08
Chapter

CARO 2016

Q.1	**In the course of audit of MM Ltd. for the financial year ended 31st March, 2020, your audit team has identified the following matter:** **All 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 2016. [Nov. 20 – New Syllabus (4Marks)]**
	Ans.: Reporting of Related Party Transactions under CARO: • Clause (xiii) of Para 3 of CARO, 2016, requires the auditor 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. • Therefore the duty of the auditor, under this clause is to report (i) Whether all transactions with the related parties are in compliance with section 177 and 188 of the Companies Act,2013: (ii) Whether related party disclosures as required by relevant Accounting Standards (AS 18, as may be applicable) are disclosed in the financial statements. • In the given case, MG Associates is a related party and also rendering marketing services to MM Ltd. in return of Consideration of ₹ 4 Lakhs which is related party transaction. No separate disclosure has been made in the notes to accounts in this context, which was required to be made. In view of above, Auditor shall report as under: 1. Nature of the related party relationship and the underlying transaction: MG Associates is a partnership firm in which Director of MM Ltd is also a managing partner, with a profit sharing ratio of 30 %. Payment of ₹ 4 Lakhs to MG Associates is a related party transaction. 2. Amount involved is consideration for the Marketing services rendered by MG Associates (₹ 4 Lakhs p.m.) is higher than the arm's length pricing by ₹ 1.50 Lakh p.m. (₹ 18 Lakhs p.a.)
Q.2	**As an auditor, how will you report under CARO in each of the following situation?** **(i) Since more than seven months, payment of electricity bills to company established under statue is outstanding.** **(ii) 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.**

(iii) 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 appeal against the order nor an application for rectification of mistake has been made. The company has just merely represented to the Assessing Officer.

(iv) The company in view of voluminous pay-roll data consistently follows the method of making lump sum deposit of estimated amount of ESI collections and adjust the excess or deficit against next following months' deposit and the difference of the said amount always remains insignificant. [Jan. 21 – Old Syllabus (5 Marks)]

Ans.: Reporting under CARO:

Clause (vii)(a) of Para 3 of CARO, 2016 requires the auditor to state in his report whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, services 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 6 months from the date they became payable, shall be indicated;

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.

Conclusion: Based on the above stated provisions, following conclusions may be drawn:

(i) Any sum payable to an electricity company as electricity bill would not constitute a statutory due as dues 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) In case of imported goods placed 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.

Interest and rent that are required to be incurred u/s 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) In relation to income tax assessment order received by the company along with demand notice, the auditor is required to check whether time limit for filing the appeal or application for rectification of mistake has expired or not. In case such time limit has expired, disputed amount will become undisputed statutory due (as mere representation to the concerned Department shall not be treated as a dispute).

Auditor is also required to ascertain whether such dues are outstanding for a period of more than 6 months from the date they became payable. Accordingly, after ensuring the above, if the statutory dues are outstanding for more than 6 months the auditor is required to report the same under clause (vii)(a) of CARO.

	However, in case the statutory dues are not outstanding for a period of more than 6 months from the date they became payable the auditor is not required to report the same under CARO. **(iv)** If the method as stated in the question 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.

Law stated in this publication is upto 31.10.2020 and is relevant for May 2021 Exams and onwards.

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