

# CARO 2016

In exercise of the powers conferred by sub-section (11) of section 143 of the Companies Act, 2013 (18 of 2013) and in supersession of the Companies (Auditor's Report) Order, 2015 published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (ii), vide number S.O. 990 (E), dated the 10th April, 2015, except as respects things done or omitted to be done before such supersession, the Central Government, after consultation with the committee constituted under proviso to sub-section (11) of section 143 of the Companies Act, 2013 hereby makes the following Order, namely:-

## 1. Short title, application and commencement.-

(1) This Order may be called the Companies (Auditor's Report) Order, 2016.

(2) It shall apply to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013 (18 of 2013) [hereinafter referred to as the Companies Act], except-

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an insurance company as defined under the Insurance Act, 1938 (4 of 1938);

(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act and a small company as defined under clause (85) of section 2 of the Companies Act; and

(v) **Pvt. Ltd. Company, not being a subsidiary** or holding of a public co., when all of the following conditions are satisfied :

- I. Paid up capital and reserves and surplus does **not exceeds Rs 1 crore as at balance sheet date**, and
- II. Total borrowings from banks or financial institutions at any point of time during financial year **does not exceed Rs 1 crore**; and
- III. Total revenue, **including revenue from discounting operations, does not exceed Rs 10 crore during the financial year as per the financial statements**

**2. Auditor's report to contain matters specified in paragraphs 3 and 4.** – Every report made by the auditor under section 143 of the Companies Act, 2013 on the accounts of every company audited by him, to which this Order applies, for the financial years commencing on or after 1st April, 2015, shall in addition, contain the matters specified in paragraphs 3 and 4, as may be applicable:

Provided the Order **shall not apply to the auditor's report on consolidated financial statements.**

**3. Matters to be included in the auditor's report.** – The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:-

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

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

(c) whether **the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;**

(ii) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account;

(iii) whether the company has granted any loans, secured or unsecured to companies, firms, **Limited Liability Partnerships or other parties** covered in the register maintained under section 189 of the Companies Act, 2013. If so,

(a) whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;

(b) whether the schedule of repayment of principal and payment of interest has been **stipulated and whether the repayments or receipts are regular;**

(c) 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;

(iv) 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.**

(v) in case, the company has **accepted 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, 2013 and the rules framed 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?**

(vi) whether **maintenance of cost records has been specified by the Central Government** under sub-section (1) of section 148 of the Companies Act, 2013 and whether such accounts and records have been so **made and maintained**.

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

(b) where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax 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).

(viii) whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, **Government** or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of **defaults to banks, financial institutions, and Government, lender wise details to be provided**).

(ix) whether moneys **raised by way of initial** public offer or further public offer (**including debt instruments**) and term loans 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;**

(x) **whether any fraud by the company or any fraud on the Company by its officers or employees** has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;

(xi) whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with **Schedule V to the Companies Act?** If not, state the amount **involved and steps taken by the company for securing refund of the same;**

(xii) whether the Nidhi **Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20** to meet out the liability and whether the Nidhi Company is maintaining **ten per cent unencumbered term deposits** as specified in the Nidhi Rules, 2014 to meet out the liability;

(xiii) 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;**

(xiv) whether the company has made any **preferential allotment or private placement of shares** or fully or **partly convertible debentures** during the year under review and if so, as to whether the requirement of **section 42** of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;

(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, 2013 have been complied with;**

(xvi) whether the company **is required to be registered under section 45-IA** of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.

4. Reasons to be stated for unfavourable or qualified answers.-

(1) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.

(2) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

## CARO

However, CARO 2016 had made this situation amply clear in its new avatar by providing that CARO 2016 is not applicable on pvt. Ltd. Company, not being a subsidiary or holding of a public co., when all of the following conditions are satisfied:

- IV. Paid up capital and reserves and surplus does **not exceeds Rs 1 crore as at balance sheet date**, and
- V. Total borrowings from banks or financial institutions at any point of time during financial year **does not exceed Rs 1 crore**; and
- VI. Total revenue, **including revenue from discontinuing operations, does not exceed Rs 10 crore during the financial year as per the financial statements**

Discontinuing Operations: As per AS 24, a discontinuing operation is a component of an enterprise:

- A. That the enterprise, pursuant to a single plan, is :
  - Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of the ownership of the component to the enterprise's shareholders; or
  - Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or
  - Terminating through abandonment; and
- B. that represents a separate major line of business or geographical area of operations; and
- C. that can be distinguished operationally and for financial reporting purposes

Coordinated Plan: It may be noted that under criterion (a) of the definition (paragraph 3(a)), a discontinuing operation may be disposed of in its entirety or piecemeal, but always pursuant to an overall plan to discontinue the entire component.

**Question A. Examine whether the following are discontinuing operations or not:**

- i. BSN Company limited was having its production plant located at location 'X', to avail backward area related tax incentives. In order to achieve economies of scale, the companies wishes to shift to location 'Y'
- ii. Meera Rescue Private Limited has four market areas, Government, Local, Export to Europe and Export other than Europe. The company finds that the it may not be able to sell to govt. in the coming years, due to change in Government's procurement policy;
- iii. Until 2014-15, S.S Electronics Limited was engaged in the production of Black and White Television sets. From 2015-16it has just entered into production of Color Television set. During the current year, i.e., 2015-16, the company reduced the production of Black and white Television Sets and concentrated on color television sets only. Gradually they stopped the production of Black And White Television Sets.
- iv. 'H' Limited a holding company is engaged in the manufacturing of textiles. It disposed off its investment in its subsidiary 'S' Limited. This 'S' Limited is also engaged in the same line of business.

Recommendation: The following recommendation can be made for each of the situations given in the question:

(i) above part states that shifting of some production or marketing activities for a particular line of business from one location to another or closing of a facility to achieve productivity improvements or other cost savings, is not a discontinuing operation. Therefore, the present situation will not constitute discontinuing operation;

(ii) In this case, Meera rescue pvt. Ltd. has not undertaken any disposal or abandonment as defined in para 3 of this statement. There is only a reduction and/or withdrawal in the number of market areas served by the company and hence, loss of Government Market is not a discontinuing operation;

(iii) The present situation will not constitute discontinuing operation, because as per above gradual or evolutionary phasing out of a product line or class of service is not a discontinuing operation within AS 24.

(iv) In relation to consolidated financial statements, selling a subsidiary whose activities are similar to those of the parent or other subsidiaries and is not a discontinuing operation

**Q1. Whether CARO is applicable to Liason Offices and Branch Offices ?**

The Order is also applicable to the audit of branch (es) of accompany under the Act since sub-section 8 of section 143 of the Act clearly specifies that a branch auditor has the same duties in respect of audit as the company's auditor. It is , therefore , necessary that the report submitted by the branch auditor contains a statement on all the matters specified in the Order to enable the company's auditor to consider the same while complying with the provisions of Order.

**Q2. (Loan from NBFC and CARO applicability on Private Limited Company)**

A sum of Rs 35 lacs each has been taken by PSU (P) Ltd. from two banks, one financial institution and one NBFC during the financial year 2015-16. Its core capital is Rs 50 lacs and sales turnover is Rs 5 crores for this year.

First state the para relating to exemption to pvt Company from CARO

In the present query , since the amount of outstanding loan for the purpose of CARO is Rs 105 lacs ( out of total outstanding loan of Rs 140 lacs) , CARO would be applicable to PSU (P) Limited as outstanding loan condition out of all the specified conditions under CARO for the private limited companies is not fulfilled

**Q3. (Cash Credit Limits and CARO applicability on Private Limited Companies)**

XYZ Private Limited has paid up Capital and Reserves of Rs 50 lacs and secured loans of Nationalized Banks having sanctioned limit of Rs 110 lacs and outstanding balance of Rs 95 lacs. The turnover of the company is 5.00 crores for the year ended 31-3-2016. The management of the company is of the opinion that CARO,2016 is not applicable to the company.

Recommendation: The core capital and sales turnover for XYZ Private Limited for the purpose of CARO are Rs 1 crore and Rs 10 crore respectively. The outstanding loan for the purpose of CARO would not be the sanctioned limit but the de facto balance outstanding which in the given query is Rs 95 lacs. Since all the specified condition are fulfilled, CARO would not be applicable to XYZ Private Limited

**Q4. (Outstanding loan with Fixed Deposits as security and CARO applicability on Private Limited Companies)**

LMN Private Limited has an outstanding loan of Rs 130 lacs during the year 2015-16 from Punjab National Bank which is secured against its fixed deposits of Rs 50 lacs and certain plant and machinery. Its core capital and sales turnover are Rs 48 lacs and Rs 9.80 crores respectively.

Recommendation: CARO would be applicable to LMN Private Limited since during the year 2015-16 the outstanding loan exceeds Rs 1 crore. The fact that it has maintained a fixed deposit as security against the loan is immaterial, i.e., the loan amount would not be reduced by the fixed deposit amount for determining CARO's applicability.

**Q5. (Securities Premium Account and P & L Account ( Dr. Balance ) vis-à-vis Core Capital calculation )**

What would be the core capital for the purposes of CARO , if ABC (P) Limited has:

1. Preference Share Capital	Rs 38 Lacs
2. Equity Share Capital (partly paid up)	Rs 50 Lacs
3. Share application money pending allotment	Rs 10 Lacs
4. Securities Premium A/c	Rs 7 Lacs
5. Revaluation Reserves	Rs 15 Lacs
6. General Reserves	Rs 3 Lacs
7. P & L A/c (Dr.)	Rs 4 Lacs
8. Capital Redemption Reserve	Rs 5 Lacs
9. 5% Convertible Debentures	Rs 4 Lacs
10. Discount on issue of Debentures	Rs 1 Lacs

Would your answer be different if P & L A/c ( Dr.) balance would have been Rs 2 lacs

Recommendation: The following calculation would be made:

Particulars	Amount (Rs in Lakhs)
Preference Share Capital	38.00
Equity Share Capital	50.00
Share application money	N.A.
Securities Premium Account [ Rs 7 lakhs less Rs 1 lakh discount on issue of debentures by virtue of section 52 of the Companies Act, 2013]	6.00
Revaluation Reserves	15.00
General Reserves	3.00
P & L A/c ( Dr. Balance) – out of Rs 4 lacs , Rs 3 lacs only adjusted to the extent of available revenue reserves	(3.00)
Capital Redemption Reserve	5.00
<b>Total</b>	<b>114.00</b>

If P & L Account (Dr.) Balance would have been Rs 2 lakhs , then General Reserves would stand at Rs 1 lacs and hence the core capital would be Rs 115 Lacs.

**Q6. (P & L Account (Dr. Balance) vis-à-vis CARO applicability on Private Limited Companies) ABC Private Limited submits the following information for the year ending on 31.3.2016:**

Paid up capital	Rs 80 lakhs
Revaluation Reserves	Rs 10 lakhs
Capital Reserves	Rs 11 lakhs
P & L Account (Dr. Balance)	Rs 2 lakhs

The Management of the Company is contending that CARO is not applicable to it. Comment.

Recommendation : For determining the applicability of the Order to a private limited company, both capital as well as revenue reserves should be taken into consideration while computing the limit of rupees 1 crore prescribed paid up capital for reserves. Revaluation reserve, if any, should also be taken into consideration while determining the figure of reserves for the limited purpose of determining the applicability of the Order. The credit balance in the profit and loss account should also be considered as a part of reserve since the balance in profit and loss account is available for general purposes like deceleration of dividend. The debit balance of the profit and loss account , if any , should be reduced from the figure of revenue reserves. Hence, CARO would be applicable because the core capital here would Rs 101 lakhs (i.e. Rs 80 lakhs + Rs 10 Lakhs + Rs 11 Lakhs) , which is more than the limit (i.e. Rs 1 crore) that is specified under the Order.

**Q7. (Sale of Goods and Rendering of Services vis-à-vis applicability of CARO on Private Limited Companies)**

T Pvt. Ltd.'s paid up Capital & Reserves are less than Rs 100 Lacs and it has no outstanding loan exceeding Rs 100 lacs from any bank or financial institution. Its sales are Rs 11 crores before deducting Trade discount Rs 10 Lacs and Sales Returns Rs 95 Lacs. The services rendered by the company amounted to Rs 10 Lacs. The company contends that reporting under Companies Auditor's Reports Order (CARO) is not applicable. Discuss.

Recommendation: Since paid up capital and reserves of T Pvt. Ltd. is less than Rs 100 lacs and has no outstanding loan rupees Rs 100 lacs from any bank or financial institution, the only other condition is whether revenue exceeds Rs 10 crores. Revenue as per AS 9 here signifies the aggregate amount for which sales are affected by the company "Sales Affected" would include sale of goods as well as services rendered by the company. For ascertaining turnover through trade discount and sales returns should be deducted, the inclusion of services rendered would result in a turnover of Rs 10.05 crores (i.e. 11-0.10-0.95+0.10 crores) Hence CARO will apply to T. Pvt. Ltd.

**Q7. A Treatment of excise duty**

A Pvt. Ltd. Is incorporated on 1<sup>st</sup> July, 2015. During the year ended 31<sup>st</sup> March, 2016. It had issued shares (fully paid up) of Rs 40 lacs, had borrowed Rs 55 lacs each from 2 financial institutions and its turnover ( Net of excise Rs 150 lacs which

is credited to a separate account) is Rs 975 lacs. Will Companies Auditor Report, 2016 (CARO) be applicable to a Pvt. Ltd.?

Recommendation: The Order exempts from its application a private limited company which fulfils all the following conditions:

- (i) its paid up capital and reserves are Rs 1 crore or less, as at balance sheet date
- (ii) it has no outstanding load exceeding Rs 1 crore from any bank or financial institution, at any point of time during the financial year; and
- (iii) its total revenue (including revenue from discontinuing operations) does not exceed Rs 10 crores during the financial year as per the financial statements

A private limited company, in order to be exempt from the applicability of the order, must satisfy all the conditions mentioned above cumulatively.

In the case of M/s A Pvt. Ltd., its paid up capital and reserves are less than Rs 100 lacs, turnover is less than Rs 10 crores since excise duty is not taken into account if it is credited separately to excise duty account. However, it fails to fulfill the condition relating to outstanding loan because as per the statement on CARO,2016, issued by the institute requires that the amount of outstanding loan taken from bank/ financial institution have to be considered on a cumulative basis.

M/s A Pvt. Ltd. Has total borrowings of Rs 110 lacs and thus fails to satisfy all conditions and accordingly CARO, 2016 will be applicable.

**Q7. B Question B. Query (CARO if applicable in one year may not be applicable in other year)**

The following details pertain to the sales turnover of ABC (P) Limited. Assuming the core capital and outstanding loan as below than threshold, advise on the applicability of CARO for each year (i.e.,2014-15 and 2015-16)

Particulars	2014-15	2015-16
Sales Turnover (gross)	6.0 crores	6.0 crores
Sales Returns(out of current year sales)	0.5 crores	0.2 crores
Sales Returns (out of previous year sales)	Nil	1.0 crores

Recommendation:

Particulars	2014-15	2015-16
Sales turnover(gross)	6.0 crores	6.0 crores
Sales Returns(out of current year sales)	0.5 crores	0.2 crores
Sales Returns (out of previous year sales)	Nil	1.0 crores
Sales Turnover for CARO	5.5 crores	4.8 crores
CARO- whether applicable	Applicable because the turnover under CARO, 2015 exceeds Rs 5 crores	Not applicable because the revenue under CARP, 2016 does not exceed Rs 10 crores

**Q8. (Conversion of Companies- various cases):**

Whether CARO is applicable in the following cases:

- 1) A NBFC et itself converted into Banking Company before the Balance Sheet Date:
- 2) A Public Company get itself converted into a Private Limited Company before the Balance Sheet Date and does not have core capital, outstanding loans and turnover exceeding the thresholds;
- 3) A Private Limited Company having borrowings from Bank amounting to Rs 130 lacs get itself converted into LLP before the Balance Sheet Date.

Recommendation: The applicability of CARO should be examined as on the Balance Sheet Date. Accordingly, in all the cases given in the query, CARO is not applicable.

**Q9. (Fixed assets verification at reasonable intervals)**

'A' Ltd. having fixed assets at 10 different locations, in total value Rs 5000 crores have been physically verifying the assets every third year. Auditor insists for yearly verification of the same – Comment

Recommendation: Clause 3 (i) of CARO the statutory auditors need to report about whether the fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the book of account. Physical verification of the assets have to be made by the management and not by the auditor. It is, however, necessary that the auditor satisfies himself that such verification was done and that there is adequate evidence on the basis of which he can arrive at such a conclusion. The auditor may prefer to observe the verification, particularly when verification of all assets can be made by the management on a single day or within a relatively short period of time. If, however, verification is a continuous process or if the auditor is not present when verification is made, then he should examine the instructions issued to the staff (which should, therefore, be in writing) by the management and should examine the working papers of the staff to substantiate the fact that verification was done and to determine the name and competence of the person who did the verification.

What constitutes "reasonable intervals" depends upon the circumstances of each case. The factors to be taken into consideration in this regard include the number of assets, the nature of assets, the relative value of assets, difficulty in verification, situation and spread of the assets, etc. The management may decide about the periodicity of physical verification of fixed assets considering the above factors. While an annual verification may be reasonable, it may be impracticable to carry out the same in some cases. Even in such cases, the verification program should be such that all assets are verified at least once in every three years. Where verification of all assets is not made during the year, it will be necessary for the auditor to report that fact, but if she is satisfied regarding the frequency of verification he should also make a suitable comment to that effect.

**Q10. (Guarantee to sister concern, Physical verification of inventory and Accumulated losses of the company)**

As the statutory auditor of B Ltd. to whom CARO, 2016 is applicable, how would you report in the following situations?

- i. The company has stood guarantee to its sister concern, whose financial condition was not healthy for a sum of Rs 20 lacs borrowed from a bank.
- ii. 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.
- iii. Accumulated losses of the company are 50.9% of its net worth and it is incurring continuous cash losses since last 2 years. The company has been in existence for past several years.

Recommendation:

- i. Para 3(iv) of CARO, 2016 requires the auditor to state in his 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. The auditor should accordingly verify compliance with requirements of section 185 and 186 of the Companies Act, 2013. It should also be ensured that the guarantee given is shown as contingent liability.

Further in light of section 143(3)(f) of the Companies Act, 2013, the auditors are required to report those observations which may have adverse impact on the functioning of company, thus, accordingly he should also determine whether the guarantee is prejudicial to the interest of the company and for this purpose, the auditor should consider financial standing of the party, nature of security offered, etc. In this case, since financial condition of the company on behalf of whom guarantee is given is not so good, the auditor may consider expressing an opinion that the terms and conditions on which the company has given guarantees for loans taken by the sister concern, i.e., M/s B Ltd., is prejudicial to the interest of the company.

- ii. Para 3(ii) of CARO, 2016 requires the auditor to state in his report whether physical verification of inventory has been conducted at reasonable interval by the management. Physical verification of the inventory is the responsibility of the management which should verify all material items at least once in a year and more often in appropriate cases. The auditor in order to satisfy himself about verification at a reasonable interval should examine the adequacy of evidence and record of verification. In the given case, the above requirement of CARO, 2015 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.

- iii. Para 3(iii) of CARO, 2015 requires the auditor to state in his report in respect of a company which is in existence for more than 5 years from the date of registration:
- Whether the accumulated losses at the end of the year are more than 50% of its net worth; and
  - Whether it has incurred cash losses during the current year and the immediately preceding final year.

In the instant case, since the company is covered by the above requirements, there are symptoms of potential sickness and thus, auditor should report the same.

#### **Q11. (Fraud in a company)**

As a Statutory Auditor, how would you report on the following under CARO:

- a) ABC Pvt. Ltd. is a Manufacture of Jewellery. A senior employee of the Company informed that the Company does not properly disclose the purity of gold used on the jewellery.

Recommendation:

- a) In the case of ABC Ltd. if purity of gold is not properly disclosed on the jewelry it amounts to defrauding the customers. That means the management is deceiving customers to obtain an illegal advantage. However, the auditor is concerned with fraudulent acts that cause a material misstatement in financial statements. As long as books of accounts are not falsified arising out of difference in purity of gold, i.e., actual cost of gold and the selling price of the gold, it has no implication for the auditor. Further, under CARO, 2016 the auditor may examine this from the view point of maintaining records of inventory. But even the requirement of maintaining proper records does not necessitate that purity as such should be maintained on the gold itself. However, the purity of gold would have implication on the valuation of inventory. But this aspect is not required to be reported under CARO, 2016. Thus, from the view point of reporting on frauds under CARO, 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.

#### **Q12. (Internal Audit System)**

PQR limited, a listed company and having an average annual turnover of more than Rs 5 crores has no internal audit system. Comment.

Recommendation: CARO, 2015 and 2016 are not containing such similar reporting requirements.

In the present case, accordingly, the statutory auditor needs to examine whether PQR limited being a listed company and having an average annual turnover of more than Rs 5 crores has appointed internal auditor in terms of provision contained in Section 138 of the Companies Act, 2013.

#### **Q13. (Rescheduling of Term Loan Taken form Nationalized Bank)**

XYZ Limited has taken a term loan from a nationalized bank in 2011 for Rs 200 lacs repayable in five equal installments of Rs 40 Lacs each from March 31<sup>st</sup>, 2012 onwards. It had repaid the loan installments due in 2012 and 2013, but defaulted in 2014, 2015 and 2016. The management of the company has also applied for reschedulement of this loan. How as a statutory auditor would you report under CARO?

Recommendation: Under Para 3 (vii) of CARO 2016, statutory auditors need to report that the company has defaulted in repayment of dues to the bank to the extent of Rs 120 Lacs.

#### **Q14. (Issue of show cause notice by Excise Department)**

ABC limited received a show cause notice from central excise department intending to levy a demand of Rs 25 lacs in December 2015. The company replied to its notice in January, 2016 contending that it is not liable for the levy. No further action was initiated by the department upto finalization of audit for the year ended on March 31<sup>st</sup>, 2016. What would be the reporting requirements under CARO?

Recommendation: Under para 3(vii)(a) of CARO, 2016 in case of dues of Income Tax/ sales tax/ wealth tax/ service tax/custom duty/excise duty/value added tax/ cess have not been deposited on account of any dispute, then all



amounts involved and the forum where dispute is pending shall be mentioned by the statutory auditors. A show-cause or similar notice generally contains the requirements/ queries of the assessing officer. Normally, issuance of show cause notice by the concerned department should not be constructed to be a demand payable by the company. In the present case, accordingly no reporting is required to be made under this para 3(vii)(a) despite the fact that the company has replied to this notice in January 2016 contending that it is not liable for the levy and no further action was initiated by the department upto the finalization of audit for the year ended on March 31<sup>st</sup>, 2016.

**Q15. (Sales Tax Demand under appeal)**

There is a sales tax demand of Rs 3 crores against X Limited relating to previous year against which the company has gone into appeal.

Recommendation: Under Para 3(vii) of CARO 2016, in case dues of Income Tax/ sales tax/ wealth tax/ service tax/custom duty/excise duty/value added tax/ cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned by the statutory auditors. It is clarified here that mere representation to the concerned Department does not constitute dispute. According to the Order, it is necessary that there should be an appeal before the relevant appellate authority. This information thus need to be reported in the Statement of Disputed Dues comprising the nature, amount and period of dispute along with the Forum where the dispute is pending.

**Q16. (PF and ESI dues but no registration under the Act)**

'B' Ltd. manufacturing cycles has 150 employees. Auditors observe that it has not registered itself for Provident Fund and ESI purposes, not remitting the dues in time and auditor insists for qualifying the report. Management contends that the absence of registration it can't be construed that the company is in default of statutory dues on regular basis- Comment.

Recommendation: SA 250 on Consideration of Laws and Regulations in an Audit of Financial Statements, auditor need to consider the impact of applicable regulatory requirements on the financial statements. Non registration of PF and ESI and does not absolve the entity from its obligation under the Respective Acts. Accordingly, this contention by the management is not admissible. Hence, the statutory auditors need to report under para 3(vii) of CARO 2016 about the default in payment of statutory dues.

**Q17. Fixed Assets disposal and utilization of Term Loan**

Under CARO, 2016 how, should a statutory auditor comment on the following:

- (i) Fixed asset comprising 1/3<sup>rd</sup> of the total assets have been disposed off during the last year
- (ii) A term loan was obtained from a bank for Rs 75 lacs for acquiring R&D equipment, out of which Rs 12 lac was used to buy a car for use of the concerned director, who was overlooking the R&D activities.

Recommendation:

(i) Under CARO, 2003, an auditor was required to state if substantial part of the fixed assets have been disposed of during the year, whether it has affected the going concern. This clause requires the auditor to carry out adequate audit procedure to satisfy himself that the company shall be able to continue as going concern for the foreseeable future despite the sale of substantial part of the fixed assets. The similar requirements about substantial disposal of fixed assets and impact on going concern, if any, are not present under CARO, 2015 and 2016, unlike CARO, 2003.

(ii) Under CARO, 2016 an auditor is required to comment whether term loans were applied for the purpose for which the loans were obtained. The auditor should examine the terms and condition of the term loan with the actual utilization of loans. If the auditor finds that the funds have not been utilized for the purpose for which they are obtained, the report should state the fact. In the instant case, since term loan taken for the purpose of R&D equipment. Therefore the car used for R&D Director cannot be considered as R&D Equipment. The auditor should state the fact in his report that the out of term loan of Rs 75 lacs, Rs 12 lac was not utilized for the purpose of acquiring R&D equipment.

**Q18. Due towards foreign financial institution**

ABC Ltd. Has defaulted in repayment of dues to a foreign financial institution. Whether the reporting would be required under clause 3(viii) of CARO?

Recommendation: No, since a foreign financial institution is not covered for reporting under this clause of CARO.

**Q19. CARO not applicable- whether comment required**

Should the auditor comment on non-applicability of CARO in the audit report of a company to which the order does not apply?

Recommendation: As a measure of prudence it is advisable to insert a comment such as:

“This report does not include a statement on the matters specified in the Paragraph 3 of the Companies( Auditor Report) Order, 2016, issued by the Ministry of Company Affairs, in terms of Sec 143(11) of the Companies Act, 2013 since in our opinion and according to the information and explanations given to us, The said order is not applicable to the company “.

**One more clauses of CARO not applicable:** On a situation where one or more of the clauses is not applicable it would be appropriate for the auditor to make suitable comment in his report bringing out the fact of non applicability of a particular clause.