

RECENT AMMENDMENTS TO THE COMPANIES (AUDITOR'S REPORT) ORDER CARO 2020

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Applicability - CARO 2020

- ❖ Financial Year commencing on or after 1.4.2021
- ❖ Foreign Companies [Sec. 2(42)]
- ❖ Branch Audits [Sec.143(8) and Rule 12 of The Companies (Audit & Auditors) Rules 2014]
- ❖ Liaison Offices or Project Offices outside India
- ❖ Exemption to Banking /Insurance /Section 8 Companies / One Person Company [Sec.2(62)/ Small Companies(Sec.2(85)]

Applicability - CARO 2020

- ❖ Sec.25 Companies under 1956 Act not mentioned
- ❖ Not applicable to REITs, IITs, CFS of Trusts and foreign subsidiaries
- ❖ Interest accrued and due is considered as borrowing but interest accrued but not due is not to be included
- ❖ Credit card dues and current maturities of long term borrowings to be included

Exemption to small company – CARO 2020

- ❖ Section 2(85) – amended w.e.f. 15-09-2022
 - Share capital not exceeding Rs. 4 crores
 - Turnover of the immediately preceding financial year not exceeding Rs. 40 crores
 - A holding company or a subsidiary company, company registered under section 8 and a company or a body corporate governed by any special Act are not small companies

Exemption to private limited company – CARO 2020

- ❖ Paid up Capital and Reserve \leq Rs.1 Cr.
- ❖ Borrowings from Bank or Financial Institutions at any point of time during the year \leq Rs.1 Cr.
- ❖ Revenue as disclosed in Schedule III (including Revenue from Discontinuing Operations) \leq Rs.10 Cr.
- ❖ Status as at Balance Sheet Date

Definitions

- ❖ Paid up Capital = Equity + Preference + Bonus Shares + Forfeited Shares – Unpaid Calls
- ❖ Reserves – Schedule III
- ❖ Borrowings – Only from Any Banks and Financial Institutions
- ❖ Current Maturities of Long Term Borrowings
- ❖ Credit Cards
- ❖ Financial Institutions Sec.2(39)
- ❖ Revenue = Disclosure in Schedule III

General Approach – CARO 2020

- ❖ Maintenance of proper records
- ❖ Audit v/s Investigation
- ❖ Not a separate Audit Engagement
- ❖ Compliance with Auditing Standards
- ❖ Interaction with Management
- ❖ Exercise of Judgement
- ❖ Consider materiality while reporting

Reporting – CARO 2020

- ❖ Reasons in report for unfavorable / qualified / unable to express opinion
- ❖ Unfavorable comment not resulting in qualification
- ❖ Adverse comment having bearing on true and fair view
- ❖ Use of Professional judgement

CARO 2020

- ❖ Inclusion of Management's Explanation to unfavorable comment need not be included unless warranted (to not make auditor comment misleading)
 - a. To make Auditors' comments itself more meaningful and complete. e.g. physical verification of inventory not done due to strike or lockout.
 - b. To explain the fact why despite an unfavorable comment; the true and fair view of the financial statement is not vitiated. e.g. no physical verification carried out at the end of the year but sufficient other evidence is produced by the management to satisfy auditor regarding existence, condition and value of inventories (subsequent sale and its value)

CARO 2020

- ❖ Indicate the information and explanation not available
- ❖ Paragraphs not applicable
- ❖ Use sample paragraphs drafted for CARO reporting in GN
- ❖ Documentation

Records of Assets

- ❖ 3. The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters
- ❖ 1(a)(A) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment;
- ❖ (B) whether the company is maintaining proper records showing full particulars of intangible assets;

Records of Assets – CARO 2020

❖ Proper Records –

- The matter of Professional Judgments
- Reconciliation with Books of Account
- Completeness, accuracy and security of Register
- Record of Movement and Numbering
- Grouping of Small Individual Value Items
- Grouping of Assets of Same Useful Life
- Adjustment to Balance to be properly documented

Physical Verification of Assets

- ❖ 3(1)(b) whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

Physical Verification of Assets – CARO 2020

- Adequate Evidence
- Observation
- Reasonableness of Method
- Reasonable Intervals
- Materiality of Discrepancy
- Assets not verifiable – underground assets in relation to gas distribution, point of sale machines and sound boxes live with customers, LPG cylinders and pressure regulators with customers, asset in distribution system

Verification of Title Deeds of Assets

- ❖ 3(1)(c) whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof in the format given.

Verification of Title Deeds of Assets - CARO 2020

❖ Title Deeds of Immovable Properties -

- Legal Deed or Document constituting evidence of right
- Confirmation from Banks/Financial Institutions
- Lost Title Deeds
- Legal determination of validity of Title Deeds
- Disputes / Pending Court Cases
- Not held in the name of the Company
- Reconciliation

Title Deeds

- ✓ Section 187 require property, security and other assets to be held in the name of company
- ✓ Details required include properties held by related parties and reason for it not being held in the name of the company along with dispute if any
- ✓ Investment property and assets held for disposal also to be included

Title Deeds

- ✓ Genuineness not to be checked
- ✓ Purpose is to find out use of company's funds without corresponding benefit accruing to the company
- ✓ No control on purchase, sale, mortgage or other benefits accruing
- ✓ Dispute may not be genuine
- ✓ Diversion of funds given may be possible

Revaluation of Assets – CARO 2020

- ❖ 3(1)(d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets

Revaluation of Assets – CARO 2020

- Valuation only through Registered Valuer
- Re-value entire class of assets
- Methods and significant assumptions applied in estimating fair values to be checked.
- Accounting treatment of revaluation surplus to be seen
- Change more than 10% or more in aggregate of net carrying value to be specified

Company holding Benami Property

- ❖ (3) (1) (e) whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements;

Benami Property

- Proceedings initiated or pending for holding any benami property covered
- Details include name and nature of property, year of acquisition, acquisition cost, details of beneficiary (name, address, government ID), whether accounted in the books (if not, give reason), nature of proceedings (attachment, adjudication, confiscation), initiating officer and date of show cause notice, status of the same

In case of dispute on the proceedings, state the period since the beginning of dispute

Physical Verification of Inventory – CARO 2020

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

Physical Verification of Inventory – CARO 2020

- ❖ Verification of all material items
- ❖ Periodicity /Reasonable Interval
- ❖ Coverage and procedure
- ❖ Material discrepancy
- ❖ Auditor to comment on discrepancy of 10% or more in the aggregate for each class of Inventory noticed on physical verification

No separate materiality to be considered

Physical Verification of Inventory – CARO 2020

- ❖ Apply 10% threshold on net basis after adjusting excesses and shortages within each class
- ❖ Exercise professional judgment to determine the materiality and the relevance of discrepancy to the users
- ❖ If not dealt with in the books of account, the extent of the discrepancies and its impact on the Financial Statements need to be reported
- ❖ Annual reconciliation of opening inventory, purchases and consumption as co-related to production is required if no inventory records are maintained
- ❖ Clause applies even if third party inventory is a security

Working Capital Limit– CARO 2020

- ❖ 3(ii)(b) whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

Working Capital Limit– CARO 2020

- ❖ Sanctioned working capital limit in excess of Rs.5 Crores any time during the year only require comment on quarterly returns to Bank to be in Agreement with Books of Accounts
- ❖ Consider both fund based and non-fund based credit facilities.
- ❖ No audit is required but only comparison of statements with books of account to be done
- ❖ Returns would include credit monitoring arrangement reports and any other additional information required by the lender
- ❖ Consider materiality and the relevance of discrepancy

Loans, Investments, Guarantees and Securities

- 3(iii) 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,
- 3(iii)(a) whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate-

Loans, Investments, Guarantees and Securities

- 3(iii)(a)(A) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates;
- 3(iii)(a)(B) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associates;

Loans, Investments, Guarantees and Securities

- ❖ A normal advance against an order in accordance with trade practice would not be an advance in the nature of loan
- ❖ Includes any advances in the nature of loans (value vs order, period vs industry practice, period of time required by supplier for execution of an order, stipulation regarding interest)
- ❖ Secured or unsecured
- ❖ Short Term, Long Term Loans in cash or kind to be covered
- ❖ Comment only on transaction during the year

Only Financial Guarantees to be considered for reporting

Loans, Investments, Guarantees and Securities

- ❖ Details such as relationship of the company with parties, gross amount of investment made, guarantees / security provided, loans / advances in the nature of loans granted during the year, date and amount of settlement of guarantee / loans / advances in the nature of loans are required to be given
- ❖ Examine minutes books of Board and General Meeting, Schedule V to SEBI LODR Regulations
- ❖ Loans given and squared-up during the year also to be commented

Loans, Investments, Guarantees and Securities

- ❖ Check prior approval of Financial Institutions, rate of interest of prevailing yield of Government securities closest to tenor of the loan.
- ❖ Check Register as per Form MBP-2
- ❖ Auditor should obtain a written representation from the management that (i) there are no guarantees issued upto the year end which are yet to be recorded and to all obligations in respect of guarantees have been duly recorded in the register of guarantees and disclosed.

Loans, Investments, Guarantees and Securities

- Ensure compliance with Section 179,180, 185, 186,187 and of the Act and Rules there under
- Section 179 – Powers of the Board
- Section 180 – Restriction on powers of the Board – loans repayable on demand or within 6 months of date of loan, CC, BD – excluded. All directors present to agree. Consent of the shareholders by special resolution

Loans, Investments, Guarantees and Securities

- Section 185 – Loan to directors – No. By special resolution only to a person in whom director is interested. Loan to be utilized by the borrowing company for its principle Business Activity (i.e. not for further lending) – Rate of interest – yield on government securities.
- Section 186 – Loan to third parties – Loan to employees, wholly owned subsidiary – exempt. All directors present to agree, for all loans, etc. irrespective of amount. Shareholders approval in certain cases. Rate of interest restricted.
- Section 187 – Investments to be held in own name

Loans, Investments, Guarantees and Securities

- ❖ Granted to related parties (subsidiaries, joint ventures) and others (associates)
- ❖ For related parties - Aggregate amount and percentage to the total loans or advances in the nature of loans to be stated
- ❖ Controls and procedures including purpose, permissibility as per applicable law, terms, person authorised etc. to be seen for related parties
- ❖ Guidance note on audit of investments, audit of loans and advances and audit of liabilities

Loans, Investments, Guarantees and Securities

- 3(iii)(b) whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are not prejudicial to the company's interest;

Loans, Investments, Guarantees and Securities

- ❖ State whether terms are prejudicial (not only interest and security, all terms to be seen)
- ❖ For loans given consider rate of Interest, Security, Terms and period of repayment, ability to lend, borrower's Financial Standing, Credit Rating. Non-availability of alternate sources of finance, urgency of borrowings, restrictive covenants and nature of entity, etc. to decide whether the loan given is prejudicial to the interest of the company.
- ❖ Capital or loan to subsidiary which is loss making – not prejudicial to the interest of holding company.

Loans, Investments, Guarantees and Securities

- ❖ Since clause is applicable to all companies auditor should consider additional guidance such as Technical Guide of NBFCs.
- ❖ In respect of investment made, to assess whether same are prejudicial to the company's interest, auditor should give consideration to the factors such as – company's ability to make such investment, financial standing of investee company, sources of fund, valuation of proposed investments, covenant's attached, etc.
- ❖ With regard to guarantees, auditor should review process of issuance of guarantees in addition to above considerations.

Loans, Investments, Guarantees and Securities

- ❖ Board Resolution sanctioning Loan, Investments of Guarantees to be seen.
- ❖ Loan to employees can not be said to be prejudicial to the interest of the company if it is per terms of the policy.

Loans, Investments, Guarantees and Securities

- ❖ 3(iii)(c) in respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

Loans, Investments, Guarantees and Securities

- ❖ The auditor should examine loan agreements or letter of arrangements
- ❖ State whether schedule of repayment stipulated and observed (regularity in repayment on due dates)
- ❖ If schedule of repayment not given, state the fact

Loans, Investments, Guarantees and Securities

- 3(iii)(d) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

Loans, Investments, Guarantees and Securities

- ❖ State overdue more than 90 days and reasonable steps to recover the amounts from all parties
- ❖ Reasonable steps –
 - ✓ Consider facts & circumstances of each case
 - ✓ Amount involved and degree of delay in recovery
 - ✓ Correspondence and Reminders
 - ✓ Legal Notice
 - ✓ Obtaining enhanced security

Loans, Investments, Guarantees and Securities

- ❖ 3(iii)(e) whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, if so, specify the aggregate amount of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans];

Loans, Investments, Guarantees and Securities

- ❖ Examine the loan agreements and letter of arrangements
- ❖ Loans falling due renewed or extended or fresh loans granted to settle over dues of existing loan given to same parties need to be covered
- ❖ Aggregate amount renewed or extended or settled
- ❖ In respect of loans falling due as on the balance sheet date and which were renewed / extended /settled post balance sheet date and before the date of audit report the same should be reported in the current year and also in the next year.

Loans, Investments, Guarantees and Securities

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

Loans, Investments, Guarantees and Securities

- ❖ Granting of loan and advances in the nature of loan, either repayable on demand or without specifying terms or period of repayment along with percentage to total loans and percentage to related party to be stated

Reporting Format -3(iii)(b)

According to the information and explanations given to us and based on the audit procedures conducted by us, in our opinion the investments made, guarantees provided, security given and advances in the nature of loans granted to companies, firms, Limited Liability Partnerships or any other parties during the year, the terms and conditions of the grant of loans and advances in the nature of loans and guarantees provided during the year, are prima facie, not prejudicial to the interest of the Company.

Reporting Format-3(iii)(c)

1. The Company has granted loans or provided advances in the nature of loan which are payable on demand. During the year the Company has not demanded such loan. Having regard to the fact that the repayment of principal or payment of interest has not been demanded by the Company, in our opinion the repayments of principal amounts and receipts of interest are regular.
2. According to the information and explanations given to us and on the basis of our examination of the records of the Company, in case of loans given to employees, in our opinion, the repayment of principle and payment of interest has been stipulated and the repayments or receipts have been regular. However, in case of advance in the nature of loan of Rs. 40 lakhs given to ____ in earlier years, the schedule of repayment of principal and payment of interest has not been stipulated and accordingly we are unable to comment on whether the repayments or receipts are regular.

Loans, Investments, Guarantees and Securities

- 3(iv) in respect of loans, investments, guarantees, and security, whether provisions of sections 185 and 186 of the Companies Act have been complied with, if not, provide the details thereof;

Loans, Investments, Guarantees and Securities

❖ **Sec.185 - Loan to Directors, etc. –**

- Applicable to Directors or any other person in whom he is interested
- No direct loan or advance or book debt in the nature of loan or provision of guarantee or security
- Loans not covered
- Form MBP-1 and Register u/s 189
- Report nature of non-compliance, maximum amount outstanding and outstanding on balance sheet date

Loans, Investments, Guarantees and Securities

❖ Sec.186 - Loan and Investment by Company –

- No investment through more than two layers of Investment Companies
- No direct or indirect loan or guarantee or security or subscription exceeding limits
- Prior Approval by special Resolution for loan etc.
- Purpose for which loan will be utilized to be stated.
- No investment or loan etc. unless consented by all directors present in the meeting
- Prior approval of Public Financial Institution
- Interest Rate
- Purpose of loan given and its utilisation

Company Deposits

- Clause 3(v) – In respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules made thereunder, where applicable, have been complied with, if not, the nature of such contraventions be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not;

Company Deposits

❖ Acceptance of Deposits – Sec. 73 to 76 –

- Exempted Deposits
- Companies (Acceptance of Deposit) Rules, 2014
- Public Companies with Net worth of 100 Crores and Turnover of 500 Crores can accept deposits from persons other than members.
- System of acceptance of deposits
- Efficacy of Internal Control System
- Limits of acceptance of Deposits
- Order passed by any authority in case of contravention

Cost Records

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

Cost Records

- Sec.148 – Classes of Companies to whom cost records maintenance is compulsory
- Turnover/Net-worth criteria
- Companies (Cost Records and Audit) Rules, 2014 – Rule 3 Table A & B – Regulatory Sector – Rs. 50 crores / Rs. 25 crores
- Sec.2(13)(iv) – Books of Accounts – includes cost records.
- Made (cost accounts or cost statements) and Maintained (cost records relating to material, labour and overhead)
- No detailed examination of records

Statutory Dues

- 3(vii)(a) whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

Statutory Dues – Undisputed

❖ Undisputed Statutory Dues –

- Any other Statutory Dues
- Emphasis on regularity – during the year even though not outstanding at the end of the year.
- Contractual or Legal relationship not covered
- Dues recoverable as arrears of Land Revenue – are to be treated as statutory dues
- Non payment of Advance Tax – error in calculation not a default
- Dispute relating to part of the demand

Statutory Dues - Undisputed

❖ Undisputed Statutory Dues –

- Sustainability or otherwise of claim by department - no judgement by auditor required
- Due date of installment payments
- Penalty and Interest – to be included in dues payable
- Lump-sum deposits of PF/ESIC
- Reporting of delays – individual instances not required to be given. Whether generally regularly deposited to be mentioned

Statutory Dues - Disputed

- ❖ 3(vii)(b) where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute);

Statutory Dues - Disputed

- Amount involved and forum of dispute-even minor amount to be reported
- Show cause – not a demand
- Tax Demand set aside – not dues
- Referral for re-assessment – if demand not cancelled then dispute
- Appeal decided in favour of company – no dispute unless department goes in appeal
- Expiry of Time limit for filing appeal – if lapsed, then not a dispute

Statutory Dues - Disputed

- More than one dispute for same statutory dues in different period – give information separately for each period
- Treatment of disputed dues in accounts is irrelevant – report even though provided for
- Deposit under protest – still disputed.

Income Surrendered or Disclosed in Tax Assessment

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

Income Surrendered or Disclosed in Tax Assessment

- Details of transactions not recorded in the books but surrendered or disclosed as Income under any Tax Assessment such as Search, Survey or otherwise
- Only voluntary admission to the addition of Income based on returns filed to be considered
- Statement retracted is not to be taken as Income surrendered

Income Surrendered or Disclosed in Tax Assessment

- Company disputing but not filing appeal is no presumption that Income is surrendered
- Reason for non-disclosure and/or non-recording to be enquired and stated
- Implication on Report on Internal Financial Controls and modifications required in nature, timing and extent of audit procedures may be material

Default in Repayment of Loan or Borrowings

- 3(ix) (a) whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format.

Default in Repayment of Loan or Borrowings

- Default existing on the balance sheet date – period of default can be previous year
- Amount not paid on due date or unpaid and no. of days delay to be reported
- Not existing on balance sheet date – no reporting required
- Schedule of repayment

Default in Repayment of Loan or Borrowings

- Agreements and Debenture Trust Deeds
- Confirmation of over dues
- Application for restructuring /reschedulement – does not mean no default
- Dispute with Lender – mention brief nature of dispute

Wilful Defaulter

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

Wilful Defaulter

- Declaration by Bank or Financial Institution or other lender as well
- Declaration upto the date of approval of Financial Statement to be considered – even though not done upto 31st March
- Declaration in the earlier year with continuing default also to be reported
- Declaration only by Government or Government authorities to be considered in ‘other lenders’
- CIBIL, CRIF, Equifax, Experian and CRILC sites to be seen

Wilful Defaulter

A “willful defaulter” means a person or an issuer who or which is categorized as a willful defaulter by any bank or financial institution or consortium thereof, in accordance with the guidelines regarding willful defaulters issued by the Reserve Bank of India.

Wilful Defaulter

RBI master circular dtd. 01-07-2014 on wilful defaulter – “wilful default” – would be deemed to have occurred if any of the following events is noted –

- a) Default in repayment obligation
- b) Diversion for purpose not specified in sanction
- c) Siphoning of funds not available even in the form of other assets
- d) Disposal or removal of assets without knowledge of bank

Application of Term Loan

- ❖ 3(ix)(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;

Application of Term Loan

- One to One relationship not required
- Purpose of the loan
- Diversion of Funds and purpose for which it is used
- All Loans including from Bank/Financial Institutions covered
- Examine Terms and Conditions for expected end use
- Check utilization and its purpose

Application of Term Loan

- Improved version/Model of Assets purchased is not a diversion
- General purpose loans – diversion – only to be used for business
- Temporary investment of surplus fund – not a diversion if ultimately utilized for the stated purpose

Diversion of Funds

RBI Circular on “Willful Defaulter” dtd. 01-07-2014 – defines diversions as –

Diversion would be construed if –

- a. Utilisation of short term working capital for long term purposes
- b. Deploying borrowed funds for purpose / activities or creation of assets other than those for which the loan was sanctioned.
- c. Transferring Borrowed funds to subsidiaries / Group companies or others

Diversion of Funds

RBI Circular on “Willful Defaulter” dtd. 01-07-2014 – defines diversions as –

Diversion would be construed if –

- d. Routing funds through banks other than lender bank/member of consortium without prior permission of the lender
- e. Acquiring equities / debts of other companies without approval of lender
- f. Shortfall in deployment of funds *vis-à-vis* the amounts disbursed / drawn and the difference not being accounted for.

Short Term / Long Term Funds

3(ix)(d) whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated;

Short Term / Long Term Funds

- Short Term sources include Cash Credit, Overdrafts
- Long Term Funds include Share Capital, Reserves & Surplus, Long Term debt securities and Long Term Loans
- Current Maturities of Long Term Loans included in current liabilities to be treated as Long Term Sources of Funds
- Long Term Application include – Investment in Property, Plant & Equipment, Intangible Assets, Long Term investments in Shares, Debentures and other securities, Repayment of Long Term Loan and Advances and redemption of Long Term debt Securities
- Comment only if there is significant difference

Funds taken for Subsidiaries, Associates and Joint Ventures

- ❖ 3(ix)(e) whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case;

Funds taken for Subsidiaries, Associates and Joint Ventures

- Entity includes all concerns irrespective of legal form
- Funds include both Long Term and Short Term
- Only new loans or advances taken to be seen
- Loans taken and squared up during the year to be also reported
- Reporting required for funds taken in earlier years also
- Obligation means a debt securities or commitment to pay a particular sum of money

Funds taken for Subsidiaries, Associates and Joint Ventures

- Obtain schedule of related party transaction
- Obtain balance confirmation
- Check cash flows to confirm if the investment is out of own funds
- Obtain Management Representation

Pledge of Securities

- ❖ 3(ix)(f) whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised;

Pledge of Securities

- Details of loan taken during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies,
- Report if the company has defaulted in repayment of such loans raised or its interest
- The question already covered in clause 3(ix)(a)
- Merely state yes or no for default

Pledge of Securities

- Consider loans taken during the year only and give details even if amount is repaid during the year
- Documents related to charges created including any modification to be seen
- Obtain Management Representation

Money Raised in Public Offer

- ❖ 3(x) (a) whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;

Money Raised in Public Offer

❖ Public Offer -

- Emphasis on disclosure of end-use of money
- Sec.23 to 41 (Public Offer), Sec.2(81) (Securities)
- Disclosure as per Schedule III
- Sec.2(4) of Securities Contracts (Regulation) Act, 1956 and SEBI (Issue and Listing of Debt Securities), Regulations 2008

Money Raised in Public Offer

❖ Public Offer -

- Actual end-use – Actual use should not be materially different than proposed end use
- Report of Monitoring Agency appointed by financial institutions to monitor utilization of proceeds
- Offer for sale of securities by existing shareholders is not money raised in public offer

Preferential Allotment

- ❖ 3(x)(b) whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance;

Preferential Allotment

- Sec.42 and Rule 14 of The Companies (Prospectus and Allotment of Securities), Rules 2014
- Forms PAS-3 (Allotment), PAS-4 (Purpose and object of offer) and PAS-5 (Record of private placement)
- Any violation would convert offer into public offer
- No fresh offer until conditions satisfied
- Subscription only by cheque or DD or Banking channel and not by cash
- Allotment within 60 days or interest @ 12%

Preferential Allotment

- Separate Bank Account
- Money cannot be used in business till allotment
- Offer only to previously identified person and list to be filed with ROC within 30 days of circulation
- No public advertisement
- Return of Allotment
- Application of Funds received to be checked for utilisation

Fraud Reporting

- ❖ 3(xi) (a) whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated;

Fraud Reporting

❖ Fraud –

- Noticed or reported
- SA 240
- Fraudulent financial reporting
- Guidance Note on Reporting on Frauds
- Intentional mis-statement
- Mis-appropriation of Assets
- Perceived opportunity for circumvention of internal control

Fraud Reporting under Companies Act

- ❖ 3(xi)(b) whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;

Fraud Reporting under Companies Act

- Fraud has been committed in the Company by its Officers and Employees to be reported to Central Government.
- Only those frauds noticed in the course of the performance of duties as auditor to be reported including the reason to believe that fraud exist.
- Check ADT-4
- Consider whether Cost Auditor or Secretarial Auditor has reported fraud.
- Take written representation of the Management

Whistle – Blower Complaints

- ❖ 3(xi)(c) whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;

Whistle-Blower Complaints

- ❖ Complaints during the year only to be considered
- ❖ See applicability of whistle-blower mechanism under Companies Act and SEBI Regulations
- ❖ Section 179(9) of Companies Act, 2013 – requires vigil mechanism to be set up for company's directors and employees to report their genuine concerns or grievances – by all listed companies, companies accepting deposits, companies borrowing from banks and financial institution – in excess of Rs. 50 crores – to give adequate safeguard against victimization.

Whistle-Blower Complaints

- ❖ Whether the companies has whistle-blower process with adequate procedure to handle complaints and to accept confidential submission of concerned about questionable accounting, internal control or auditing matters to be verified
- ❖ SEBI LODR Regulations 4(2)(d) – mandates effective Whistle Blower mechanism for all listed companies – not only for directors and employees but for other persons also (clients, customers, suppliers, shareholders, etc.) to freely communicate their concerns about illegal or unethical practices. Audit committee to review the functioning of such mechanism and put it on company's website

Whistle-Blower Complaints

- ❖ Auditor may consider principles of materiality while reporting
- ❖ Action taken by management on complaints to be considered
- ❖ Auditor to modify nature, timing and extent of audit procedures based on complaints received and management action
- ❖ Auditor to consider whistle blower complaint on fraud or suspected fraud – Auditor to analyse stages of identification of fraud as per Para 80 of guidance note on Reporting of fraud under section 143(12) of the Companies' Act, 2013.
4 stages – speculation, suspicion, reason to believe, knowledge
Change audit process accordingly

Nidhi Companies

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

Nidhi Company

- Sec.406 – Incorporation as Nidhi Company or declared as such under Sec. 620A(1)
- Nidhi Rules, 2014
- Rule 3(d),5(1) and Rule 14 – 200 members or more, net owned funds Rs.10 lakh and more, unencumbered Term Deposits of 10% or more of the outstanding amount, Ratio of Net Owned funds to deposit not more than 1:20

Nidhi Company

- Report of short-fall
- Check Form NDH-3 filed half yearly for information on deposits
- Consider defaults existing at the year end and also during the period even if made good
- Mention details of disputes

Related Party Transactions

- ❖ (xiii) whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act where applicable and the details have been disclosed in the financial statements, etc., as required by the applicable accounting standards;

Related Party Transactions

- Applicable to all companies – Section 188
- Approval of Board and Shareholders
- List of transactions covered is comprehensive
- Transactions with WOS, at Arms Length – SA 550 and in ordinary course of business not covered
- Factors for considering whether a transaction is at Arm's length-
 - a) Benefit / consideration for each of the parties
 - b) Prevalent market / Industry practice
 - c) Economic circumstances
 - d) Specific contractual understanding
 - e) Similar contracts executed between other unrelated parties

Related Party Transactions

In order to know whether transactions are in the ordinary course of business consider –

- a) Transactions covered by objects
- b) Usual or unusual
- c) Frequent or infrequent
- d) Arm's length price
- e) Business purpose
- f) Similar basis with third party
- g) Size and volume
- Approval of Audit Committee u/s 177
- SA 550
- Register u/s 189 and Form MBP- 4
- Review of auditor's working papers of prior years

Internal Audit

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

Internal Audit

- ❖ Refer Section 138 of Companies Act, 2013 with Companies (Accounts) Rules, 2014 for applicability of clause

- ❖ **Companies (Accounts) Rules 2014 – Rule 13**

Internal Audit shall be required in –

- Every listed company
- Every unlisted public company having paid-up share capital of Rs. 50 crores or more or turnover of Rs. 200 crores or more or outstanding borrowings from banks or public financial institutions exceeding Rs. 100 crores or more outstanding deposits of Rs. 25 crores or more

Every private company – having turnover of Rs. 200 crores or more outstanding loans or borrowings from banks or financial institution exceeding Rs. 100 crores or more.

Internal Audit

- ❖ To verify whether company has an Internal Audit system commensurate with the size and nature of its business
- ❖ Consider adequacy of scope, functioning, periodicity and methodology along with adequate staffing for conducting Internal Audit
- ❖ Meeting with Internal Auditor to evaluate the impact of the observations on Financial Statements

Internal Audit

- ❖ The consider impact of control deficiencies found by Internal auditor
- ❖ Change nature, timing and extent of Audit procedure
- ❖ Consider impact on Report on Internal Financial Control over Financial Reporting
- ❖ See full report and not Executive Summary
- ❖ See that there is no limitation on scope of Internal Audit imposed by the Management

Internal Audit

- ❖ For external agency as Internal Auditor – evaluate competency, objectivity and Independence along with qualifications, experience and professional standing
- ❖ For Listed companies, refer presentation to audit committee by Internal Auditor along with minutes of ACB and Board
- ❖ Review Independence and effectiveness of Internal Audit function
- ❖ See whether Technical assistance provided to Internal audit Department
- ❖ Refer follow-up systems on the deficiencies pointed out

Non Cash Transactions with Directors

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

Non Cash Transactions with Directors

- Sec.192
- Arrangement by which director of Company / Holding Company/Subsidiary/Associate Company/person connected to acquire or is to acquire assets from company for consideration other than cash prohibited
- Arrangement where company to acquire or is to acquire assets for consideration other than cash from Director or connected person prohibited

Non Cash Transactions with Directors

- Prior Resolution in General Meeting of the company and Resolution by Holding Company
- Entry of acquisition settled in next year is not a non-cash transaction
- Valuation by Registered Valuer
- Sec.185(2), Sec.2(77) and Rule 4 (Relative) of The Companies (Specification of Definition details) Rules 2014 and person connected with the director

Non Cash Transactions with Directors

- MBP-1 (Notice of Interest by Director),
- MBP-2 (Register of Loans, Guarantees, Security and Acquisition made by the Company),
- MBP-4 (Register of Contracts with Related Parties),
- FA Register, Minutes Books,
- MGT-15(Reports of AGM), subsequent period information

NBFCs

- ❖ (xvi) (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;
- ❖ (xvi) (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;

NBFCs

- ❖ (xvi)(c) whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria;
- ❖ (xvi)(d) whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group;

NBFCs

❖ **Registration u/s 45-IA of RBI Act, 1934**

“A Non-Banking Financial Company (NBFC) is a company registered under the Act, engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures / securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business

But does not include any institution whose principle business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale / purchase / construction of immovable property”.

NBFCs

❖ Registration u/s 45-IA of RBI Act, 1934

- Financing activity as the principal business
- Business of NBFC requires registration
- Financial activity as defined by RBI –
- Financial Activity is considered as a principle business when a company's financial assets constitutes more than 50% of the total assets and income from financial assets constitute more than 50% of the gross income (50:50 test)

NBFCs

❖ Registration u/s 45-IA of RBI Act, 1934

- Only companies predominantly engaged in financial activity get registered with RBI and are regulated and supervised by it
- If companies which are not NBFCs are doing some financial business in a small way, they will not be regulated by the Reserve Bank.

Net owned Funds requirement –

Net owned Funds' for NBFC as per RBI include paid up capital + Reserve – Accumulated losses – deferred revenue expenses – intangible assets – investments in subsidiaries / group companies / other NBFCs – Amount in excess of 10% of all above calculations as invested in Debt / Bonds / outstanding loans and advances to subsidiaries and group companies

Cash Losses

- (xvii) whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses;

Cash Losses

- ❖ Reporting of Cash losses in the financial year and immediately preceding Financial Year
- ❖ Cash loss = Net Profit/Loss after tax + Non Cash items such as – Depreciation, amortization, impairment provision, deferred tax income/expenses, Foreign Exchange Gain/Loss, Fair Value changes
- ❖ Adjustment for effect of qualifications in the respective audit reports to the extent of their quantification to be considered
- ❖ Do not use cash flow statement to determine cash loss as it gives operating cash flow only which does not include items like interest income, interest expenses which are relevant for determination of cash flows
- ❖ If cash losses only for one year, comment on two years separately

Resignation of Auditors

- ❖ (xviii) whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors;

Resignation of Statutory Auditor

- ❖ In case of resignation of Statutory Auditor during the year, the new auditor needs to consider the issues, objections or concerns raised by outgoing auditor
- ❖ Ethical issues and compliances with company law provisions to be verified
- ❖ Ethical Issues – outgoing auditor shall reply and assist new auditor to understand the assignment better

Resignation of Statutory Auditor

- ❖ Section 140(2) , Rule 8 of the Companies (Audit and Auditors) Rules 2014 and Form ADT-3 (to be filed in 30 days of resignation, indicating reasons and other facts as may be relevant with regard to resignation) need to be considered
- ❖ Other pre-occupation, personal reasons, administrative reasons, health reasons, mutual consent or unavoidable circumstances as reasons being ambiguous are not acceptable to ROC
- ❖ Reading of Minutes of the Board, communication to Audit Committee and enquiry with the Management required

Resignation of Statutory Auditor

- ❖ Consider “Implementation guide on resignation/withdrawal from an Engagement to Perform Audit of Financial Statements”
 - a) Inability to obtain sufficient appropriate audit evidence, the reason for that inability
 - b) Possible effects on the financial statements of undetected mis-statements, both material and pervasive
 - c) Material mis-statement of specific amount – give description and quantification of financial effects
 - d) Bonafide reasons for inability to complete audit assignment
 - e) Communication with TCWG
 - f) Management response to communication by Auditor
 - g) Last limited review report issued by the auditor

Resignation of Statutory Auditor

- ❖ Consider SEBI Circular CIR/CFD/CMD1/114/2019 dated October 18, 2019 on “Resignation of Statutory auditors from listed entities and their material subsidiaries”

Company to obtain information from Auditor in Form A –

- Detailed reason for resignation,
- Details of association with listed entity / its material subsidiary,
- Whether inability to obtain sufficient appropriate audit evidence was due to a management imposed limitation or circumstances beyond the control of the management,
- Whether lack of information was prevalent in the previous reported financial statements / results.

Resignation of Statutory Auditor

- ❖ The reasons for resignation should be considered, such as non-availability of sufficient appropriate evidence, while issuing audit opinion on the financial statements of the current year
- ❖ Obtain Management Representation that there are no concerns of outgoing auditor beyond those stated in NOC and resignation letter

Material uncertainty in Meeting Liabilities

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

Material uncertainty in Meeting Liabilities

- ❖ Consider Financial Ratios, ageing and expected dates of realization of financial assets and payment of financial liabilities, other information, auditors knowledge for Management Plans to understand whether the company is capable of meeting its liabilities as and when they fall due within a period of one year from the Balance Sheet date
- ❖ Management Plans – to liquidate assets (non-core), borrow money, or restructure debt, reduce or delay expenditure or increase capital (Investor)
- ❖ Confirm existence, legality and enforceability of the arrangements
- ❖ Evaluation of assumption relating to future cash flows
- ❖ Evaluate whether situation will improve even if the plans are successfully executed

Material uncertainty in Meeting Liabilities

- ❖ SA-570 – Going Concern – Whether material uncertainty exists about the entity's ability to continue as a Going Concern
- ❖ SA-560 – Subsequent Events
- ❖ Consider recoverability of Financial Assets based on Agreements, Contracts, Historical Trends and Correspondence with debtors and borrowers
- ❖ In case of support letter from Holding Company, Auditor to evaluate whether holding company has ability to discharge such liabilities
- ❖ Ratios need to be calculated on the balance sheet date and also on the date nearer to audit report

Material uncertainty in Meeting Liabilities

- ❖ Consider MIS for subsequent months, cash flow projection for 12 months and commitment and guarantees on behalf of other entities
- ❖ Auditor to give negative assurance in his report stating that he neither gives any guarantee nor any assurance that all liabilities falling due within a period of one year from the balance sheet date will get discharged by the company as and when they fall due

Material uncertainty in Meeting Liabilities

- ❖ “According to the information and explanations given to us and on the basis of the financial ratios, ageing and expected dates of realization of financial assets and payment of financial liabilities, other information accompanying the financial statements, our knowledge of the Board of Directors and management plans and based on our examination of the evidence supporting the assumptions, nothing has come to our attention, which causes us to believe that any material uncertainty exists as on the date of the audit report that company is not capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date. We, however, state that this is not an assurance as to the future viability of the company. We further state that our reporting is based on the facts up to the date of the audit report and we neither give any guarantee nor any assurance that all liabilities falling due within a period of one year from the balance sheet date, will get discharged by the company as and when they fall

CSR

- ❖ (xx) (a) whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act;
- ❖ (b) whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with the provision of sub-section (6) of section 135 of the said Act;

CSR

- Section 135, Schedule VII and Companies (Corporate Social Responsibility Policy) Rules, 2014
- Consider Board Approved Policy
- Minutes of CSR Committees
- Working of CSR Amount
- Management Representation

CSR

- Utilisation of Funds and its monitoring
- Unspent Amount
- Transferred to separate Bank Account
- Recording of provision

CFS

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

CARO for CFS

- ❖ Qualifications and adverse remarks in CARO by subsidiary auditors need to be indicated by way of details of the companies and the paragraph numbers of the CARO report containing such qualification or remarks.
- ❖ Does not include qualification or adverse opinion given as per SA-705
- ❖ If subsidiaries audits are not finalized, state the fact
- ❖ Include qualification / adverse remark given in parent companies standalone CARO report also
- ❖ Text of subsidiaries CARO report is not required
- ❖ Do not evaluate materiality from consolidation perspectives

Thank you