Companies (Auditor's Report) Order, 2015

Presented By

CA. Abhay Vasant Arolkar

9th May 2015,

Saturday

Selected Major Special Considerations

Schedule III of the Companies Act, 2013, Accounting Standards, Companies Act, 2013 and Other Regulatory requirements

Main Audit Report

CARO

Report under Section. 227(1A) – Items of specific inquiry

- Loans & Advances – Whether Secured, Terms & Conditions, not prejudicial
- Whether Transactions represented by book entries are not prejudicial
- In case of Company other than investment or banking Company - Securities sold below the purchase price
- Whether Loans & Advances shown as deposits
- Whether personal expenses charged to revenue account
- Whether cash received in respect of allotment if not, whether position of balance sheet misleading

Schedule III – Major Disclosures

Share Capital and Reserves & Surplu

Non-current Liabilitie

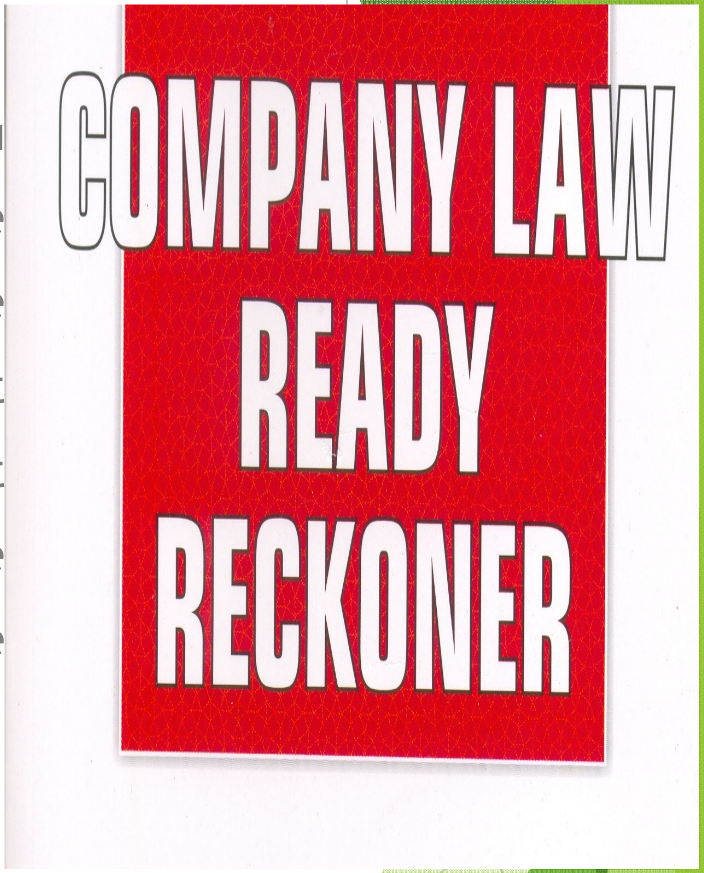
Current Liabilitie

Non-Current Asset

Current Asset

Contingent Liabilitie

Other disclosure



3

CARO – Major Items

Fixed Assets – Maintenance of Record & Physical Verification

Inventories – Maintenance of Record & Physical Verification

Details pertaining to parties registered u/s 301

Internal Control System

Deposits

Cost Records

Statutory Liabilities

Guarantees for borrowings of others

Net worth reoded companies

End use of Funds out of term loans & Default in repayment

Fraud – noticed or reported

4

Applicability

- Applicability to every company including foreign company
- Non-applicability:

a) Banking Company

b) Insurance Company

c) Section 8 Company

d) One Person Company

e) Small Company

f) Private Limited Company

- with paid-up capital and reserves <= 50 lacs rupees and
- loan outstanding <= 25 Lacs rupees from any bank or financial institution and
- turnover <= five crore rupees

at any point of time during the financial year

i. A Pvt. Ltd. a new company registered with a capital of Twenty Five Lakhs, and subsequently before the year end raised the capital to Rs. One crore, Is the Order applicable to it?

ii. B Pvt. Ltd. has a revaluation reserve of Rs. 10 Lakhs, capital reserve of Rs. 10 Lakhs, Free reserves of Rs. 10 Lakhs, Credit balance in profit and loss account of Rs. 10 Lakhs and paid up capital of Rs. 20 Lakhs. What should be included while arriving at the reserves for the purpose of the order?

iii. C Pvt. Ltd., has paid up capital of Rs. 5,00,000/-. During the year the company issued new equity shares of Rs. 15,00,000/- (Face Value) @ premium of 200% of the face value. Is the Order applicable to it? Is the Order applicable to it, if, thereafter, the company issues Bonus shares to its existing shareholders @ 1 share for every two shares held from out of its Share Premium Account?

iv. D Pvt. Ltd. has a paid up share capital of Rs. 10,00,000/- against its authorized capital of Rs. 1,00,00,000/-. During the year the company received share application money amounting to Rs. 90,00,000/-. The Directors have not made the allotment till the end of the financial year. Is the Order applicable to it?

v. F Pvt. Ltd. has a loan of Rs. 17 Lakhs from a Bank at the beginning of the year & received Rs. 15 Lakhs during the year from a Financial Institution. Since its borrowings from each of the Bank & Financial Institution is not exceeding Rs. 25 Lakhs at the beginning of the year, is the Order applicable to it?

vi. G Pvt. Ltd has received Rs 50 Lakhs on account of sale of scrap. It wants to know whether, it should be considered while arriving at Turnover for the purpose of this clause?

vii. AB Co. Pvt. Ltd. is a closely held company having a paid-up capital of Rs. 10,00,000/- and the Reserves and Surplus include General Reserve of Rs. 2,00,000 and Profit & Loss Account Credit Balance of Rs. 3,00,000. The company has not taken any loans or deposits from banks or financial institutions and the turnover of the company is Rs. 10,00,00,000/-. Is the Order applicable to it?

viii. AC Co. Pvt. Ltd., has a paid up capital of Rs. 20 Lakhs and the accumulated debit balance in the Profit & Loss Account as on March 31 2008 was Rs. 15 Lakhs. However the company had a credit balance in its Revaluation Reserve of Rs. 40 Lakhs. Is the Order applicable to the company?

ix. H a private company, limited by shares and guarantee, having licence u/s 8 of the Companies Act, 2013 is having paid up capital of Rs. 30 Lakhs and the balance in the Income & Expenditure Account exceeds Rs. 25 Lakhs during the year. Is the Order applicable to it?

x. I Bank Ltd., a public company registered under the Companies Act, 1956, is a Scheduled Bank. Is the Order applicable to it?

xi. J Insurance India Ltd., a public company registered under the Companies Act, 1956, has tied up with a leading international insurance major. It is registered with the IRDA and commences business in India. Is the Order applicable to it?

xii. K Pvt. Ltd., has a turnover of sales of Rs. 4 crores. Besides the company has Other Income as follows:

a) Profit on sale of Fixed Assets (Sale Value Rs. 1 crore) Rs. 20 Lakhs
b) Interest on Deposits with Banks Rs. 10 Lakhs
c) Dividend from its subsidiary company (private company) Rs. 80 Lakhs

Is the Order applicable to it?

xiii. M Pvt. Ltd., has accepted deposits from its directors amounting to Rs. 50 Lakhs. However the limits as to the paid up capital and reserves as also the turnover of the company has not crossed Rs. 50 Lakhs and Rs. 5 crores respectively. The company has taken an overdraft limit from its bankers of Rs. 30 Lakhs, which is unutilised.

xiv. AD Pvt. Ltd., enjoys sanctioned cash credit facility of Rs. 30 Lakhs from its bank. The credit balance as per the books of account of the company as on March 31, 2008 was Rs. 25.80 Lakhs. The company had issued a cheque as advance to a supplier of capital equipment, which was presented to the bank only on April 1, 2008. Thus the debit balance in the said account in the books of the bank was Rs. 24.80 Lakhs. The company claims that as the balance as per the bank statement has never exceeded the limit prescribed, the Order is not applicable. Advise.

xv. N Pvt. Ltd., has disclosed its sales in accordance with the requirement of Schedule VI and the applicable accounting standards as follows:

Sales (excl. of VAT)	Rs. 510 Lakhs
Less Excise Duty	Rs. 86 Lakhs
Net Sales	Rs. 424 Lakhs

Besides the company has paid Maharashtra VAT of Rs. 64 Lakhs in respect of the said sales. The sales is accounted in the books at net of taxes. Is the Order applicable to it?

Clause (i) – Fixed Assets:

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

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

xvi. O Pvt. Ltd., has not maintained any statutory registers including the Fixed Assets Register as required by the Companies Act. On the directors' request, the auditors had not qualified their report, and instead had stated in their report that the fixed asset registers are under preparation. In the subsequent year, the directors have once again requested that auditors state that the fixed assets are under preparation. What should the auditor do? Will he be liable in any manner.

xvii. P Ltd., has genuinely made efforts to maintain the Fixed Assets Register as required by the Companies Act. However due to the complexity of the number of assets, their costs of acquisition/improvement, locations etc., the fixed asset registers could not be ready in full. The directors have stated that the fixed assets are under preparation and provided the status of the work. What should the auditor do? Will he be liable in any manner.

xviii. The Directors of Q Pvt. Ltd., claim that they have physically verified the fixed assets during the year and have issued a management certificate to the effect. No evidence was provided in that regard. On subtle enquiry the auditor has found that there was no such stock taking carried out by the management. Should the auditor qualify? If not, what are the implications?

xix. The management of R Ltd., has physically verified the fixed assets during the year and minor discrepancies were found. These discrepancies have not been given any effect in the accounts. Should the auditor report?

xx. S Ltd., is in the business of manufacturing and trading in an industrial spare part used in the pharma companies. The company had carried out a costing exercise and concluded that the manufacturing activity should be discontinued and outsourced. Thus the company sold its manufacturing unit, the assets of which constituted a major portion of the fixed assets in the books. How should the auditor report?

xxi. T Pvt. Ltd., is engaged in the business of manufacturing. The management has decided to change its line of business and hence decided to sell the fixed assets at its factory. Due to recent renovation in its corporate office, the fixed assets at its factory constituted less than 20% of the total fixed assets reflected in the Balance Sheet of the company. As a precautionary measure, the company had taken approval of the shareholders u/s 293(1)(a) of the Companies Act, 1956. How should the auditor report?

xxii. U Pvt. Ltd., has maintained its fixed asset register in an excel file, with all the relevant columns. However the number of items being large, the company requests the auditor to ask for only certain extracts of the said register so as to satisfy that proper record have been maintained. As an auditor do you agree?

Clause (ii) - Inventory :

a) *whether physical verification of inventory has been conducted at reasonable intervals by the management;*

b) *are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported;*

Clause (ii) - Inventory (Contd....) :

c) *whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account;*

xxiii. V Pvt. Ltd., is engaged in the business of civil construction as a contractor. The company has valued the inventory in accordance with the Accounting Standard 7. There are no qualifications in the auditors' report under CARO, 2015. Discuss.

xxiv. W Pvt. Ltd., is engaged in the business of manufacturing machinery. Its inventory includes the work-in-progress which is valued by the management on the basis of estimation. How should the auditors' report thereon?

xxv. X Ltd., normally takes physical stock of inventory once a year at the end of the financial year. The auditors are informed that due to demand pressure, the company has not been able to physically verify the stock and requests the auditor to not qualify the report that physical verification was not carried out. Advise the auditors.

xxvi. In principle, a company carries out 100% physical verification once in three years. The company has no programme for such verification. The company had conducted physical verification one year back and the company claims that it will conduct the physical verification in the next year. What are the reporting requirements by the auditor.

Clause (iii) - Loans :

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

a) *whether receipt of the principal amount and interest are also regular; and*

b) *if overdue amount is more than rupees one lakh, whether reasonable steps have been taken by the company for recovery/payment of the principal and interest;*

xxvii. Y Pvt. Ltd., has advanced as well as taken loans to various parties, covered in the register required to be maintained u/s 189 of the Companies Act, 2013, which have operated the account as a current account. No interest is paid or received in respect thereof. Advise the auditor as to how he should report in respect of the same.

xxxix. The auditor has not obtained the list of parties entered in the register u/s 301 of the Companies Act, 1956. The company has not maintained the requisite register. During the year there was inspection by the concerned Registrar of Companies, wherein it was found that the company had not maintained the register and consequently the reportable transactions with such parties were in fact not reported. Is the auditor liable for negligence?

xxviii. In the above case, one of the parties, who is the daughter of the Managing Director of the company and has been studying, is advanced a sum of Rs. 2 Lakhs for a period of two years, which has expired, but there is no repayment. The company says that the Managing Director is the unstated guarantor of the amount and hence there is no question of taking any steps to recover the amount. How does the auditor report on this matter?

xxix. AA Pvt. Ltd., has a policy of giving loans to the employees at a concessional rate of interest. The auditor has not reported under clause of the Order a case where such loan was given to an employee of the company who is also a relative of a director of the company. Advise?

xxx. Reporting requirements of auditor where:

a) Loans were given to or taken from parties at such time when the particulars of parties were required to be entered in the register maintained under section 189 of the Act, but thereafter ceased to be covered;

b) loans given to or taken at such time when the particulars of parties were not required to be entered in the register maintained under section 301 of the Act, i.e., parties, at the relevant point of time when the loans were given, were not covered by the conditions imposed under section 187 and section 188 of the Act, but during the year came within the ambit of those sections;

c) Loans were given or taken to parties after they ceased to be covered under sections 184 or 188 of the Act.

xxxi. What are the reporting requirements where loans are repayable on demand (given or taken) by the company in respect of which no demand has been made by/on the company?

Clause (iv) - Internal Control System :

is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system;

xxxii. Z Pvt. Ltd., is a closely held company which is controlled by its Managing Director. Every decision is taken by him and hence he claims that there is full control of the company. Whether the auditor can conclude that there is internal control system in place?

xxxiii. Under clause 4 (iv) of the Order, the two requirements, i.e., adequacy of internal controls in regard to sale of goods, purchase of fixed assets and purchase of inventory and continuing failure in the internal controls are inter-related. Accordingly, can the internal control procedures be said to be adequate when a major weakness has not been detected therein?

xxxiv. The auditor has not prepared any internal control questionnaire. There was a fraud in the cash section where the cashier was found guilty of teeming and lading. The auditor had orally warned that the internal control was weak. Thereafter there was no further action. In his report, the auditor proposes to qualify that major weakness was reported and that the company had continually failed to rectify the same. The company opposes this stance of the auditor. Advise.

How is the terms “continuing failure” defined? Does it refer to only those weaknesses which are uncorrected for more than a year?

xxxv. There is no internal audit function. The auditor disclaims that he is unable to trace out the continuing failure in correcting major weaknesses in internal controls in regard to purchase of inventory, fixed assets and sale of goods. Whether such position is correct or not?

Clause (v) - Deposits from Public :

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

xxxvi. E Pvt. Ltd has received security deposit from its clients, whether the same will considered as a Public Deposit?

xxxvii. Whether deemed deposits, being loans from shareholders, relatives or other parties should also be examined and reported under this clause?

xxxvii. During the year, K. Mahindra Ltd, a non-banking financial company, has been converted into a private bank after receiving the necessary approvals from RBI and other regulatory authorities. The company is listed on a recognized stock exchange. As on the balance sheet date, it is a banking company. Is the reporting under CARO, 2003 applicable.

xxxviii. During the year, AC Ltd., a public company was converted into a private limited company. From the date of converting, the private limited company satisfies all the conditions for exemption from the Order. Is the reporting under CARO, 2003 applicable.

Clause (vi) - Cost Records :

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

xxxix. AF Pvt. Ltd., maintains cost records. However it does not carry out the cost audit as the same is not required by law. How should the auditor report?

xl. AG Pvt. Ltd., is engaged in an industry where normally cost audit is conducted. However the company does not maintain cost records as the same is not required by law. How should the auditor report?

Clause (vii) - Statutory Dues :

a) is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income-tax, Sales-tax, Wealth Tax, *Service Tax*, Custom Duty, Excise Duty, cess and any other statutory dues with the appropriate authorities and if not, 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, shall be indicated by the auditor.

Clause (vii) - Statutory Dues (Contd….) :

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

xli. AH Pvt. Ltd., has not deducted tax at source as required by law. Accordingly the same are subjected to disallowances while filing the return of income. Whether for the purposes of reporting under this clause income tax includes taxes deduced at source?

a) Does non-payment of advance income tax constitute default in payment of statutory dues reportable under this clause?

b) How is the term "statutory dues" defined?

c) What constitutes "other statutory dues"?

d) Whether tax and cess collected by the State Governments through electricity bills constitute "other statutory dues"?

xlii. What are the reporting responsibilities of the auditor under this clause in case the company had five years back imported material and had placed them under a bond and even till the current financial year, has not removed the goods there from? Further, interest and rent liability thereon is being provided by the company each year. However, after issuance of Accounting Standard 2, the fact that the company is not loading customs duty appears as a qualification in the auditor's report ?

xliii. What are the reporting responsibilities of the auditor in case the company has not paid the service tax to a transporter for the transportation services availed from him ?

xliv. What are the reporting responsibilities of the auditor under this clause in case a company was statutorily required to get itself registered under the Provident Fund Act, but has not got itself so registered? Further, what would be manner of qualification and the quantification thereof ?

xlv. Are the following payments covered by this clause of the Order:

a) Bonus payable under the payment of Bonus Act, 1965

b) Turnover Fees payable to SEBI by brokers

c) APMC charges

d) Service Tax

e) Penalty/interest on service tax

f) Gratuity liability under the payment of Gratuity Act not funded by the company

g) cess payable by a company under section 441A of the Companies Act, 1956 xlvi. What are the auditor's reporting responsibilities under this clause in case there are dues outstanding for a little less than six month as at the balance sheet date as well as in case of previous dues, which though late, were deposited just before the close of the financial year?

xlvii. What are the auditor's reporting responsibilities under this clause in case the company has not provided for the statutory dues payable, as the company is accounting taxes on cash basis ?

xlviii. Does “regular” means within due date? If a company is making payments of TDS, PF etc., but with a delay of one or two days,can the company be said to be regular in depositing statutory dues ?

xlix. Whether, having regard to the materiality considerations, minor amounts need to be reported under this clause? If yes, then can these amounts be clubbed and reported in one line?

l. How is the term “disputed dues” defined?

li. Should the amounts, which has been disputed at a forum, but which have already been provided for in the books, be reported under this clause?

lii. AI Pvt. Ltd., has received a show-cause notice as to why penalty should not be levied u/s 271(1) (c) of the Income Tax Act, 1961. The company is in the process of replying the same. Should the auditor report about the same.

liii. What if the penalty is levied or demand for tax on additions made by the AO has been made, which is under the dispute. The company is in the process of filing an appeal but the time limit for filing the appeal has lapsed?

liv. Should such statutory dues, the demands of which have been set aside/referred for reassessment or stayed be disclosed or will a statement clarifying that the disclosure excludes the disputes which have been stayed/remanded, along with the aggregate amount, suffice?

lv. Whether the disclosure requirements of the disputed statutory dues, require that each dispute be reported separately or can various disputes of the same nature (and also pertaining to the same authority) be aggregated?

Clause (viii) – Net-worth eroded Companies :

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

lvi. How to compute “cash losses” as required under this clause?

lvii. The definition of “net worth” refers to the reduction of provision or expenses as may be prescribed. What are the provisions of expenses prescribed or to be prescribed and why? What are the implications in the case of a trading or a consulting company whose accumulated losses are more than 50% of its net worth?

lviii. What are the reporting responsibilities of the auditor under this clause in case the company does not have cash losses in both the years (that is, the current financial year and the preceding financial year) but only in one of these years? Should the auditor report separately for both the years or should his opinion state that the company has not incurred cash losses in two consecutive years?

lix. With reference to paragraphs 62 (c) and (d) of the statement:

a) What would happen if the qualifications are not quantified though quantifiable?

b) How many years' financial statements are to be reviewed to consider quantified qualification?

Clause (ix) - Dues to Banks, etc.:

whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported;

lx. Would the Company be construed as having defaulted in repayment of dues in case it has defaulted in repayment of debentures or institutional dues? If yes, then the concept of going concern itself it would be at stake as the lenders have recourse to the assets under the Securitization Act.

Clause (x) - Terms and conditions of guarantees given :

whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company;

lxi. The question whether the guarantee given by the company on behalf of others is prejudicial to the interests of the company or not is already covered under section 186 of the Companies Act, 2013 and is reported by the Company Secretary in his Audit Report. What, therefore, is the reason behind including it in the Order also?

lxii. Would the guarantee given by the company to any of its personnel or to an entity, for loans taken from sources other than a bank or a financial institution, be deemed to be prejudicial to the interests of the company?

lxiii. This clause requires the auditors to determine whether the company has given any guarantee for loans taken by others from banks or financial institutions. AJ Pvt. Ltd., does not maintain a minute book or a register of guarantee, if maintained by the company. What procedures should the auditor adopt where he has to report under this clause?

Clause (xi) - Utilisation of term loans :

whether term loans were applied for the purpose for which the loans were obtained;

lxiv. How is the expression" term loans" defined?

Whether reporting under this clause also covers term loans obtained from entities/persons other than banks/financial institutions?

Further, whether reporting is to be made on the term loans obtained during the year or outstanding as at the end of the year irrespective of the year in which they are obtained?

lxv. What procedures should be adopted by the auditor for reporting under this clause incase of general borrowings or loans for financing working capital where it might not be possible to track the end use of loan on a one-to-one basis? Further, Accounting Standard 16 allows capitalization of short-term borrowings in qualified assets, therefore, why the requirements in the Order are different?

lxvi. What procedures and reporting should be adopted by the auditor in case of term loans from banks, raised against title deeds, long term FDRs, NSCs etc., where the bank is not concerned with the purpose for which it is being obtained?

Clause (xii) - Reporting on fraud :

Whether any fraud on or by the company has been noticed or reported during the year. If yes, the nature and amount involved is to be indicated.

lxvii. Whether a transaction where the company gets a fake purchases bill from the supplier and a letter of credit is issued against such purchases, and the latter gets the LC discounted and gives the money back to the company, would need to be reported under this clause?

Should the auditor consider materiality of the amount involved for reporting under this clause?

Should a fraud risk committed in one quarter but rectified in the other quarter (2nd Quarter) of the year be reported under this clause?

Should teeming and lading frauds be reported under this clause?

lxviii. What are the reporting responsibilities of the auditor under this clause where frauds have been committed by the directors of the company but are not reported by the company and come to the knowledge of the auditor from private sources?

lxix. Whether, for the purpose of reporting under this clause, a total amount of all the frauds noticed on reported to be disclosed, explaining the nature of the fraud committed?

Whether the total amount of frauds and the major frauds can be clubbed and disclosed? Or whether individual amount involved in each fraud is to be separately listed out with the corresponding nature of fraud?

lxx. Is it enough if the auditor expresses his opinion on the frauds noticed and reported by a detective appointed to approach his work with suspicion?

lxxi. What are the reporting responsibilities of the auditor as well as the disclosure requirements in case of a private limited company to which the Order is not applicable?

lxxii. What are the reporting responsibilities of the auditor of a branch of a private limited company under the Order in case such a branch fulfills the conditions for exemption from the applicability of the Order?

lxxiii. What is the manner of reporting or disclosure in case of liaison offices, project offices and branch offices of foreign companies for the purposes of the Order?

Ans.: same as branch of an Indian company.

lxxiii. Whether the auditor has to comment separately on each of the clauses such that the total number of clauses reported upon is 21?

Should we maintain the sequence of the clauses as contained in the said Order?

lxxiv. What should be the manner of reporting in the main auditor's report in case any of the reply to any of the clauses under the Order is in adverse, especially with respect to statutory dues and disposal of fixed assets.

By
CA Abhay Vasant Arolkar
Bcom (Hons.), LLB, ACS, FCA

M/s. A. V. Arolkar & Co., Chartered Accountants,
09R/13th Floor, Navjivan Commercial Premises,
Co-operative Society Ltd., Dr. D. B. Marg, Mumbai 400 008.
Contact – 4354 4435 / 2301 2301
Mobile – 98209 99231
email – arolkarca@gmail.com