

- II. **>= 50 Crores** - **Paid up share capital** during the preceding financial year; or
- III. **> 100 Crores** - **Outstanding loans / borrowings** from banks or public financial institutions at any point of time during the preceding financial year; or
- IV. **>= 200 Crores** - **Turnover** during the preceding financial year
- (c) Every **PRIVATE COMPANY** having-
- I. **> 100 Crores** - **Outstanding loans / borrowings** from banks or public financial institutions at any point of time during the preceding financial year; or
- II. **>= 200 Crores** - **Turnover** during the preceding financial year
- IFSC public company (unlisted) and IFSC Private Company Section 138 applicable with AOA provide for it.
- (iii) **Conclusion:-** Hence, since the **turnover of the company is less than 200 Crores** (assuming average turnover is the turnover for preceding financial year) the company **may not necessarily have an internal audit system**. However, company shall still be responsible to have adequate internal financial controls.

105.

Applicability of Provisions of Internal Audit

MWF (P) Ltd. is a private company having ₹ 50 lacs paid up capital during the preceding financial year. The company had turnover of last three consecutive financial years, immediately preceding the financial year under audit, being ₹ 210 crores, ₹ 205 crores and ₹ 200 crores (latest), but does not have any internal audit system. In view of the management, internal audit system is not mandatory. You are required to state the provisions related to applicability of internal audit as per the Companies Act, 2013 and comment upon the contention of the management of the company.

Ans.



- (i) **Provision:-** As per **section 138** of the Companies Act, 2013, **following class of companies** (prescribed in **Rule 13 of Companies (Accounts) Rules, 2014**) shall be required to appoint an **internal auditor or a firm of internal auditors or Body Corporate**,
- (ii) **Applicability (Rule 13):** Companies required to appoint **internal auditor / firm of internal auditors**:
- (a) **Every listed company;**
- (b) Every **UNLISTED PUBLIC COMPANY** having-
- I. **>= 25 Crores** - **Outstanding deposits** at any point of time during the preceding financial year; or
- II. **>= 50 Crores** - **Paid up share capital** during the preceding financial year; or
- III. **> 100 Crores** - **Outstanding loans / borrowings** from banks or public financial institutions at any point of time during the preceding financial year; or
- IV. **>= 200 Crores** - **Turnover** during the preceding financial year
- (c) Every **PRIVATE COMPANY** having-
- I. **> 100 Crores** - **Outstanding loans / borrowings** from banks or public financial institutions at any point of time during the preceding financial year; or
- II. **>= 200 Crores** - **Turnover** during the preceding financial year
- IFSC public company (unlisted) and IFSC Private Company Section 138 applicable with AOA provide for it.
- (ii) **In the instant case:-** MWF (P) Ltd. is a **private company** having **turnover of ₹ 200 crores** during the preceding financial year which is covered under the limit prescribed for the applicability of provisions on internal audit.
- (iii) **Conclusion:-** Hence, the **company has the statutory liability to appoint an Internal Auditor and mandatorily conduct internal audit**. Consequently, the contention of the management of the company is not tenable.

105A.

Section 138 & Rule 13– Appointment of internal auditor

ABC Pvt Ltd was involved in the business of manufacturing pipes and holdings. For financial year 2020-21 the company had the following turnover from its various segments and product:

Segment Name	Turnover	Profit
Steel / Iron Pipe Manufacturing	140 Crore	10 Crore
Holdings and Civil Structure Accessories	25 Crore	50 Lakh
PVC / Yellow Pipe Manufacturing	65 Crore	8 Crore

During Financial Year 2021-22, the company's performance was considerably lower compared to FY 2020-21 due to competition and high prices. Turnover and Profit of the company for FY 2021-22 is given hereunder:

Segment Name	Turnover	Profit
Steel / Iron Pipe Manufacturing	60 Crore	2 Crore
Holdings and Civil Structure Accessories	15 Crore	35 Lakh
PVC / Yellow Pipe Manufacturing	35 Crore	3 Crore

The company was fully financed through its own capital during both years. Kindly assess whether the company was required to appoint internal auditor as per section 138 read with Rule 13 of the Companies (Accounts) Rules, 2014 for FY 2021-22. (MTP-Nov-2022)

Ans.



(i) **Provision:- As per section 138** of the Companies Act, 2013, such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, **who shall either be:**

- A **chartered accountant** whether engaged in practice or not or
- A **cost accountant**, or
- Such **other professional** as may be decided by the Board to conduct internal audit of the functions and activities of the companies

(ii) **As per Rule 13 of the Companies (Accounts) Rules, 2014**

- The following class of companies shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate, namely:

(a) **Every listed company;**

(b) **Every UNLISTED PUBLIC COMPANY** having-

- I. **>= 25 Crores - Outstanding deposits** at any point of time during the preceding financial year; or
- II. **>= 50 Crores - Paid up share capital** during the preceding financial year; or
- III. **> 100 Crores - Outstanding loans / borrowings** from banks or public financial institutions at any point of time during the preceding financial year; or
- IV. **>= 200 Crores - Turnover** during the preceding financial year

(c) **Every PRIVATE COMPANY** having-

- I. **> 100 Crores - Outstanding loans / borrowings** from banks or public financial institutions at any point of time during the preceding financial year; or
- II. **>= 200 Crores - Turnover** during the preceding financial year

(iii) **In the current scenario:-** The company is a private limited company with having **turnover of ₹ 230 Crore in FY 2020-21** and **₹ 110 Crore in FY 2021-22**. As per Rule 13, every private company with a turnover of two hundred crore rupees or more during the preceding financial year **must appoint an internal auditor** who may be either an individual, a partnership firm or a body corporate.

(iv) **Conclusion: - Hence, ABC Pvt Ltd is required to appoint Internal Auditor for FY 2021-22.**

UNIT - 3 : DIVIDENDS, LLP & OTHER PROVISIONS

5.19 – Section 123 Declaration of Dividend

106.

Declaration of Dividend and Transfer to Reserve

While adopting the accounts for the year, the Board of Directors of Sunrise Ltd. decided to consider the

Interim Dividend declared @15% as final dividend and did not consider transfer of Profit to reserves.
 Comment. (Study Material) (Nov-2016)

Ans.



- (i) **Provision:-** Section 123(3) of the Companies Act, 2013 provides that the **Board of Directors** of a company **may declare interim dividend** during any financial year:-
- **out of the surplus** in the Statement of Profit and Loss and
 - **out of profits** of the financial year in which such interim dividend is sought to be declared.
- The amount of dividend **including** interim dividend should be **deposited in a separate bank** account within **five days** from the declaration of such dividend for the compliance of **Section 123(4)** of the said Act.
- Since interim dividend is also a dividend, companies should **provide for depreciation** as required by **Section 123** before declaration of interim dividend.
- (ii) **Section 123(1)** provides that a company may, **before the declaration of any dividend** in any financial year, **transfer such percentage of its profit** for that financial year **as it may consider appropriate to the reserves** of the company irrespective of the size of the declared dividend i.e. the company is **not mandatorily required to transfer** the profit to the reserves, it is an option available to the company to transfer such percentage.
- (iii) **In the instant case:-** The Board has decided to pay **interim dividend @15%** of the paid-up capital. **Assuming** that the company has **complied with the depreciation** requirement, the interim / final dividend can be declared without transferring such percentage of its profits as it may consider appropriate to the reserves of the company.
- (iv) **Conclusion:-** Therefore, from the **above facts and provisions**, it may be concluded that **Sunrise Ltd. is under no violation of law** i.e. the company is free to transfer any amount of its profit to the reserves, without any compulsion or restriction, before declaration of any dividend.

107.

Deferred Dividend

X Ltd. is good in profits, but suffers temporarily in liquidity. It proposes to declare dividend of 10% in annual general meeting, but the Board proposes to defer payment of dividend by two months from the date of annual general meeting by getting a resolution passed in AGM. Comment as an auditor.

Ans.



Declaration of Dividends:

- (i) **Provision:-** As per law, **dividend once declared cannot be revoked**.
- (ii) **Facts of the case:-** X Ltd. has **not declared** the dividends so far because **Board proposed to recommend declaration of 10% dividend in annual general meeting** but in **view of liquidity problem it proposes to defer** the payment of dividend **by two months** from the date of annual general meeting by getting a resolution passed in AGM.
- (iii) **Conclusion:-** As per the question **it is clear that the Board has only made a proposal** and the same has **not been passed by the shareholders**. Therefore, in such a case, **X Ltd. may declare dividends at a subsequent general meeting**.

108.

Decision to Rescind the Recommended Dividend

The Board of Directors of ACP Ltd. has recommended the dividend of 15% on paid up share capital of ₹ 450 crore for the year ended 31st March, 2022, at their meeting held on 1st of May, 2022 when the accounts for the financial year 2021-22 were approved. The Board of Directors when they met on 7th July, 2022 for the review of first quarter accounts, they realized that results were negative for the first quarter. Therefore, the Board has decided to rescind their decision to recommend dividend. The notice for AGM to be held on 14.8.2022 was sent on 15th July, 2022 without any recommendation for dividend.

At the AGM, the members asked the management how they can rescind the declaration of dividend once recommended. Comment. (May-2016, MTP-Nov-2018)

Ans.



- (i) **As per Regulation 80 of Table-F:-** Dividend is firstly **recommended by the Board**. Thereafter, the **members in the Annual General Meeting (AGM) may declare** the dividend by passing **ordinary resolution**. The members **may reduce the rate** or amount recommended by the Board, but they **cannot increase it**.
- (ii) **Provisions:-**

- **Section 123 of the Companies Act, 2013**, provides that the dividend shall be **declared or paid** by a company for any financial year **out of the profits** of the company for that year arrived at after providing for **depreciation** in prescribed manner.
 - **As per section 127 of the Act**, dividends once declared **become the liability** of the company and must be **paid within 30 days** from the date of declaration. Any failure to do so **attract a penalty** for the various persons associated with the management.
- (iii) **In the instant case:-** Board of Directors of **ACP Ltd. has recommended** the dividend in their meeting. Such dividend is **not declared in AGM**. Further, Board has decided to **rescind the decision** before the date of Annual General Meeting.
- (iv) **Conclusion:-** Thus, the dividend which is only recommended and not declared **does not attract penal provisions**. Therefore, **Board of Directors may rescind their decision** to recommend dividend.

109.

Declaration of Interim Dividend

A Company has paid interim dividend at 10% based on its half-yearly performance while at the end of the year suffered at net loss. How you will deal with the matter in your audit report as a statutory auditor?

Ans.

**(i) Provisions:-**

- **As per Section 2(35)** of Companies Act, 2013 **dividend includes interim dividend**. Therefore the **procedures** which are applicable to **final dividend** also apply to **any interim dividend**.
- **Section 123(1)** of the Companies Act, 2013 provides that **dividend cannot be declared or paid by a company** for any financial year **except:**
 - out of **profits of the company** for that year arrived at after providing for **depreciation** in accordance with the **provisions of Section 123(2)**, or
 - **out of the profits** of the company for **any previous financial year or years** arrived at after providing for **depreciation** in the manner aforementioned and **remaining undistributed**, or
 - **out of both.**

(ii) **In the given case:-** The company has **suffered a net loss** at the end of the year, which indicates that the **directors have miscalculated** the performance of the company about the **second half of the year**.

(iii) Analysis of case:-

- **In case of sufficient balance:-** If the company had a **sufficient balance in the profit and loss** account as at the **beginning of the year**, the dividend declared **could be paid out of the same**. In such a case the auditor **need not report anything**.
- **In case of insufficient balance:** If such balance was not available, the **dividend could also be paid out of the free reserves subject to fulfillment of certain conditions** as prescribed in Companies (Declaration and Payment of Dividend) Rules, 2014

(iv) **Conclusion:-** Assuming there is **no balance in the profit and loss account nor any reserves** were available, the dividend would be **clearly paid out of capital**. The auditor would **have to qualify his report mentioning the fact** of the dividend having been paid out of capital.

110.

Audit of Payment of Dividends

AARK Ltd is a large-sized listed company having annual turnover of INR 4000 Crores. The company also has a plan to get listed on New York Stock Exchange next year. The company has paid good amount of dividend during the year to its shareholders which is significantly higher as compared to earlier years. The statutory auditors would like to focus on this aspect at the time of their statutory audit. Please advise the relevant procedures that the statutory auditors should perform in respect of this area. **(RTP-May 2019)**

Ans.



The Auditor should **obtain appropriate audit evidence** as regard to **audit of payment of dividends**. The procedures include the following:

- Check that all the rules and regulations** concerning the declaration or payment of dividends **have been complied with**.
- Examine** that the **accounting and disclosure procedure** has been complied with related to the declaration and payment of dividend **like depreciation has been provided before declaration** etc.
- Scrutinize** that the dividends have been **declared or paid only out of distributable profit** i.e.

- **Profits for the current year** for which dividend is declared, or
 - **Accumulated profits** of the previous years, or
 - **Money provided** by the Central or State Government as per Section 123(1).
- (iv) **Inspect** that the dividend has been **paid only out of "free reserves"** i.e. the reserves which, as per the latest audited balance sheet of a company, are **available for distribution as dividend**
- (v) **In case of inadequacy or absence of profits** in any financial years, **verify that the rules related to such distribution** has been complied
- (vi) **Verify** that the **dividend recommended** by the Board has been **approved by the members** at the annual general meeting.
- (vii) **Verify** that the dividend has been transferred to the **separate scheduled bank a/c within 5 days from the declaration** of such dividend as required by **Section 123(4)** of the Companies Act, 2013.
- (viii) **Verify** that the dividend has been **paid within 30 days from the declaration**. If in case the dividend has **not been claimed or paid within 30 days** from the declaration, verify that the unpaid or unclaimed dividend amount has been transferred to a special account **called unpaid dividend account** as per **Section 124(1)** of the Companies Act, 2013.
- (ix) **Verify** that the company has **prepared a statement within a period of 90 days** of making any transfer of an amount to the **Unpaid Dividend Account** containing:
- The **names**,
 - Their **last known addresses** and
 - The unpaid **dividend to be paid** to each person, and
have placed it on the **website of the company**, if any, and also on **any other website** approved.
- (x) **Check the procedures that have been followed for the payment** of unclaimed dividend out of unpaid dividend account.
- (xi) In case the company has **outsourced the activity to the Service Organisation**, check that all the **compliances with laws, regulations, accounting and disclosure** related to the dividends have been made appropriately.

111.

Provision of Depreciation

ABC Limited is in the practice of maintaining consistent dividend payment over a minimum of 14%. The Financial year 2021-22 was so very bad for the Company that it was not possible for the Company to maintain the payment of consistent dividend as above. The Management, being hopeful of recovery of its performance in next year, felt that the depreciation of the year to the extent of 75% alone be charged to the Statement of Profit and Loss and the remaining 25% be kept in a separate account code in the Balance Sheet- 'Debit Balances Adjustable against Revenue account'. The Management was of the view that it would be in fair practice of accounting if the depreciation for asset is charged before the expiry of the lives of assets and the amount parked in asset code as above would unfailingly be adjusted to Revenue before the close of next financial year anyway. Analyse the issues involved and state how the Auditor should decide on this matter.

(Study Material, Nov-2018-New)

OR

R Limited has been paying dividend consistently over 15% year on year. The Financial year 2021-22 was so very bad for the Company and it was not possible for the Company to maintain the payment of consistent dividend as mentioned above. The Management, being hopeful of recovery of its performance in next year, felt that the depreciation of the year to the extent of 65% alone be charged to the Statement of Profit and Loss and the remaining 35% be kept in a separate account code in the Balance Sheet- 'Debit Balances Adjustable against Revenue account'. The Management was of the view that it would be fair practice of accounting if the depreciation for assets is charged before the expiry of the life of assets and the amount parked in asset code as above would unfailingly be adjusted to Revenue before the close of next financial year anyway. Analyse the issues involved and state how the Auditor should decide on this matter.

(MTP-Nov-2020)

Ans. (i) Provision:- Section 123(1) of the Companies Act, 2013 provides that **dividend cannot be declared**



or paid by a company for any financial year except:

- out of **profits of the company** for that year arrived at after providing for **depreciation** in accordance with the **provisions of Section 123(2)**, or
- **out of the profits** of the company for **any previous financial year or years** arrived at after providing for **depreciation** in the manner aforementioned and **remaining undistributed**, or
- **out of both.**

Further, it is the **duty of auditor** to **check** whether the **depreciation was provided** according to provision of **AS 10 / IND AS 16/Schedule II** to the Act.

- (ii) **In the instant case:-** ABC Limited is in the practice of **maintaining consistent dividend payment** over a **minimum of 14%**. Due to bad financial condition, company has not provided for dividend for the year **2017-18**. In addition to this management has also taken decision to charge **75% of the depreciation** in the statement of **Profit and Loss** whereas **25% of the depreciation** amount kept in a **separate account** code in the Balance Sheet – '**Debit Balances Adjustable against Revenue Account**'.
- (iii) **Conclusion:-** **Contention of management** that it would be in **fair practice of accounting** where the **depreciation of asset is charged before the expiry of the life of assets** and the amount parked in asset code would **unfailingly be adjusted to revenue** before the close of next financial year is **not tenable**.

Therefore, the auditor of the company should ensure the **compliance of provisions of section 123 and Schedule II**. In case the management **does not comply** with the provisions and **does not charge the 100% depreciation** the auditor of the company shall **suggest the management** for the same and **if management refuses, the auditor should qualify his report** accordingly.

112. Transfer to Reserve

As a statutory auditor, how would you deal with the following: ABC Ltd. having a paid-up capital of ₹ 1 crore earned as total net profit of ₹ 1 crore for the years 2018-19 to 2020-21. The Company did not declare any dividend nor transferred any amount to Reserves for these years. The entire profit was retained in the Profit & Loss Account. In 2021-22, the company made a profit of ₹ 20 lacs. The company also proposed in 2021-22 to declare dividend @25% of capital out of accumulated profits.

Ans.



- (i) **Provision:-** **Section 123(1)** of the Companies Act, 2013 provides that **dividend cannot be declared or paid by a company** for any financial year **except**:
- out of **profits of the company** for that year arrived at after providing for **depreciation** in accordance with the **provisions of Section 123(2)**, or
 - **out of the profits** of the company for **any previous financial year or years** arrived at after providing for **depreciation** in the manner aforementioned and **remaining undistributed**, or
 - **out of both.**
- (ii) **Section 123(1)** provides that a company may, **before the declaration of any dividend** in any financial year, **transfer such percentage of its profit** for that financial year **as it may consider appropriate to the reserves** of the company irrespective of the size of the declared dividend i.e. the company is **not mandatorily required to transfer** the profit to the reserves, it is an option available to the company to transfer such percentage.
- (iii) **In the instant case:-** Company earns a profit of ₹ 20 Lacs, but wants to declare dividend @ 25%, of capital that amounts to ₹ 25 Lacs. The deficiency of ₹ 5 Lacs may be paid out of accumulated profits.
- (iv) **Conclusion:-** Therefore, **from the above facts and provisions**, it may be concluded that **The company is well within its power and right to declare the dividend of ₹ 25 lacs for the year 2021-22.**

113. Transfer to Reserve

For the year ended on 31st March, 2022, P Ltd. proposed to pay a dividend of 25% on its equity shares and it further proposed to transfer 20% of Net profit for that year after tax to its reserves. Its auditor objected to the same stating that 10% is the maximum permissible limit to transfer to reserves.

Ans.

- (i) **Provision:-** **Section 123(1)** of the Companies Act, 2013 provides that **dividend cannot be declared**



or paid by a company for any financial year except:

- Out of **profits of the company** for that year arrived at after providing for **depreciation** in accordance with the **provisions of Section 123(2)**, or
- **Out of the profits** of the company for **any previous financial year or years** arrived at after providing for **depreciation** in the manner aforementioned and **remaining undistributed**, or
- **Out of both.**

(ii) **Section 123(1)** provides that a company may, **before the declaration of any dividend** in any financial year, **transfer such percentage of its profit** for that financial year **as it may consider appropriate to the reserves** of the company irrespective of the size of the declared dividend i.e. the company is **not mandatorily required to transfer** the profit to the reserves, it is an option available to the company to transfer such percentage.

(ii) **In the instant case:-** P Ltd. has proposed to pay a **dividend of 25%** on its equity shares and it further proposed to transfer **20% of Net profit** for that year after tax to its reserves.

(iii) **Conclusion:-** Therefore, **from the above facts and provisions**, it may be concluded that **P Ltd. is under no violation of law** i.e. the company is free to transfer any amount of its profit to the reserves, without any compulsion or restriction, before declaration of any dividend.

5.20 – Section 125 Investor Education and Protection Fund

114.

Investor Education and Protection Fund

Write short note on: Investor Education and Protection Fund.

Ans.



Section 125 of the Companies Act, 2013 empowers the Central Government to **establish a fund** known as **Investor Education and Protection Fund**. The purpose of this fund is to utilize the money for the promotion of investor awareness and protection to the interests of the investors.

The amount that are required to be credited in this fund are:

- (a) Amount given by the **C.G. by way of grants** after due appropriation made by Parliament by law in this behalf;
- (b) **Donations** given to the Fund by the C.G., State Governments, companies or any other institution;
- (c) Amount in the **Unpaid Dividend Account** of companies;
- (d) Amount in the **general revenue account** of the C.G. which had been transferred to that **account u/s 205A(5) of the Companies Act, 1956**, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and **remaining unpaid or unclaimed** on the commencement of this Act;
- (e) The amount lying in the **Investor Education and Protection Fund u/s 205C** of the Companies Act, 1956;
- (f) The **interest or other income received** out of investments made from the Fund;
- (g) The amount received under **section 38(4)**;
- (h) The **application money received** by companies for allotment of any securities and due for refund;
- (i) **Matured deposits** with companies other than banking companies;
- (j) **Matured debentures** with companies;
- (k) **Interest accrued on the amounts** referred to in clauses (h) to (j);
- (l) **Sale proceeds of fractional shares** arising out of issuance of bonus shares, merger and amalgamation for seven or more years;
- (m) **Redemption amount of preference shares** remaining unpaid or unclaimed for seven or more years; and
- (n) **Such other amount as may be prescribed;**

Provided that **no such amount referred to in clauses (h) to (j)** shall form part of the Fund **unless such amount has remained unclaimed and unpaid for a period of seven years** from the date it became due for payment.

5.21 – Limited Liability Partnership & Other Provisionse
115. Maintenance of Books of Accounts & Audit of LLP

AMc LLP is a newly set up LLP (Limited Liability Partnership). The operations of the LLP have been picking up and management is currently in the process of setting up processes and procedures in place. As per the understanding of the management of the LLP, its accounts would not be required to be audited mandatory because of its operations but still the management has decided that they would get the accounts audited voluntarily. In this regard, the management would like to understand some of the aspects which they should consider not only limited to audit but also about the maintenance of books of accounts as per the relevant laws. Please advise.

(RTP-May-2022)(RTP-May-2019)

OR

Write a short note on: Statutory provisions as to Audit of Limited Liability partnerships and also briefly describe the auditor's duty regarding audit of LLP.

Ans.



(i) Books of accounts:-

As per Section 34 of LLP Act, 2008:- An LLP shall be under obligation to **maintain annual accounts** reflecting **true and fair view** of its state of affairs.

LLPs are required to maintain books of accounts which shall contain -

- Particulars of all sums of **money received and expended** by the LLP and the matters in respect of which the **receipt and expenditure** takes place,
- A record of the **assets and liabilities** of the LLP,
- Statements of costs of **goods purchased, inventories, WIP, FGs and COGS**,
- **Any other particulars** which the partners may decide.

The books of account which a LLP is **required to keep shall be preserved for eight years** from the date on which they are made.

(ii) Audit:- As per Section 34 of LLP Act, 2008:

- **Applicability:-** The accounts of **every LLP shall be audited** in accordance with **Rule 24 of LLP Rules 2009**. Such rules, inter-alia, provides that:
 - Any LLP, whose **turnover does not exceed, in any financial year, 40 lakh rupees**, or
 - Whose **contribution does not exceed 25 lakh rupees**, is **not required to get its accounts audited**. However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rule.
- **Eligibility for auditor:-** A person **shall not be qualified** for appointment as an auditor of a LLP **unless he is a Chartered Accountant in practice**.
- **Period of Appointment:-** Auditor of a LLP shall be appointed for **each financial year** of the LLP for auditing its accounts.
- **Appointment of Auditor:** The auditor may be **appointed by the designated partners** of the LLP–
 1. At any time for the **first financial year** but before the end of first financial year,
 2. At least **30 days prior** to the end of **each financial year** (other than the first financial year),
 3. To fill the **causal vacancy** in the office of auditor,
 4. To fill the casual vacancy **caused by removal of auditor**.

The **partners may appoint** the auditors **if the designated partners have failed** to appoint them.

- **Tenure of Auditor:** Auditor shall hold office in accordance with **the terms of his or their appointment** and shall continue to hold such office **till the period the new auditors are appointed**, or they are **re-appointed**.

(iii) Auditor's duty regarding Audit of LLP

- Auditor should **obtain instructions in writing** as to the work to be performed by him.
- **The auditor should read the LLP agreement & note the following provisions**

- (a) **Nature of the business** of the LLP
- (b) Amount of **capital contributed** by each partner
- (c) **Interest** – in respect of additional capital contributed
- (d) **Duration** of partnership
- (e) **Drawings** allowed to the partners
- (f) **Salaries, commission etc** payable to partners
- (g) **Borrowing powers** of the LLP
- (h) **Rights & duties** of partners
- (i) **Method of settlement of accounts** between partners at the time of admission, retirement, admission etc.
- (j) **Any loans advanced** by the partners
- (k) **Profit sharing ratio.**
- **Auditor should report**
 - (a) Whether the records reflects **true and fair view**
 - (b) Whether he **obtains all information & explanation**
 - (c) Whether **any restriction/limitation imposed** upon him.
- If **minute book** is being maintained, auditor shall **refer it for any resolution passed** regarding the accounts.

116.

Benefits of Audit of LLP

List the benefits that arise to LLP from getting the accounts audited.

Ans.



- (a) **Detection** of errors & frauds
- (b) **Verification** of financial statements
- (c) **Resolving disputed** among the partners in relation to accounting matters.
- (d) **Arranging finance** from banks & financial institutions.
- (e) **Improved management** of the LLP
- (f) **Settlement of accounts** between partners at the time of admission, death, retirement, insolvency, insanity, etc

5.22 – Miscellaneous Provision

117.

Section 181- Donations

OST Limited, a manufacturing company donated ₹45,000 and ₹55,000 to Charitable Societies namely "Healthy World Charitable Foundation: and "Learning Kids Foundation" respectively during the financial year 2021-22. The company has not taken any approval in general meeting for such donation. The average net profits of the company for the last three years were ₹ 15 lakhs. As an auditor, what will be your comment?

(RTP-May-2016, MTP-Nov-2016)

Ans.


Donation to Charitable Institutions

- (i) **Provision: -Section 181 of the Companies Act, 2013** provides that the **Board of Directors** of a company may contribute **to bona fide charitable and other funds** with prior permission of the company in **general meeting** for such contribution **in case any amount the aggregate** of which, in **any financial year, exceed 5 per cent** of its average net profits for the three immediately preceding financial years.
- (ii) **In the instant case: -** OST Limited has **given donation of ₹ 1,00,000/- (₹ 45,000/- + ₹ 55,000/-)** to two charitable organisations. The average profit of the **last 3 years is ₹ 15 lakhs and the 5%** of this works out to **₹ 75,000**. Hence the maximum of donation could be ₹ 75,000 only. **For excess of ₹ 25,000** the company is required to **take prior permission in general meeting which is not been taken.**
- (iii) **Conclusion: -**Therefore, **by paying donations of ₹ 1,00,000** which is **more than ₹ 75,000**, the **Board has contravened the provisions of section 181** of the Companies Act, 2013. Hence, the **auditor should qualify his report accordingly.**

118.

Section 182 - Political Contribution

LN Ltd., a well reputed manufacturing public limited company has made a contribution of ₹ 2.5 lacs during the financial year ended 31.3.22 to a political party for running a school, situated in the village, where most of the workers of the company reside. It is admitted that the benefit of the school is mostly for the children of the workers of the company. The company has not made any profits in the last four years.

(RTP-May-2017, RTP-Nov-2017, RTP-May-2015)

Ans.



(i) **Provision:-** Section 182 of the Companies Act, 2013 deals with **prohibitions and restrictions regarding political contributions.**

- a **government company** or any other company which has been in **existence for less than three financial years cannot contribute** any amount directly or indirectly to any political party
- **in other cases:-** There is no restriction on making any contribution to political parties under Section 182 of the Act.

(ii) **Facts of the case:-** LN Ltd., a well reputed manufacturing public limited company has made a **contribution of ₹ 2.5 lacs** during the financial year ended **31.3.22 to a political party for running a school**, situated in the village, where most of the workers of the company reside. It is admitted that the benefit of the school is mostly for the children of the workers of the company. The company has not made any profits in the last four years.

(iii) **Conclusion:-** As per the **provision and facts given above in other cases there is no restriction** on making any contribution to political parties The **auditor need not qualify his report.**

119.

Section 183- Contribution to National Defence Fund

The Board of Directors of Polite Ltd. made an aggregate of online contribution of ₹ 37.5 lakhs to a National Defence Fund for the financial year ending on 31st March, 2015. All the contribution of the fund is used for the welfare of the members of the Armed Forces and their dependents. The average net profit of the company during the three immediately preceding financial years was ₹ 476 lakhs.

The manager of the company is of the view that the maximum contribution that can be made to a National Defence Fund is ₹ 35.7 lakhs and, therefore, the company is violating the provisions of the Companies Act, 2013. (RTP-Nov-2015)

Ans.



(i) **Provision:-** Section 183 of the Companies Act, 2013 deals with the **power of Board and other persons** to make **contributions to National Defence Fund, etc.** This section **permits** the Board and other person to make contributions to the National Defence Fund or any other Fund approved by the Central Government for the purpose of National Defence **to any extent as it thinks fit.**

(ii) **In the given case:-** The board of **Polite Ltd.** has made an aggregate of **online contribution of ₹ 37.5 lakhs** to a **National Defence Fund.** However, according to the manager of Polite Ltd., the maximum contribution that can be made to the Fund is ₹ 35.7 lakhs

In this context, it may be noted that there is **no such restriction imposed** on contributions to National Defence Fund. The board is **free to contribute such amount as it thinks fit.**

(iii) **Conclusion:-** Therefore, the **view of the manager of Polite Ltd. is not appropriate** and, thus, there is **no such violation of the provisions of section 183** of the Companies Act, 2013. The data on average net profit of the company given in question is of no relevance here.

120.

Section 52 - Application of Securities Premium Account

Pirana Ltd. issued 10,000 shares of face value of 10 each at a premium of ₹ 490 each in May, 2022. The company received the stated minimum amount in the prospectus and transferred a sum equal to the aggregate amount of the premium received on shares (i.e. ₹ 49 lakhs) to the 'Securities Premium Account'. Unfortunately, in the month of July, the godown of the company caught fire and stock worth ₹ 45 lakhs burnt to ashes. Now, the management desires to adjust the loss due to fire against the said premium account.

(RTP-Nov-2015, RTP-Nov-2018)

OR

Miranda spinning mills Ltd. is a sick company and has accumulated losses of ₹ 10 crores. The company has ₹ 12 crores in its Share Premium Account. The management desires to adjust the accumulated losses against

the share premium balance. Advise the company giving your reasons.

Ans.



- (i) **Provision:- Section 52 of the Companies Act, 2013** deals with the **application of premium received** on issue of shares.
- The said section provides that **where a company issues shares at a premium**, whether for **cash or otherwise**, a sum **equal to the aggregate amount** of the premium received on those shares shall be transferred to an account called **"Securities Premium Account"** and
 - The provisions of this Act relating to **reduction of share capital** of a company **except** as provided in this section shall apply as if the securities premium account was the paid up share capital of the company.
- (ii) **Application of Securities Premium Account:-** As per **section 52**, the securities premium account may be **applied for the following purposes**:
- towards the **issue of fully paid bonus shares**;
 - in writing off the **preliminary expenses**;
 - in **writing off the expenses** of, or the commission paid or discount allowed on, any issue of shares or debentures;
 - in providing for the **premium payable on the redemption** of any redeemable preference shares or debentures; or
 - for the **purchase of its own shares** or other securities under **section 68** of the Companies Act, 2013.
- (iii) **In the given case:-** the management of **Pirana Ltd.** desires to adjust the loss due to fire against the securities premium account.
- (iv) **Conclusion:-** In view of the **above provisions** of the Companies Act, 2013, it may be noted that the company is **not permitted to adjust its loss** against the securities premium account.

121.

Section 188 - Director's Contract with Companies

Mr. X is a whole-time director of Manthan Ltd. who has a very good relation with the Director (Operations) of the company. Consequently, he entered into a purchase contract for supply of goods of ₹5,00,000 with the company without obtaining prior consent of the Board. What is the responsibility of the auditor in relation to the Companies Act, 2013?

OR

Mr. X, Director of ABC Ltd. made a purchase contract for ₹ 10,00,000 with the company. Comment.

Ans.



- (i) **As per Section 188 of the Companies Act, 2013:**
- No company shall enter into any contract or arrangement with a related party** with respect to **sale, purchase or supply of any goods or materials**, except with the consent of the **Board of Directors** given by a resolution at a Board Meeting.
 - In the case of a company having specified **paid-up share capital**, or **transactions exceeding prescribed sum**, no contract or arrangement shall be entered into except with the prior approval of the company by a resolution.
 - It is not applicable to any transactions** entered into by the company in ordinary course of business other than transactions which are not on an arm's length price.
 - Section 189 of Companies Act 2013** requires that particulars of such contracts or arrangements shall be maintained in one or more registers.
- (ii) **As per Section 184 of the Companies Act, 2013:** Every director who is in any way **whether directly or indirectly interested in a contract or proposed contract** shall disclose the **nature of his interest** at the meeting of the Board in which such contract is discussed and shall not participate in such meeting
- (iii) **In the present case:-** one of the director of the company has entered into a contract for supply of goods worth ₹ 5,00,000 without obtaining consent of the Board. Auditor is required to determine whether the transactions is in ordinary course of business or entered on arm's length price.
- (iv) **Conclusion:-** Auditor is required to ensure compliance of **Section 184, 188 & 189 of Companies Act 2013**. In case of any violation, auditor is required to **state the fact in his audit report** accordingly.

122.

Consideration of Useful Lives Estimated by Management

M/s IT Limited has prepared the financial statements for the year 2018-19 and mentioned in the significant accounting policies that depreciation on tangible fixed assets is provided on the straight-line method over the

useful lives of the assets as estimated by the management. The company has ignored the useful lives of assets mentioned in Schedule II of the Companies Act, 2013. As statutory auditor of the company how would you deal with this? (Nov-2015)

Ans.



- (i) **As per Schedule II to the Companies Act, 2013:-** The useful life of an asset is the period over which an asset is **expected to be available for use** by an entity or the number of production or similar units expected to be obtained from the asset by the entity.
- (ii) The useful life of an asset shall not be longer than **the useful life specified in the Part C of Schedule II**. If, however, where a **company uses a different useful life** justification for the difference shall be **disclosed in the financial statement with justification** supported by **technical advice**.
- (iii) **In the given case:-** Auditor is required to **examine the appropriateness of disclosures** made in the financial statements with respect to **difference in estimated useful life**. If appropriate not given in the financial statements, **auditor need to qualify his report** stating the appropriate facts.
- (iv) **Conclusion:-** Company may use different useful lives, but **disclosure is required** in financial statements with justification supported by technical advice

123.

Failure to Detect Untrue and Incorrect Financial Position of a Company

C Ltd. declared dividend amounting to ₹ 5 lacs out of Profits for the year ended 31.3.2022. Subsequently, it was noticed that company had failed to make provisions for outstanding expenses of ₹ 7.80 lacs and closing stock was also overvalued, which was not reported by auditors of the company. Management of C Ltd. held auditors responsible for this situation. It was established that auditor was grossly negligent in conduct of his duties.

Ans.



- (i) **In the given case:-** Profit of the company has been inflated by **non-provisioning of outstanding expenses** of ₹ 7.80 lacs and by **overvaluation of closing stock** and based on such inflated profit the company has **declared and paid dividend of ₹ 5.00 lacs**. Thus it can be said that dividend has been paid out **"inflated profit"** and not out of **"real profit"**. If there is **insufficient profit** after above adjustment of outstanding expenses and correction of stock valuation and there is no past reserve, it would amount to payment of dividend out of capital.
- (ii) **Auditor's responsibility:-** It was the duty of auditor to ascertain whether the **Balance Sheet and Statement of Profit and Loss** of the company show a true and fair view of the financial position and revenue earning capacity.
For that he has to exercise proper audit procedure of substantive test (i.e. vouching and verification) and valuation of various items of Balance Sheet and Statement of Profit and Loss.
- The auditor should have checked whether all the **outstanding expenses have been provided or not** and
 - Whether **closing stock** has been **properly valued as per AS-2**.
 - If he was not satisfied, he should have **issued a qualified report or adverse report**.
- (iii) **Conclusion:-** In the instant case he has failed to do so, **he will be guilty of gross negligence** in the performance of his duty.
- (v) **Case Law** -The facts of the case are similar to the established judgement on **"The Leeds Estate Building & Investment Co. Ltd vs Shepherd (1887)"**, where, it was held, that **it was an auditor's duty to ascertain that the accounts, he certifies, are correct** and that if he fails in his duty, he is liable for damages for dividends wrongly paid by the company out of capital.

UNIT-4: CARO, 2020

5.23 – Applicability of CARO

124.

Applicability of CARO, 2020

T Pvt. Ltd.'s paid up capital & reserves are less than ₹ 50 lakhs and it has no outstanding loan exceeding ₹ 25 lakhs from any bank or financial institution. Its sales are ₹ 11 crores before deducting trade discount ₹ 10 lakhs and sales returns ₹ 95 lakhs. The services rendered by the company amounted to ₹ 10 lakhs. The company contends that reporting under Companies Auditor's Reports Order (CARO) is not applicable. Discuss. **(Study Material)**

Ans.



(i) **As per CARO-2020:-** The Companies (Auditor's Report) Order, 2020, **exempts private limited companies**, not being a **subsidiary or holding of a public company**, from its application which fulfills all the **following conditions**:

- its **paid-up capital and reserves** are **not more than ₹ 1 Cr.** as on Balance Sheet date, and
- its **total borrowings** any bank or financial institution are **not more than ₹ 1 cr.** at any point of time during the financial year; and
- its **total revenue as disclosed in Schedule III** (including revenue from discontinuing operations) **does not exceed ₹ 10 Cr.** during the financial year as per the financial statements.

(ii) **In the present case:-** Paid up capital and reserves of T Pvt. Ltd. are **less than ₹ 1 crore** and has **no loan outstanding exceeding ₹ one crore** from any bank or financial institution. Further, its **total revenue** as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) is **exceeding rupees ten crore** during the financial year as per the financial statements. (Revenue is 1100 – 10 – 95 + 10 lakhs)

(iii) **Conclusion:-** As per the provision & facts given above **CARO 2020 will be applicable to T Pvt. Ltd.**

125.

Applicability of CARO, 2020

Sanjana Private limited reports the following position as on 31st March 2022:

Paid up capital ₹55Lacs

Revaluation reserves ₹25Lacs

Capital reserves ₹26Lacs

P & L A/c (Dr. Balance) ₹8Lacs

The management of the company contends that CARO 2020 is not applicable to it.

OR

Ramya Private Limited Company reports the following position as on 31st March, 2022:

Paid up Capital ₹ 75 Lacs

Revaluation Reserve ₹ 25 Lacs

Capital Reserve ₹ 20 Lacs

Profit & Loss (Dr.) Balance ₹ 25 Lacs

The Management of the Company contends that CARO, 2020 is not applicable to it. Comment.

Ans.



(i) **As per CARO-2020:-** The Companies (Auditor's Report) Order, 2020, **exempts private limited companies**, not being a **subsidiary or holding of a public company**, from its application which fulfills all the **following conditions**:

- its **paid-up capital and reserves** are **not more than ₹ 1 Cr.** as on Balance Sheet date, and
- its **total borrowings** any bank or financial institution are **not more than ₹ 1 cr.** at any point of time during the financial year; and
- its **total revenue as disclosed in Schedule III** (including revenue from discontinuing operations) **does not exceed ₹ 10 Cr.** during the financial year as per the financial statements.

(ii) **As per Guidance Note on CARO, 2020** issued by ICAI:

- While computing paid up capital and reserves, capital reserves, revenue reserves, revaluation reserves and credit balance of Profit and loss account **are to be considered in aggregate as reduced by debit balance in the profit and loss account**, if any

(iii) **In the present case:- Paid up capital and reserves** after deducting debit balance of Profit & Loss Account amounts to ₹ 98 Lacs (55 + 25 + 26 - 8).

(iv) **Conclusion:- CARO is not applicable** as paid up capital and reserves does not exceed ₹ 1 Cr.

Note:- assuming that other conditions as to borrowings and revenue also satisfied

126.

Applicability of CARO, 2020

Janta Pvt. Ltd. is a subsidiary of a listed entity. The management of the company believes that since Janta Pvt. Ltd. is a private company and satisfies all conditions under CARO 2020, reporting under CARO is not applicable.

Ans.



(i) **As per CARO-2020:-** The Companies (Auditor's Report) Order, 2020, **exempts private limited companies**, not being a **subsidiary or holding of a public company**, from its application which fulfills certain conditions

(iii) **In the given case:-** M/s Janta Pvt. Ltd. is a subsidiary of a listed entity and its management believes that the company satisfies all conditions as required under CARO 2020.

(iv) **Conclusion:- Exemption from CARO is not available** to a private company which is a subsidiary of a public company. Hence **contention of the management** that company being a private limited company and satisfies all the conditions required for exemption, **is not correct**.

127.

Applicability of CARO, 2020

H Private Ltd (not a small company) had taken overdrafts from two banks with a limit of ₹ 40 lacs each against the security of fixed deposit it had with those banks and an unsecured overdraft from a financial institution of ₹ 36 lacs. The said loans were outstanding as at 31st March 2022. The paid-up capital and reserves of the company as at that date was ₹ 80 lacs and its revenue during the financial year ended on 31st March 2022 was ₹ 6 crores. The management of the company is of the opinion that CARO, 2020 is not applicable to it because turnover and paid up capital were within the limits prescribed and loans taken against the fixed deposits cannot be considered. The company further contended that loan limit is to be reckoned per bank or financial institution and not cumulatively. Comment.

Ans.



(i) **As per CARO-2020:-** The Companies (Auditor's Report) Order, 2020, **exempts private limited companies**, not being a **subsidiary or holding of a public company**, from its application which fulfills all the **following conditions**:

- its **paid-up capital and reserves** are **not more than ₹ 1 Cr.** as on Balance Sheet date, and
- its **total borrowings** any bank or financial institution are **not more than ₹ 1 cr.** at any point of time during the financial year; and
- its **total revenue as disclosed in Schedule III** (including revenue from discontinuing operations) **does not exceed ₹ 10 Cr.** during the financial year as per the financial statements.

(ii) **As per Guidance Note on CARO, 2020** issued by ICAI:

- While **computing total borrowings** from banks and financial statements, **loans against Fixed deposits are to be taken into consideration**.
- Further loans from banks and financial institutions are to be **taken cumulatively not individually**.

(iii) **In the present case:-** Paid-up capital is **less than ₹ 1 Cr.**, Revenue is **less than ₹ 10 Crores** but its **total borrowings** from banks and financial institution is **₹ 1.16 Cr.**

(iv) **Conclusion:- Contention of H Ltd. is not correct** as total borrowings exceeds ₹ 1 Cr., hence reporting under CARO, 2020 will be required.

128.

Applicability of CARO, 2020

Ansh Pvt. Ltd. is a private limited company, not being a subsidiary or holding company of a public company, having fully paid capital and reserves and surplus of ₹ 50 lakh. During the financial year, the company had

borrowed ₹ 80 lakh from a financial institution. It has the revenue of ₹ 8 crore from normal operations and ₹ 3 crore from discontinuing operations as disclosed In Scheduled III to the Companies Act, 2013. Will companies (Auditor's Report) Order, 2020 (CARO, 2020) be applicable to Ansh Pvt. Ltd.? **(MTP-Nov-2016)**

Ans.



- (i) **As per CARO-2020:-** The Companies (Auditor's Report) Order, 2020, **exempts private limited companies**, not being a **subsidiary or holding of a public company**, from its application which fulfills all the **following conditions**:
- its **paid-up capital and reserves** are **not more than ₹ 1 Cr.** as on Balance Sheet date, and
 - its **total borrowings** any bank or financial institution are **not more than ₹ 1 cr.** at any point of time during the financial year; and
 - its **total revenue as disclosed in Schedule III** (including revenue from discontinuing operations) **does not exceed ₹ 10 Cr.** during the financial year as per the financial statements.
- (ii) **In the present case:-** Ansh Pvt. Ltd. is a **private limited company**, not being a subsidiary or holding company of a public company. It has **paid capital and reserves and surplus** of **₹ 50 lakh** i.e. less than ₹ 1 crore, **outstanding loan of ₹ 80 lakh** i.e. less than ₹ 1 crore. However, it has **total revenue of ₹ 11 crore** (₹ 8 crore from normal operations + ₹ 3 crore from discontinuing operations) i.e. exceeding ₹ 10 crore as disclosed in Scheduled III to the Companies Act, 2013.
- (iii) **Conclusion:-** Ansh Pvt. Ltd. fails to fulfil the condition relating to **total revenue. Thus, CARO, 2020 will be applicable to it.**

129.

Applicability of CARO, 2020

Under CARO, 2020, how, as a statutory auditor would you comment on the following:

X Pvt. Ltd. is a subsidiary of a listed entity incorporated outside India the management of the company believes that since, X Pvt. Ltd. is a Private Company and satisfies all condition under the Companies (Auditor's Report) Order, 2020, reporting under CARO is not applicable.

Ans.



- (i) **As per CARO-2020:-** The Companies (Auditor's Report) Order, 2020, **exempts private limited companies**, not being a **subsidiary or holding of a public company**, from its application which fulfills all the **following conditions**:
- its **paid-up capital and reserves** are **not more than ₹ 1 Cr.** as on Balance Sheet date, and
 - its **total borrowings** any bank or financial institution are **not more than ₹ 1 cr.** at any point of time during the financial year; and
 - its **total revenue as disclosed in Schedule III** (including revenue from discontinuing operations) **does not exceed ₹ 10 Cr.** during the financial year as per the financial statements.
- (ii) **In the present case:-** X Pvt. Ltd. is a **subsidiary of a listed entity incorporated outside India**. The management of the company believes that since, **X Pvt. Ltd. is a Private Company** and satisfies all condition under the Companies (Auditor's Report) Order, 2020, reporting under CARO is not applicable.
- (iii) **Conclusion:-** Since X Pvt. Ltd. is a subsidiary of a listed entity incorporated outside India, **CARO, 2020 will not be applicable X Pvt. Ltd.**

130.

Applicability of CARO, 2020

TI NEXT Pvt. Ltd. is a holding company of C21 Ltd. Whether CARO is applicable to TI NEXT Pvt. Ltd.?

Ans.



- (i) **As per CARO-2020:-** The Companies (Auditor's Report) Order, 2020, **exempts private limited companies**, not being a **subsidiary or holding of a public company**, from its application which fulfills all the **following conditions**:
- its **paid-up capital and reserves** are **not more than ₹ 1 Cr.** as on Balance Sheet date, and
 - its **total borrowings** any bank or financial institution are **not more than ₹ 1 cr.** at any point of time during the financial year; and
 - its **total revenue as disclosed in Schedule III** (including revenue from discontinuing operations) **does not exceed ₹ 10 Cr.** during the financial year as per the financial statements.

(ii) **In the present case:-** TI NEXT Pvt. Ltd. is a **holding company of C21 Ltd.**, hence reporting under CARO is required.

(iii) **Conclusion:-** As per the facts given above **CARO is applicable on TI NEXT Pvt. Ltd.**

131.

Applicability of CARO, 2020

Astha Pvt. Ltd. has fully paid capital of ₹ 140 lakhs. During the year, the company had borrowed ₹ 15 lakhs each from a bank and a financial institution. It had the turnover (Net of GST ₹ 50 lakhs which is credited to a separate account) of ₹ 975 lakhs. Will Companies (Auditor's Report) Order, 2020 be applicable to Astha Pvt. Ltd.?

(Study Material)

Ans.



(i) **As per CARO-2020:-** The Companies (Auditor's Report) Order, 2020, **exempts private limited companies**, not being a **subsidiary or holding of a public company**, from its application which fulfills all the **following conditions**:

- its **paid-up capital and reserves** are **not more than ₹ 1 Cr.** as on Balance Sheet date, and
- its **total borrowings** any bank or financial institution are **not more than ₹ 1 cr.** at any point of time during the financial year; and
- its **total revenue as disclosed in Schedule III** (including revenue from discontinuing operations) **does not exceed ₹ 10 Cr.** during the financial year as per the financial statements.

(ii) **In the present case:-** In the case of Astha Pvt. Ltd., it has **outstanding loan of ₹ 30 lakhs** (₹ 15 lakhs + ₹ 15 lakhs) collectively from bank and financial institution **which is less than ₹ 1 crore** and **turnover is ₹ 475 lakhs i.e. also less than ₹ 10 crores** and not exceeding the limit. However, it has **paid capital of ₹ 140 lakhs i.e. more than ₹ 1 crore.**

(iii) **Conclusion:-** Thus, considering **its paid up capital which is exceeding the prescribed limit** for exemption, **CARO, 2020 will be applicable** to Astha Pvt. Ltd.

132.

Applicability of CARO, 2020

Evolution Pvt. Ltd., borrowed a sum of ₹110 lakhs from Banks & Financial Institutions, subsequently company defaulted in repayment thereof to the extent of 50%. The management of company contends that that it being a private limited company, the Companies (Auditor's Report) Order, 2020 is not applicable. You are required to state the list of companies to which CARO is not applicable and state whether it will be applicable on Evolution Pvt. Ltd.

(RTP-Nov-2017)

OR

E-Tech Pvt. Ltd., which has an aggregate outstanding loan of ₹20 lakhs from Banks and ₹30 lakhs from Financial Institutions, defaulted in repayment thereof to the extent of 50%. The company holds that it being a private limited company, the Companies (Auditor's Report) Order, 2020 is not applicable. You are required to state the list of companies to which CARO is not applicable and state how would you deal with the given situation as an auditor of the company.

(RTP-Nov-2015)

Ans.



(i) **As per CARO-2020:-** The Companies (Auditor's Report) Order, 2020, shall apply to **every company including a foreign company** as defined u/s 2(42)3 of Act, 2013.

Exception:- list of companies to which CARO is not applicable

- a **banking company** as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;
- an **insurance company** as defined under the Insurance Act, 1938;
- a **company licensed to operate under section 8** of the Companies Act;
- a **one person company** as defined in clause (62) of section 2 of the Companies Act and
- a **small company** as defined in clause (85) of section 2 of the Companies Act; and
- **private limited companies**, not being a **subsidiary or holding of a public company**, from its application which fulfills all the **following conditions**:
 - its **paid-up capital and reserves** are **not more than ₹ 1 Cr.** as on Balance Sheet date, and
 - its **total borrowings** any bank or financial institution are **not more than ₹ 1 cr.** at any point of time during the financial year; and

- its **total revenue as disclosed in Schedule III** (including revenue from discontinuing operations) **does not exceed ₹ 10 Cr.** during the financial year as per the financial statements.
- (ii) **In the present case:-** E-Tech Pvt. Ltd., which has an **aggregate outstanding loan of ₹ 50 lakhs**(20+30), From Bank & FI together which is **not exceeding the limit prescribed** under order for applicability of exemption & but defaulted in repayment thereof to the extent of 50%.
- (iii) **Conclusion:-** Contention of the E Tech Pvt. Ltd., is **correct** that **CARO, 2020 will not be applicable** on it as outstanding loan from banks and financial institution in aggregate **does not exceeds ₹ 1 Cr**

133.

Applicability of CARO, 2020

A Pvt. Ltd. is incorporated on 1st July, 2019. During the year ended 31st March, 2022, it had issued shares (fully paid up) of ₹ 80 lakhs, had borrowed ₹ 60 lakhs each from 2 financial institutions and its turnover (Net of GST ₹ 100 lakhs which is credited to a separate account) is ₹ 950 lakhs. Will Companies Auditors Report Order, 2020 (CARO) be applicable to A Pvt. Ltd.?

Ans.



- (i) **As per CARO-2020:-** The Companies (Auditor's Report) Order, 2020, **exempts private limited companies**, not being a **subsidiary or holding of a public company**, from its application which fulfills all the **following conditions**:
- its **paid-up capital and reserves** are **not more than ₹1 Cr.** as on Balance Sheet date, and
 - its **total borrowings** any bank or financial institution are **not more than ₹1 cr.** at any point of time during the financial year; and
 - its **total revenue as disclosed in Schedule III** (including revenue from discontinuing operations) **does not exceed ₹ 10 Cr.** during the financial year as per the financial statements.
- (ii) **Facts of the case**
- Paid-up capital is ₹ 80 lakhs, turnover is less than ₹ 10 Crores** but its **borrowings** from banks and financial institution is **₹ 120 Lakhs.**
 - While computing revenue, **GST will not be considered** as per the **requirements of Schedule III.**
 - While computing borrowings** from banks and financial statements, loans are to be taken **cumulatively not individually.**
- (iii) **Conclusion:-** Contention of the A Pvt. Ltd. is **not correct** as total borrowings exceeds ₹1 Cr., hence reporting under CARO, 2020 will be required.

134.

Applicability of CARO, 2020 & Defaulted in Repayment of Loans

L Private Ltd., which has outstanding loan of more than ₹ 100 lakhs from Financial Institution defaulted in repayment thereof to the extent of 50%. The company holds that it being a private limited company, the Companies Auditors Report Order (CARO) is not applicable.

Ans.



- (i) **As per CARO-2020:-** The Companies (Auditor's Report) Order, 2020, **exempts private limited companies**, not being a **subsidiary or holding of a public company**, from its application which fulfills all the **following conditions**:
- its **paid-up capital and reserves** are **not more than ₹ 1 Cr.** as on Balance Sheet date, and
 - its **total borrowings** any bank or financial institution are **not more than ₹ 1 cr.** at any point of time during the financial year; and
 - its **total revenue as disclosed in Schedule III** (including revenue from discontinuing operations) **does not exceed ₹ 10 Cr.** during the financial year as per the financial statements.
- (ii) **As per para 3 (ix) of CARO 2020** requires the auditor to comment whether the company has defaulted in repayment of loans or borrowings to a financial institution, bank, government or debenture holders? If yes, the period and amount of default to be reported.
- (iii) **Facts of the case:-** In the instant case the **total borrowings exceed ₹ 100 Lakhs** out of which **company defaults in repayment to the extent of 50%.** As **borrowings exceeds ₹ 1 Cr.** during the year, reporting under CARO is required.

- (iv) **Conclusion:-** Contention of L Pvt. Ltd. is **not correct** as borrowings from financial institution exceeds ₹ 1 Cr., and **auditor is required to report the period and amount of default** in repayment of dues under **Para 3(ix) of CARO, 2020.**

135.

Applicability of CARO, 2020

Grow More Pvt. Ltd.'s paid up Capital & Reserves are less than ₹1 cr. and it has no outstanding loan exceeding ₹ 1 Cr. from any bank or financial institution. Its sales are ₹12 crores before deducting Trade discount ₹ 20 lakhs and Sales returns ₹1.90 Cr. The services rendered by the company amounted to ₹20 lakhs. The company contends that reporting under Companies Auditor's Reports Order (CARO) is not applicable. Discuss.

Ans.



- (i) **As per CARO-2020:-** The Companies (Auditor's Report) Order, 2020, **exempts private limited companies**, not being a **subsidiary or holding of a public company**, from its application which fulfills all the **following conditions**:

- its **paid-up capital and reserves** are **not more than ₹ 1 Cr.** as on Balance Sheet date, and
- its **total borrowings** any bank or financial institution are **not more than ₹ 1 cr.** at any point of time during the financial year; and
- its **total revenue as disclosed in Schedule III** (including revenue from discontinuing operations) **does not exceed ₹ 10 Cr.** during the financial year as per the financial statements.

- (ii) **As per Schedule-III:**

- Revenue from operations shall consists of **revenue from sale of products, sale of services, and other operating revenues.**
- While computing total revenue, **trade discount** as well as **sales returns** are **required to be deducted.**

- (iii) **In the present case:-** The **turnover** of the company including value of service rendered after deducting trade discount and sales returns amounts to **₹ 10.10 crores (i.e. 12 - 0.20 - 1.90 + 0.20 crore).**

- (iv) **Conclusion:-** Contention of the company that CARO is **not applicable is not correct**, as Total Revenue exceeds ₹ 10 Cr.

136.

Applicability of CARO, 2020 - Kind of Loan to be considered

For the purpose of availing exemption from CARO what kind of loan to be considered? **(Study Material)**

Ans.



- **Borrowings from banks or financial institutions can be long term or short term** and are normally in the form of **term loans, demand loans, export credits, cash credits, overdraft facilities, bills purchased or discounted.**
- **Outstanding balances of such borrowings should be** considered as borrowing outstanding for the purpose of computing the **limit of rupees one crore. Non-fund based credit facilities**, to the extent such facilities have devolved and have been converted into fund-based credit facilities, should also be considered as outstanding borrowings.
- **The figures of outstanding borrowing would also include** the amount of bank guarantees issued by the company where such guarantee(s) has (have) been **invoked and encashed** or where, say, **a letter of credit has been devolved on the company.**
- In case of term loans, interest accrued and due is **considered as a borrowing** whereas interest accrued but not due is not considered as a borrowing. Further, in case the company enjoys a facility, say, **a cash credit facility**, whose balance is fluctuating in nature, the Order would apply to the company in case on any day during the financial year concerned, the amount outstanding in the cash credit facility exceeds ₹ one crore as per books of the company along with other borrowings.
- **The aggregate borrowings disclosed in the financial statements** would need to be considered based on **applicable generally accepted accounting principles in India (Ind AS/ AS).**

5.24 - Matters to be Reported in CARO-2020 & Disclosures in Audit Report

137.

Physical Verification of PPE

The Property, Plant and Equipment of Nasir Ltd. included ₹23.49 crores of earth removing machines of outdated technology which had been retired from active use & had been kept for disposal after knock down. These assets appeared at residual value and had been last inspected 7 years back. As an Auditor, what may be your reporting concern in view of CARO, 2020 on matters specified above?

(MTP-May-2020, MTP-May-2021)

OR

The Property, Plant and Equipment of ABC Ltd. included ₹ 25.75 crores of earth removing machines of outdated technology which had been retired from active use and had been kept for disposal after knock down. These assets appeared at residual value and had been last inspected ten years back. As an Auditor, what may be your reporting concern as regards matters specified above? (MTP-May-2018, May-2018-New)

Ans.



The auditor is required to **specifically include certain matters as per CARO, 2020 under section 143 of the Companies Act, 2013.**

(i) **As per Clause (i)(a) & (b) of Para-3 of CARO-2020:**

- Whether the company is **maintaining proper records** showing full particulars, including quantitative details and situation of **Property, Plant and Equipment**;
- Whether the company is **maintaining proper records** showing full particulars of **intangible assets**;
- 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;

(ii) **In the present case:-** Nasir Ltd. has intention to sale its **earth removing machines** of outdated technology which had been **retired from active use** and had been kept for disposal after knock down and these assets are **appearing at residual value**. Further, inspection of such machines (though it is a retired machine, however **value is ₹ 23.49 crores** which is material amount) was done **7 years back**, is not in compliance with CARO, 2020.

(iii) **Conclusion:-** Hence, this fact needs to be **disclosed in the Audit Report as per clause (i) (a) and (b) of Paragraph 3 of CARO 2020.**

138.

Title Deeds of Immovable Property in the Name of Bank

ABC Ltd. owns a piece of Land and Building situated at IP road, Mumbai which was purchased before 30 years. The title deeds for the same are deposited with State Bank of India for obtaining credit facilities by the company. As the statutory auditor of the company for the year ended 31st March, 2022, what are the audit procedures to be followed and what is the reporting under CARO 2020? (May-2017)

Ans.



The auditor is required to **specifically include certain matters as per CARO, 2020 under section 143 of the Companies Act, 2013.**

(i) **As per Clause (i)(c) of Para-3 of CARO-2020:**

- 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 **prescribed format which includes:**
 - **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)

(ii) Audit Procedure:

- The auditor should **verify the title deeds available and reconcile** the same with the PPE register.
- The **scrutiny of the title deeds** of the immovable property **may reveal a number of discrepancies** between the details in the PPE register and the details available in the title deeds.
- The auditor should **carry out a detailed examination** of the **Registered sale deed and related documents** of Land and Building. Where the title deeds of the immovable property have been **mortgaged with the Banks/ Financial Institutions**, etc., for securing the borrowings and loan raised by the company, **a confirmation about the same** should be sought from the respective institution to this effect.
- The auditor may **also consider verifying this information from the online records**, if available, of the relevant State.

(iii) In the given case:- ABC Ltd. owns a piece of land and building situated at IP road Mumbai and **title deeds for the same are deposited with State Bank of India** for obtaining credit facilities by the company.

(iv) Conclusion:- Thus, the **auditor needs to follow the audit procedure as mentioned above** and shall report on the same under **Clause (i)(c) of Paragraph 3 of the CARO, 2020**.

139.

Title Deeds of Immovable Property

The Company is in the process of selling its office along with the freehold land available at Chandigarh and is actively on the lookout for potential buyers. Whilst the same was purchased at ₹ 25 Lakhs in 2008, the current market value is ₹ 250 Lakhs, This property is pending to be registered in the name of the Company, due to certain procedural issues associated with the Registration though the Company is having a valid possession and has paid its purchase cost in full. The Company has disclosed this amount under Fixed Assets (PPE) though no disclosure of non-registration is made in the notes forming part of the accounts.

(RTP-May-2016)**Ans.**

The auditor is required to **specifically include certain matters as per CARO, 2020 under section 143 of the Companies Act, 2013. Matter to be includes as per Clause (i)(c) of Para-3 of CARO-2020:**

- 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 **prescribed format which includes:**
 - **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)

140.

Title Deeds of Immovable Property in the Name of Director)

NSP Limited has its factory building, appearing as fixed assets in its financial statements in the name of one of its director who was overlooking the manufacturing activities.

(RTP-May-2017, MTP-Nov-2017, RTP-Nov-2019)**Ans.**

The auditor is required to **specifically include certain matters as per CARO, 2020 under section 143 of the Companies Act, 2013.**

(i) As per Clause (i)(c) of Para-3 of CARO-2020:

- 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 **prescribed format which includes:**
 - **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)

(ii) Audit Procedure:

- The auditor should **verify the title deeds available and reconcile the same** with the PPE register.
- The **scrutiny of the title deeds** of the immovable property **may reveal a number of discrepancies** between the details in the PPE register and the details available in the title deeds. This **may be due to various reasons** which needs to be examined.

(iii) In the given case:- NSP Limited has its factory building, appearing as PPE in its financial statements in the name of director.

(iv) Conclusion:- Thus, the **auditor shall report on the same under Clause (i)(c) of Paragraph 3 of the CARO, 2020.**

141.

Physical Verification of PPE & SA-570 Going Concern

X Ltd. closed its manufacturing operations and sold all its manufacturing fixed assets during the financial year ended 31st March, 2022. However, it intends continue its operations as a trading company. In respect of other PPE, the company carried out a physical verification as at the end of 31st March, 2022 and found a material discrepancy to the tune of ₹ 1 lac, which was written off and is disclosed separately in the profit and loss account. Kindly incorporate the above in your audit report. **(RTP-Nov-2016)**

Ans.



The auditor is required to **specifically include certain matters as per CARO, 2020 under section 143 of the Companies Act, 2013.**

(i) As per Clause (i) (b) of Para-3 of CARO-2020:

- 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;

(ii) As per SA 570 "Going Concern":- The auditor need to perform appropriate procedures so as to ensure **appropriateness of going concern assumption**. The auditor shall **determine whether the financial statement:**

- Adequately describe the **principle event or conditions** that may **caste significant doubt** on the entity's **ability to continue as a going concern** and management's plan to deal with these events or conditions; and
- Disclose clearly that there is a **material uncertainty related to events or conditions** that may further required to specifically include certain matters as per **CARO-2020 under section 143** of the Companies Act, 2013.

(iii) In the present case:- X Ltd. had **closed its manufacturing operations** and **sold all its manufacturing Property, plant & equipment's**, but it intends continue its operations **as a trading company**.

(iv) Conclusion:- Hence **auditor is required to examine management plans for continuation** of the company and appropriateness of going concern assumption by performing appropriate procedures.

• Para in the audit report

In respect of other **Property, plant & equipment**, company has carried out **physical verification** and **found a material discrepancy** of ₹ 1 Lacs which was written off and disclosed separately in the profit and loss account. In respect of this, **auditor should incorporate the below mentioned para in his report:**

- **"As per AS-1, "Disclosure of Accounting Policies",** "the enterprise is **normally viewed as a going concern**, that is as continuing its operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations." Similar provision also exist in Ind AS 1, Presentation of FS.

- Although **the company has disposed off its manufacturing PPE** during the financial year ending on 31-03-2020, **it is still a going concern in the form of a trading company.**
- **We also report that on physical verification of other PPE**, a material discrepancy to the tune of ₹ 1 Lac was noticed and that the same has been **properly dealt with in the books of account**”.

142.

Reporting Requirement for Closing Stock

Whilst the Audit team has identified various matters, they need your advice to include the same in your audit report in view of CARO 2020:- Physical verification of only 40% of items of inventory has been conducted by the company. The balance 60% will be conducted in next year due to lack of time and resources.

(RTP-Nov-2019, Study Material)

OR

Physical verification of only 30% (in value) of items of inventory has been conducted by the company. The balance 70% will be conducted in next year due to lack of time and resources.

(Study Material)

OR

As the statutory auditor of B Ltd. to whom CARO, 2020 is applicable, how would you report in the following situations: Physical verification of only 50% (in value) of items of inventory has been conducted by the company. The balance 50% will be conducted in next year due to lack of time and resources.

(RTP-May-2016, MTP-Nov-2016)

Ans.



The auditor is required to **specifically include certain matters as per CARO, 2020 under section 143 of the Companies Act, 2013.**

(i) As per Clause (ii)(a) of Para-3 of CARO-2020:

- 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**;

(ii) Management's Responsibility:- Physical verification of inventory is the responsibility of the management which should normally verify **all material items at least once** in a year and more often in appropriate cases.

(iii) Auditor's Responsibility:- The auditor in order to satisfy himself about verification at reasonable intervals should **examine the adequacy of evidence and record of verification.**

(iv) In the given case:- Physical verification of only 40% of items of inventory has been conducted by the company. The balance 60% will be conducted in next year due to lack of time and resources.

(v) Conclusion:- The above **requirement of CARO, 2020 has not been fulfilled** as such and the auditor should **point out the specific areas** where he believes the procedure of inventory verification is not reasonable. He may **consider the impact on financial statement and report accordingly.**

143.

Reporting Requirement for Closing Stock

What are the reporting requirements for closing stock in the CARO, 2020.

Ans.



The auditor is required to **specifically include certain matters as per CARO, 2020 under section 143 of the Companies Act, 2013.**

(i) As per Clause (ii)(a) of Para-3 of CARO-2020:

- 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**;

(ii) As per Clause (ii)(b) of Para-3 of CARO-2020:

- 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;

144.

PPE Valuation, Working Capital limit & Quarterly Returns

Mr. Arjun was appointed as the engagement partner on behalf of Bhism & Co., a Chartered Accountant Firm, for conducting statutory audit assignment of Sinwar Ltd., unlisted public company.

Mr. Brijesh, one of the senior engagement team members, was given the responsibility to audit the matters as per the requirements of CARO, 2020 and in that connection, he made the following observations, that may be relevant for reporting as per the said Order:-

Sr. No.	Observations
(a)	One of the Plant and Equipment taken on a lease ('right of use' asset) by Sinwar Ltd. was revalued based on the valuation by a registered valuer and the net carrying value of Plant and Equipment in aggregate was changed from ₹ 4 crore to ₹ 4.45 crore.
(b)	During the year under consideration, cash credit limit of ₹ 5.5 crore was sanctioned to Sinwar Ltd. by DMC Bank based on the security of current assets which was reduced to ₹ 4.5 crore after 6 months. In this connection, quarterly returns have been filed by the company with the DMC bank which are in agreement with Books of Accounts.

You are required to examine the contention of Mr. Brijesh regarding reporting of the above observations in accordance with CARO 2020. (RTP-May-2022)

Ans.



Matters to be reported by Mr. Brijesh as per CARO, 2020 are as follows:

(a) According to Clause (i) (d) of Para 3 of CARO 2020

- The auditor is required to report 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 the change is 10% or more** in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;
- **In the given situation:** - Sinwar Ltd. has revalued one of the **Plant and Equipment taken on a lease** ('right of use' asset) based on the valuation by a registered valuer. The amount of change in the value of such Plant and Equipment is ₹ 45 lakh. As the net carrying value of Plant and Equipment in aggregate was changed from ₹ 4 crore to ₹ 4.45 crore i.e. change was 10% or more.
- **Conclusion:** -Thus, the auditor is required to **report the amount of change of ₹ 45 lakh** in accordance with **Clause (i)(d) of Para 3 of CARO 2020**.

(b) As per Clause (ii) (b) of Para 3 of CARO 2020

- The auditor is required to report 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**;
- **In the instant case:** - Sinwar Ltd. has been sanctioned a **cash credit limit of ₹ 5.5 crore** by DMC Bank during the year under consideration, which is exceeding the prescribed limit of ₹ 5 crore based on the security of current assets. Further, **quarterly returns have also been filed by the company with the DMC bank** in this connection which is in agreement with Books of Accounts.
- **Conclusion** - In view of the above, the **auditor is required to report the same** in accordance with **Clause (ii) (b) of Para 3 of CARO, 2020**

145.

Loan to Subsidiaries

H Ltd. granted unsecured loan of ₹1 crore @ 15% p.a. to two of its subsidiaries during the Financial Year 2021-22. Before the year end both the companies repaid the loan. The management of H Ltd. is of the opinion that since no balance is outstanding as on 31st March 2022, these loans are not required to be reported in CARO 2020. Comment and draft a suitable report.

Ans.



The auditor is required to **specifically include certain matters as per CARO, 2020 under section 143 of the Companies Act, 2013.**

- (i) **As per Clause (iii) of Para-3 of CARO-2020:** 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,-
- Whether during the year the company has provided loans or provided advances **in the nature of loans, or stood guarantee, or provided security** to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate- The **aggregate amount** during the year, **and balance outstanding** at the **balance sheet date** with respect to such loans or advances and guarantees or security **to subsidiaries, joint ventures and associates; & parties other than subsidiaries, joint ventures and associates;**
 - 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;**
 - 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;
 - If the amount is overdue, **state the total amount overdue for more than 90 days**, and whether **reasonable steps have been taken** by the company for recovery of the principal and interest;
- (ii) **As per Guidance Note on CARO, 2020:-** This clause **covers not only the loan granted** during the year but **covers all loans including opening balances**. Therefore, while examining the loans, the **auditor should also take into consideration the loan transactions** that have been **squared-up** during the year and **report such transactions** under the clause.
- (iii) **In the given case:-** H Ltd. has granted **unsecured loan** of ₹ 1 crore @15% p.a. **to two of its subsidiaries** during the Financial Year 2019-20. During the year, both the companies have **repaid its loan**
- (iv) **Conclusion:-** Therefore, the **auditor need to consider the transaction and comment as follows:**
 "The Company has granted loan of ₹ 1 Crore @ 15% p.a. to 2 of its subsidiaries covered in the register maintained under Section 189 of the Companies Act, 2013 during the Financial Year 2019-20. The maximum amount involved during the year was ₹ 1.00 crore and the year-end balance of such loans was Nil".

146.

Loan to Associate/Sister Concern

ABC Ltd. has granted a loan of ₹ 20 crores to its sister concern XYZ Ltd. at the beginning of the financial year and it remain outstanding at the year end. How would you report the fact?(RTP-Nov-2015, RTP-May-2016)

Ans.



The auditor is required to **specifically include certain matters as per CARO, 2020 under section 143 of the Companies Act, 2013.**

- (i) **As per Clause (iii) of Para-3 of CARO-2020:** 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,-
- Whether during the year the company has provided loans or provided advances **in the nature of loans, or stood guarantee, or provided security** to any other entity [not applicable to companies

whose principal business is to give loans], if so, indicate- The **aggregate amount** during the year, **and balance outstanding** at the **balance sheet date** with respect to such loans or advances and guarantees or security **to subsidiaries, joint ventures and associates; & parties other than subsidiaries, joint ventures and associates;**

- 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;**
 - 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;**
 - If the amount is overdue, **state the total amount overdue for more than 90 days**, and whether **reasonable steps have been taken** by the company for recovery of the principal and interest;
- (ii) **In the given case:-** ABC Ltd. has granted a loan of ₹ 20 crores to its associates at the beginning the Financial Year and it **remain outstanding** at year end.
- (iii) **Conclusion:-** Auditor is required to **report the matters as required under Para 3(iii) of CARO, 2020**

147.

Inter-Corporate Loan granted by the Company

As a Company auditor you noticed that there is an inter-corporate loan granted by the company. What are the reporting requirements as regard the matters concerning terms of interest on the inter-corporate loan?

(RTP-Nov-2015, RTP-May-2016, Nov-2018-Old)

Ans.


(i) As per Clause (iv) of Para-3 of CARO-2020:

- The auditor is required to report in respect of **loans, investments, guarantees, and security** whether provisions of **section 185 and 186** of the Companies Act, 2013 **have been complied with. If not, provide the details** thereof.

(ii) Compliance of section 186:

- The auditor should **obtain the details of, loans given to any person or other body corporate, guarantee given or security provided** in connection with a loan to any other body corporate or person and
- **Securities acquired of any other body corporate** by way of subscription, purchase or otherwise, made during the year as well as the outstanding balances as at the beginning of the year **in accordance with section 186.**

(iii) Auditor's procedure:- As per **Clause (iv) of CARO, 2020**, with respect to **matters concerning terms of interest** on the inter-corporate loan **the auditor is required to:**

- (i) Check whether **rate of interest is not lower than the prevailing yield** of one year, three year, five year or ten year government security closest to the tenor of the loan granted.
- (ii) Check **if the company is in default in the repayment** of any deposits accepted or in payment of interest thereon, then the **company is not allowed to give any loan** or guarantee or any security or an acquisition till such default is subsisting.

(iv) Reporting of Non-compliance:- Non-compliance with respect to interest on the inter-corporate loan **may be reported incorporating following details:-**

S.No.	Non-compliance of Section 186				Remarks, if any
		Name of Company/Party	Amount Involved	Balance as at Balance Sheet Date	
	Loan given at rate of interest lower than prescribed				
	Any other default				

148.

Cost Records

CARO, 2020 requires the auditor of the company to report whether maintenance of cost records has been specified by the Central Government under section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained. You are required to briefly explain the audit procedure to be followed by the auditor and suggest the reporting pattern.

(RTP-May-2017, MTP-Nov-2017, RTP-Nov-2018)

Ans.

**(i) As per Clause (vi) of Para-3 of CARO-2020:**

- The auditor is required to comment “whether **maintenance of cost records** has been specified by the **CG u/s 148(1)** of the Companies Act, 2013 and
- Whether such accounts and records have been so **made and maintained**”

(ii) Explanation to clause:

- The word “**made**” applies in respect of **cost accounts** (or cost statements) and the word “**maintained**” applies in respect of **cost records** relating to materials, labour, overheads, etc.

(iii) Audit Procedure & Compliance of Section-148:

- The **auditor has to report under the clause** irrespective of whether a cost audit has been ordered by the central government.
- The auditor should **obtain a written representation from the management** stating:
 - (a) **whether cost records are required to be maintained** for any product(s) or services of the company **u/s 148 of the Act**, and the Companies (Cost Records and Audit) Rules, 2014; and
 - (b) whether cost accounts and records are **being made and maintained regularly**.
- The auditor should also **obtain a list of books/records** made and maintained in this regard.
- The Order **does not require a detailed examination** of such records.
- The auditor should, therefore, **conduct a general review** of the cost records to ensure that the records as prescribed are made and maintained.
- He should, of course, **make such reference to the records** as is necessary for the purposes of his audit.

(iv) Reporting:- It is necessary that the extent of the examination made by the auditor is clearly brought out in his report. The following wording is, therefore, suggested:

- “We have **broadly reviewed the books** of account maintained by the company pursuant to the **Rules made by the Central Government** for the maintenance of cost records under **section 148** of the Act, and are of the opinion that prima facie, the prescribed accounts and records **have been made and maintained.**”

149.

Statutory Dues

XYZ Pvt. Ltd. has submitted the financial statements for the year ended 31-03-22 for audit.

The audit assistant observes and brings to your notice that the company’s records show following dues:

- Income Tax relating to Assessment Year 2019-20 ₹125 lacs – Appeal is pending before Hon’ble ITAT since 30-09-20.
- Customs duty ₹ 85 lakhs – Demand notice received on 15-09-21 but no action has been taken to pay or appeal. As an auditor, how would you bring this fact to the members?

(RTP-Nov-2016, MTP-Nov-2018, RTP-May-2019)

Ans.

**(i) As per Clause (vii) of Para-3 of CARO-2020:**

- 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;

- 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);

(ii) Responsibility of auditor:

- The auditor should also **obtain a management representation** about the disputed dues, the amounts involved and the forum where the dispute is pending.
- The auditor should **carry out necessary audit procedures** to verify the information provided by the management.

(iii) Reporting :- In the present case, there is **Income Tax demand of ₹ 125 Lacs** and the company has **gone for an appeal**, it should be brought to notice of members by reporting under **Para 3(vii)(b) of CARO, 2020** as below:

S. No.	Name of the Statute	Nature of Dues	Amount (in Lacs)	Period to which amount relates	Forum where dispute is pending
1	Income Tax Act, 1961	Income Tax	125.00	AY 2016-17	ITAT

- In reference to **demand notice received for Custom Duty of ₹ 85 Lacs on 15.09.2019** for which company has not taken any action and is **outstanding for more than 6 months**, it leads to the **irregularity** which should be **brought to notice of members** by reporting under Para 3(vii)(b) of CARO, 2020.

150.

Statutory Dues

Big and Small Ltd. received a show cause notice from central excise department intending to levy a demand of ₹25 lakhs in December 2021. The company replied to the above notice in January 2022 contending that it is not liable for the levy. No further action was initiated by the central excise department upto the finalization of the audit for the year ended on 31st March, 2022. As the auditor of the company, what is your role in this?

Ans.



(i) As per Clause (vii) of Para-3 of CARO-2020:

- Where statutory dues referred to in sub-clause (a) (**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) **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**);

(ii) In the present case -Big and Small Ltd. received a show cause notice from central excise department intending to levy a demand of **₹ 25 lakhs in December 2019**.The company replied to the above notice in **January 2020** contending that it is not liable for the levy. **No further action was initiated** by the central excise department

(iii) Conclusion:- Issuance of **show cause notice** by **Excise Department** does not **tantamount to demand** payable by the Company. In as much as the Company has replied to the notice and no further correspondence was received from the Department, **it has to be construed that there is no demand. The auditor needs not to report on this.**

151.

Statutory Dues

Comment on the following: Is the company 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 with the appropriate authorities and if not, the extent of 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.

Ans.

(i) **As per Clause (vii) of Para-3 of CARO-2020:**

- 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;

(ii) **Responsibility of auditor in compliance of Para-3 (vii):**

- Auditor is required to **comment upon regularity in depositing** undisputed statutory dues.
- Payment includes **all statutory dues payable** by the company. The amount payable will include the **interest/penalty payable** under the respective laws.
- **If the company is not regular in depositing** the undisputed statutory dues the auditor is required to state the **extent of outstanding statutory dues** as at the last day of the financial year from a period of **more than six months** from the date they became payable.
- The auditor has to **get a written representation from the management** indicating the details of disputed claims, undisputed but have remained outstanding for more than six months and a statement as to the completeness of the information provided by the management.

152.

Statutory Dues

As a Statutory Auditor, how would you deal with the following: PQR Ltd. has not deposited Provident Fund contribution of ₹ 10 lakhs with the authorities till the year-end.

Ans.

(i) **As per Clause (vii) of Para-3 of CARO-2020:**

- 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;

(ii) **As per SA 250 "Consideration of Laws and Regulations in an audit of financial statements:**

- The auditor also requires to **obtain sufficient appropriate audit evidence** regarding compliance with the provisions of **those laws and regulations** generally recognised to have a direct effect on the determination of **material amounts and disclosures** in the financial statements.
- A company is **required to deposit provident fund and Employees State Insurance** dues to **appropriate authorities within the period prescribed** under the EPF Act and the Rules governing it.

(iii) **In the present case:** -PQR Ltd. is **not regular in depositing** the provident Fund.(iv) **Conclusion:-Non-payment of PF needs to be disclosed** by the auditor in his audit report as per requirement of **Para 3(vii)(a) of CARO 2020.**

153.

Statutory Dues

During the course of Audit of M/s CT Ltd. for the financial year 2021-22, it has noticed that ₹ 2.00 lakhs of employee contribution and ₹ 9.50 lakhs of employer contribution towards employee state insurance contribution have been accounted in the books of accounts in respective heads. Whereas, it was found that ₹ 4.00 lakhs only have been deposited with ESIC department during the year ended 31st March, 2022. The Finance Manager informed that auditor that due to financial crunch they have not deposited the amount due, but will deposit the amount overdue along with interest as and when financial position improves. Comment as a statutory auditor. **(RTP-Nov-2015, May-2016, MTP-Nov-2017, MTP-May-2018, MTP-Nov-2018)**

Ans.


(i) As per Clause (vii) of Para-3 of CARO-2020:

- 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;

(ii) As per SA 250 "Consideration of Laws and Regulations in an audit of financial statements:

- The auditor also requires to **obtain sufficient appropriate audit evidence** regarding compliance with the provisions of **those laws and regulations** generally recognised to have a direct effect on the determination of **material amounts and disclosures** in the financial statements.
- A company is **required to deposit provident fund and Employees State Insurance** dues to **appropriate authorities within the period prescribed** under the EPF Act and the Rules governing it.

(iii) In the present case: -M/s CT Ltd. is **not regular in depositing** the provident Fund/ESI Contributions. The reason put forward by the Chief Accountant that the **amount has not been deposited due to financial problems** faced by the Company is no excuse for not remitting the PF/ESI Contributions.

(iv) Conclusion:-Non payment of PF/ESI contribution needs to be disclosed by the auditor in his audit report as per requirement of Para 3(vii)(a) of CARO 2020.

154.

Statutory Dues

As an auditor, how will you report under CARO in each of the following situation?

- Since more than seven months, payment of electricity bills to company established under statute is outstanding.
- The company had imported goods 5 years back and were placed in bonded warehouse till the end of financial year under Audit. The company has not paid import duty as goods have not been removed from such warehouse. The company has also not paid rent and interest expenditure payable on the amount of custom duty.
- The company has received income tax assessment order along with demand notice from Assessing Officer. The company has not paid dues payable as the same is not acceptable to the company. The company has neither preferred an appeal against the order nor an application for rectification of mistake has been made. The company has just merely represented to the Assessing Officer.
- The company in view of voluminous pay-roll data consistently follows the method of making lump sum deposit of estimated amount of ESC collections and adjust the excess or deficit against next following months' deposit and the difference of the said amount always remains insignificant. **(Jan-2021-Old)**

Ans.


(a) As per Clause: -Clause (vii) of Para 3 of CARO, 2020

- Whether the company is **regular in depositing undisputed statutory dues** including **provident fund, employees' state insurance**, income-tax, sales-tax, **Goods and Services 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**;
- 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)
- It is important to mention that **any sum, which is to be regularly paid** to an appropriate authority under a statute (whether Central, State or Local or Foreign) **applicable to the company**, should be considered as a **"statutory due"** for the purpose of this clause.

- In other words, **obligation to pay a statutory due** is created or arises **out of a statute**, rather than being based on an **independent contractual or legal relationship**.

(b) Reporting under CARO-2020

(i) Electricity dues

- **Any sum payable to an electricity company** as electricity bill **would not constitute a statutory due** despite the fact that such a company has been established **under a statute**.
- This is so because the **due has arisen on account of contract of supply of goods or services** between the parties.
- Thus, **reporting under CARO is not required** for electricity dues.

(ii) Payment of import duty

- In the given situation, **payment of import duty** where the goods had been **imported five years back** and were **placed in the bonded warehouse** and even till the end of the financial year under audit, the **goods have not been removed** from such warehouse.
- It may be noted that when the **imported goods are lodged** in a bonded warehouse, the **payment of import duty is to be made** when the goods are removed from the bonded warehouse.
- However, **till the time the importer opts to remove the goods** from the warehouse, the importer is required to **incur the rent and interest expenditure** on the amount of **customs duty payable**.
- **Since the payment of the custom duty is not due** in the current case, the question of **regularity does not arise** in respect of custom duty.
- However, it may be noted that the **interest and rent that are required to be incurred** under section 61 of the Customs Act, 1962 **would come under other statutory dues** and the auditor would have to **examine and comment upon the regularity** of the company in depositing **such interest and rent**.

(iii) Income tax demand

- In the given situation, the **company has received income tax assessment** order along with **demand notice** from Assessing Officer and company has **not paid such demand** and is also **not in agreement** for the same. Further, the company has **just merely represented** before the Assessing Officer.
- The auditor is required to check **whether time limit for filing the appeal is expired** / application for rectification of mistake or not. In case **time limit, for filing the appeal** or application for rectification of mistake, **has expired disputed** amount will become **undisputed statutory due** (as mere representation to the **concerned Department shall not be treated as a dispute**).
- Further, the auditor is **also required to ascertain whether such dues** are outstanding for a period of **more than six months** from the date they became payable.
- Accordingly, after ensuring the above, if the statutory dues are outstanding for more than six months the auditor is **required to report the same under clause (vii)(a) of CARO, 2016**.
- However, **in case the statutory dues are not outstanding** for a period of **more than six months** from the date they became payable the **auditor is not required to report** the same under CARO.

(iv) ESI Payable

- **It is possible that in a large company** where there are a **number of departments** with separate **payrolls** and where payments are spread over a number of days, the collection of **data regarding the provident fund/employees' state insurance collections** and the company's contribution thereto may take some time.
- **In order to ensure that deposit** of the dues is made in time, the company **may make lump-sum deposits** of estimated amounts and **adjust the excess or deficit** against the following month's deposit.

- If this method is consistently followed and the difference between the **total dues and the lump-sum deposit is not significant**, it need not be considered that dues have **not been regularly deposited** and **no unfavorable comment is necessary**.
- Thus, **no reporting is required for the same under CARO**.

155.

Default in Repayment of Loans or Other Borrowings

C Limited has defaulted in repayments of dues to a financial institution during the financial year 2021-22 and the same remained outstanding as at March 31, 2022. However, the Company settled the total outstanding dues including interest in April, 2022 subsequent to the year end and before completion of the audit. Discuss how you would deal with this matter and draft a suitable Auditor's Report. **(RTP-May-2018)**

OR

R Ltd as at 31st March 2022 defaulted in the repayment of interest and principal due to a financial institution. The due date was 28th February 2022. However, the defaulted amount was paid on 5th April 2022. The company's management is of the opinion that since the default is set right before the audit completion these need not be reported in CARO 2020. Comment and draft a suitable report. **(MTP-May-2016)**

Ans.


(i) As per Clause (ix) of Para-3 of CARO-2020:

(a) Whether the **company has defaulted in repayment of loans or other borrowings** or in the payment of interest thereon to any lender, **if yes, the period and the amount of default** to be reported as per the **prescribed format which includes:**

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

(b) whether the company is a **declared wilful defaulter** by any bank or financial institution or other lender;

(ii) Schedule-III to the companies Act-2013:

- As per the general instructions for preparation of Balance Sheet, provided under Schedule III to the Companies Act, 2013, **terms of repayment of term loans and other loans is required to be disclosed** in the notes to accounts.
- It also requires disclosure of **period and amount of continuing default** as on the balance sheet date in repayment of loans and interest, separately in each case.

(iii) In the given case:- Company has **defaulted in repayments of dues** to a financial institution during the **financial year 2021-22** which remain outstanding as at **March 31, 2022**. However, the **company has settled the total outstanding** dues including interest in **April, 2022** but, the dues were **outstanding as at March 31, 2022**.

(iv) Conclusion:- The auditor is **required to state in his report the default** of the company in respect of **repayment of its dues and report** as under: "The company has defaulted in repayment of principal and interest to the financial institution amounted to ₹, that **become due on 28th Feb, 2022**. However, the outstanding sum was **settled by the company on 5th April, 2022**."

156.

Default in Repayment of Loans or Other Borrowings

OK Ltd. has taken a term loan from a nationalized bank in 2017 for ₹200 lakhs repayable in five equal instalments of ₹ 40 lakhs from 31st March, 2018 onwards. It had repaid the loans due in 2018 & 2019, but defaulted in 2020, 2021 & 2022. As the auditor of OK Ltd. what is your responsibility assuming that company has sought re-schedulement of loan? **(Study Material, RTP-May-2015)**

Ans.

(i) As per Clause (ix) of Para-3 of CARO-2020:

(a) Whether the **company has defaulted in repayment of loans or other borrowings** or in the payment of interest thereon to any lender, **if yes, the period and the amount of default** to be reported as per the **prescribed format which includes:**



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

(b) whether the company is a **declared wilful defaulter** by any bank or financial institution or other lender;

(ii) Schedule-III to the companies Act-2013:

- As per the general instructions for preparation of Balance Sheet, provided under Schedule III to the Companies Act, 2013, **terms of repayment of term loans and other loans is required to be disclosed** in the notes to accounts.
- It also requires disclosure of **period and amount of continuing default** as on the balance sheet date in repayment of loans and interest, separately in each case.

(iii) As per Guidance Note on CARO-2020:- The submission of application for re-schedulement/restructuring **does not mean that no default has occurred.**

(iv) In the given case:- OK Ltd. has **defaulted in repayment of dues for three years.** Application for rescheduling will not change the default position.

(v) Conclusion:- Hence the **auditor has to report in his audit report that the Company has defaulted** in its repayment of dues to the bank to the extent of ₹ 120 lakhs.

157.

Utilisation of Term Loans

Under CARO, 2020 how, as a statutory auditor how would you comment on the following: A Term Loan was obtained from a bank for ₹ 80 lakhs for acquiring R&D equipment, out of which ₹ 15 lakhs were used to buy a car for use of the concerned director, who was overlooking the R&D activities.

(RTP-May-2016, MTP-Nov-2017, MTP-May-2018, MTP-Nov-2018, Study Material)

Ans.



(i) As per Clause (ix) of Para-3 of CARO-2020:

(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;

(ii) Auditor's Procedure:-

- Auditor should **examine the terms and conditions** of the term loan with the actual utilisation of the loans.
- If the auditor finds that the **fund has not been utilized for the purpose** for which they were obtained, the **report should state the fact.**

(iii) In the instant case:- Term loan was taken for the purpose of **purchase of Research & Development equipment**, but a part of it has been **utilized for purchase of vehicle** for the use of Director.

- Purchase of vehicle for use by Director who was in-charge of the R&D activities, **cannot be considered as purchase of Research & Development equipment.**

(iv) Conclusion:- Auditor is **required to report the fact in his audit report.** Reporting may be as follows: "In our opinion and according to the information and explanations given to us, the **term loans were applied** for the purpose for **which the loans were obtained**; Except **₹ 15 lakhs were used to buy a car** for use of the concerned director, who was overlooking the R&D activities."

158.

Utilisation of Term Loans in Temporary Investment

As a Statutory Auditor, how would you deal with the following: LM Ltd. had obtained a Term Loan of ₹ 300 lakhs from a bank for the construction of a factory. Since there was a delay in the construction activities, the said funds were temporarily invested in short term deposits. **(Study Material)**

Ans.

(i) As per Clause (ix) of Para-3 of CARO-2020:

(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;


(ii) Auditor's Procedure:-

- Auditor should **examine the terms and conditions** of the term loan with the actual utilisation of the loans.
- If the auditor finds that the **fund has not been utilized for the purpose** for which they were obtained, the **report should state the fact**.

(iii) As per Guidance Note on CARO, 2020:-

- Sometimes, **companies, may, temporarily invest the surplus funds** pending utilization for the purpose for which funds were arranged.
- In such cases, the **auditor should mention the fact that pending utilisation of the funds raised through term loans** for the stated purpose, the funds were temporarily used for the purpose other than for which they were raised but were ultimately utilised for the stated end-use.

(iv) In the instant case:- Term loan was taken for the purpose of construction of a factory, but said funds were invested in short term deposits due to delay in construction activities.

(v) Conclusion:- Auditor is required to **report the fact that the pending utilisation of term loan, the funds are temporarily invested in short term deposits**, in his audit report as per requirement of Para 3 (ix)(c) of CARO, 2020.

159.

Reporting as to Mis-utilisation of Term Loans

During the financial year ended on 31/03/2022, LM Private Limited had borrowed from a Nationalized Bank, a term loan of ₹120 lakhs consisting of ₹100 lakhs for purchase of a machinery for the new plant and ₹20 lakhs for erection expenses. As on the date of 31st March, 2022, the total of capital and free reserves of the Company was ₹ 50 lakhs and turnover for the year 2021-22 was ₹ 750 lakhs. The Bank paid ₹ 100 lakhs to the vendor of the Company for the supply of machinery on 31/12/2021. The machinery had reached the yard of the Company. On 28/02/2022, the Company had drawn the balance of loan viz. ₹20 lakhs to the credit of its current account maintained with the Bank and utilized the full amount for renovating its administrative office building. The machinery had been kept as capital stock under construction. Comment as to reporting issues, if any, that the Auditor should be concerned with for the financial year ended on 31/03/2022, in this respect. **(Nov-2018-New)**

Ans.



(i) Applicability:- Reporting under CARO, 2020 is applicable in case of a **private limited company** if the total **borrowings exceed ₹1 Cr.** from any bank or financial institution at any point of time during the financial year.

(ii) As per Clause (ix) of Para-3 of CARO-2020:

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;

(iii) In the instant case:- LM Private limited had borrowed from a Nationalized Bank, a **term loan of ₹ 120 lakhs** consisting of **₹ 100 lakhs for purchase of a machinery** for the new plant and **₹ 20 lakhs for erection expenses**. The Bank paid ₹ 100 lakhs to the vendor of the Company for the supply of machinery on 31/12/2021. The machinery had reached the yard of the Company. On 28/02/2022, the Company had drawn the balance of loan viz. **₹ 20 lakhs to the credit of its current account** maintained with the Bank and **utilized the full amount for renovating its administrative office building**.

(iv) Conclusion:- Auditor of LM Private Limited is **under obligation to report on matters covered under CARO, 2020** as total borrowings exceed RS. 1 Cr. & As per requirement of **Para 3(ix) of CARO, 2020**, auditor is required to **report the fact** that out of the **term loan obtained** for machinery purchase and erection, ₹20 Lacs was **not utilized for the purpose** of erection of machinery.

159A.

Defaulted in repayment of loans or other borrowings – CARO Reporting

Gautam Limited had borrowed ₹ 1000 crore from XYZ Bank, the principal of which was repayable after 5 years and interest was payable at the end of each year. For 4 years, Gautam Limited paid the interest amount on time. Gautam Limited defaulted the 5th instalment of interest payment and principal which was due on

June 30, 2021. On March 31, 2021, Gautam Limited approached XYZ bank and MNO bank to restructure the existing liability. As a result, the existing principal and outstanding and overdue interest was restructured into a new loan amounting to ₹ 1,100 crore. The management did not provide any disclosure for the default on the loan on the belief that the old loan ceased to exist and the new loan has maturity after 5 years. During the statutory audit for the financial year 2021-22, KP & Co. identified this transaction and obtained the relevant documents and understanding. Based on the underlying documents, it was identified that the said restructuring agreement was approved and signed on April 8, 2022, by both of the banks. As a result, on March 31, 2022, the restructuring was still not approved. In the light of the above scenario, kindly guide the statutory auditors in the reporting of this transaction. **(RTP-Nov-2022)**

Ans.



- (i) **Provision: -As per Clause 3(ix) of CARO 2020**, the auditor is required to report 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.				

- (ii) **In the given case:** - The company Gautam Limited defaulted in payment of the **principal amount of the loan due of ₹ 1000 crore on 30 June 2021** and the **interest instalment of ₹ 100 crore**. The said default continued till the end of the year and on **8 April 2022**, a restructuring agreement was signed by the banks and company for re-structuring the outstanding loan. Moreover, **no disclosure** was provided by the company with respect to the said matter.

- (iii) **Conclusion :**

- Hence the auditor is required to **report the same matter under Clause (ix) of Para 3 of CARO 2020**, i.e., whether the company has defaulted in **repayment of loans or other borrowings** or in the payment of interest thereon to any lender, if yes, then provide the details of the period and the amount of default.
- Also, the auditor needs to consider** the impact of such **non-disclosure and the non-compliance with the financial reporting framework** and accordingly the auditor needs to either **issue a qualified opinion or an adverse opinion** as per SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

160.

Fraud Reporting

As a statutory auditor, how would you report on the following under CARO: ABC Pvt. Ltd. is a manufacturer of jewellery. A senior employee of the Company informed you that the Company does not properly disclose the purity of gold used on the jewellery.

Ans.



- (i) **As per Clause (xi) of Para-3 of CARO-2020:**

- 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;
- Whether **any report under section 143(12)** 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**;
- Whether the auditor has considered **whistle-blower complaints**, if any, received during the year by the company;

- (ii) **In the present case:-** Purity of gold is **not properly disclosed** on the jewellery by the company it amounts to **defrauding the customers**. It implies that the management is **deceiving customers** to obtain an illegal advantage.

- (iii) As per SA 240 "The Auditor's responsibilities in relation to an audit of Financial Statements":- The auditor is **concerned with fraudulent acts** that cause a **material misstatement in financial statements**. Hence as long as books of account are not falsified arising out of difference in the purity of gold, i.e., actual cost of the gold and the sale price of gold, **it has no implication for the auditor**.
- (iv) **Conclusion:-** As per the facts given above in SA-240 & reporting on frauds under CARO, 2020, there is **no implication for misstatement in the financial statements**. Hence, **no reporting is necessary** for non-proper disclosure of purity of gold on the jewelry.

161.

Fraud Reporting

The Internal Auditor of the Company has identified a fraud in the recruitment of employees by the HR department wherein certain sums were alleged to have been taken as kick-back from the employees for taking them on board with the Company. After due investigation, the concerned HR Manager was sacked. The amount of such kick-backs is expected to be in the range of ₹12 Lakhs. **(MTP-May-2019, RTP-May-2019)**

Ans.



- (i) **As per Clause (xi) of Para-3 of CARO-2020:**
- 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;
 - Whether **any report under section 143(12)** 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**;
 - Whether the auditor has considered **whistle-blower complaints**, if any, received during the year by the company;
- (ii) **In the present case:-** The Internal Auditor of the Company has identified a **fraud in the recruitment of employees by the HR department** wherein certain sums were alleged to have been taken as kick-back from the employees for taking them on board with the Company. After due investigation, the concerned HR Manager was sacked. The **amount of such kick-backs is expected to be in the range of ₹ 12 Lakhs**.
- (iii) **Reporting under this clause:-** Reporting is required, as a **fraud has been identified in recruitment of employees** by the HR Department wherein **certain sums were alleged to have been taken as kick-back from the employees** of company amounting to **₹12 Lakhs. approx.**

162.

Fraud Reporting

What are the reporting requirements in the audit report under the Companies Act, 2013/CARO, 2020 for the following situations?

- A fraud has been committed against the company by an officer of the company.
- A fraud has been committed against the company by a vendor of the company.
- The company has committed a major fraud on its customer and the case is pending in the court.
- A fraud has been reported in the cost audit report but not noticed by statutory auditors in his audit.

(Study Material, Nov-2018-Old)

Ans.



- (i) **As per Clause (xi) of Para-3 of CARO-2020:**
- 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;
 - Whether **any report under section 143(12)** 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**;
 - Whether the auditor has considered **whistle-blower complaints**, if any, received during the year by the company;
- (ii) **As per Section 143(12) of Companies Act 2013:-** If an auditor of a company in the course of the performance of his duties as auditor, has **reason to believe that an offence of fraud** involving **such amount** or amounts **as may be prescribed**, is being or has been **committed in the company** by its officers or employees, **the auditor shall report the matter to the Central Government** within **such time** and in **such manner as may be prescribed**.

(iii) Rule 13 of Companies Act 2013:

- **For the above purpose**, prescribes the amount of **₹ 1 Cr. or more**.
- However, in case of a **fraud involving lesser than the specified amount**, i.e. below ₹ 1 Cr., the auditor shall **report the matter to the audit committee** constituted u/s 177 or to **the Board in other cases** within such time and in such manner as may be prescribed:

(iv) In the present case:-

- Accordingly, reporting requirements will be:

Situation	Reporting under Companies Act, 2013	Reporting under CARO, 2020
A fraud has been committed against the company by an officer of the company	Reporting required to C.G. if amount of fraud exceeds ₹1 Cr.	Nature of Fraud and amount involved need to be reported under Para 3(xi).
A fraud has been committed against the company by a vendor of the company.	No reporting required.	No reporting required.
The company has committed a major fraud on its customer and the case is pending in the court.	Effect of such fraud on financial statements need to be reported.	Nature of Fraud and amount involved need to be reported under Para 3(xi).
A fraud has been reported in the cost audit report but not noticed by statutory auditors in his audit.	Effect of such fraud on financial statements need to be reported.	Para 3(xi) requires reporting of fraud that has been noticed or reported during the year.

163.

Compliances by Nidhi Company

CARO 2020 has made several significant changes and has introduced many new reporting requirements vis-à-vis CARO 2016. In view of the above, describe the relevant clause relating to Nidhi Companies – compliance with net owned funds to deposit requirements and the relevant provisions. What audit procedures are to be adopted for verification and reporting on the same? **(Nov-2016)**

Ans.

**(i) As per Clause (xii) of Para-3 of CARO-2020:**

- Whether the Nidhi Company has complied with the **Net Owned Fund to Deposits in the ratio of 1: 20** to meet out the liability and
- Whether the Nidhi Company is **maintaining 10% unencumbered term deposits** as specified in the Nidhi Rules, 2014 to meet out the liability.
- Whether there has been any **default in payment of interest on deposits or** repayment thereof for any period and if so, the details thereof;

(ii) Audit Procedures:

- **Net Owned Funds:-** As per Rule 3(d) **Net Owned Funds** are defined as the **aggregate of paid-up equity share capital and free reserves as reduced by accumulated losses and intangible assets** appearing in the last audited balance sheet. Provided that, the amount representing the **proceeds of issue of preference shares, shall not be included** for calculating Net Owned Funds.
- **Deposits:-** A Nidhi company **can accept fixed deposits, recurring deposits and savings deposits from its members** in accordance with the directions notified by the Central Government. The aggregate of such deposits is referred to as “deposit liability”.
- **Computation & Ratio:-** The auditor should **ask the management to provide the computation of the deposit liability and net owned funds** on the basis of the requirements mentioned above. This would enable him to verify that the **ratio of deposit liability to net owned funds** is in accordance with the requirements prescribed in this regard

164.

Compliance with Section 177 and 188

In the course of audit of MM Ltd. for the financial year ended 31st March, 2022, your audit team has identified the following matter: An amount of ₹4 Lakh per month for the marketing services rendered is paid to M/s. MG Associates, a partnership firm in which Director of MM Ltd. is also a managing partner, with a profit-sharing ratio of 30%. Based on an independent assessment, the consideration paid is higher than the arm's length pricing by ₹ 1.50 Lakh per month. Whilst the transaction was accounted in the financial statements based on the amounts paid, no separate disclosure has been made in the notes forming part of the accounts. Give your comments for reporting under CARO, 2020. **(Nov-2020-New)**

OR

An amount of ₹ 3.25 Lakhs per month is paid to M/s. WE CARE Associates, a partnership firm, which is a 'related party' in accordance with the provisions of the Companies Act, 2013 for the marketing services rendered by them. Based on an independent assessment, the consideration paid is higher than the arm's length pricing by ₹ 0.25 Lakhs per month. Whilst the transaction was accounted in the financial statements based on the amounts paid, no separate disclosure has been made in the notes forming part of the accounts highlighting the same as a 'related party' transaction. **(MTP-Nov-2019)**

Ans.


(i) As per Clause (xiii) of Para-3 of CARO-2020:-

Auditor is required to report "whether **all transactions with the related parties** are in compliance with **sections 177 and 188 of Companies Act, 2013** where applicable and the details have been **disclosed in the Financial Statements etc.**, as required by the applicable accounting standards".

(ii) Analysis of case:- Reporting is required, as one of **related party transaction amounting ₹ 3.25 lakhs per month** i.e. in lieu of marketing services has been noticed of which amount **₹ 0.25 lakh per month is exceeding the arm's length price** has not been disclosed highlighting the same as related party transactions as per **AS-18/IND-AS 24**.

(iii) Conclusion:- Thus, the auditor is required to report accordingly.

165.

Compliance with Section 177 and 188

Strong Ltd. holding 60% of the equity shares in Weak Ltd. purchased goods worth ₹ 50 Lakhs from Weak Ltd. during the financial year 2021-22. The Managing Director of Strong Ltd. is of the opinion that it is normal business activity and there is no need to disclose the same in the final accounts of the Company. Comment.

Ans.


(i) As per Clause (xiii) of Para-3 of CARO-2020:

- Auditor is required to report "whether **all transactions with the related parties** are in compliance with **sections 177 and 188 of Companies Act, 2013** where applicable and the details have been **disclosed in the Financial Statements etc.**, as required by the applicable accounting standards".

(ii) As per AS 18 "Related Party Disclosure:- Parties are considered to be related **if at any time during the reporting period** one party has the ability to **control the other party** or **exercise significant influence over the other party** in making financial and/or operating decisions.

(iii) As per Section 188 of the Companies Act, 2013:- The sections also prescribes to **take the permission of the Board of Directors by resolution** at board meeting for such related party transactions.

(iv) Analysis of the case:- Related party transaction means **a transfer of resources or obligations between related parties**, regardless of **whether or not a price is charged**. Strong Ltd. is the holding company of Weak Ltd. as it holds **more than 50% of the voting power** of Weak Ltd. and thus should be treated as related parties as per AS-18.

(v) Conclusion:- In the instant case since there is related party transaction the **contention of Managing Director of Strong Ltd. is not correct**. The auditor is required to verify the **compliance of section 188 of the Companies Act** and insist to **make proper disclosure as required by AS-18** and if the management refuses, the auditor **as per SA 550 "Related Parties", should express a qualified opinion**. The auditor is also required to report under **Clause (xiii) of Para 3 of CARO, 2020 (Alternatively reference to Ind AS 24 Related Party Disclosure may be given)**

166. Compliance with Sections 177 and 188

Whilst the Audit team has identified various matters, they need your advice to include the same in your audit report in view of CARO 2020:-

- (i) The long term borrowings from the parent has no agreed terms and neither the interest nor the principal has been repaid so far. **(MTP-Dec-2021)**

Ans.**(i) As per Clause (xiii) of Para-3 of CARO-2020:**

Auditor is required to report "whether **all transactions with the related parties** are in compliance with **sections 177 and 188 of Companies Act, 2013** where applicable and the details have been **disclosed in the Financial Statements etc.**, as required by the applicable accounting standards".

- (ii) **Reporting:-** In the present case, the auditor is required to report **as per clause xiii of para 3 of CARO 2020** regarding receipt of **long term borrowing from Parent Company** which qualifies as a transaction with the related party.

167. Compliance with section 177 and 188

RNT Ltd. has entered into non-cash transactions with Mr. Ram, son of one of the directors of the company, which is an arrangement by which the RNT Ltd. is in process to acquire assets for consideration other than cash. Under CARO, 2020, as a statutory auditor, how would you report? **(RTP-Nov-2019)**

OR

RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of one of the directors of the company, which is an arrangement by which the RPS Ltd. is in process to acquire assets for consideration other than cash. Under CARO, 2020, as a statutory auditor, how would you report?

(RTP-May-2017, MTP-Nov-2017, MTP-May-2018)**Ans.****(i) As per Clause (xv) of Para-3 of CARO-2020:**

- The auditor requires to comment "whether the company has **entered into any non-cash transactions with directors or persons connected** with him and if so, whether provisions of **Section 192** of Companies Act, 2013 have been **complied with**."

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

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

- (iii) **Reporting under this clause:-** The reporting requirements under this clause are in two parts.

- The first part** requires the auditor to report on **whether the company has entered into any non-cash transactions with the directors or any persons connected** with such director/s.
- The second part** of the clause requires the auditor to **report whether the provisions of section 192 of the Act have been complied with**.

Therefore, the second part of the clause becomes reportable **only if the answer to the first part is in affirmative**.

- (iv) **Suggested paragraph on reporting:-** "According to the **information and explanations given to us**, the Company has **entered into non-cash transactions** with **one of the directors/person connected** with the director during the year, by the **acquisition of assets by assuming directly related liabilities**, which in our opinion is covered under the **provisions of Section 192 of the Act**, and for which approval has not yet been obtained in a general meeting of the Company".

168.

Registration with Reserve Bank of India

In the case of companies carrying on the business of NBFC, the auditor needs to report under CARO, 2020 whether the registration has been obtained under section 45-IA of the Reserve Bank of India Act, 1934, if required. You are required to state the brief the audit procedure to be followed while reporting under above mentioned circumstances.

(Jan-2021-Old, RTP-Nov-2017, RTP-May-2018)

OR

The RBI restrict companies from carrying on the business of NBFC, without obtaining the certificate of registration, therefore, obtaining registration under section 45-IA of the Reserve Bank of India Act, 1934 is necessary additionally, new clause has been inserted under CARO-2020 for commenting whether the registration has been obtained, if required. Being an expert in latest provisions under CARO-2020 you are required to state the brief the audit procedure and reporting to be followed under above mentioned circumstances.

(RTP-May-2017, MTP-Nov-2017, MTP-May-2019)

Ans.


(i) As per Clause (xvi) of Para-3 of CARO-2020:

- (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;

(ii) Audit Procedure:

- The auditor should **examine the transactions** of the company with **relation to the activities covered under the RBI Act and directions** related to the NBFC.
- The financial statements **should be examined to ascertain** whether company's **financial assets constitute more than 50% of total assets and income from financial assets constitute more than 50% of gross income.**
- Whether the company has **net owned funds** as required for the registration as NBFC
- Whether the company has **obtained the registration as NBFC**, if not the **reason should be sought** from the management and documented.
- The auditor **should report incorporating the following:-**
 - (i) Whether the **registration is required under section 45-IA** of the RBI Act, 1934.
 - (ii) If so, whether **it has obtained** the registration.
 - (iii) If the registration not obtained, **reasons** thereof.

169.

Registration with Reserve Bank of India

Rishabh Finance Ltd. is a Non-Banking Finance Company and was in the business of accepting public deposits and giving loans since 2017. The company was having net owned funds of ₹ 1,50,00,000/- (one crore fifty lakh) and was not having registration certificate from RBI and applied for it on 30th March 2022. The company appointed Mr. Gautam as its statutory auditors for the year 2021-22. Advise the auditor with reference to auditor procedures to be taken and reporting requirements on the same in view of CARO 2020?

(MTP-Dec-2021)

Ans.


(i) As per Clause (xvi) of Para-3 of CARO-2020:

- (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) The auditor is required to examine whether the **company is engaged in the business which attract the requirements of the registration.** The registration is required where the financing activity is a **principal business** of the company. The RBI restrict companies from carrying on the business of a non-banking financial institution without obtaining the certificate of registration.

(ii) Audit Procedure:

- The auditor should **examine the transactions** of the company with **relation to the activities covered under the RBI Act and directions** related to the NBFC.
- The financial statements **should be examined to ascertain** whether company's **financial assets** constitute **more than 50% of total assets** and **income from financial assets** constitute **more than 50% of gross income**.
- Whether the company has **net owned funds** as required for the registration as NBFC
- Whether the company has **obtained the registration as NBFC**, if not the **reason should be sought** from the management and documented.
- The auditor **should report incorporating the following:-**
 - (i) Whether the **registration is required under section 45-IA** of the RBI Act, 1934.
 - (ii) If so, whether **it has obtained** the registration.
 - (iii) If the registration not obtained, **reasons** thereof.

(iii) In the instant case: - Rishabh Finance Ltd. is a **Non Banking Finance Company** and was in the business of accepting public deposits and giving loans since 2015. The company was having **net owned funds of ₹ 1,50,00,000/- (one crore fifty lakhs)** which is less in comparison to the prescribed limit i.e. **2 crore rupees** and was also not having registration certificate from RBI (though applied for it on 30th March 2020).

(iv) Conclusion: -The auditor is required to report on the same **as per Clause (xvi) of Paragraph 3 of CARO 2020**

170.

Title Deed of Immovable Property

What documents constitute title deed of Immovable property

(Study Material)**Ans.**

Following documents constitute title deed of immovable property

- **Registered sale deed/transfer deed/ conveyance deed, etc.** of land, land & building together, etc. purchased, allotted, transferred, by any person including any government, government authority/body/agency/corporation, etc. to the company.
- **In case of leasehold land and land & building together** covered under the head PPE, the **lease agreement duly registered** with the appropriate authority

5.25 - AS/Ind-AS & Schedule III Based Questions

171.

Schedule III Based Question

The Balance Sheet of G Ltd. as at 31st March, 2022 is as under. Comment on the presentation in terms of Schedule III

Heading	Note No.	31 st March, 22	31 st March, 21
Equity & Liabilities			
Share Capital	1	XXX	XXX
Reserves & Surplus	2	0	0
Employee stock option outstanding	3	XXX	XXX
Share application money refundable	4	XXX	XXX
Non-Current Liabilities		XXX	XXX
Deferred tax liability (Arising from Indian Income Tax)	5	XXX	XXX
Current Liabilities			
Trade Payables	6	XXX	XXX
Total Assets		XXXX	XXXX
Non-Current Assets			
Fixed Assets-Tangible	7	XXX	XXX
CWIP (including capital advances)	8	XXX	XXX
Current Assets			

Trade Receivables	9	XXX	XXX
Deferred Tax Asset (Arising from Indian Income Tax)	10	XXX	XXX
Debit balance of Statement of Profit and Loss		XXX	XXX
Total		XXXX	XXXX

(Study Material, RTP-May-2020)

Ans.



(a) Following Errors are noticed in presentation as per Schedule III:

- (i) **Share Capital and Reserve & Surplus** are to be reflected under the heading “**Shareholders’ funds**”, which is not shown while preparing the balance sheet. Although it is a part of Equity and Liabilities yet it must be shown under head “shareholders’ funds”. The heading “Shareholders’ funds” is missing in the balance sheet given in the question.
- (ii) **Reserve & Surplus is showing zero balance, which is not correct** in the given case. Debit balance of statement of Profit & Loss should be shown as a negative figure under the head ‘Surplus’. The balance of ‘Reserves and Surplus’, after adjusting negative balance of surplus shall be shown under the head ‘Reserves and Surplus’ even if the resulting figure is in the negative.
- (iii) Schedule III requires that **Employee Stock Option outstanding** should be disclosed under the heading “**Reserves and Surplus**”.
- (iv) **Share application money refundable** shall be shown under the sub-heading “**Other Current Liabilities**”. As this is refundable and not pending for allotment, hence it is not a part of equity.
- (v) **Deferred Tax Liability** has been correctly shown under **Non-Current Liabilities**. But Deferred tax assets and deferred tax liabilities, **both, cannot be shown in balance sheet** because only the net balance of Deferred Tax Liability or Asset is to be shown if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.
- (vi) Under the main heading of Non-Current Assets, **Property, Plant and Equipment and Intangible assets are further classified as under:**
 - (a) Property, Plant and Equipment
 - (b) Intangible assets
 - (c) Capital work in Progress
 - (d) Intangible assets under development.

Keeping in view the above, the CWIP shall be shown under Property, Plant and Equipment and Intangible assets as Capital Work in Progress. The amount of Capital advances included in CWIP shall be disclosed under the sub-heading “Long term loans and advances” under the heading Non-Current Assets.

Subsequent to the notification of Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, the words “Fixed assets” shall be substituted with the words “Property, Plant and Equipment”. Further, subsequent to notification dated 24th March, 2021, under the heading –II Assets, under sub-heading –Non-current assets, after the words –Property, Plant and Equipment, the words – and Intangible assets are inserted and for the words –Tangible Assets, the words –Property, Plant and Equipment are substituted.

- (e) **Deferred Tax Asset** shall be shown under **Non-Current Asset**. It should be the net balance of Deferred Tax Asset after adjusting the balance of deferred tax liability if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.
- (f) Subsequent to the **notification of Ministry of Corporate Affairs** dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, **Trade Payables should be disclosed as follows:-**
 - (A) Total outstanding dues of **micro enterprises and small enterprises**; and
 - (B) Total outstanding dues of **creditors other than micro enterprises and small enterprises.**”

- (b) **Following Errors have been noticed in presentation, as per Division II of Schedule III:**
- (i) Balance sheet should begin with **Assets on top** and then, **Equity and Liabilities** should be presented.
 - (ii) Under the **main heading of Non-Current Assets**, following sub-headings are provided in the format as per **Division II: (a)** Property, plant and equipment **(b)** Capital work-in-progress In view of the above, the Fixed asset- Tangible should be presented as "Property, Plant and Equipment". CWIP should be presented as "Capital Work in Progress". Under Ind AS Schedule III, 'Capital Advances' are not to be classified under 'Capital Work in Progress', since they are specifically to be disclosed under 'Other non-current assets'.
 - (iii) **Deferred Tax Asset** should be presented under "Non-Current Asset". It should be the net balance of Deferred Tax Asset, after adjusting the balance of deferred tax liability, if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.
 - (iv) **Trade receivables** shall be presented under sub-heading "Financial assets" under heading "Current Assets".
 - (v) **Share capital and Reserves & Surplus** need to be presented under the heading "Equity". The heading Equity is missing in the balance sheet given in the question. Reserves & Surplus would form part of sub-heading "Other Equity" in the notes to accounts and such balance of "Other Equity" would be presented on face of balance sheet under the heading "Equity".
 - (vi) **Debit balance of statement of profit and loss** would be presented as negative balance under "Retained Earnings" in sub-heading "Other Equity" in the notes to accounts. Such balance of "Other Equity" even if negative, would be presented on face of balance sheet under the heading "Equity".
 - (vii) **Division II of Schedule III** requires that Employee Stock Option outstanding should be disclosed under the sub-heading "Other Equity" in the notes to accounts which should be presented on face of balance sheet under the heading "Equity".
 - (viii) **Share application money refundable** should be presented under the sub-subheading "Other Financial Liabilities" under the sub-heading "Financial Liability". As this is refundable and not pending for allotment, hence, it should not form part of equity.
 - (ix) **Deferred Tax Liability** has been correctly presented under "Non-Current Liabilities". But Deferred tax assets and deferred tax liabilities, both, cannot be presented in balance sheet since only the net balance of Deferred Tax Liability or Asset is to be disclosed if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.
 - (x) **Trade payables** should be presented under sub-heading "Financial liabilities" under the heading "Current liabilities". Subsequent to notification by Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, Trade Payables should be disclosed as follows:
 - (A) Total outstanding dues of micro enterprises and small enterprises; and
 - (B) Total outstanding dues of creditors other than micro enterprises and small enterprises.

172. Schedule III Based Question

Comment on the following with reference to Schedule III to the Companies Act, 2013

- (i) A company has disclosed performance guarantee and counter guarantees as Contingent Liabilities.
- (ii) A company has clubbed all other expenses under the head 'Other Expenses' on the basis of 1 percent of total revenue or ₹ 5,000 whichever is higher.
- (iii) A company has shown Deferred Tax Liability under Non-Current Liabilities and Deferred tax assets under Non-Current Asset in balance sheet.

(MTP-May-2020)

- Ans.**
- (i) **A contingent liability in respect of guarantees** arises when a **company issues guarantees to another person on behalf of a third party** e.g. when it undertakes to guarantee **the loan given to a subsidiary** or to another company or gives a guarantee that another company will perform its contractual obligations.



However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to **show such items as contingent liabilities in the Balance sheet**. For various reasons, it is customary for guarantees to be issued by Bankers **e.g. for payment of insurance premia**, deferred payments to foreign suppliers, letters of credit, etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter guarantee" is not really a guarantee at all, but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premia when demanded or to make deferred payments when due. Hence, such performance guarantees and counter-guarantees should not be disclosed as contingent liabilities.

- (ii) **All other expenses** not classified under other heads will be classified under "**Other Expenses**". For this purpose, any item of expenditure which exceeds **one percent of the revenue** from operations or **₹ 1,00,000 whichever is higher**, needs to be disclosed separately. The given treatment in the scenario is not in order.
- (iii) **Deferred Tax Liability** should be shown under **Non-Current Liabilities**. Deferred Tax Asset shall be shown under **Non-Current Asset**. But Deferred tax assets and deferred tax liabilities, **both, cannot be shown in balance sheet** because only the net balance of Deferred Tax Liability or Asset is to be shown. Thus, DTA and DTL shown separately in the balance sheet by the company is not correct.

173.

Disclosure Compliances - Division II of Schedule III

The financial statements of MP Ltd. as on March 31st, 2022 are to be prepared under Division II of Schedule III to the Companies Act, 2013. Comment on the disclosure compliances for MP Ltd. from the following information in the financial statements which are required to be drawn up in compliance with Ind AS.

- (i) Property, Plant and Equipment include ₹ 2.50 crore for a boiler-plant under construction.
- (ii) Cash and cash equivalents include ₹ 1.25 crore deposited with a nationalized bank on 31st March, 2022 for 18 months. It is shown under current assets.
- (iii) Non-current assets include under caption "Biological assets other than bearer Plants" a sum of ₹ 1.50 crore being cost of cultivation for bringing to yield level, the cashewnut trees whose yield period, according to estimate shall not be less than 10 years. **(Study Material)**

Ans.



- (i) **Disclosure of Boiler Plant under Construction:** Boiler plant under construction should be shown under the heading '**Capital Work in Progress**' instead of Property Plant and Equipment. **Thus, inclusion of value of boiler plant under construction in Property Plant and Equipment is not in order.**
- (ii) **Disclosure of Cash and Cash Equivalents deposited with Nationalised Bank:** Bank deposits with **more than 12 months** maturity shall be disclosed under '**Other financial assets**'. **Therefore, disclosure of deposits rupees 1.25 crores** in a nationalised bank for 18 months as Cash and Cash Equivalents is not in order as per Division II of Schedule III.
- (iii) **Disclosure of Cost of Cultivation for bringing to yield level the Cashewnut trees:** Cost of 1.5 crore rupees for Cultivation for bringing to yield level, the **cashewnut trees** whose yield period is **more than one period** will form part of '**Bearer Plant**'. Hence it will not be considered as '**Biological Assets** other than bearer plant'. **Therefore, it should be shown under the heading 'Property Plant and Equipment' as Bearer Plant as per Division II of Schedule III.**

174.

Division II of Schedule III – Compliance

Comment on the disclosure compliances from the following information in respect of the financial statements of PP Ltd. which have to be drawn up in compliance with Ind AS, under Division II of Schedule III to the Companies Act, 2013.

- (i) Insurance claims receivable is classified as Non-current Trade Receivables.
- (ii) Foreign exchange differences relating to foreign currency borrowings to the extent not capitalised in accordance with Ind AS 23 is disclosed under other expenses.
- (iii) Interest on shortfall in payment of advance income-tax is clubbed with, the current tax disclosed on the face of the statement to profit and loss account.
- (iv) Share based payment to employees in accordance with Ind AS 102 are disclosed under Finance cost.
- (v) Expenditure on CSR activities has been disclosed in the notes to the cash flow, statement **(Jan-2021-Old)**

Ans.


Disclosure compliances in financial statements of PP Ltd.
(i) Insurance claims receivable

- It should be classified as "**other financial assets**" and each such item should be **disclosed nature-wise**.
- Thus, disclosure of insurance claims receivable by the company under **Non-current Trade Receivable is not in compliance** with Division II of Schedule III of the Companies Act, 2013.

(ii) Foreign exchange differences

- Foreign exchange differences relating to **foreign currency borrowings** to the extent **not capitalized** in accordance with **Ind AS 23** can be presented under the head **finance costs**.
- Thus, disclosure of **foreign exchange difference** relating to foreign currency borrowing to the extent not capitalised under other expenses is **not in compliance with Division II of Schedule III** of the Companies Act, 2013.

(iii) Interest on tax

- **Any interest on shortfall** in payment of **advance income-tax** is in the nature of **finance cost** and hence **should not be clubbed with the Current tax**.
- The same should be classified as **Interest expense** under finance costs.
- However, **such amount should be separately disclosed**.
- Thus, **disclosure of interest of shortfall** by the company is **not in compliance** with Division II of Schedule III of the Companies Act, 2013.

(iv) Share based payment

- Share based payment to employees in **accordance with Ind AS 102** should be disclosed under the head **Employee Benefits Expense**.
- Therefore, **disclosure of share based payment to employees** under Finance Cost is **not in compliance** with Division II of Schedule III of the Companies Act, 2013.

(v) Expenditure on CSR

- Expenditure incurred on **corporate social responsibility** activities it is recommended that all expenditure on CSR activities, **that qualify to be recognised as expense** should be recognised as a separate line item as '**CSR expenditure**' in the **statement of profit and loss**.
- Further, **the relevant note should disclose** the break-up of **various heads** of expenses included in the line item '**CSR expenditure**'.
- Thus, **disclosure of expenditure** on CSR Activities in notes to the cash flow statement is **not in compliance** with Division II of Schedule III of the Companies Act, 2013

175.

Treatment of Leave Encashment - AS 15

Z Ltd. changed its employee remuneration policy from 1st April, 2021 to provide for 12% contribution to provident fund on leave encashment also. As per the leave encashment policy, the employees can either utilize or encash it. As at 31st March, 22, the company obtained an actuarial valuation for leave encashment liability. However, it did not provide for 12% PF contribution on it. The auditor of the company wants it to be provided but the management replied that as and when the employees availed leave encashment, the provident fund contribution was made. The company further contends that this is the correct treatment as it is not sure whether the employees will avail leave encashment or utilize it. Comment.

(Study Material)(Nov-2020-Old)

Ans.



- (i) As per Accounting standard:-** As per Para 11 of **AS-15 on "Employee Benefits"**, issued by the Institute of Chartered Accountants of India, an enterprise should **recognize the expected cost of short-term employee benefits** in the form of **compensated absences** in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences.
- (ii) Analysis of the case:-** Since the company **obtained actuarial valuation for leave encashment**, it is obvious that the **compensated absences are accumulating in nature**. An enterprise should measure

the expected cost of accumulating compensated absences **as the additional amount** that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

- (iii) **Conclusion:-** Here, Z Ltd. will accumulate the amount of leave encashment benefits as it is the liability of the company to provide 12% PF on amount of leave encashment. Hence the **contention of the auditor is correct** that **full provision should be provided by the company.**

176.

General Instructions for Preparation of Balance Sheet

MG Pvt. Ltd. seeks your advice while preparing the financial statements i.e. the general instructions to be followed while preparing Balance Sheet under Companies Act, 2013 in respect of current assets and liabilities **(Study Material)**

Ans.



- (i) **General Instruction in respect of Current Assets:** An asset shall be **classified as current when it satisfies any of the following criteria-**
- (1) it is **expected to be realized** in, or is intended for sale or consumption in, the company's **normal operating cycle**;
 - (2) it is **held primarily** for the purpose of being **traded**;
 - (3) it is expected to be **realized within twelve months** after the reporting date; or
 - (4) **it is cash or cash equivalent unless** it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.
- (ii) **General Instruction in respect of Current Liabilities:** A liability shall be **classified as current when it satisfies any of the following criteria-**
- (1) it is **expected to be settled** in the company's **normal operating cycle**;
 - (2) it is **held primarily** for the purpose of being **traded**;
 - (3) it is due to be **settled within twelve months** after the reporting date; or
 - (4) the company **does not have an unconditional right** to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

177.

Non-Provisions for Proposed Dividends

As a statutory auditor of the company, comment on the following: For the year ended 31st March 2022, the financial statements of A (Pvt) Ltd. were adopted on 30th April, 2022. At this meeting, the directors proposed a dividend for the year 2021-22 of 25% on the equity share capital amounting to ₹ 10 Lacs. No entry was passed for the proposed dividend in the books of the company, since in the view of the directors the same was not required as per Schedule III.

Ans.



- (i) **As per Schedule-III (and Ind AS 1) :-** It requires **disclosure of the amount of dividend proposed** to be distributed to equity and preference shareholders **for the period and the related amount** per share to be disclosed separately. It also requires **separate disclosure** of the arrears of **fixed cumulative dividends** on preference shares.
- (ii) **As per AS-4, "Contingencies and Events Occurring after the Balance Sheet Date", and Ind AS 10 Events After the Reporting Period :-** There are events which they **take place after the balance sheet date**, are sometimes reflected in the financial statements **because of statutory requirements** or because of their **special nature**. Ind AS 10 also requires disclosure of significant non-adjusting events. **For example**, if dividends are declared after the balance sheet date but before the financial statements are approved for issue, the dividends are not recognised as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes.
- (iii) **In the present case:-** Directors proposed a dividend for the year 2019-20 of 25% on the equity share capital amounting to ₹ 10 Lacs but no entry was passed for proposed dividend.
- (iv) **Conclusion:-** **Contention of the management not to provide dividend is correct**

178.

General Instructions for Preparation of FSs

Mr. Khanna has been appointed as statutory auditor of RST Ltd. for the financial year ended 31st March, 2021. The financial statements of RST Ltd. are to be drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015. The Chief financial officer is of the view that the disclosure requirements specified under Division II of Schedule III of the Companies Act, 2013 are complete and no other additional disclosures shall be made in the Notes or by way of additional statements. Advise on the General instructions to be considered by RST Ltd. while preparing its financial statements. **(Dec-2021-New)**

Ans.

**General Instructions for Preparation of FS of a Company required to comply with Ind-AS:**

- Every company to which **Indian Accounting Standards apply**, shall prepare its **financial statements** in accordance with this **Schedule** or **with such modification** as may be required under certain circumstances.
- Where **compliance with the requirements of the Act** including **Indian Accounting Standards** (except the option of **presenting assets and liabilities in the order of liquidity** as provided by the relevant Ind AS) as applicable to the companies require any **change in treatment or disclosure** including addition, amendment substitution or deletion in the head or sub-head or any changes inter se, in the financial statements or statements forming part thereof, the same shall be made and the requirements under this Schedule shall stand modified accordingly.
- The **disclosure requirements** specified in this Schedule are **in addition to and not in substitution** of the disclosure requirements specified in the Indian Accounting Standards. **Additional disclosures** specified in the Indian Accounting Standards shall be made in the **Notes or by way of additional statement or statements** unless required to be disclosed on the face of the Financial Statements. **Similarly**, all other disclosures as required by the **Companies Act, 2013** shall be made in the Notes in addition to the requirements set out in this Schedule.
- Notes shall contain information** in addition to that presented in the Financial Statements and shall provide where required-
 - narrative description** or disaggregation of items recognised in those statements; and
 - information** about items that do not qualify for recognition in those statements.
 - Each item on the face of the Balance Sheet, Statement of Changes in Equity and Statement of Profit and Loss** shall be **cross-referenced** to any related information in the Notes. In preparing the Financial Statements including the Notes, a balance shall be maintained between **providing excessive detail that may not assist users** of Financial Statements and not providing important information as a result of too much aggregation.
- Financial Statements **shall contain the corresponding amounts** (comparatives) **for the immediately preceding reporting period** for all items shown in the Financial Statement **including Notes** except in the case of first Financial Statements laid before the company after incorporation.
- Financial Statements shall disclose all 'material' items**, i.e. the items if they could. **Individually or collectively, influence the economic decisions** that users make on the basis of the financial statements. Materiality depends on the size or nature of the item or a combination of both, to be judged in the particular circumstances.
- Where **any Act or Regulation requires specific disclosure** to be made in the standalone financial statement of a company, the said disclosure **shall be made in addition** to those required under this Schedule.

178A.

Division II of Schedule III – Disclosure

The Balance Sheet Extract of Siddha Limited, required to prepare financial statement under Ind-AS, as at 31st March, 2022 is as under. Comment on the presentation in terms of Division II of Schedule III to the Companies Act, 2013.

Particulars	As at 31st March, 2022	As at 31st March, 2021
<u>Property Plant and Equipment</u>		
Trademark	XXXX	XXXX
<u>Other Non-current Assets</u>		
Bank deposit with more than 12 months maturity	XXXX	XXXX
<u>Equity</u>		
Share Options Outstanding Account	XXXX	XXXX

Other Current Liabilities

Application money received for allotment of securities to the extent refundable and interest accrued thereon.

xxxx

xxxx

(RTP-Nov-2022)

Ans.



Following Errors have been noticed in presentation, as per Division II of Schedule III:

- (i) **"Trademark"** is not to be classified under **"Property Plant and Equipment"** since they are specifically to be disclosed under **"Other Intangible Assets"** as per Division II of Schedule III.
- (ii) **"Bank deposit** with more than 12 months maturity" is not to be classified under **"Other Non-current Assets"** since they are specifically to be disclosed under **"Other Financial Assets"** as per Division II of Schedule III.
- (iii) **"Share Option Outstanding Accounts"** is not to be classified under **"Equity"**, since it has to be disclosed under **"Other Equity"** as per Division II of Schedule III.
- (iv) **Interest accrued** thereon" is not to be classified under **"Other non-current assets"**, since they are specifically to be disclosed under the head **"Other Financial Liabilities"** as per Division II of Schedule III.

Notes



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