ,Professional Qualifications ,
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Member IFAC-PAIB committee 2001-2004; Member IFRS SMEIG London 2018-2020

Ex-director - SBI mutual fund, BOI mutual fund, global mediator and international arbitrator
 B. Com (Hons), M.Com, FCA, FCS, FCMA, LL.B, LLM(Constitution),Dip CG, MBA, Dip IFRS (UK),
 DLL&LW, Dip IPR, Dip in Criminology, Ph. D, Mediation ,IP(IBBI), MBF, Dip HRM, Dip Cyber Law
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Student of: MA (Psychology), MA (Economics), PGD CSR, PGD Crime Investigation IBBI (RV)

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Ranks ALL INDIA 1st in Inter CA; 6th in CA Final; 3rd in CMA Final, 5th in Mumbai University +++

Chairman western region ICAI 1997; Council Member ICAI 1998-2016

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Origin and Development of Company Law in India

The history of the Modern Company Law in England began in 1844 when the Joint Stock Companies Act was passed. The history of Indian Company Law began with the Companies Act 1850, which was modeled on the British Companies Act 1844. After many amendments, the Act of 1850 was replaced in 1913. Between 1882 and 1912, the Companies Act was amended many times. Thereafter the Indian Companies Act 1913 was based on British Companies Act 1908. Subsequent amendments were made in 1914, 1915, 1920, 1926, 1930, 1932, and 1936. However,

after independence it was found that Companies Law should again be amended and hence on the recommendations of the Bhabha Committee Report it was amended, and it came into effect from 1st April 1956. The Companies Act, 1956, has since provided the legal framework for corporate entities in India.

The Companies Act, 1956 had undergone changes by amendments in 1960, 1962, 1963, 1964, 1965, 1966, 1967, 1969, 1971, 1977, 1985, 1988, 1996, 1999, 2000, 2002 (Amendment), 2002 (Second Amendment), and 2006. Major amendments to the Act were made through Companies (Amendment) Act, 1988 after considering the recommendations of the Sachar Committee, and then again in 1998, 2000 and finally in 2002 through the Companies (Second Amendment) Act 2002, consequent to the report of the Eradi Committee.

The Companies Act, 1956 was also amended consistent with the enactment of the Depositories Act, 1996. There were some unsuccessful attempts made in 1993 and 1997 to replace the present Act with a new law.

History of Companies (Auditor's Report) Order [CARO], 2020



Section 227(4A) of the Companies Act, 1956 (1956 Act) required that the auditor's report of certain class of companies should include a statement on certain prescribed matters. Reporting under Companies (Auditor's Report) Order profoundly known as "CARO Reporting" or "CARO" dates back to 1975 when the Central Government introduced Manufacturing and Other Companies (Auditors Report) Order, 1975 ('MAOCARO 1975') which was superseded by

MAOCARO 1988. Later on in 2003 it came to be known as Companies (Auditor's Report) Order, 2003 [CARO 2003] newer version of the report were issued as CARO 2015 and CARO 2016. These reporting requirements were prescribed under the Companies (Auditor's Report) Order, 2003 (CARO – 2003) by the Ministry of Corporate Affairs (MCA). Section 227(4A) of the 1956 Act ceased to be operational from 1 April 2014 after notification of section 143(11) under the Companies Act, 2013 (2013 Act).

Though section 143(11) of the 2013 Act provides requirements similar to section 227(4A) of the 1956 Act, the MCA had not prescribed CARO related requirements till April 10, 2015. Consequently, after consulting the Institute of Chartered Accountants of India, the MCA on 10 April 2015 issued the Companies (Auditor's Report) Order, 2015 (CARO – 2015) prescribing certain reporting requirements for auditors of certain class of companies. CARO – 2015 will be effective from the date of its publication in the Official Gazette. The same was revised in 2016.

The MCA has notified Companies (Auditor's Report) Order, 2020 on 25 February 2020 (CARO 2020) after consultation with the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013. Over the time, with supersession the reporting has increased the responsibility on the auditors. CARO 2020 seems to be the largest in terms of reporting requirement amongst all previous orders.

Applicability of CARO, 2020

CARO 2020 was originally planned to be made applicable for statutory audits commencing on or after April 1, 2020 corresponding to the financial year 2019-20. However, the Ministry of Corporate Affairs vide Order dated 17.12.2020 has extended the applicability date of Companies (Auditor's Report) Order, 2020 for one more year, i.e. for the financial years commencing on or after the **1st April, 2021**. Accordingly, CARO, 2020 will be applicable from FY 2021-22 and onwards.

The requirements of the CARO are over and above the existing provisions of section 143 of the Act regarding the auditor's report. While normal statutory audit under section 143 (1), (2) & (3) are applicable to all companies, the CARO exempts certain categories of companies from its application. These exemptions are discussed below.

The order is applicable to all companies as were covered in CARO 2016 including audit of foreign companies, audit of branches, project offices and liaison offices, if they do not fall under specified exemptions. Accordingly, the order applies to all the companies except the following companies specifically excluded from its purview:

- One Person Company
- Small companies (Companies with paid up capital less than/equal to Rs 50 lakh and with a last reported turnover which is less than or equal to Rs. 2 Crore)
- Banking companies
- Companies registered for charitable purposes under section 8 of the Act. [Also see note 2]
- Insurance companies.
- The private companies that satisfy following conditions are also exempt from the requirements of CARO, 2020:[Also see note 3]
 - Whose gross receipt or revenue is less than or equal to Rs 10 crore in the financial year; [Also see note 4]
 - Whose paid up share capital plus reserves [Also see note 5] is less than or equal to Rs 1 crore as on the Balanceance sheet date (i.e. usually at the end of the FY);
 - Not a holding or subsidiary of a Public company; and
 - Whose borrowing is less than or equal to Rs 1 crore at any time during the financial year [Also see note 6 & 7].

Note 1: CARO 2016 was not applicable to consolidated financial statements. However, CARO 2020 comprises a clause which is now applicable to auditor's report on CFS. According to this clause, where any qualifications or adverse remarks are highlighted by the auditors in their respective standalone companies CARO reports, then the details of such remarks are to be mentioned by the auditor of the company in his CARO report of CFS.

Note 2: The specific exemption under the Order is given to companies licensed to operate under section 8 of the Act. However, it would appear that in view of the provisions of section 465 of the Act, the exemption would also extend to companies licensed to operate under section 25 of the Companies Act, 1956.

Note 3: A private limited company, in order to be exempt from the applicability of the Order, must satisfy all the conditions mentioned herein collectively.

Note 4: The total revenue/total income would include other income and revenue from discontinuing operations

Note 5: Clause (64) of section 2 of the Act defines the term “paid-up share capital” as such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid up in respect of shares issued and also includes any amount credited as paid up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called. The “Glossary of Terms Used in Financial Statements” issued by the Research Committee of ICAI defines the term “reserve” as, “the portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability”.

Note 6: The limit of “exceeding one crore rupees” would apply in aggregate to all borrowings, long term or short term, secured or unsecured, collectively from all banks and financial institution including credit card dues and current maturities of long term borrowings.

Note 7: Clause (39) of section 2 of the Act defines the term “financial institution” to include a scheduled bank, and any other financial institution defined or notified under the Reserve Bank of India Act, 1934”. The term financial institution has been defined under clause (c) of Section 45I of the Reserve Bank of India (RBI) Act, 1934 and includes any non-banking institution which carries on as its business or part of its business activities like:

1. the financing, whether by way of making loans or advances or otherwise, of any activity other than its own;

2. the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature;
- letting or delivering of any goods to a hirer under a hire purchase agreement
 - the carrying on of any class of insurance business;
 - managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries

The term “financial institution” shall also cover a non-banking financial company (NBFC), private banks or foreign banks.

Content of CARO, 2020

The additional matters to be included in the Auditor’s Report under Section 143 of the Companies Act, 2013 are specified in the paragraphs 3 and 4 of the CARO 2020, as may be applicable. Paragraph 3 has twenty one clauses in all which are main content of the CARO. Paragraph 4 of the CARO 2020 requires the auditor to state the basis for unfavorable or qualified answer if any in the report and where the auditor is unable to express any opinion on any specified matter, to indicate such fact together with the reasons as to why it is not possible for him/her to give his opinion on the same.

The 21 clauses of paragraph 3 are discussed below:

1. In respect to (a) Property, Plant and Equipment (PPE) and (b) Intangible Assets

- (a) **Whether the company is maintaining *proper records* showing full particulars, including quantitative details and situation of PPE:**

Coverage:

- PPE as defined in AS 10 (Revised), “Property, Plant and Equipment” or Ind AS 16, “Property, Plant and Equipment” as may be applicable.
- In case of right of use (ROU) assets covered under Ind AS 116, “Leases’ where the auditee, under a lease agreement, obtains the right to use an asset
- Investment Property as covered under Ind AS 40, Investment Property

- Non-current assets held for sale as defined under Ind AS 105, Noncurrent Assets Held for Sale and Discontinued Operations.

Proper Records:

As the term ‘proper records’ is nowhere defined, it is onto professional judgment, skepticism and acumen of the auditor to determine if the proper records are maintained, electronically or otherwise. However, the records relating to PPE at minimum must generally be sufficient to determine the following details:

- (i) Sufficient description of the PPE to make identification possible;
- (ii) Classification of PPE like, plant and machinery, office equipment, etc;
- (iii) Situation of PPE;
- (iv) Quantity,
- (v) Original cost;
- (vi) Year of purchase;
- (vii) Date of put to use;
- (viii) Useful life;
- (ix) Residual value;
- (x) Component-wise breakup; (wherever applicable)
- (xi) Adjustment for revaluation or for any increase or decrease in cost and date of revaluation, if any;
- (xiii) Rate/basis of depreciation;
- (xiv) Depreciation for the current year;
- (xv) Accumulated depreciation
- (xvi) Particulars regarding impairment;
- (xvii) Particulars regarding sale, discarding, demolition, destruction, etc. Of PPE

If the books of account or other documents are kept in electronic mode they should be

- accessible in India
- retained completely in the format in which they were originally generated, sent or received
- be capable of being displayed in a legible form
- Shall not be disposed of or rendered unusable, unless permitted by law.

Audit Consideration

The audit procedure to be adopted may vary as per the nature, size and complexity of the enterprise. However, in respect to PPE the auditor must take care of the following:

- PPE register may be maintained manually or electronically. The reliance on electronic record should only be done if it can be retrieved in a legible form and as per the controls and security measures in the company, once finalized, the PPE register cannot be altered without proper authorization and audit trail.
- In case no PPE register has been maintained, it should be seen as a serious lacuna and accordingly reported.
- In case of moveable PPE, it should be sufficient if record of movement/custody of the equipment is maintained instead of location.
- If any item of PPE is located in the residential premises of members of the staff, the PPE register should indicate the name & designation of the person who has custody of the item.
- Assets of small individual value may be conveniently grouped for purposes of entry in the PPE register.
- For assets having same useful life, depreciation for the group as a whole may be shown.
- Quantitative details in respect of PPE may be in case of:
 - Land by survey numbers and by deeds of conveyance;
 - Leaseholds by individual leases;
 - Buildings may be classified into factory buildings, office buildings, township buildings, service buildings, etc and any further sub classification wherever feasible
 - Plant and machinery may be sub-divided into immovable and movable and sub classified item wise
 - Development of property can be sub-divided according to the buildings or plant for which the development work is undertaken.
 - Vehicles can be identified by reference to the registration numbers.
- If the details regarding allocation of cost over identified units of assets are not available, it would have to be made by an analysis of the purchases and the disposals of the preceding years by the management in consultation with the auditor.
- A code number may be affixed on the asset on initial identification which would give sufficient details for future identification.

- If discrepancies between the assets as verified and the details compiled from the records are noticed, the reason for same should be analyzed keeping the concept of materiality in mind and adjustments that finally have to be made by the management should be properly documented.

(b) Whether the company is maintaining *proper records* showing full particulars of intangible assets?

Coverage:

AS 26 defines the term “Intangible Asset” as an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Ind AS 38 defines the term “Intangible Asset” as an identifiable non-monetary asset, without physical substance. An illustrative list of Intangible Assets would be:

- Customer lists / customer loyalty;
- Trademark, formula;
- Broadcasting license;
- Music copyright / literary works/musical works;
- Patents including patent on digital device;
- Recipe, trade secrets, processes, designs;
- Publishing title;
- Algorithms;
- Fishing license;
- Franchisee;
- Formulations;
- Non-competition agreements;
- Internet domain names, distribution network;
- Royalty agreements, employment contracts;
- Operating rights/marketing rights/servicing rights; and
- Website development.

Proper Records

Since the term 'proper records' is not defined, the professional judgment of the auditor will enable him to determine if the proper records are maintained, electronically or otherwise. However, the records relating to intangible asset at minimum must generally be sufficient to determine the following details:

- sufficient description of the intangible asset so as to identify them separately;
- controls around capitalization;
- situation;
- original cost;
- year of purchase;
- date of put to use;
- useful life;
- residual value;
- adjustment for revaluation or for any increase or
- decrease in cost;
- date of revaluation, if any;
- rate(s)/basis of amortization;
- amortization for the current year;
- accumulated amortization;
- particulars regarding impairment;
- Particulars regarding sale, discard etc.

Audit Considerations

- Intangible assets, can be classified as:
 - a) Customer-based intangible assets;
 - b) Marketing-based intangible assets;
 - c) Contract-based intangible assets;
 - d) Technology-based intangible assets; or
 - e) Artistic-based intangible assets.

- Auditor must check relevant documents like registration under Copyright Act, 1957, Patents Act, 1970, Trade Marks Act, 1999, Designs Act, 2000, Information Technology Act, 2000, etc
- In case of Self-generated intangible assets, auditor must see if it meets recognition and measurement criteria as specified in relevant accounting standards;

The Financial Report must convey the following in respect to intangible assets:

- Reasonable and sufficient description of the asset to facilitate identification should be available for inspection.
 - Location
 - Detailed commercial agreements with respect to intangible assets
 - Quantity of the intangible assets per category /classification
 - Original cost details.
 - For self generated assets, cost of development).
 - Date on which the asset becomes available for use by the company with documentary evidence.
 - Subsequent expenditure on the asset that is included in its carrying amount, along with the date of incurrence of the expenditure.
 - Register of amortization
 - Impairment Register/Record
 - Retirement & Disposal Book
 - Record of registration
 - License Register
 - Records/registers of litigations involving intangible assets
- (c) **Whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account.**

Coverage:

- PPE as defined in AS 10 (Revised), “Property, Plant and Equipment” or In AS 16, “Property, Plant and Equipment” as may be applicable.

- In case of right of use (ROU) assets covered under Ind AS 116, “Leases’ where the auditee, under a lease agreement, obtains the right to use an asset.

Audit Considerations

- Physical verification of the assets is the responsibility of the management; hence auditor need not physically verify them. However, he must satisfy that such verification has been periodically carried on by the management on basis of either personal observation of the verification process or through available evidence like instructions to staff.
- Verification may be made by outside expert agencies engaged by the management for the purpose.
- Auditor must to ensure that the person making the verification had the necessary technical knowledge where such knowledge is required.
- Method of verification should be reasonable according to the circumstances of the assets
- The management may decide about the periodicity of physical verification of PPE. Generally, an annual verification may be reasonable; it may not be it may be possible in some cases. However, in all cases the verification programme should be such that all assets are verified at least once in every three years. In case all assets have not been verified by management during the year, the auditor should report that fact, but if he is satisfied regarding the frequency of verification he should also make a suitable comment to that effect.
- If the discrepancies are material the auditor must report the same. The materiality may be determined by Factors like:
 - material discrepancy is such that, if it is omitted to be reported or considered, may fail to give a true and fair view of the property, plant and equipment of the company the cost of the asset / asset class and its relationship to the total cost of all assets by percentage value or numerical count.
 - The nature of the significance of the asset, its value, in the overall production /processing /manufacturing process (for example, mission-critical assets), operational criticality of the asset, its current situation / location.
 - Size, nature and complexity of the business of the entity.
- (d) **Whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favor of the lessee) disclosed in the financial statements are held in the name of**

the company? if not, provide the details of Description of property , Gross carrying value , Held in name of, Whether promoter, director or their relative or employee, Period held and Reason for not being held in name of company.

Coverage

- As per General Clauses Act, 1897, “Immovable Property shall include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth”.
- investment property (as defined under Ind AS 40) and
- non-current assets held for sale as defined under Ind AS 105

However, Transfer Development Rights (TDRs), plant and machinery embedded in land, etc., are not considered as an immovable property.

Audit Considerations

- The auditor is required to identify immovable properties and verify the title deeds of such immovable properties. The auditor should verify the title deeds available and reconcile the same with the PPE register.
- The auditor should carry out detailed examination in the cases where immovable property is transferred as a result of conversion of partnership firm or limited liability partnership into company or amalgamation of companies,
- In case property has been mortgaged a confirmation about the same should be sought from the lending institution to this effect.
- In case the title deeds were lost the certified copies of the documents, as available with the company, and details about the FIR filed about loss of such documents needs to be obtained and documented.
- Any discrepancy, including any pending/disputed court cases relating to ownership, needs detailed discussion with the management and should be properly documented.
- In case the title deeds of all the immovable properties (other than properties where the company is the lessee disclosed in the financial statements are not held in the name of the company the auditor should ascertain Description of the property, Gross carrying amount, Name of the individual holding the title, period of such holding and reason for the immovable property not being held in the name of the company
- In case of any pending dispute, the auditor may obtain the support of any legal expert.

- (e) **Whether the company has revalued its PPE (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of PPE or intangible assets.**

Coverage

It will cover both upward and downward revaluation under revaluation model. Revaluation shall however not include:

- Fair valuation of PPE upon first time adoption of Ind AS.
- Remeasurements
- Changes to ROU assets due to lease modification

Audit Considerations

- The process of revaluation may be carried out at sufficient regularity such that the carrying amount does not differ materially from the fair value.
- The auditor while reporting under this clause has to consider the requirements of section 247 of the Companies Act, 2013 - “Valuation by Registered Valuers”
- If a single item of PPE is revalued, then the entire class of PPE to which that item belongs should be revalued.
- Auditor must consider the following aspects:
 - Date of revaluation
 - Name of the registered valuer
 - Place and date of valuation report.
 - Membership/license number of the registered valuer
 - Review of valuation report
 - Methods and significant assumptions applied in estimating fair values.
 - Extent to which fair values were determined directly or estimated.
 - Accounting treatment of revaluation surplus.
- The auditor also needs to specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of PPE or intangible assets.

- (f) **Whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made there under, if so, whether the company has appropriately disclosed the details in its financial statements.**

Coverage

The term "benami property" has been defined in the Section 2(8) of the **Prohibition of Benami Property Transactions Act, 1988 and** means any property which is the subject matter of a benami transaction and also includes the proceeds from such property. Section 2(9) of the Act also defines the term "benami transaction" to mean,—

(A) a transaction or an arrangement—

- a. where a property is transferred to, or is held by, a person, and the consideration for such property has been provided, or paid by, another person; and
- b. the property is held for the immediate or future benefit, direct or indirect, of the person who has provided the consideration,

Except when the property is held by karta, a person standing in a fiduciary capacity for the benefit of another person, spouse, children and in case of joint ownerships brother or sister or lineal ascendant or descendant,

(B) a transaction or an arrangement in respect of a property carried out or made in a fictitious name;

(C) a transaction or an arrangement in respect of a property where the owner of the property is not aware of, or, denies knowledge of, such ownership; or

(D) A transaction or an arrangement in respect of a property where the person providing the consideration is not traceable or is fictitious.

Audit Considerations

- The auditor is required to examine whether proceedings have been initiated under Section 24(1) of the Prohibition of Benami Property Transactions Act 1988 by the Initiating Officer during the year and/ or any proceedings are pending against the company.
- In case any proceedings are initiated or pending, the auditor is required to examine whether appropriate disclosures are made in the financial statements. Appropriate disclosures shall include nature of property, carrying value of the property in the books of account, status of proceedings before the relevant authority, consequential impact on the

financial statements and/ or the liability that may arise in case the proceedings are decided against the company.

- The auditor is also required to evaluate whether the liability is required to be disclosed as “contingent liabilities” or whether provisions are required to be made.
- Where the proceedings are initiated post Balanceance sheet date but before the signing of the auditor’s report, the auditor should consider the requirements of SA 560, “Subsequent Events”.
- Auditor is required to report only on the adequacy of disclosure in the financial statements in cases where proceedings are initiated with the company being treated as a benamidar but not in case where the company is beneficial owner.

2. **Detail of Inventories and Working Capital**

- (a) **Whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account?**

Items Covered

“Inventories are assets:

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

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

(C) In the form of materials or supplies to be consumed in the production process or in the rendering of services.”

Inventory includes raw material, work-in-progress, finished goods, goods purchased and held for resale, maintenance supplies, consumables and loose tools. However, inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of PPE.

Audit Considerations

- Like in case of PPE, the physical verification of inventory is the responsibility of the management of the company which should verify all material items at least once in a year

and more often in appropriate cases. However, the auditor must 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.

- In the process, the following documents can be examined by the auditor in this regard:
 - a. written instructions given by the management to the concerned staff engaged in the physical verification process;
 - b. physical verification inventory sheets duly authenticated by the field staff and responsible officials of the company;
 - c. summary sheets/consolidation sheets duly authenticated by the responsible officials;
 - d. internal memos etc., with respect to the issues arising out of physical verification of inventory;
 - e. extent of coverage of inventory having regard to their value; and
 - f.* Any other relevant documents evidencing physical verification of inventory.
- The auditor is expected to examine the methods, procedures and the coverage of such verification.
- Auditor needs to use his professional judgment to comment on the appropriateness of method used for physical verification which should be reasonable and adequate in relation to the size of the company and nature of its business.
- The auditor may compare the final inventories with stock records and other corroborative evidence.
- Auditor must see whether the procedures for identifying damaged and obsolete items of inventory are well designed and operate properly.
- For items of stock which are held by third parties, the auditor should obtain confirmations for stock held by them.
- Auditor must report any discrepancies of 10% or more in the aggregate for each class of inventory have been noticed on physical verification of inventories when compared with books of account. The 10% threshold for reporting must be applied on a net basis after adjusting excesses and shortages within the class.

(b) Whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or

financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details

Coverage:

The requirement is very specific and is only applicable if the following conditions are met:

- Loan exceeds 5 crores (on any day in the year);
- It is for working capital needs [i.e. for conducting day-to-day operations of an enterprise];
- It is from bank or financial institution; and
- It is secured by current assets.

Hence, the auditor need not report here if such limits are unsecured or sanctioned on the basis of assets other than current assets.

It should be noted that the auditor is required to check the working capital sanctioned limit and not its utilization. Moreover, the term "sanction" here should include fresh sanction during the year as well as limits renewed or due for renewal during the year and both fund based and non-fund based credit facilities availed by the company should be considered for the purpose of checking the limit.

Audit Considerations

- The auditor should determine the sanctioned limit with reference to the sanction letter issued by banks or financial institutions and relevant agreements executed with them.
- The auditor should examine the important terms in the sanction letters and other correspondence with the lender and the documents, if any, evidencing charge in respect of such facilities availed and the register of charges.
- The auditor should obtain a list of the statements or returns which are submitted to the banks/ financial institutions and compare the same with the books of account as to its accuracy or otherwise. Such returns/statements would include stock statements, book debt statements, credit monitoring arrangement reports, statements on ageing analysis of the debtors/other receivables, and other financial information to be submitted in stipulated format on a quarterly basis to lenders.

- If any discrepancy arises when such returns/statements are compared with the books of account, the auditor is required to report the same.

3. Detail of Investments, guarantee or security, advances and loans given

Whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties? If so,

- (a) whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate**
- **the aggregate amount during the year, and Balanceance outstanding at the Balanceance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates;**
 - **the aggregate amount during the year, and Balanceance outstanding at the Balanceance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associates;**
- (b) whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are not prejudicial to the company's interest;**
- (c) in respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether there payments or receipts are regular;**
- (d) if the amount is overdue, state the total amount over due for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;**
- (e) whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the over dues of existing loans given to the same parties, if so, specify the aggregate amount of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature**

of loans granted during the year[not applicable to companies whose principal business is to give loans];

- (f) whether the company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, if so, specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013;**

Coverage:

It is applicable to all companies except Clause (a) and (f) which do not apply to companies whose principal business is to give loans for example NBFC registered as core Investment Company. Auditor has to report in respect of all kind of loans whether long term or short term, whether given in cash or in kind to any party(s). Whether an advance is in the nature of a loan would depend upon the circumstances of each case after considering normal trade practices, amount of advance vis-a-vis amount of order, tenure of advance etc. The auditor's response in this clause would be limited to financial guarantees only

Audit Considerations

- The auditor should obtain an understanding around the controls and procedures established by the company with regard to making of investments, provision of guarantees, security, grant of loans and advances in nature of loans and check the operating effectiveness of the same.
- The auditor should ensure compliance with all the requirements of sections 179, 180, 185, 186, 187 of the Act and related rules.
- The auditor should obtain following details of all investments made, guarantee or security provided or loans/advances in nature of loans granted during the year from the management::
 - name of the parties,

- Relationship of the company with the parties (i.e. whether subsidiary, joint venture or associate, promoter, any other party etc.),
 - gross amount of involved,
 - date and amount of settlement
 - Amounts outstanding as at the year end.
- The auditor should also examine the register of guarantees, if any, maintained by the company and compare with the list provided by the management and check minute books to check if the guarantees have been issued by or under sanction of the competent authority.
 - The auditor should also take into consideration the loans/advances in nature of loan transactions that have been squared-up during the year
 - ***For the purpose of clause b***, the “terms and conditions” would primarily include rate of interest, security, terms and period of repayment and restrictive covenants, nature of entity. In respect of investments made, to assess whether same are prejudicial to the company’s interest, the auditor would have to give due consideration to the factors connected with such an investment, including company’s ability to make such investment, financial standing of the investee company, sources of fund, valuation of the proposed investment, covenant’s attached and so on. In determining whether the guarantee is prejudicial to the interest of the company, the auditor would have to give due consideration to a number of factors connected with the guarantee, including the financial standing of the party on whose behalf the company has given the guarantee, party’s ability to borrow, the nature of the security offered by the party, etc.
 - ***For purpose of clause c***, The auditor has to examine from the loan agreements / mutually agreed letter of arrangement, as the case may be, whether the schedule of repayment of principal and payment of interest has been stipulated at the time of sanction of loan. If there is no such agreement / arrangement or the agreement / arrangement does not contain the schedule of repayment of principal and payment of interest, the auditor shall report that there is no stipulation of schedule of repayment of principal and payment of interest and may report that he is unable to make specific comment on the regularity of repayment of principal & payment of interest. In case of material irregularity, auditor must report

- ***For purpose of clause d,*** auditor Must determine the total amount overdue (principal and interest) for more than ninety days from all parties as at Balanceance sheet date. Auditor should apply professional judgment to determine if reasonable steps have been taken by management to demand the payments. Reasonable steps would normally be like sending notices, reminder mails, obtaining enhanced security, etc.
- ***For purpose of clause e,*** auditor has been entrusted with the responsibility identify instances of ‘ever greening’ of loans/advances in nature of loans to mask loan default by giving new loans to help delinquent borrowers to repay/adjust principal or pay interest on old loans. The auditor has to obtain the list of parties to whom loan has been renewed or extended and check the renewal agreement.
- ***For the purpose of clause f,*** the auditor has to obtain the list of promoters and related parties and consider the requirements of SA 550, Related Parties. After checking the agreement, if the auditor identifies that loans/advances in nature of loans are granted to promoters or related parties which are repayable on demand or without specifying any terms or period of repayment, the auditor should state the fact and report the gross amount of such loans/advances in nature of loan granted during the year.

4. Relating to Loans to Directors and layering of Investments

In respect of loans, investments, guarantees, and security, whether provisions of section 185 and 186 of the Companies Act have been complied with, if not, provide the details thereof?

Coverage

Section 185 of the Act prohibits advance of any loan to directors, etc., directly or indirectly. The auditor should report the nature of non-compliance; the maximum amount outstanding during the year and the amount outstanding as at the Balanceance sheet date in respect of the directors and any person in whom any of the directors of the company is interested (specify the relationship with the director concerned).

Section 186 of the Act governs giving of loans, and guarantee or providing any security in connection with a loan, by a company to any person or other body corporate and acquiring securities of any other body corporate by a company exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more. These restrictions are not applicable in respect of any loan made,

any guarantee given or any security provided or any investment made by banking company or an insurance company or a housing finance company in the ordinary course of its business, or a company established with the object of and engaged in the business of financing industrial enterprises, or of providing infrastructural facilities and government company engaged in defense production.

The section 186 also prohibits a company from making investments through more than two layers of investment companies.

Audit Consideration

- Obtain the details of, loans/ guarantee /security given to any person or other body corporate.
- Auditor must check whether, at any point of time during the year in case of aforesaid transactions, the company has exceeded the limits specified and if it exceeds the limits specified above, whether prior approval by means of a special resolution passed at a general meeting has been obtained.
- Auditor must ensure that the entity has disclosed the full particulars of the loan/investment/ guarantee/ security provided in the financial statements.
- He must check the interest rates. If the company is in default in the repayment of any deposits accepted or in payment of interest thereon, then the company is not allowed to give any loan or guarantee or provide any security or make an acquisition till such default is subsisting.

5. Compliance in respect of deposits accepted

In respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules made there under, where applicable, have been complied with, if not, the nature of such contraventions be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not;

Coverage: Section 2(31) of the Companies Act, 2013 has defined ‘deposit’ to include any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India. Section 73 of the Act prohibits a company (other than a banking company, non-banking financial company (NBFC) and such other company as may be specified by the central government in consultation with the Reserve Bank of India), to invite, accept or renew deposits from the public except in the manner provided in this section and the Companies (Acceptance of Deposits) Rules, 2014.

Audit Considerations

- Auditor should acquire understanding of sections 73 to 76 and Companies (Acceptance of Deposits) Rules, 2014.
- If the number of deposits is very large, he 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.
- Where available, the auditor should also examine the Form DPT-3 filed by the company.
- The auditor should examine the efficacy of the internal controls instituted by the company so that the deposits are within limits
- The auditor should obtain a management representation in respect to compliance with requirement of section 73 to 76 and compliance with the orders has been passed by any of the relevant authorities mentioned, if any.

6. **Regarding Cost Records**

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

Coverage

Cost records are books of account relating to utilization of materials, labour and other items of cost as applicable to the production of goods or provision of services. In exercise of the powers conferred by sub-section (1) and (2) of section 469 and section 148 of the Act, the Central Government has issued the Companies (Cost Records and Audit) Rules, 2014 which has

specified the list of class of companies in which maintenance of cost records is prescribed under section 148 of the Act. As per the rules, the cost records are required to be maintained as per the Form CRA-1.

Audit Considerations

- The auditor should obtain a written representation from the management stating whether cost records are required to be maintained for any product(s) or services of the company under section 148 of the Act, and the Companies (Cost Records and Audit) Rules, 2014; and whether cost accounts and records are being made and maintained regularly.
- The auditor should ascertain whether maintenance of cost records has been specified for the company by the Central Government or not. If maintenance of cost records has been specified, the auditor should obtain a list of books/records made and maintained and conduct a general review of the cost records to ensure that the records as prescribed are made and maintained.
- Where cost audit is applicable to the company, the auditor may obtain copy of cost audit report of immediately preceding year and note any qualifications or comments in the cost audit report.

7. Depositing the statutory Liability

- (a) Whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated.**
- (b) Where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute)**

Coverage

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

Audit Considerations

- The auditor should clearly understand the nature of each statutory due payable by the company and frequency and due dates while examining the aspect of regularity before commenting on the same.
- The auditor should also enquire of the management of the company about the statutes under which the company is required to pay any statutory dues.
- The auditor has to report on the regularity of deposit of statutory dues irrespective of the fact whether or not there are any arrears on the Balanceance sheet date.
- The auditor has to report on the regularity of deposit of statutory dues after applying appropriate judgment wherever necessary.
- The auditor must review various statutory returns and challans
- The auditor should obtain a written representation with reference to the date of the Balanceance sheet from the management specifying the cases and the amounts considered disputed and containing a list of the cases and the amounts in respect of the statutory dues which are undisputed and have remained outstanding for a period of more than six months
- If the auditor is of the opinion that the company is not regular in depositing undisputed statutory dues the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, are required to be mentioned by the auditor in his audit report.

- In case of clause (b), disputed statutory dues, the amounts involved should be stated along with the forum where the dispute is pending. Here even minor amounts would be required to be reported in a manner so that the reader is able to understand the dispute and the amount involved. The auditor should also obtain a management representation about the disputed dues, the amounts involved and the forum where the dispute is pending.

8. Unrecorded Income

Whether any transactions not recorded in the books of account have been *surrendered or disclosed* as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year;

Coverage

Reporting under this clause shall be applicable only when the transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the income tax assessments. As per Section 158B of the Income Tax Act, 1961, "undisclosed income" includes any money, bullion, jewellery or other valuable article or thing or any income based on any entry in the books of account or other documents or transactions, where such money, bullion, jewellery, valuable article, thing, entry in the books of account or other document or transaction represents wholly or partly income or property which has not been or would not have been disclosed for the purposes of this Act, or any expense, deduction or allowance claimed under this Act which is found to be false. Another important point is that the emphasis is on the words surrendered or disclosed which implies that the company must have voluntarily admitted to the addition of such income, which can be demonstrated on the basis of the returns filed by the company. Accordingly, where the addition is made by the income tax authorities and the company has disputed such additions, reporting under this clause is not applicable.

Audit Considerations

- The auditor should obtain a copy of the statements made in the course of search and survey to verify the nature of income so surrendered or disclosed.

- Auditor must review all the tax assessments completed during the year under audit including completed subsequent to the Balance sheet date but prior to signing of the auditor's report.
- Auditor needs to review the submissions and the statements filed by the assessee in the course of assessments to ascertain whether such additions were as a consequence of admissions.
- The auditor should obtain a representation letter from the management that all the assessments completed during the year have been duly informed to the auditor.
- In case the auditor identifies unrecorded transactions which are surrendered or disclosed as income, he should identify the nature of income surrendered and ascertain whether proper recording of such transactions has been duly made in the books of account including proper disclosure of it in the financial statements of the company.

9. Default in repayment of borrowings

- (a) Whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the prescribed format.**
- (b) whether the company is a declared willful defaulter by any bank or financial institution or other lender;**
- (c) whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported;**
- (d) whether funds raised on short term basis have been utilized for long term purposes, if yes, the nature and amount to be indicated;**
- (e) whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case;**
- (f) whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised.**

Coverage

The borrowings do not include public deposits and preference share capital should not be considered as borrowings. The auditor should also report the period and amount of all defaults existing at the Balanceance sheet date irrespective of when those defaults have occurred.

For the purpose of Clause b, as per RBI Circular a *Willful Defaulter* is:

- (A) The unit has defaulted in meeting its payment / repayment obligations to the lender even when it has the capacity to honor the said obligations.
- (B) The unit has defaulted in meeting its payment / repayment obligations to the lender and has not utilized the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.
- (C) The unit has defaulted in meeting its payment / repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilized for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.
- (D) The unit has defaulted in meeting its payment / repayment obligations to the lender and has also disposed off or removed the movable or immovable.

For Clause b, the auditor should restrict the reporting under this clause to declaration of willful defaulter by banks, financial institutions, government or government authorities.

For the purpose of clause c, as per RBI Circular *Diversion of funds* would be construed to include any one of

The undernoted occurrences:

- (a) utilization of short-term working capital funds for long-term purposes not in conformity with the terms of sanction;
- (b) deploying borrowed funds for purposes / activities or creation of assets other than those for which the loan was sanctioned;
- (c) transferring borrowed funds to the subsidiaries / Group companies or other corporate by whatever modalities;
- (d) routing of funds through any bank other than the lender bank or members of consortium without prior permission of the lender;
- (e) investment in other companies by way of acquiring equities / debt instruments without approval of lenders;

- (f) Shortfall in deployment of funds vis-à-vis the amounts disbursed / drawn and the difference not being accounted for.

For the purpose of Clause d, Short-term sources of funds include temporary credit facilities like cash credits, overdraft. Long-term sources of funds would include share capital, reserves and surplus, long-term debt securities and long-term loans. Long term applications of funds include investment in property, plant & equipment, intangible assets, long-term investments in shares, debentures and other securities and other assets of similar nature, repayment of long-term loans and advances or redemption of long-term debt or securities, etc.

For the purpose of Clause f, reporting is required only in case of loans taken during the year.

Audit Considerations

- The auditor should obtain the agreement or other loan document and schedule of repayments to all lenders from the management of the company.
- The auditor should then correlate whether the repayments as per the books of account and bank statements are in accordance with the terms and conditions of the relevant agreement.
- External confirmation may be sought by the auditor to know the status of loan.
- In case of any dispute between the company and the lender, the auditor should consider the prevailing terms and conditions only and may mention about such dispute in his report.
- *For clause b,* the auditor may also obtain latest CIBIL report of the company and verify whether the company has been categorized as willful defaulter or verify the database of Central Repository of Information on Large Credits (CRILC).
- In case there is no evidence of willful default by company, the auditor should also obtain
- A representation letter from the management that the company has neither been declared as a willful defaulter nor has received any show cause notice.
- *For the purpose of clause c,* the auditor may also examine the proposal for grant of loan made to the lender and sanction letter as these generally contain the end use of funds. The auditor should then compare the purpose for which term loans were sanctioned with the actual utilization of the loan and if he finds that funds have been diverted to other use other than for which it was sanctioned, he should report giving details like nature of loan,

name of lender, purpose for which sanctioned, purpose for which used, amount diverted, etc.

- *For the purpose of clause d*, it is often may not be possible to directly determine the use of fund raised. So auditor should determine the overall picture of the sources and application of funds of the company. Accordingly, he should review the cash flow statement thoroughly.
- *For the purpose of clause e*, the auditor needs to consider new loans or advances given during the year, meeting the obligations of subsidiaries, joint ventures, or associate companies during the year and new investments. The auditor should obtain list of all subsidiaries, associates and joint ventures and details of all loans, advances including advances in the nature of loans granted to them from the company. The auditor may also consider obtaining suitable management representation letter in this regard.

For the purpose of clause f, the auditor should obtain schedule of all loans raised during the year and related agreements to check nature of security given. He should also obtain and verify the documents related to charges created including any modification thereof. It would be prudent to take a management representation in this respect.

10. Fund Raised and Utilization

- (a) Whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported.**
- (b) Whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance**

Coverage

Part 1 of Chapter III (sections 23 to 41) of the Companies Act 2013 deals with public offer. Section 23(1) (a) provides that “a public company may issue securities to public through prospectus which is also referred to as “public offer” and an Explanation to it states that, “public offer” includes initial public offer or further public offer of securities to public by a company, or an offer for sale of securities to the public by an existing shareholder, through issue of prospectus.

Currently there is no legal requirement of disclosing end use of fund raised in financial statements, it appears that this clause envisages that companies should disclose the end use of money raised by the initial public offer or further public offer (including debt instruments) in the financial statements by way of notes and the auditor should verify the same.

Audit Considerations

Auditor should verify the offer document and then see if there is discrepancy in proposed use and end use. He must also obtain a management representation letter in respect to the actual end utilization of money raised, if auditor is unable to verify the end use, he should express his inability with reason in his report.

11. Fraud and Whistle Blower

- (a) Whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated.**
- (b) whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;**
- (c) whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;**

Coverage

The auditor has to report whether any fraud has been noticed or reported either on the company or by the company during the year and is not only by the officers or employees of the company

but by any one. However, the clause does not cast responsibility on auditor to detect a fraud, rather it requires an auditor to report any fraud that has been noticed or reported.

Rule 13 of the Companies (Audit and Auditors) Rules, 2014 specifies the manner in which the auditor is required to report on fraud to the Central Government and Form ADT-4 prescribed in these Rules provides the format and information to be included in such report.

Audit Consideration

- Auditor should make inquiries of management and others in organization regarding any known fraud or suspected fraud that the company is investigating.
- He should study internal audit reports and the minutes of the audit committee and board of directors if available.
- Auditor must obtain management representation as to the fact there is no noticed material misstatement resulting from fraud.
- The auditor reporting under this clause, should consider whether cost auditor or secretarial auditor has filed any report under section 143(12) of the Act in Form ADT-4 and accordingly report the fact.
- The auditor should check as to whether the company has whistle blower process with adequate procedures to handle anonymous complaints and such complaints are investigated and resolved by the company in an appropriate and timely manner.
- The auditor should obtain written representation from the Board or Audit Committee, regarding completeness of whistle blower complaints.

12. Compliance by Nidhi Company

- (a) Whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability;**
- (b) Whether the Nidhi Company is maintaining ten per cent. unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;**
- (c) Whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof;**

Coverage

This clause has limited applicability i.e. only in respect to Nidhi Companies and requires the auditor to report whether, in the case of a Nidhi Company, net-owned funds to deposit liability

ratio is more than 1:20 and the Nidhi Company is maintaining 10% in unencumbered term deposits as specified in the Nidhi Rules 2014 to meet out the liability and whether there has been any default in payment of interest on deposits or repayment thereof for any period. If any of the parameters are not met, auditor should report the details thereof.

13. **Compliances on transaction with related parties**

Whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, where applicable and the details have been disclosed in the financial statements etc., as required by the applicable accounting standards?

Coverage

The related party, with reference to a company is defined in section 2(76) of the Companies Act, 2013. Section 177(4) (IV) of the Act requires that audit committee to approve transactions of the company with related parties.

Section 188 of the Companies Act, 2013 is applicable to all classes of companies, and requires the approval of Board of Directors and/or the approval of the shareholders in transactions with related parties for transactions with related parties listed therein except in cases where transactions entered into by the company in its ordinary course of business and on an arm's length basis. The approval of shareholders by way of resolution is also not required for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

Section 189 of the Act requires companies to maintain register of contracts entered by company in which director's are interested. Form MBP-1

Audit Considerations

- The auditor should obtain written representations from management that they have disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware; and they have appropriately

accounted for and disclosed such relationships and transactions in accordance with the requirements of the applicable financial reporting framework.

- The auditor must review the minutes of audit committee meetings and Board meetings.
- The auditor may examine the prices paid with reference to list prices of the supplier concerned, other trade terms of the supplier, etc to determine if the transaction with related party is at arm's length.
- If the auditor comes across any non-compliance of requirements of sections 177 and 188 of the Act, then, it should be duly reported.

14. Effectiveness of Internal Audit System

- (a) **Whether the company has an internal audit system commensurate with the size and nature of its business?**
- (b) **Whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor?**

As per Section 138 of the Act, mandates internal audit system for certain class of companies. Rule 13 of Companies (Accounts) Rules, 2014 states that the following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely:

- every listed company
- every unlisted public company having–
 - paid up share capital of Rs. 50 crore or more during the preceding financial year; or
 - turnover(income) of Rs. 200 crore or more during the preceding financial year; or
 - outstanding loans or borrowings from banks or public financial institutions exceeding Rs. 100 crore rupees or more at any point of time during the preceding financial year; or
 - outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
- every private company having

- turnover of Rs. 200 crore or more during the preceding financial year; or
- outstanding loans or borrowings from banks or public financial institutions exceeding Rs. 100 crore or more at any point of time during the preceding financial year:

Audit Considerations

- The auditor should evaluate the size of the internal audit department, qualifications and reporting responsibility of the persons who undertake the internal audit work.
- He should examine the reports submitted by the internal auditor and see if follow up actions are being taken
- The auditor should include in the audit documentation as to how assessment of internal audit system was made and conclusions reached thereon.
- If any deficiency is found in internal audit system, then the auditor should communicate with the Audit Committee/Board and seek their inputs and report accordingly

15. Non Cash Transactions

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

Coverage

Section 192 of the Companies Act, 2013 deals with restriction on non-cash transactions involving directors or persons connected with them. The section prohibits the company from entering into following types of arrangements unless it meets the conditions laid out in the section:

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

Such arrangements can only be entered by the company on fulfillment of the conditions laid out in section 192 of the Act which are as under:

- The company should have obtained prior approval for such arrangement through a resolution of the company in general meeting.
- In case the concerned director or the person connected therewith, is also a director of its holding company, a similar approval should have been obtained by the holding company through a resolution at its general meeting.

Audit Considerations

- Auditor should obtaining a management representation as to whether the company has undertaken any non-cash transactions with the directors or persons connected with the directors and corroborate it with sufficient appropriate audit evidence.
- The Auditor must check the following to draw proper conclusion:
 - Form No. MBP 1, *Notice of Interest by Director*,
 - Form No. MBP 2, *Register of Loans, Guarantee, Security and Acquisition Made by the company*
 - Form No. MGT 15, *Report on Annual General Meeting*
 - Minutes book of the General Meeting and Meetings of Board of Directors
 - Movements in the Property, Plant and Equipment Register
 - Reports available in the public domain, which are to be substantiated from the company.
- In case non-cash transactions have been entered by the company, the auditor should check compliance with section 192(2) of the Act and verify the notice of the general meeting that it includes particulars of arrangement along with the value of the assets involved in such arrangements.

16. Registered under section 45-IA of the Reserve Bank of India Act, 1934

- (a) **Whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 (2 of 1934) and if so, whether the registration has been obtained?**

- (b) Whether the company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934?**
- (c) Whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfill the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfill such criteria?**
- (d) Whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group?**

Coverage

Section 45IA of the Reserve Bank of India Act, 1934 requires registration where the company is engaged in the business of a non-banking financial institution as its principal business. The Reserve Bank of India prohibits companies from carrying on the business of a non-banking financial institution without obtaining the certificate of registration.

For Clause c, as per the Core Investment Companies (Reserve Bank) Directions, 2016, Core Investment Company is a NBFC carrying on the business of acquisition of shares and securities and which satisfies the following conditions as on the date of the last audited Balanceance sheet:-

- it holds not less than 90% of its net assets in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies;
- its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies and units of Infrastructure Investment Trust only as sponsor constitute not less than 60% of its net assets mentioned in clause above.

For the purpose of clause c & d, “Companies in the Group” means an arrangement involving two or more entities related to each other through any of the following relationships:

- Subsidiary – parent
- Joint venture
- Associate
- Promoter-promotee

- a related party as defined in terms of AS 18
- Common brand name, and
- investment in equity shares of 20% and above

Audit Considerations

- The auditor shall obtain sufficient knowledge of the company's business and nature of its revenues and assets.
- Auditor should carefully examine the transactions and financial statement of the company to see if it falls under the definition of NBFC or Core Investment Company
- If it meets the definition, he should check if it meets the net owned fund criteria and whether the company has obtained the registration as NBFC and if not, the reason for it.
- The auditor shall obtain written representation from the management and examine, whether the certificate of registration has been withdrawn/revoked/suspended/surrendered during the year.
- The auditor should obtain the list of Companies in the group and a written representation from management about the CICs in the group. He should then corroborate this with the list of registered CICs in the RBI's Website.
- In case company is conducting NBFC business without a registration, the same should be reported by the auditor under the clause. If company is a CIC and not registered as such, it must also be reported.

17. Regarding Cash Loses

Whether the Company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses;

Coverage

It applies to all companies. The term cash losses has not been defined but is commonly understood as the figure of net profit/loss after taxes shown in the Statement of Profit and Loss adjusted for the effects of transactions of non-cash nature such as depreciation, amortization, impairment or its reversal, deferred tax income/expense, foreign exchange gain/loss, fair value changes, etc. The figure so arrived should also be adjusted for qualifications in report. The figure

of cash losses, if any, of the company is to be given for the financial year covered by the audit report and the immediately preceding financial year.

Audit Considerations

The auditor is expected to quantify cash losses after considering the adjustments to be made due to audit qualifications. In case any of the qualifications in the audit report is not capable of being quantified, the auditor should state the fact.

18. Communication with previous auditor

Whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors

Coverage

This clause has limited applicability. It applies where new auditor is appointed during the year to fill a vacancy caused by resignation of the auditor. As per ICAI's Code of Ethics, the incoming auditor before accepting the audit assignment is required to communicate with the previous auditor to know the reasons for his resignation. Besides, section 140(2) of the Act read with Rule 8 of the Companies (Audit and Auditors) Rules 2014 requires the resigning auditor to file form ADT-3 with the Registrar of Companies, within a period of 30 days from the date of resignation. Further, in case of listed entity, SEBI has prescribed conditions and format for disclosure requirements to be complied with when the statutory auditors of a listed entity or its material subsidiary resign in Annexure A of its circular on *Resignation of statutory auditors from listed entities and their material subsidiaries*. As per ICAI guidance note on CARO ,2020 this clause does not cover change of auditors pursuant to mandatory rotation requirements prescribed under Companies Act, 2013.

Audit Considerations

- The new auditor should obtain a copy of letter of resignation stating the reasons as submitted to the management and copy of Form ADT 3 as submitted to ROC and in case of listed entity copy of Annexure A.

- The new auditor should also verify minutes of board and audit committee meetings and apply his judgment and also refer to last audit/review report issued by the resigning auditor.
- The incoming auditor should obtain a management representation letter that there are no other concerns of outgoing auditor beside those stated in resignation letter.

19. **Material Uncertainty**

On the basis of the financial ratios, ageing and expected dates of realization of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of Balanceance sheet as and when they fall due within a period of one year from the Balanceance sheet date?

Coverage

Financial assets and financial liabilities have been defined in Ind AS 32, Financial Instruments: Presentation. There is no legal requirement under the Act for the companies to provide such explicit disclosure as above-said. However, AS 1, Disclosure of Accounting Policies, considers going concern as a fundamental accounting assumption and paragraph 27 of AS 1 requires a disclosure where such assumption is not followed. Ind AS 1, Presentation of Financial Statements, requires that when preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern

The auditor is required to report that no material uncertainty exists as on the date of the audit report about company's ability to meet its liabilities existing at the date of Balanceance sheet as and when they fall due within a period of one year from the Balanceance sheet date. **The emphasis, therefore, is on the company's ability to meet its liabilities.**

As per revised SA 570, (Going Concern, the auditor's responsibilities) are to obtain sufficient appropriate audit evidence regarding, and to conclude on, the appropriateness of management's

use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained

The Schedule III to the Act states that if, in the opinion of the Board, any of the assets other than property, plant and equipment and non-current investments do not have a value on realization in the ordinary course of business at least equal to the amount at which they are stated, the fact that the Board is of that opinion, shall be stated

Test of existence of material uncertainty is to be done as on the date of audit report for the position of liabilities existing at the date of Balance sheet. In other words, the auditor needs to consider the subsequent period transactions between the date of Balance sheet and the date of audit report

While conducting audit of the financial statements, the auditor is required to carry out audit procedures in accordance with SA 560 “Subsequent Events. The auditor generally tests the ageing and expected dates of realization of financial assets and payment of financial liabilities in the normal course of audit of the financial statements, for example, subsequent status of trade receivables and payables, subsequent payment of statutory liabilities, etc.

Audit Considerations

- Auditor must make List of liabilities, their due dates, check their actual payment dates and draw up a residual list of dues remaining after the payments, after the Balance Sheet date, till the date of reporting - Auditor should then evaluate with management, the capacity to pay such remaining liabilities, as on or near to the Reporting date.
- At this stage, Auditor should also test check the recoverability of the various debtors and any other receivable falling due for recovery. This recovery status and plan should be supported and not merely on basis of verBalance assurances of management
- At times, an entity may not be able to pay its dues stand alone, but its dues may be paid by its holding company – In such cases, the position of the holding company should be seen and disclosure eb made as to such fact.
- The auditor should read the section of director’s report, management discussion and analysis forming part of the annual report of the company, made available to Auditor till the reporting date.

- Ratio analysis for Liquidity Ratio, Current Ratio etc are done as on Balance Sheet date and Reporting Date, to evaluate that such ratios are positive and robust as on the reporting date.
- Auditor should obtain MIS information and Cash Flow projections for coming 12 months after the Balanceance Sheet date, to evaluate any potential issues therein, based on various business and other factors.
- Auditor should obtain details of guarantees given by the entity, which could in any way affect its paying capacities or liquidities.
- Management representation as to any adverse events occurring after Balanceance Sheet date, not in knowledge of Auditor should be taken by the Auditor.
- Auditor should give a clean chit and negative assurance that there is no Going Concern issues for the entity and that matters are overall safe and liquid and under control for the company.
- Where the auditor concludes based on the information obtained from the management and audit procedures performed that material uncertainty exists then the auditor should discuss his findings and conclusion with the management and the Board of Directors, and should make suitable comment in his report by stating the existence of material uncertainty and reasons thereof.
- The auditor will also need to ensure there are adequate disclosures in the financial statements regarding material uncertainty related to going concern. The auditor may consider detailed guidance on going concern given in the Implementation Guide to SA 570 (Revised).

20. Regarding Corporate social Responsibility

- Whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act?**
- Whether any amount remaining unspent under section (5) of section 135 of Companies Act, pursuant to any ongoing project, has been transferred to special**

account in compliance with provision of sub section (6) of section 135 of the said Act; [Paragraph 3(xx)(b)]

Coverage

The Board of every company as in sub-section (1) of sec 135 of the Act shall ensure that the company spends, in every financial year, at 2% of the average net profits of the company made during the three immediately preceding financial years. Second proviso to sub-section (5) of Section 135 requires that if the company fails to spend such amount, Board shall, in its report under clause (o) of sub-section (3) of section 134, specify reasons for not spending the amount & unless the unspent amount relates to any ongoing project referred to in sub-section (6), transfer such unspent amount to a Fund specified in Schedule VII, within a period of 6 months of the expiry of the financial year.

Such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within a period of three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund, specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year.

Audit Considerations

- The auditor should obtain from the Board, details of amount spent, in respect of projects other than ongoing projects. The auditor should also verify if the amount spent is in accordance with the Corporate Social Responsibility Policy of the company and in accordance with the provisions of the Act and the rules there under.
- On basis of above verification, auditor should verify that any unspent amount, in respect of other than ongoing projects, has been transferred to a Fund specified in Schedule VII to the Act within a period of six months of the expiry of the financial year.
- The auditor shall check whether the company has recorded a provision as at the Balanceance sheet date, to the extent considered necessary in accordance with AS 29/ Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, in respect of the unspent amount.

- The auditor may also consider obtaining a representation from the management regarding compliance of requirements of section 135
- In case the company has not transferred the unspent amount, in respect of other than ongoing projects, to a fund specified in Schedule VII to the Act within the time limits, the auditor should ascertain the details as a part of his working papers for reporting under this clause
- The auditor shall report compliance with this clause as follows: In respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act, 2013 within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act, except as stated.
- The auditor shall verify the amount spent in respect of ongoing projects with the supporting documents such as expenditure receipts, bank statements etc. In respect of unspent amount, the auditor shall verify the bank account to ensure whether it is earmarked for Corporate Social Responsibility activity, opened for that respective financial year only and called as Unspent Corporate Social Responsibility Account.
- Though the auditor is not required to report under this clause, the auditor is required to verify that the amount transferred to such specified bank account, has been utilized for the Corporate Social Responsibility activities as per Corporate Social Responsibility policy, within three years from the date of such transfer, failing which the amount should be transferred to the fund as specified under Schedule VII to the Act.
- The auditor shall check whether the company has recorded a provision or disclosures as at Balance sheet date, to the extent considered necessary in accordance with the provisions of AS 29/ Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, in respect of the unspent amount on ongoing projects
- In case the company has not transferred the unspent amount, in respect of ongoing projects, to a special account as specified under section 135(6) of the Act within the time limits, the auditor should ascertain such details as a part of his working papers, for only formally reporting in respect of the delay in transfer to the fund said.

21. Qualification or Adverse remark in other group companies

Whether there have been any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the consolidated financial statements, if yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.

Coverage

Reporting here is required only for those entities which are included in the consolidated financial statements to which CARO 2020 applies. The auditor is required to state, whether there have been any qualifications or adverse remark/s by the respective auditors, in the CARO reports of the companies included in the consolidated financial statements. It is required that the auditor provide the details of those companies and only the paragraph numbers of the respective CARO report containing the qualifications or adverse remarks and nothing else.

Audit Considerations

- To decide, whether responses to various clauses are qualifications or adverse remarks, principal auditor would need to apply professional experience and judgment, because qualification/adverse opinion as used in SA 705(Revised); are in connection with issuance of auditor's opinion on the financial statements as a whole whereas answers to questions in CARO 2020 are to specific questions which are expected to be answered in affirmative or negative.
- Principal auditor will take inputs from the component auditor and request him as part of the group reporting instructions, to comment on which clauses amount to a qualification/adverse remark.
- Where the component auditor has reported on the financial statements of the component to the principal auditor but has not issued his statutory audit report by the date of the principal auditor's audit report, the principal auditor should clearly mention this fact, while reporting on this clause, that CARO report of that entity, has not been issued by its auditor till the date of principal auditor's report.
- Qualifications/adverse remarks given in the parent company's standalone CARO report are also required to be included while reporting on consolidated financial statements.

- The requirement is to provide paragraph numbers of the CARO report containing the qualifications or adverse remarks & accordingly, text of those paragraphs are not required to be reproduced.
- The auditor is not required to re-evaluate the materiality from a consolidation perspective. Hence every qualification/adverse remark made by every individual component including the parent should be included

CARO: An Opportunity for Chartered Accountants



As we have discussed above the requirements of CARO are very specific and relevant. Though the CARO provides exemptions to certain companies, in my belief auditor of every company and other form of businesses should take care of matters provided therein to do justice with the audit assignment. It is a guide not only for statutory auditor, but also for internal auditor and internal control team as the items discussed in CARO are relevant to determine the overall health of the entity. It is instrumental in enhancing the quality of audit and each clause, if applicable should be dealt with precision and in its true spirit. CARO also present a huge opportunity for practicing Chartered Accountants not only as certifying authority of CARO report itself, but also in respect of internal auditor or specific item auditor like inventory auditor or audit of CSR fund etc.

