

CHAPTER 6 – CARO, 2020

APPLICABILITY

Question 1. (Important)

What are the various types of companies covered under Companies (Auditor's Report) Order, 2020 [CARO, 2020]?

OR

Examine the applicability of CARO,2020 in the below mentioned cases:

(a) Educating child is a limited company registered under section 8 of the companies Act, 2013

(b) ASHU PVT. LTD. having paid up capital and reserves of Rupees 50 lakhs. During the year, the company had borrowed Rupees 70 Lakhs each from a bank and financial institution independently. Turnover for the year was Rs. 900 lakhs.

Ans. Types of Companies Covered Under CARO, 2020: The Companies (Auditor's Report) Order, 2020 is an additional reporting requirement Order which has been issued by the Central Government in consultation with the Institute of Chartered Accountants of India under section 143(11) of the Companies Act, 2013. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013.

However, the Order specifically exempts the following class of companies-

- (i) A **banking company** as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;
- (ii) An **insurance company** as defined under the Insurance Act, 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;
- (v) A **small company** as defined under clause (85) of section 2 of the Companies Act; and
- (vi) A **private limited company, not being a subsidiary or holding company of a public company:**
 - Having a **paid-up capital and reserves and surplus not more than rupees one crore** as on the balance sheet date and
 - Which **does not have total borrowings exceeding rupees one crore** from any bank or financial institution at any point of time during the financial year and
 - Which **does not have a total revenue as disclosed in Scheduled III** to the Companies Act, 2013 (including revenue from discontinuing operations) **exceeding rupees ten crore** during the financial year as per the financial statements.

Conclusion:

- (a) CARO, 2020 is not applicable in case of Educating Child as it is registered under section 8 of the companies act 1956.
- (b) In case of Ashu Pvt. Ltd. CARO 2020 is applicable as borrowing in aggregate exceeds Rupees 1 crore.

Question 2.

Astha Pvt. Ltd. has fully paid capital of Rupees 140 lakh. During the year, the company had borrowed Rupees 15 lakh each from a bank and a financial institution independently. It has the turnover (Net of excise Rupees 50 lakh which is credited to a separate account) of Rupees 475 lakh. Will Companies (Auditor's Report) Order, 2020 be applicable to Astha Pvt. Ltd.?

Ans. Applicability of CARO, 2020: The CARO, 2020 specifically **exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date** and which does not have **total borrowings exceeding rupees one crore** from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

In the case of Astha Pvt. Ltd., it has outstanding loan of Rupees 30 lakh (Rupees 15 lakh + RUPEES 15 lakh) collectively from bank and financial institution which is less than Rupees 1 crore rupees and turnover is Rupees 4.75 crore i.e. also less than Rupees 10 crore and not exceeding the limit. However, it has paid capital of Rupees 140 lakh i.e. more than Rupees 1 crore.

Thus, in view of rupees 140 lakh paid up capital which is exceeding the prescribed limit for exemption, CARO, 2020 will be applicable to Astha Pvt. Ltd.

Question 3.

T Pvt. Ltd.'s paid up Capital & Reserves are less than Rupees 50 lakhs and it has no outstanding loan exceeding Rupees 25 lakhs from any bank or financial institution. Its sales are Rupees 6 crores before deducting Trade discount Rupees 10 lakhs and Sales returns Rupees 95 lakhs. The services rendered by the company amounted to Rupees 10 lakhs. The company contends that reporting under Companies Auditor's Reports Order (CARO) is not applicable. Discuss.

Ans. Applicability of CARO, 2020: The CARO, 2020 specifically exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

In the given case, paid up capital and reserves of T Pvt. Ltd. is less than Rupees one crore and has no loan outstanding exceeding Rupees one crore from any bank or financial institution. Further, its total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) is not exceeding rupees ten crore during the financial year as per the financial statements. **Thus CARO 2020 will not be applicable to T Pvt. Ltd.**

For Students Some cases are given below to understand CARO,2020 Applicability:

a) ABC Pvt. Ltd. is a holding company of XYZ Ltd. Whether CARO is applicable to ABC Pvt. Ltd.?

Ans: A private limited company, not being a subsidiary or holding company of a public company. In the present case, ABC Pvt. Ltd. is a holding company of XYZ Ltd. i.e. ABC PVT LTD is holding of Public company (XYZ LTD) hence, reporting under CARO is required.

Conclusion: CARO is applicable.

b) DSC Pvt. Ltd. has fully paid capital of Rupees140 lakh. During the year, the company had borrowed Rupees15 lakh each from a bank & a financial institution independently. It has the turnover (Net of excise RS. 50 lakh which is credited to a separate account) of Rupees475 lakh. Will Companies (Auditor's Report) Order, 2020 be applicable to Astha Pvt. Ltd.?

Ans. In the present case, paid up capital of the company exceeds Rupees1 Cr. Hence, reporting under CARO is required.

Conclusion: CARO is applicable over the company.

c) E-Tech Pvt. Ltd., which has an aggregate outstanding loan of Rupees20 lakhs from Banks and Rupees 30 lakhs from Financial Institutions, defaulted in repayment thereof to the extent of 50%. The company holds that it being a private limited company, the Companies (Auditor's Report) Order, 2020 is not applicable.

Ans. In the instant case the total borrowings do not exceed Rupees100 Lakhs during the year, reporting under CARO is not required.

Conclusion: Contention of the E Tech Pvt. Ltd., is correct that CARO, 2020 will not be applicable on it as outstanding loan from banks and financial institution in aggregate does not exceeds Rupees1 Crore.

d) A Pvt. Ltd. is incorporated on 1st July, 2018. During the year ended 31st March, 2019, it had issued shares (fully paid up) of RUPEES80 lakhs, had borrowed Rupees60 lakhs each from 2 financial institutions and its turnover (Net of excise Rupees100 lakhs which is credited to a separate account) is Rupees950 lakhs. Will Companies Auditors Report Order, 2020 (CARO) be applicable to A Pvt. Ltd.?

Ans. In the present case paid-up capital is Rupees 80 lakhs, turnover is less than ` 10 Crores but its borrowings from banks and financial institution is Rupees120 Lakhs,

While computing revenue, excise duty will not be considered as per the requirements of Schedule III.

While computing borrowings from banks and financial statements, **loans are to be taken cumulatively not individually.**

Conclusion: Contention of the A Pvt. Ltd. is not correct as total borrowings exceeds Rupees1 Cr., hence reporting under CARO, 2020 will be required.

e) As an auditor, how would you deal with the following: L Private Ltd., which has outstanding loan of more than Rupees100 lakhs from Financial Institution defaulted in repayment thereof to the extent of 50%. The company holds that it being a private limited company, the Companies Auditors Report Order (CARO) is not applicable. (Important)

Ans. In the instant case the total borrowings exceed rupees 100 Lakhs out of which company defaults in repayment to the extent of 50%. As borrowings exceeds Rupees1 Crore during the year, reporting under CARO is required.

Para 3 clause (viii) of CARO, 2020 requires the auditor to comment whether the company has defaulted in repayment of loans or borrowings to a financial institution, bank, government or debenture holder? If yes, the period and amount of default to be reported.

Conclusion: Contention of L Pvt. Ltd. is not correct as borrowings from financial institution exceeds Rupees1 Cr., and auditor is required to report the period and amount of default in repayment of dues under Para 3(viii) of CARO, 2020.

f) K Pvt. Ltd.'s paid up Capital & Reserves are less than Rupees1 cr. and it has no outstanding loan exceeding Rupees1 Cr. from any bank or financial institution. Its sales are Rupees12 crores before deducting Trade discount Rupees20 lakhs and Sales returns Rupees1.90 Cr. The services rendered by the company amounted to Rupees20 lakhs. The company contends that reporting under Companies Auditor's Reports Order (CARO) is not applicable. Discuss.

Ans. While computing total revenue, trade discount as well as sales returns are required to be deducted. In the present case the turnover of the company including value of service rendered after deducting trade discount and sales returns amounts to Rupees10.10 crores (i.e. 12 - 0.20 - 1.90 + 0.20 crore).

Conclusion: Contention of the company that CARO is not applicable is not correct, as Total Revenue exceeds Rupees 10 Cr

g) A Private limited company reports the following position as on 31st March 2019: Paid up capital Rupees60 Lacs Revaluation reserves Rupees20 Lacs Capital reserves Rupees22 Lacs P & L A/c (Dr. Balance) Rupees4 Lacs. The management of the company contends that CARO, 2020 is not applicable to it.

Ans. As per Guidance Note on CARO, 2020 issued by ICAI, while computing paid up capital and reserves, capital reserves, revenue reserves, revaluation reserves and credit balance of Profit and loss account are to be considered in aggregate as reduced by debit balance in the profit and loss account, if any. In the present case, paid up capital and reserves after deducting debit balance of Profit & Loss Account amounts to Rupees98 Lacs (60 + 20 + 22 - 4).

Conclusion: CARO is not applicable as paid up capital and reserves does not exceed ` 1 Cr. (assuming that other conditions as to borrowings and revenue also satisfied).

h) Under CARO, 2020, how as a statutory auditor would you comment on the following: X Pvt. Ltd. is a subsidiary of a listed entity. The management of the company believes that since X Pvt. Ltd. is a private company and satisfies all conditions under CARO, 2020, reporting under CARO is not applicable.

Ans. Exemption from CARO is not applicable to a private company which is a subsidiary of a public company.

Conclusion: Hence contention of the management that company being a private limited company and satisfies all the conditions required for exemption, is not correct.

i) H Private Ltd. (not a small company) had taken overdrafts from two banks with a limit of Rupees40 lacs each against the security of fixed deposit it had with those banks and an unsecured overdraft from a financial institution of Rupees36 lacs. The said loans were outstanding as at 31st March 2019. The paid-up capital and reserves of the company as at that date was Rupees80 lacs and its revenue during the financial year ended on 31st March 2019 was Rupees6 crores. The management of the company is of the opinion that CARO, 2020 is not applicable to it because turnover and paid up capital were within the limits prescribed and loans taken against the fixed deposits cannot be considered. The company further contended that loan limit is to be reckoned per bank or financial institution and not cumulatively. Comment.

Ans. In the present case paid-up capital is less than Rupees1 Cr., Revenue is less than Rupees10 Crores but its total borrowings from banks and financial institution is Rupees1.16 Cr. As per Guidance Note of CARO, 2020 issued by ICAI, while computing total borrowings from banks and financial statements, loans against Fixed deposits are to be taken into consideration. Further loans from banks and financial institutions are to be taken cumulatively not individually.

Conclusion: Contention of H Ltd. is not correct as total borrowings exceeds Rupees1 Crore., hence reporting under CARO, 2020 will be required.

j) A Private Limited Company reports the following position as on 31st March, 2019: Paid up Capital Rupees70 Lacs Revaluation Reserve Rupees 24 Lacs Capital Reserve Rupees 20 Lacs Profit & Loss (Dr.) Balance Rupees24 Lacs. The Management of the Company contends that CARO, 2020 is not applicable to it. Comment.

Ans. As per Guidance Note on CARO, 2020 issued by ICAI, while computing paid up capital and reserves, capital reserves, revenue reserves, revaluation reserves and credit balance of Profit and loss account are to be considered in aggregate as reduced by debit balance in the profit and loss account, if any

In the present case, paid up capital and reserves after deducting debit balance of Profit & Loss Account amounts to Rupees 90 Lacs (70 + 24 + 20 - 24).

Conclusion: CARO is not applicable as paid up capital and reserves does not exceed Rupees 1 Cr. (assuming that other conditions as to borrowings and revenue also satisfied).

Questions on CARO Clauses:

Question 4. (Important)

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

Ans: Reporting under CARO, 2020 w.r.t. Fraud:

Para 3 clause (xi) of CARO, 2020 requires the auditor to comment 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;

(further **CARO, 2020** requires the auditor to comment 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;)

(further **CARO, 2020** requires the auditor to comment whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;)

In the present case if purity of gold is not properly disclosed on the jewellery it amounts to defrauding the customer. It implies that the management is deceiving customers to obtain an illegal advantage.

As per **SA 240 "The Auditor's responsibilities in relation to an audit of Financial Statements"** the auditor is concerned with fraudulent acts that cause a material misstatement in financial statements. Hence as long as books of account are not falsified arising out of difference in the purity of gold, i.e., actual cost of the gold and the sale price of gold, it has no implication for the auditor.

Conclusion: From the view point of reporting on frauds under CARO, 2020, there is no implication for misstatement in the financial statements. Hence, no reporting is necessary for non-proper disclosure of purity of gold on the jewellery.

Question 5.

Discuss the matters to be included in the auditor's report regarding statutory dues and repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders as per CARO, 2020.

(RTP MAY 18)

OR

State the matters to be included in the auditor's report as per CARO, 2020 regarding:

- a. Defaulted in repayment of Loans or borrowings to a financial institution, banks etc.*
- b. Fraud by the company or on the company by its officers or employees.*

Ans. Matters to be included in the auditor's report- statutory dues and repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders (CARO, 2020):

(a) Statutory Dues:

Clause (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 with the appropriate authorities and if not, **the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated.**

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 constitute a dispute).

(b) Repayment of Loans and Borrowings or Defaulted in repayment of Loans or borrowings to a financial institution, banks etc.:

Clause (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 follows:-

1. Nature of borrowing
2. Name of Lender
3. Amount not paid on due date
4. Whether Principal or interest
5. No. of days delay or unpaid

(c) **Fraud by Company or on the company:**

whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated;

whether any report under 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

whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;

Question 6.

State the matters to be included in the auditor's report as per CARO, 2020, regarding:

(I) Private Placement of Preferential Issues.

(II) Utilisation of IPO and further public offer.

Ans. (I) The auditor is required to report as per **clause x (b) of paragraph 3 of CARO 2020**, 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 noncompliance;

(II) It is duty of the auditor to report **as per clause x (a) of paragraph 3 of CARO 2020**, 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;

Question 7.

Discuss the reporting requirements regarding Fixed Assets under CARO, 2020.

Ans. Reporting requirements regarding Fixed Assets under CARO, 2020 are:

As per clause(i) of Para 3 of CARO,2020 reporting requirements in respect of Fixed Assets are:

- (A)
 - i. whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment;
 - ii. whether the company is maintaining proper records showing full particulars of intangible assets;
- (B) whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
- (C) whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof as follows:-
 1. Description of property
 2. Gross Carrying Value
 3. Held in the name of
 4. Whether promoter, director or their relative or employee
 5. Period held-indicate range, where appropriate
 6. Reason for not being held in name of company
- (D) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;
- (E) whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements;

Question 8.

The scope of auditor's inquiry under clause (xi) of paragraph 3 of Companies (Auditor's Report) Order, 2020 is restricted to frauds 'noticed or reported' during the year. Explain.

Ans. Reporting under Companies (Auditor's Report) Order, 2020:

The auditor is also required to report under **clause (xi) of para 3** of Companies (Auditor's Report) Order, 2020, whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated;

whether any report under 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

whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;

The scope of auditor's inquiry under clause (xi) of paragraph 3 of Companies (Auditor's Report) Order, 2020 is restricted to frauds "noticed or reported" during the year. It may be noted that this clause of the Order, by requiring the auditor to report whether any fraud by the company or on the company by its Officer or employees has been noticed or reported, does not relieve the auditor from his responsibility to consider fraud and error in an audit of financial statements.

In other words, **irrespective of the auditor's comments under this clause, the auditor is also required to comply with the requirements of SA 240, "The Auditor's Responsibility Relating to Fraud in an Audit of Financial Statements"**.

Question 9.

The company has raised funds by issuing fully convertible debentures. These funds were raised for the expansion and diversification of the business. However, the company utilized these funds for repayment of long-term loans and advances." Advise the auditor regarding reporting requirements under CARO, 2020.

(NOV 18)

Ans. The auditor is required to **report as per clause x (b) of paragraph 3 of CARO 2020**, 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 noncompliance;

In view of the above clause, **the auditor would report that funds raised by the company for expansion and diversification of business have not been used for the said purpose** rather the company has utilised these funds for repayment of long-term loans and advance.

Question 10. M Ltd has given certain loans to related parties and also has accepted certain deposits. As an auditor, how you include the above items in paragraph 3 of CARO, 2020?

(Nov19)

Ans. 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 **Para 3(iii) of CARO,2020 requires the auditor to report the following:**

(i) **Loans to related parties:** Para 3 **clause (iii) of CARO, 2020** requires auditor to report 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,-

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

(A) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates;

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

II. 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;

III. 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;

IV. 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;

- V. 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];
- VI 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;

(ii) **Public Deposits: Para 3 clause (v) of CARO, 2020 requires auditor to report:**

In case the company has accepted deposits from the public, **para 3 clause (v) of CARO, 2020** requires auditor to report 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;

Question 11. (Important)

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

(i) A Term Loan was obtained from a bank for Rupees 80 lakh for acquiring R&D equipment, out of which Rupees 15 lakh was used to buy a car for use of the concerned director who was overlooking the R&D activities.

(ii) Physical verification of only 50% 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.

Ans. Reporting requirement under CARO, 2020

(i) Utilisation of Term Loans: According to **clause (x (a)) of Para 3 of CARO, 2020**, the auditor is required to report 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;

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

In the instant case, term loan taken for the purpose of R&D equipment has been utilized for the purchase of car which has no relation with R&D equipment. **Therefore, car though used for R&D Director cannot be considered as R&D equipment. The auditor should state the fact in his report as per Paragraph 3 clause ix of the CARO 2020, that out of the term loan taken for R&D equipment, Rupees 15 lakh was not utilised for the purpose of acquiring R&D equipment.**

(ii) Physical Verification of Inventory: According to **Clause (ii (a)) of Para 3 of CARO, 2020** requires the auditor to report on 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;

In the given case, the above requirement of CARO, 2020 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory verification is not reasonable. He may consider the impact on financial statement and report accordingly.

Question 12. During the financial year ended on 31.03.2018 LM Private Limited had borrowed from a Nationalized Bank, a term loan of Rs.120lakhs consisting of Rs. 100 lakhs for purchase of a machinery for the new plant and Rs.20 lakhs for erection expenses. As on the date of 31st March 2018, the total of capital and free reserves of the Company was Rs.50lakhs and turnover for the year 2017-18 was Rs. 750 lakhs. The Bank paid Rs.100lakhs to the vendor of the Company for the supply of machinery on 31.12.2017. The machinery had reached the yard of the Company On 28.02.2018, the Company had drawn the balance of loan viz. Rs.20 lakhs to the credit of its current account maintained with the Bank and utilized the full amount for renovating its administrative office building. The machinery had been kept as capital stock under construction. Comment as to reporting issues, if any, that the Auditor should be concerned with for the financial year ended on 31.03.2018, in this respect.

Ans. Applicability of CARO 2020 : CARO, 2020 specifically exempts a private limited company, not being a subsidiary company of a public company, having a paid up capital, reserves & surplus not more than rupees one crore as on balance sheet date and which does not have **total borrowing exceeding rupees one crore from any bank or financial institution at any point of time during the year** and which does not have a total revenue as disclosed in Schedule III to the companies Act 2013 exceeding Rs 10 crore during the financial year as per financial statements.

In the case of LM Pvt. Ltd, it has paid up capital of rupees 50 lacs which is below the specified limit of rupees 1 crore and turnover is rupees 7.5 crore which is also less than specified rupees 10 crore. **However, there is total borrowing of rupees 1.20 crore which is more than rupees 1 crore and exceeding the specified limits of rupees 1 crore. Hence CARO, 2020 will be applicable to LM Pvt. Ltd.**

Utilisation of Term Loan:

As per **clause (x (a)) of Para 3 of CARO, 2020**, an auditor need to state in his report that 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;

The auditor should examine the terms and conditions subject to which the company has obtained the term loans. The auditor may also examine the proposal for grant of loan made to the bank. As mentioned above, normally, the end use of the funds raised by term loans is mentioned in the sanction letter or documents containing the terms and conditions of the loan. **The auditor should ascertain the purpose for which term loans were sanctioned.**

The auditor should also compare the purpose for which term loans were sanctioned with the actual utilization of the loans. The auditor should obtain sufficient appropriate audit evidence regarding the utilization of the amounts raised. **If the auditor finds that the funds have not been utilized for the purpose for which they were obtained, the auditor's report should state the fact.**

In the present case, the term loan obtained by LM Private Ltd. amounting rupees 20 lakh have not been utilized for erection expenses instead its utilized for renovating its administrative office building. Further, assuming that erection work has not been done and machinery is not being installed, disclosure of the same as Capital Stock under construction is in order.

Here, the auditor should report the fact in his report that pending utilization of the term loan for erection expenses, the funds were temporarily used for the purpose other than the purpose for which the loan was sanctioned as per clause (x (a)) of Para 3 of CARO, 2020.

Question 13.

C Ltd. has defaulted in repayment of dues to a financial institution during the financial year 2020-17 and the same remained outstanding as at March 31, 2017. However, the Company settled the total outstanding dues including interest in April, 2017 subsequent to the year end and before completion of the audit. Discuss how you would deal with this matter and draft a suitable Auditor's Report.

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

Further, as per **clause (ix (a)) of Para 3 of CARO, 2020**, the auditor of a company has to state in his report whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as follows:-

1. Nature of borrowing
2. Name of Lender
3. Amount not paid on due date
4. Whether Principal or interest
5. No. of days delay or unpaid

In the given case, C Ltd. has defaulted in repayments of dues to a financial institution during the financial year 2020-17 which remain outstanding as at March 31, 2017. **However, the company has settled the total outstanding dues including interest in April, 2017 but, the dues were outstanding as at March 31, 2017. Therefore, it needs to be reported in the notes to accounts.**

The draft report for above matter is as under:

"The company has taken a loan during the year, from a financial institution amounting to FXXXX @ X% p.a. which is repayable by monthly installment of Rs. XXXX for XX months.

The company has defaulted in repayment of dues including interest to a financial institution during the financial year 2015-16 amounting to Rs. XXXX which remained outstanding as at March 31, 2017. The period of default is XXX days. However, the outstanding sum was settled by the company in April 2017."

Question 14. Advise the auditor regarding reporting requirements under CARO, 2020 of following clauses:

- 1. Clause(iv) In respect of loans, investments, guarantees, and security**
- 2. Clause(vi) maintenance of cost records**
- 3. Clause(xii) Nidhi Company has complied provisions contained in the Nidhi Rules, 2014**

Ans. (1) Clause (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.

1. As per section 185 of the companies Act, 2103, no company shall directly or indirectly-

- a) Advance **any loan** to a “**specified person**”.
- b) give **any guarantee** in connection with a loan taken by a “specified person”
- c) Provide **any security** in connection with a loan taken by a “specified person”.

Except in certain cases

2. Auditor shall examine loans and guarantees to **ensure compliance with section 185** and comment on this clause accordingly.
3. As per the provision of section 186 of the companies Act, 2013, if the loans, investments etc. already made by the company along with loans, investments etc. proposed to be made by the company exceed the **limit specified under section 186(2), approval by special resolution** is required.
4. Moreover, **approval of board is required prior to making any loan, or giving any guarantee or providing any security** to any person or investing in securities of anybody corporate, irrespective of amount involved therein.
5. Auditor should **obtain the copies of board resolution and SR**, if any, to check compliance with section 186.
- 6. Section 186 requires following disclosures in financial statement as well:**
 - (i) **full particulars** of loans, investments etc.
 - (ii) **purpose** of the recipient
- 7. Auditor shall, after examining the same, comment under this clause accordingly.**

(2) clause (vi) Where maintenance of cost records have been prescribed by the central Government under section 148(1) of the Act, whether such accounts and records have been made and maintained.

1. The order requires the auditor to report whether **cost accounts and records have been made and maintained** when required under 148(1)
2. The auditor should **obtain a written representation** from the management.
3. The auditor should, **conduct a general review of the cost records** to ensure that the records as prescribed are made and maintained.
4. **Auditor should report** on this clause in such cases also, where maintenance of cost records is required although cost audit is not mandatory.

(3) Clause (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 has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability;

whether the Nidhi Company is maintaining ten per cent. unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof;