

CARO, 2020

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“Throughout the world, there is a great awareness among citizens in general that every learned profession should develop a sense of social purpose and social obligation and this should be more so in the case of the accounting profession, which because of the present context in the country has assumed considerable importance.

The Chartered Accountant is a person on whom every member of the society could rely and rely strongly. His certificate would be one by way of a seal and a hall mark of which would inspire confidence in the minds of all concerned as certificates by a person fully competent and holding a charter from the Supreme Legislature of the country for the purpose.”



Amendments of CARO,2020 at a glance

The Amendments introduced in CARO,2020 are as follows:

	Number of clauses
CARO, 2016	16
Deleted Clauses	1
Remained	15

No. of 9 clauses amended (in this old clause no. 9 & 14 merged in new clause no. 10 as per CARO, 2020)

No. of 5 clauses retained old

Amendments of CARO,2020 at a glance

The Amendments introduced in CARO,2020 are as follows:

	Number of clauses
Retained Clauses	5
Retained – with Changes	9
Deleted Clauses	1
Newly Introduced	7
CARO 2020	21
Sub Clauses	47

5 (Retained) +
9 (Modified)

7 Newly Added

Newly Added (Clauses) (7)	Modified (Clauses) (9)	Retained (Clauses) (5)	Deleted (clause) (1)
Transaction Not recorded in Books-Clause 8	Fixed assets-Clause 1	Loans ,Investments, securities & guarantee's - Sec 185 & 186-Clause 4	Managerial Remuneration-Old Clause No. 12 from CARO 2016
Internal Audit System (CARO 2003)-Clause 14	Inventory-Clause 2	Maintenance of cost records-Clause 6	
Cash Loss (CARO 2003)-Clause 17	Repayment of Loans granted by company-Clause 3	Payment of statutory dues-Clause 7	
Statutory Auditor Resignation-Clause 18	Acceptance of deposits-Clause 5	Related Party Transactions-Clause 13	
Ability of Company to meet its Liabilities NTM-Clause 19	Default in repayment of loans or other borrowings-Clause 9	Non-Cash Transactions-Clause 15	
CSR - Transfer of Unspent Amount to Fund-Clause 20	Application of funds raised-Clause 10		
CFS : reference to negative remarks in Subsidiary CARO-Clause 21	Reporting Of Frauds-Clause 11		
	Nidhi Company-Clause 12		
	Registration With RBI-Clause 16		

Applicability Of CARO,2020

- ❑ **Applicable to Foreign Companies defined u/s 2(42)**
- ❑ **Non Applicable to :**
 1. **Banking Company**
 2. **Insurance Company**
 3. **Section 8 Company-Non Profit Organization**
 4. **Private Company, if :**
 - a) Its not a subsidiary or holding company of a public company ; **AND**
 - b) (Paid Up Capital + Reserve & Surplus) \leq Rs. 1 Crore **as on B/S Date; AND**
 - c) Total Borrowings from Bank /F.I. \leq Rs. 1 Crore at **any point of time during the FY ; AND**
 - d) Total Revenue (including revenue from discontinuing operations) under Schedule III \leq Rs. 10 Crores **during the financial year** as per the financial statements

5. One Person Company [Sec. 2(62)]
6. Small Company [Sec. 2(85)] (Rule 2(1)(t) as inserted by the companies (Specification of definition details) amendment rule , 2021, w.e.f.1-4-2021 - A company having :
 - a) Paid Up Share Capital \leq 2 crore; **And**
 - b) Turnover as per immediately preceding financial year P & L (as per P&L account) \leq 20 crore

Following do not qualify as a small company :

- ▶ Public Company
- ▶ Holding or a subsidiary company of public company
- ▶ Section 8 company
- ▶ Company or body corporate governed by any special act

- ▶ Old Definition of Small Company
 - **Paid up share capital \leq 50 lacs ; and**
 - **Turnover as per preceding year P & L \leq 2 cr.**

Particulars (XYZ Pvt Ltd)	2021-2022	2020-2021	2019-2020
Paid Up Capital (A)	48 lakhs	48 lakhs	48 lakhs
Reserve And Surplus (B)	3 lakhs	1.5 lakhs	45 lakhs
Total A+B	51 lakhs	49.5 lakhs	93 lakhs
Borrowing From Banks/F.I.	3 crore	2 crore	1.2 crore
Total Revenue/Turnover	8 crore	8 crore	6 crore
CARO Applicability ?	Not Applicable, Small Company	Applicable, Borrowings Exceeded	Applicable, Borrowings Exceeded

Particulars	2021-2022	2020-2021	2019-2020
Reason	<p>As per the amended definition of small company, turnover of last year i.e. in the FY 2020-2021 was 8 cr. Which is below the threshold limit of 20 cr. And paid of capital in the FY 2021-2022 is 48 lakhs which is below the threshold limit of 2cr. Hence company falls in the definition of small company</p>	<p>As per the old definition of small company, turnover of last year i.e. in the FY 2019-2020 was 8 cr. Which is above the threshold limit of 2 cr. Hence the company is not a small company and company's borrowings is exceeding the threshold limit of 1 crore.</p>	<p>Assuming company's turnover of last year i.e. in the FY 2018-2019 was above the threshold limit of 2 cr. Hence the company is not a small company and company's borrowings is exceeding the threshold limit of 1 crore.</p>

Clauses	Amend/New/No Change	Short Overview of changes
1-Property, Plant , Equipment	Amended	Fixed Assets replaced with the Property Plant and Equipment; disclosure for intangible assets included; title deeds of immovable property is further extended with detailed table disclosure; Disclosure on Revaluation of PPE, Disclosure on Benami Property
2-Inventory	Amended	Opinion of auditor required on the coverage and procedure of physical verification of inventory by management; material discrepancies <u>replaced</u> with discrepancies of 10 % or more in the aggregate for each class of inventory; new sub clause addition of sanctioned working capital loans during the year

Clauses	Amend/New/ No Change	Short Overview of Changes
3-Repayment of Loans Granted by Company	Amended	Advances in the nature of loans added with the loan; disclosure for company has made investments in , disclosure with quantification of loan or advances in the nature of loan; renewal or extended or fresh loans granted to settle the over dues of existing loans; aggregate amount of loans or advances in the nature of loan on repayment of demand or without specifying any terms percentage thereof to the total loans granted, aggregate amount of loans granted to promoters , related parties
4-Loans, Investment, Securities & guarantee's section 185 & 186	No change	
5-Accepctance of Deposits	Amended	Addition of amount which are deemed to be deposits with the deposits

Clauses	Amended/New/ No Change	Short Overview Of Changes
6-Maintenance of Cost Records	No Change	
7-Payment of Statutory Dues	No Change	
8-Transaction not Recorded in Books	New	Whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year If so, whether the previously unrecorded income has been properly recorded in the books of account during the year

Clauses	Amended/New /No Change	Short Overview Of Changes
9-Default in Repayment of Loan	Amended	Defaulted in the payment of interest added with the repayment of loan/borrowings further a table is introduced for more disclosure; declared willful defaulter, disclosure on loans regarding their applications; funds raised on short term basis have been utilized for long term purposes; company has taken funds from outside to meet the obligation of its subsidiaries, associates or joint ventures, raised loans on the pledge of securities held in subsidiaries, joint ventures or associate

Clauses	Amend/New/No Change	Short Overview of Changes
10-Application of Funds Raised	Amended	Merger of Old Clause 9 and Clause 14 and deletion of term loan part from clause 9
11-Reporting of Frauds Clause	Amended	Reporting of Frauds by the Auditor in Form ADT-1, Consideration of whistle blower complaints
12-Nidhi Company	Amended	Default in payment of interest on deposits or repayment thereof
13-Related Party Transaction	No Change	

Clauses	Amend/New/No Change	Short Overview of Changes
14-Internal Audit System	New	Whether the company has an internal audit system commensurate with the size and nature of its business. Whether the reports of the internal Auditors for the period under audit were considered by the statutory auditor.
15-Non Cash Transaction	No Change	

Clauses	Amend/New/ No Change	Short Overview of Changes
16-Registration with RBI	Amended	Company has conducted any non-banking financial or housing finance activities without a COR , disclosure on core investment company
17-Cash Losses	New	Whether the co. has incurred cash losses in the <ul style="list-style-type: none">• Financial year ; and• Immediately preceding financial year If so, state the amount of cash losses

Clauses	Amend/New / No Change	Short Overview of Changes
18-Statutory Auditor Resignation	New	<p>Whether there has been any resignation of the statutory auditors during the year.</p> <p>If so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.</p>

Clauses	Amend/New/ No Change	Short Overview of Changes
19-Ability of Company to meet its Liabilities NTM	New	<p>On the basis of financial ratios, aging and expected dates of realization of financial assets and payment of financial liabilities, other information accompanying the F.S, the auditor's knowledge of the BOD and management plans,</p> <p>Whether the auditor is of the opinion that :</p> <ul style="list-style-type: none">• No material uncertainty exists as on the date of audit report• Co. is capable of meeting its liabilities existing at the date of B.S. as and when they fall due within a period of 1 year from the B.S. date

Clauses	Amend/ New/ No Change	Short Overview of Changes
20-Transfer of CSR unspent amount to Fund	New	<p>(a) whether, in respect of other than ongoing projects, the company has CSR-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;</p> <p>(b) whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account (UNSEPCT CORPORATE SOCIAL RESPONSIBILITY ACCOUNT) within 30 days from the end of the FY in compliance with the provision of sub-section (6) of section 135 of the said Act;</p>

Clauses	Amend/New/ No Change	Short Overview of Changes
21-CFS : Reference to negative remarks in subsidiary CARO	New	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.

LETS START THE
DISCUSSION IN DETAIL

The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely

(I) PROPERTY PLANT AND EQUIPMENT'S-AMENDED

(a) (A) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment;

(B) whether the company is maintaining proper records showing full particulars of intangible assets;

(b) 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;

(c) 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 favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof in the format below:-

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held – indicate range, where appropriate	Reason for not being held in name of company*
-	-	-	-	-	*also indicate if in dispute

(d) whether the company has [revalued](#) its Property, Plant and Equipment (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 Property, Plant and Equipment](#) or intangible assets;

(e) 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 thereunder, if so, whether the company has appropriately disclosed the details in its financial statements;

*As amended in 2016

Factors to be considered:

- i. PPE Meaning-as per AS 10 (Revised) and Ind AS 16 Property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes **and** are expected to be used during more than one period.
- ii. The term 'Property, Plant and Equipment' covers **bearer plants** also. Bearer plant is a plant that is used in the production or supply of agricultural produce and is expected to bear produce for more than a period of twelve months and has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales. E.g. **in an oil palm plantation, the trees that produce fruit are bearer plants**, whilst the fruit bunches growing on the tree are agricultural produce until harvested.

- iii. Class of PPE is a grouping of assets of a similar nature and use in operations of an enterprise. The following are examples of separate classes:
- ✓ Land
 - ✓ Land and buildings;
 - ✓ machinery;
 - ✓ ships;
 - ✓ aircraft;
 - ✓ motor vehicles;
 - ✓ furniture and fixtures;
 - ✓ office equipment; and
 - ✓ bearer plants

- iv. Leases of Right of use assets under Ind AS 116 also requires to report.
- v. Constitute 'Reasonable Intervals' depends upon [circumstances of each case](#).
- vi. Intangible Assets-Consideration should be made to principles, accounting aspects and disclosures requirements in Ind AS 38 and AS 26.
- vii. Intangible assets can be customer based, marketing based, contract based, technology based or artistic based assets.
- viii. Auditor to consider self generated intangible assets and their classification and acquired intangible assets and their classification.
- ix. Title deeds of Immovable Property-Auditor should refer SA 250, Consideration of Law and Regulations in an audit of Financial Statements for legal determination of validity of title deeds.
- x. In case of lease agreements check these agreements duly registered with under appropriate authority.

- xi. Revaluation shall not include** : Fair Value of PPE upon first time adaption of Ind AS and remeasurement(e.g. changes in value due to interest or forex rates) cannot be construed as revaluation, changes to ROU assets due to lease modification as per Ind AS 116.
- xii.** Auditor not to review or comment on specific aspects of valuation report such as purpose of valuation and appointing authority, identify of any other experts involved in the valuation etc.
- xiii.** Auditor may retain a copy of Valuation report carried out by registered valuer as per SA 230, Audit Documentation.
- xiv.** Compliance of section 247 of the companies act, 2013 and companies (Registered Valuer and valuation) Rules 2017 by the company's management while appointing a valuer for revaluation of PPE and intangible assets.
- xv.** The objective of reporting requirement under Para 3(i)(e) of the Order is to ensure whether the company has appropriately disclosed the details of these proceedings in its financial statements as contingent liabilities. The proceedings filed by the company for relief may also go against the company and would involve contingent liabilities. Therefore, **it is opined that the proceedings filed by the company for relief which are pending would also be covered in the scope of Para 3(i)(e) of the Order.**

- xvi. Proceeding could be initiated by initiating officer and/or proceedings being against the company before the initiating officer/adjudicating authority/Appellate Tribunal/High Court /Supreme Court during any of the preceding financial years.
- xvii. Reporting on whether such properties have been appropriately disclosed in the FS.
- xviii. Nature of Property, carrying value of property in books of accounts, status of proceeding before relevant authority and liabilities.
- xix. Reference should be made to benami property transactions Act, 1988 and relevant rules.
- xx. Reporting limited to the adequacy of disclosure in the financial statements and to cases where proceeding are initiated with the company being treated as benamindar.
- xxi. Auditor to make necessary inquiries from the management on such properties including obtaining a management representation letter.

(II) INVENTORY-AMENDED

(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;

(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;

Factors to be considered :

- i. Meaning of Inventory : as per AS 2 and Ind AS 2 Inventories are assets held for sale in the ordinary course of business and in the process of production for such sale and in the form of materials or supplies to be consumed in the production process or in the rendering of services.
- ii. Class of Inventory:
 - As per AS 2–common classification of inventories are Raw materials and components, Work in Progress, Finished Goods, Stores and Spares, Loose Tools.
 - As per Ind As 2–common classification of inventories are merchandise, production supplies, materials, work in progress and finished goods.
- iii. Wider reporting requirements with respect to physical verification of inventory.
- iv. In addition to the existing requirements of reporting on the reasonability of the intervals in which inventory physical verification was conducted and the discrepancies if any, were recorded in the books of account, additional reporting is required on the appropriateness of :

- Coverage of such verification
- Procedure for such verification and
- Discrepancies of 10 % or more for each class of inventory were noticed.

- v. What constitutes 'appropriate' is a matter of professional judgment. The coverage and procedure of such verification will normally not be appropriate if it is not reasonable and adequate in relation to the size of the company and nature of its business.
- vi. Auditor required to report where a net discrepancy of 10% or more arises in value, for any class of inventory, **irrespective of planning materiality.**
- vii. Clause does not require reporting where such limits are unsecured or sanctioned on the basis of assets other than current assets.
- viii. Threshold of 5 crores limits **sanctioned** to be examined for any day during the year and not as at the end of the financial year, irrespective of drawn down.

- ix. Sanctioned limit with reference to the sanction letter issued by banks or financial institutions and relevant agreements executed with such banks/FI. The terms 'sanction' here to include fresh sanction during the year as well as limits renewed or due for renewal during the year. Moreover, both fund based and non-fund based credit facilities availed by the organizations should be considered for the purpose of checking the limit.
- x. The limits would cover the working capital limits by all the banks and financials institutions in aggregate excluding any working capital limits which are sanctioned without the security of the organization's current assets.
- xi. Refer schedule III for definition of current assets.
- xii. Auditor not required to audit quarterly returns statements; should compare it with books of account and report disagreement, if any, even if company submitting returns/statements on a monthly basis; exercise professional judgment to determine materiality and relevance of discrepancy to the users of financial statements.
- xiii. Statements include stock statements, book debt statements, credit monitoring arrangement reports, statements on ageing analysis of debtors/other receivables and other financial information's.
- xiv. Auditor need to check working capital sanctioned limits and its utilization.

(III) REPAYMENT OF LOANS GRANTED BY COMPANY-AMENDED

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-
 - (A) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates;
 - (B) the aggregate amount during the year, and balance outstanding at the balance 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 the repayments or receipts are regular;
- d. If the amount is overdue, state the total amount overdue 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 party as defined in clause(76) of section 2 of the companies act, 2013.

Factors to be considered

*Advances in the Nature of Loan-not defined, depends on facts.

- i. The following principles may help in determining, whether an advance is a genuine advance or 'advance in the nature of loan':
 - a) An advance may be considered as a loan when the amount given is disproportionate to the value of goods purchased or services obtained having regard to the prevalent trade practices.
 - b) For example, if in a particular trade, the practice is to give an advance of 20% of the value of orders placed with the party, the company gives 100% advance or 4 times the amount of order as advance, this will be treated as advance in the nature of loan;
 - c) If advance is outstanding for a long time (having regard to the normal lead time in the industry) and material ordered has not been received, the amount given must be treated as advance in the nature of loan. These loans disguised as advances are "Advances in the nature of loans"

- ii. Sub clause (a) & (e) not applicable to companies who are in the principle business of giving loans (e.g. Fls, NBFCs)
- iii. Requires determination of gross amounts (i.e. without adjusting any subsequent settlements) of all loans, advances in the nature of loans, guarantees, security provided during the year to subsidiaries, joint ventures, associates and to any other parties.
- iv. Subsidiaries, joint ventures , associates to be interpreted in accordance with the companies act, 2013.
- v. Loans given in cash or in kind-reporting required; loans squared up during the year to be reported.
- vi. Guarantees to cover financial guarantees only.
- vii. Refer section 179, 180, 185, 186, 187 of the companies act, 2013 and relevant rules thereunder; auditor to ensure compliance.

(iii)(b) Investments /guarantees/ Security/Loans & Advances-Whether prejudicial

- i. Reporting to also include investment in, guarantees or security provided in addition to loans or advances in nature of loans to companies, firms, LLPs or any other parties (as against those parties covered under section 189 of the Act in the erstwhile clause.
- ii. Earlier the reporting on this clause was restricted to loans to parties covered under section 189 of the companies act, 2013 and to rate of interest and other terms and conditions of loans given by companies.
- iii. Clauses also applicable to companies like NBFCs whose principle business is to grant loans.
- iv. Auditor to determine the terms and conditions at the time of the grant of the loans and advances in the nature of loan (i.e. rate of interest, security, terms and period of repayment, restrictive covenants nature of entity)-may be challenging to ascertain in respect of advances in nature of loans

- v. Auditor to determine terms and conditions in which company has made an investment, provided a guarantee or given a security (evaluate factors connected with an investment including company's ability to make such investments; financial standing of party on whose behalf company has given guarantees , parties ability to borrow, nature of security offered by the party.

(iii)(c)(d) Schedule of repayment , regularity of repayment and amounts overdue

- i. Advances in nature of loans may not necessarily carry an interest.
- ii. Covers the loans and advances in the nature of loans guaranteed during the year and also all loans having opening balances.
- iii. An amount is considered to be overdue when the payment has not been received on the due date as per the lending arrangements.
- iv. 'regular' means principle and interest received whenever they fall due.

- v. Absence of stipulation of schedule of repayment of principle and payment of interest –Auditor to state that he is unable to make specific comment on regularity of repayment of principle and interest.
- vi. Management of a company would need to provide the steps taken to recover the principle and interest in writing.

Ever greening of Loans and Advances (e)

- i. New reporting under this clause to identify instances of 'ever greening' of loans /advances in nature of loans.
- ii. Applicable to all companies other than those who are in the nature of business of giving loans.
- iii. Evergreen implies an attempt to mask loan default by giving new loans to help delinquent borrows repay principle or pay interest on old loans

- iv. Clause not restricted to 'overdue' loans but also extends to situations where fresh loans given close to settlement date.
- v. Report loans falling due as on the balance sheet date and which were renewed/extended/settled post balance sheet date and before the date of audit report.

Loans or Advances repayable on demand or with no stipulation (f)

- i. New reporting of the gross amount in respect of loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment.
- ii. Reporting of Aggregate amount to all parties.
- iii. Reporting of the aggregate amount of loans granted to promoters under section 2(69), related parties as defined in section 2(76) of the Act.

- iv. Auditor to examine from loan agreements/mutually agreed letter of arrangement with such parties to ascertain whether agreement/arrangement contains schedule of repayment of principle and payment of interest.
- v. Auditor to consider SA 550, Related Parties.

(IV) LOANS, INVESTMENTS, SECURITIES & GUARANTEE'S- RETAINED OLD

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

Factors to be considered

Section 185:- This primarily deals with the subject of person to whom company cannot give loan.

Section 186:- This section enlists the exceptions and specifies the limits up to which a company can give loan.

The section 185 of CA, 2013, restrict the company on giving loans, guarantee or provide security to Directors or any other person in whom Director is interested. The ways via which a director can be interested has been covered via 5 inclusions:-

1. Any Director of lending company
2. Any relative of Director
3. Director of a company which is its holding company
4. Any firm in which such director is partner or relative is a partner
5. Any partner of such director

1) Any PRIVATE Limited company in which such director is a Director or member.
2) Body corporate in which such Director or Directors hold more than 25% shares.
3) Body Corporate, MD, BOD or manager accustomed to act in accordance with direction of board or Director of lending company. A body corporate does not include a co-operative society. But it includes a foreign company.

EXCEPTION TO SECTION 185

- 1) Managing Director/Whole Time Director
 - a) As a part of service extended to all of its employee.
 - b) Any Scheme Approved by members by special resolution.
- 2) Given in ordinary Course of Business*

How to check ordinary course of business*

- a) Is the company engaged in lending activity regularly.
- b) Lend not only to Directors and related parties but also to Arm Length Parties or unrelated parties.

KEY TAKEAWAY :- All NBFC may not be engaged in lending activities in ordinary course.

NOW LET US UNDERSTAND THE SECTION WITH THE HELP OF PRACTICAL EXAMPLE

Company A has two Directors Mr. X and Mr. Y. Both holds 50% share each of Company.

Company A wish to give loan to following and have asked for your views on same.

- A) Loan to Director X.
- B) Loan to a relative of Director Y.
- C) Director of company D which is the holding company of A.
- D) A partner of Director of Holding Company.
- E) A partner of Director of company A.
- F) To a firm in which Mr. X is a partner.
- G) To a firm in which relative of Mr. Y is a Partner.

S.NO.	Loan to	Whether Co Can	Reasons
A	Loan to Director X	No	Included in definition
B	Loan to a relative of Director Y	No	Do
C	Director of company D which is the holding company of A	No	Do
D	A partner of Director of Holding Company	YES	A partner of director of holding co is not included
E	A Partner of Director of Company A	No	Included in definition
F	To a Firm in which Mr. X is a Partner	No	Included in definition
G	To a firm in which relative of Mr.Y is a partner	No	Included in definition

Section 186: Loan and Investment by company

186(1) Without prejudice to the provisions contained in this Act, A company shall unless otherwise prescribed, make investment through not more than two layers of investment companies.

186(2) No Company shall directly or indirectly-

- a) Give any loan to any person or other body corporate;
- b) Give any guarantee or provides security in connection with a loan to any other body corporate or person; and
- c) Acquires by way of subscription, purchase or otherwise, the securities of any other body corporate.

Section 186(2)

Exceeding SR Approval Required if :

- 1) Existing (Loans + Guarantee +Security +Investment)
Plus
- 2) Proposed (Loans+Guarantee+Security+Investment)

Is More than the high of the following

- 60 % of (paid up capital + free reserves+ securities premium)
- 100% of (free reserves +securities premium)

(V) ACCEPTANCE OF DEPOSITS-AMENDED

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 thereunder, 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;

Factors to be considered

- i. Slight modification has been made to the existing clause to include “deemed deposits”
- ii. Section 2(31) has defined ‘deposits’ to include any receipt of money by way of deposits 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.

- iii. This Clause includes reporting on 'amounts which are deemed to be deposits' in addition to deposits accepted by the company.
- iv. Explanation to sub clause (xii) of Rule 2(1) © -Company (Acceptance of Deposits) Rule, 2014, explains that the amount shall be deemed to be deposits on the expiry of fifteen days from the date that become due for refund.
 - i. Advance for supply of goods or provision of services accounting for in any manner whatsoever provided such advance appropriated against supply of goods or provision of services with in a period of 365 days from the date of acceptance of such advance.
- v. Refer Sec 164(2) of Co Act, 2013- If Company fails in repayment of deposits, interest thereon, debentures, interest thereon, dividend and the default is more than the one year, the directors of such company cannot be appointed as director of such company or appointed in other company for next five years.

What does Companies Act say

- i. A company making allotment **shall allot its securities within 60 days** from the date of receipt of the application money.
- ii. If the company is not able to allot the securities within that period, it shall **repay the application money to the subscribers within 15 days** from the date of completion of 60 days.
- iii. If the company fails to repay the application money within the aforesaid period, it shall be liable to **repay that money with interest @12% p.a.** from the expiry of 60th day – Section 42(6).
- iv. If the securities for which application money or advance for such securities was received **cannot be allotted within 60 days from the date of receipt of the application money** and such application money is not refunded to the subscribers within 15 days from the date of completion of 60 days, **such amount shall be treated as a deposit.**
- v. Refer Rule 2(1)(c)(vii) of Companies (Acceptance of Deposits) Rules, 2014.

(VI) MAINTENANCE OF COST RECORDS-RETAINED OLD

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

(VII) PAYMENT OF STATUTORY DUES-RETAINED OLD

- (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);

Questions :

- Whether amounts due to MSMED (micro, small and medium enterprises development) Enterprises are Statutory Dues?
- What if Company was irregular in deposit of undisputed statutory dues but has cleared all dues before year end? Will auditor have to report it?
- What are the reporting responsibilities of auditor in case a Co. is required statutorily to get itself registered under the PF Act, but has not done so?
- Is non-payment of advance tax is default in payment of statutory dues?

Are the following payments covered by para 3(vii) of CARO:

- ▶ **Bonus payable under the Payment of Bonus Act, 1965** - No - Since this is payable to employees and not to any statutory authority
- ▶ **Turnover fees payable to SEBI by brokers** – Yes, Since SEBI is a statutory authority
- ▶ **Gratuity liability under the Payment of Gratuity Act not funded by the company** - No - Since this is payable to employees and not to any statutory authority

Practice Point

- i. Section 143(3)(j) of the Act requires that the auditor's report shall also state "such other matters as may be prescribed."
- ii. Rule 11(a) of the Companies (Audit and Auditors) Rules, 2014 notified under section 143(3)(j) requires that the auditor's report shall also include their views and comments on "whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement".
- iii. It would be better if the auditor reconciles the data reported under Para 3(vii)(b) of CARO, 2020 with data reported under Rule 11(a) and keeps details in his working papers.

(VIII) TRANSACTION NOT RECORDED IN BOOKS-NEW

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;

Factors to be considered

- i. Emphasis is on the words surrendered or disclosed implies that the company must have voluntarily admitted to the addition of such income, can be demonstrated on the basis of the returns filed and statements made during search and survey.
- ii. Where the addition is made by the income tax authorities and the company has disputed such additions, reporting under this not applicable.

- iii. Review tax assessments made subsequent to the BS date but prior to signing of the auditor's report If the surrendered or disclosed income relates to year under audit or prior years.
- iv. Proper recording implies proper disclosure in the financial statements.
- v. Auditors needs to evaluate disclosure of such income as exceptional/extra ordinary item under AS 5 and Application of Ind AS 8 for corrections of prior period items.

(IX) DEFAULT IN REPAYMENT OF LOANS OR BORROWINGS-AMENDED

- 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 format below:-

Nature of borrowing, including debt securities	Name of lender*	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any
*lender wise details to be provided in case of defaults to banks, financial institutions and Government.					

- b) whether the company is a declared wilful 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 utilised 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;

Factors to be Considered

(ix)(a)

- i. Enhances and wider reporting requirements.
- ii. Default in repayment of loans or other borrowings or interest thereon to any lender will now be required to be reported under this clause unlike previous reporting in case of default in repayment of dues to a financial institution (FI) , banks, Government or debenture holders only.
- iii. “Default” would mean non-payment of dues to lenders on the last dates specified in loan documents or debenture trust deed.
- iv. Auditor to report :
 - Amount of all defaults committed during the year and the number of days of default (consider period up to date of audit report).

- Amounts remaining unpaid, period and amount of all defaults existing at the balance sheet date irrespective of when those defaults have occurred.
- Lender wise details in the format to be given where defaults to banks, FIs or Government; for other lenders-Aggregate for each type of lender may be given –e.g. debenture holders.
- Consider loans/borrowings/interest payable on demand with no terms specified.
- Consider application for re-schedule /restructuring proposals to lenders.

(ix)(b)

- i. Declaration restricted to relevant FY under audit till date of audit report
- ii. Term 'lender' in RBI circular covers all banks/Financials Institutions (FIs) to which any amount is due, provided it is arising on account of any banking transaction, including off balance sheet transaction such as derivatives, guarantee and letter of credit.
- iii. Lack of clarity whether definition of wilful defaulter can be applied for banks, FI, Government or other lenders

- iv. ICAI clarified in GN-Auditor should restrict the reporting under this clause to declaration of wilful defaulter by banks, Financial institutions and in respect of others lenders should restrict the reporting to declaration of wilful defaulter by government/government authorities.
- v. While obtaining confirmations of outstanding loans and interest from banks/financials institutions, include a question whether the company has been declared a wilful defaulter
- vi. Auditor to search for information on website of credit information's companies, RBI and other information available in public domain.

(ix)©

- i. Modification to the existing clause. Auditor is required to examine whether term loans were applied for the purpose for which these loans were obtained and where the term loans were not applied for the purpose for which these loans were obtained, report the amount of loan so diverted and the purpose for which it is used.
- ii. Term loans obtained from entities/persons other than banks/financial institutions also to be examined by the auditor
- iii. RBI Circular defines diversion of funds

- iv. Auditor need to examine whether the company has utilised the term loans for any of the purposes defined as diversion by the RBI circular. Such process may include checking whether the company has granted loans to other parties, including related parties, or made investment.
- v. Temporary utilization of funds to be reported.
- vi. Consider general purpose loans-to be evaluated from perspective of diversion of funds.
- vii. Under Ind AS, Certain term loan(e.g. Mezzanine loans- Mezzanine financing is a hybrid of debt and equity financing that gives the lender the right to convert the debt to an equity interest in the company in case of default) may be classified as equity or compound instruments-GN clarifies it is as debt while reporting under this clause.

(ix)(d)

- i. Reinstated from CARO 2003.
- ii. Auditor to disclose the nature of application of funds if the company has financed long term assets out of short terms funds.
- iii. Nature of application of funds can be determined only if the funds raised can be directly identified with an assets. Further, such movement in funds should be supported by relevant documentation.
- iv. Short-term sources of funds include temporary credit facilities like cash credits, over draft. Reduction in current assets or increase in current liabilities are also sources of short term decrease in funds.
- v. Long term application of funds includes investment in PP & E, long term investments in share, debentures and other securities and other assets of similar nature, repayment of long term debt etc.
- vi. Auditor to use data contained in balance sheet to ascertain whether funds raised on short term basis used for long term investment.

(ix)(e)

- i. Auditor needs to consider new loans or advances taken during the year for meeting the obligations of subsidiaries joint ventures or associate companies during the year and new investments (equity or debt investment) made during the year.
- ii. Reporting under this clause will be required for :
- iii. All funds taken from any entity or person during the year even if these have been repaid before the year end
- iv. Where funds were taken in earlier years and were repaid during the year or are outstanding as at the year end
- v. For the purpose of this clause definitions of subsidiary associate or joint venture will be as defined in the companies Act 2013
- vi. Fund will include both long term and short terms funds

- vii. Obligation implies a commitment to pay a particular sum money; obligation of subsidiary, joint venture or associate means amounts required to be paid by subsidiary, joint venture or associate to their vendors or lenders or employees or statutory authorities.
- viii. Perform procedures to ensure compliance with AS 18 or Ind AS 24 and SA 550.
- ix. Seek information from other auditors as per SA 600 (for component auditors).

(ix)(f)

- i. Under this clause the auditor is required to report :
- ii. Whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies.
- iii. If yes, give details of such loans; and
- iv. Report is the company has defaulted in repayment of such loans raised

v. Definition of securities-refer section 2(81) of the companies Act, 2013

GN Clarifies as below

- i. Reporting to cover all loans taken during the year from any lender even if these have been repaid during the year
- ii. Reporting required only in case of loans taken during the year, therefore loans taken in earlier years and outstanding as at the balance sheet date not to be reported
- iii. Default include both repayment of principle & interest
- iv. Requirement of clause 3(ix)(a) to report in repayment of loans or other borrowings or in payment of interest to any lender-would also cover in respect of loans referred to in the clause; details to be reported in specified reporting format.

(X) APPLICATION OF FUNDS RAISED-AMENDED

- (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;

Points for analysis in (x)(a)

- i. Slight modification has been made to the existing clause by removing 'term loans'. Comprehensive reporting requirements for term loans included in clause(ix) of CARO
- ii. Auditor is required to report whether money raised by the company through initial public offer (IPO) of further Public Offer (FPO)(including debt instruments) during the year have been utilized for the purposes for which those were raised. If no, the auditor is required to report the details together with delays or default and subsequent rectification, if any, as may be applicable.
- iii. Auditor to consider SEBI(LODR) Regulations, 2015
- iv. Companies may temporarily invest surplus funds to reduce cost of capital, check ultimate utilization.

Points for analysis (x)(b)

- i. Slight modification to the existing clause
- ii. Previously, only specific reference to section 42 of the Act for private placement of shares or debentures and no reference made to section 62 of the Act which discuss preferential allotment
- iii. Clause requires that in case of preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible), during the year, whether the requirements of section 42 and section 62 of the Act and the Rules framed thereunder have been complied with
- iv. Auditor to report upon the utilization of the said funds for the purposes for which it has been raised, if not, the reporting is required giving details of the amount involved and nature of non-compliance

- v. Auditor required to verify :
- vi. Compliance with sections 42 and 62 of the Companies Act, 2013
- vii. End use of the funds which have been raised by the Company

(XI) REPORTING OF FRAUDS-AMENDED

- (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;

Point for analysis (xi)(a)-

- i. Wider ambit of reporting under CARO 2020 by removing the words “officers or employees”
- ii. Earlier clause required the auditor to report whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year.

- i. New reporting requirement to also include reporting on fraud committed by the company and on the company by anyone including officers, employees, third parties outside the company like vendors, agents etc.
- ii. Scope of auditor's inquiry restricted to frauds 'noticed or reported' during the year.
- iii. Use of the words "noticed or reported" indicated that the management of the company should have the knowledge about the frauds by the company or on the company that have occurred during the period covered by the auditor's report.
- iv. Report 'established' fraud and not 'suspected/alleged fraud'-definition of fraud as per section 447 of the Act.
- v. Auditor responsibilities to consider fraud and error in an audit of financials statements; comply with the requirements of standard on Auditing (SA) 240. "The Auditor's responsibility relating to fraud in an audit of Financials Statements" and guidance note on section 143(12).

- vi. Consider implications of other CARO clauses (working capital limits, unrecorded transaction, whistle-blower complaints).
- vii. GN requires auditor to consider principles of materiality outlined un SAs.

Point for analysis (xi) (b)-

- i. Reporting requirement under Section 143(12) is for the statutory auditors of the company
- ii. Also check if predecessor auditor has reported u/s 143(12) before appointment (in ADT 4)
- iii. Reporting u/s 143(12) :
 - a) Includes only fraud by officers or employees of the company and does not include fraud by third parties such as vendors and customers

- b) Requires the statutory auditor to report to the central government on fraudulent activities which involves individually an amount of rupees one crore or above, being committed or has been committed in the company by its officers or employees, noticed during the audit of the financial statements.
- c) applies to the cost accountant conducting cost audit under section 148 of the Act; and to the company secretary conducting secretarial audit under section 204 of the Act.
- iv. Auditor to obtain management representation if cost auditor or secretarial auditor filed report

Points for analysis (xi)©-

- i. New reporting requirement under CARO 2020 requiring the auditor to consider whistle blower complaints, if any received by the company during the year under audit.
- ii. Section 177(9) of the Act requires every listed company, companies which accept deposits from the public and companies which have borrowed money from banks and public financial institutions in excess of fifty crore rupees to establish a vigil mechanism for their directors and employees to report their genuine concerns or grievances.

- iii. For listed entities, regulation 4(2) (d) of SEBI LODR regulations mandates listed entities for devising an effective whistle blower mechanism enabling directors, employees or any other person to freely communicate their concerns about illegal/unethical practices
- iv. For other companies wherein establishment of whistle blower mechanism not mandatory-voluntary establishment of vigil mechanism/whistle mechanism-auditor to consider all whistle blower complaints
- v. If no whistle blower mechanism established(in case it is not mandatory), GN requires auditor to obtain from management all whistle blower complaints and review such complaints
- vi. Consideration of whistle blower complaints received or identified, during the course of audit , about a fraud or suspected fraud
- vii. Auditor not required to consider whistle blower complaints pertaining to earlier years while reporting under this clause; consider principles of materiality
- viii. Refer NOCLAR Policy-(Non compliance with laws and regulations)

(XII) NIDHI COMPANY-AMENDED

- (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;

Points of analysis :

- i. Auditor to report the period and amount of all defaults in payment of interest:
- ii. Existing as at the year-end; and
- iii. Defaults exiting during ant period and made good during the year
- iv. In case of the dispute between the company and the depositor, auditor to consider prevailing terms and conditions . Also report on nature of dispute

(XIII) RELATED PARTY TRANSACTION-REMAINED OLD

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;

Factors to be considered

Audit requirements:

As per AS 18 : Related party transaction: a transfer of resources or obligations between related parties, regardless of whether or not a price is charged

As per Companies Act :

- i. A company can enter into specified related party transaction only with approval of Board - Section 188(1);
- ii. Nothing in this sub-section shall apply to any transactions entered into by the company in its ordinary course of business which are on an arm's length basis - 4th Proviso.

► Specified related party transactions:

- a. sale, purchase or supply of any goods or materials
- b. selling or otherwise disposing of, or buying, property of any kind
- c. leasing of property of any kind
- d. availing or rendering of any services
- e. appointment of any agent for purchase or sale of goods, materials, services or property
- f. such related party's appointment to any office or place of profit
- g. underwriting the subscription of any securities or derivatives

As Per AS 18

- ▶ There is a general presumption that transactions reflected in F.S. are consummated on an arm's length basis between independent parties. However transactions between related parties may not be effected at the same terms and conditions as between unrelated parties. Sometimes, no price is charged in related party transactions, e.g. free provision of management services and the extension of free credit on a debt – Para 16.

► Examples of related party transactions – Para 24:

- a. purchases or sales of goods (finished or unfinished)
- b. purchases or sales of fixed assets
- c. rendering or receiving of services
- d. agency arrangements
- e. leasing or hire purchase arrangements
- f. transfer of research and development
- g. finance (including loans/ equity contributions in cash/ kind)
- h. guarantees and collaterals

Areas not to be overlooked :

- i. Assess whether a related party transaction is in ordinary course of business
- ii. Evaluate management's representations that related party transactions are at arm's length by testing whether prices charged are at arm's length;
- iii. Be careful about the transactions which are in scope of AS 18 but not in scope of Section 188

(XIV) INTERNAL AUDIT SYSTEM-NEW

- (a) whether the company has an internal audit system **commensurate with the size and nature of its business**; (Reintroduced From CARO 2003)
- (b) whether the reports of the Internal Auditors for the period under audit were **considered by the statutory auditor**; (Newly Added)

Various Factors that should be considered : Refer SA 610-using the work of internal Auditors, Section 143(3)(i)-Internal Financial Control, Section 138- Classes of company who shall be required to appoint Internal Auditor.

SA 610-Using the Work of Internal Auditors

- i. If the specific work of the internal auditor can be used and if so, to what extent
- ii. Whether Such work is adequate for the audit purpose.

- ▶ If the internal auditor's work is adequate for audit purpose and evaluate:
 - a. Objectivity of internal audit function.
 - b. Internal auditor's technical competence.
 - c. Effective communication between the internal auditor and the external auditor.
 - d. Nature and scope of specific work performed or to be performed.
 - e. Assessed risk of material misstatement at the assertion level for a particular class of transaction, account balance and disclosure.

SECTION 138-COMPANIES REQUIRE TO APPOINT INTERNAL AUDITOR

	Listed Companies	Unlisted Companies	
		Public Co. (in cores) <u>equal to or more</u>	Private Co. (in cores) <u>equal to more</u>
Turnover	Always Applicable	200	200
Loan at any point of time	Always Applicable	100	100
Paid Up Share Capital	Always Applicable	50	N.A.
O/S Deposits at any point of time	Always Applicable	25	N.A.

Sec 143(3)(i) of the companies act , 2013 the Auditor is required to be report as follows:
“Whether the company has adequate **internal financial controls** system and the operating effectiveness of such controls”

Internal Financial Controls :

- ▶ The orderly and efficient conduct of its business
- ▶ Including adherence to Company's Policies
- ▶ The safeguarding of Assets
- ▶ The Prevention and detection of frauds
- ▶ The Accuracy and completeness of the accounting records

Also ICAI has issued Guidance note on Audit of IFC over Financial Reporting.

(XV) NON CASH TRANSACTION-REMAINED OLD

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;

(XVI) REGISTRATION WITH RBI-AMENDED

- (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 fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil 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;

Factors to be considered

- i. In terms of section 45-IA of the RBI Act, 1934, no Non-banking financials company can commence or carry on business of a non-banking financials institutions without obtaining a certificate of registration (COR) from the Bank and without having a Net Owned Funds of Two Crore.
- ii. Auditor should obtain the COR from the management of the company and verify if any transaction in the nature of non banking financials or housing finance activity has been conducted by such company prior to obtaining the registration certificate from the reserve bank of India.
- iii. Companies in the group defined in the core investment company (reserve bank) directions.
- iv. If the group has more than one COC (including CICs exempt from registration and CICs) not registered, auditor to report number of CICs in the group.

- v. Refer RBI circular and master directions for core investment companies
- vi. If any of the non-compliance is reported in this clause the auditor should also consider whether such non-compliance should be reported by way of an exception report to reserve bank of India in terms of non banking financial companies auditor's report(reserve bank)directions. 2016

(XVII) CASH LOSSES

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; (Reintroduced from CARO 2003)

Discussion points

- ▶ However incurring of cash losses in the current financial year , even if there was no cash losses in immediately preceding financial year, will have to factored in by the auditor in making comments under para 3(xix) as to :

Whether in his opinion “material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet date as and when they fall due within a period of one year from the balance sheet date”

- ▶ Whether the reporting requirement under para 3(xvii) applies even during gestation period (Say for start up companies)

Factors to be considered

Auditor will additional required to verify and report on cash losses, if any incurred by the company in the preceding FY in addition to the current FY; Separate comment required for two years

- ❑ Figure of cash losses to be adjusted for effect of qualifications.
- ❑ Quantum of cash losses incurred will also be required to be reported in the audit report.

(XVIII) STATUTORY AUDITOR RESIGNATION

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;

Reference of Sections/Standards/Rules

- i. Section 140 (2) of companies act-if the Auditor has resigned from the company, a statement in prescribed form shall be filed by him indicating the reasons and other facts as may be relevant with regard to his resignation.
- ii. Rule 8 of Companies (Audit and Auditors) Rules, 2014-For the purposes of sub-section (2) of section 140, when an auditor has resigned from the company, the resigning Auditor shall file a statement in Form ADT-3
- iii. Part 1 of the First schedule of CA Act –Professional misconduct in relation to chartered accountants in practice.

- iv. SA 510-Initial Audit Engagements –Opening Balances : The objective of the auditor in conducting an initial audit engagement regarding opening balances is to obtain sufficient and appropriate audit evidence about the:
 - Material misstatements in the opening balances that could affect current period's financial statements; and
 - Whether accounting policies in the previous period have been consistently applied in the current period, and any changes in these policies are properly accounted for, presented and disclosed according to the applicable financial reporting framework.
 - The auditor shall examine the recent financial statements and the predecessor auditor's report for concluding disclosures regarding opening balances.
- v. SA 710-Comparative Information about comparative figures and comparative financial statements :

Factors to be considered

Applicable where new auditor ("incoming auditor ") is appointed during the year to fill the casual vacancy caused by the resignation of the auditor created in the office of the previous auditor under section 140(2) of the companies act 2013.

- i. Incoming auditor to comply with ICAI Code of Ethics (professional courtesy clearance), implementation guide issued by the ICAI, ADT 3, SEBI Circular to be followed by company on resignation of Auditor.
- ii. Obtain ADT 3, Annexure A filed pursuant to SEBI Circular (for listed companies) and consider reasons for resignation.
- iii. Read last issued audit/review report to understand modifications; assess potential impact of reasons for resignation on his/her audit strategy/ reporting.

(XIX) ABILITY OF COMPANY TO MEET ITS LIABILITIES

On the basis of the financial ratios, ageing and expected dates of realisation 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 balance sheet as and when they fall due within a period of one year from the balance sheet date;

Factors to be considered

- i. Financial Ratio, Efficiency Ratio such as :
 - ▶ **Current Ratio,**
 - ▶ **Debt-Equity Ratio,**
 - ▶ **Debt Service Coverage Ratio,**
 - ▶ **Return on Equity Ratio,**

- ▶ **Inventory turnover ratio,**
- ▶ **Trade Receivables turnover ratio,**
- ▶ **Trade payables turnover ratio,**
- ▶ **Net capital turnover ratio,**
- ▶ **Net profit ratio,**
- ▶ **Return on Capital employed,**
- ▶ **Return on investment**
- ii. Aging and expected dates of realization of financial assets and payment of Financial Liabilities
- iii. SA 720-Other information accompanying the financial statement. To consider whether there is a material inconsistency between the other information and the financial statements. To consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit. To respond appropriately when the auditor identifies that such material inconsistencies appear to exist, or when the auditor otherwise becomes aware that other information appears to be materially misstated.

- iv. Auditor's Knowledge of the Board of Director's and Management plans.
- v. Emphasis on company's ability to meet its liabilities and not on 'going concern' basis.
- vi. Test of existence of materiality uncertainty is to be done as on the date of audit report for the position of liabilities existing at the date of balance sheet.
- vii. Consider guidance in SA 570 and implementation guide on SA 570, to the extent relevant for reporting on this clause.
- viii. If it is expected that liabilities due within one year are based on holding company's letter of support, this fact required to be stated.
- ix. The company shall explain the items included in numerator and denominator for computing the above ratios. Further explanation shall be provided for any change in the ratio by more than 25% as compared to the preceding year.

- ix. The “Management Discussion and Analysis” Section shall include **details of significant changes** (i.e. change of 25% or more as compared to the immediately previous financial year) **in key financial ratios**, along with detailed explanations therefor, including:
- Debtors Turnover
 - Inventory Turnover
 - Current Ratio
 - Debt Equity Ratio
 - Operating Profit Margin (%)
 - Net Profit Margin (%)
- x. Details of any **change in Return on Net Worth as compared to the immediately previous financial year** along with a detailed explanation thereof.

(xx) TRANSFER OF UNSPENT AMOUNT FUND-NEW

- (a) whether, in respect of other than ongoing projects, the company has CSR-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;
- (b) whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account (UNSEPCT CORPORATE SOCIAL RESPONSIBILITY ACCOUNT) within 30 days from the end of the FY in compliance with the provision of sub-section (6) of section 135 of the said Act;

Factors to be considered

- i. First need to check the applicability of Section 135 of the Act are applicable to the company? If answer is no, clause 3(xx)(a) and 3(xx)(b) are not applicable to the company.
- ii. Auditor can only report compliance regarding unspent funds for preceding financial year as due date for compliance will fall during the year under audit.

- ii. As far as compliance for year under audit is concerned, it is possible that the audit report is signed much before the due date for compliance has expired. It would be better for auditor to point out that as of date of audit report, due date for compliance has not expired and as of date of audit report, company is yet to transfer.
- iii. Refer SA 560-Subsequents Events.
- iv. Refer SA 720-The Auditor responsibilities relating to other information in reference to Whether auditor needs to report on utilization of amount transferred to special bank account within 3 financial years?

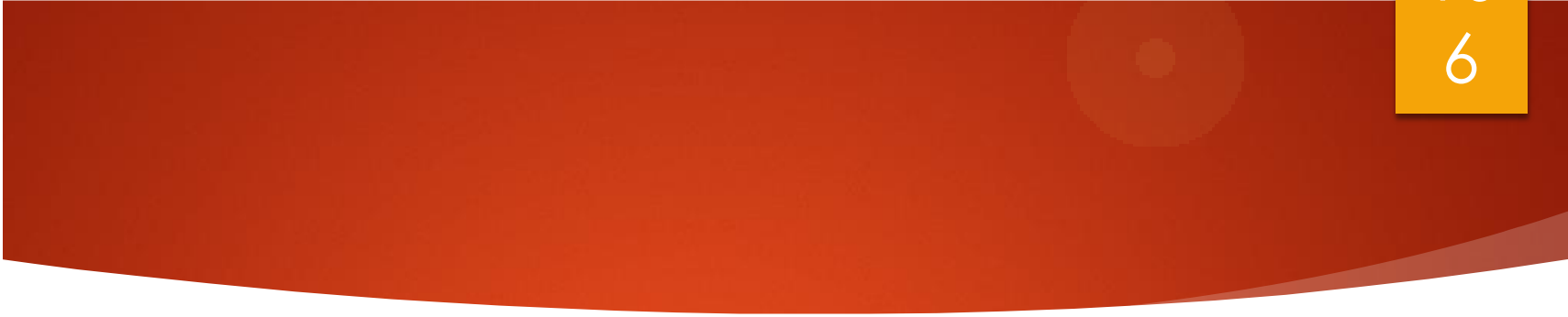
[Section 135(6) requires that such amount transferred to special account shall be spent by the company in pursuance of its obligation towards the CSR Policy within a period of 3 financial years from the date of such transfer. If company fails to so spend within 3 financial years, the company shall transfer the same to a Fund specified in Schedule VII, within a period of 30 days from the date of completion of the 3rd financial year]

(XXI) CFS : REFERENCE TO NEGATIVE REMARKS IN SUBSIDIARY CARO-NEW

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.

Factors to be considered

1. Whether there have been any qualification 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?
 - i. Obtain the list of companies (holding company/subsidiary/associate/joint venture) included in the consolidated financial statement.
 - ii. For companies included in the consolidated financial statements, has the principle auditor received CARO reports of such companies from the management of the company? If no, whether the principal auditor has mentioned appropriate remarks under this clause mentioning the details of such companies?

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- iii. Examine the CARO reports obtained from the management /component auditors or available with the principle auditor for respective companies and assess whether the observations and comments as given in the respective CARO reports are in the nature of qualifications or adverse remarks.
 - 2. Indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.

Thank You

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CA. Gyan Chandra Misra
Central Council Member
ICAI