

## 6. AUDIT REPORTING

### SA 700 FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

#### A. OBJECTIVES OF THE AUDITOR UNDER SA- 700:

The objectives of the auditor are:

- a) To form an opinion on the financial statements based on the conclusions drawn from audit evidence obtained; and
- b) To express an opinion on the financial statements through a written report, known as Auditor's report.

#### B. DEFINITIONS:

##### Unmodified opinion:

When the auditor concludes that the financial statements are free from material misstatements (i.e. give a true and fair view) and are also prepared in accordance with the applicable financial reporting framework, then he shall express an unmodified opinion which is also known as Unqualified Opinion or Clean Opinion.

##### Unmodified opinion indicates:

1. The auditor has obtained sufficient appropriate evidence.
2. The financial statements disclosed all relevant information as required by law or regulatory.
3. The accounting policies and changes therein are adequately disclosed in the financial statements.
4. The financial statements are prepared as per applicable financial reporting framework.

#### C. EVALUATIONS TO BE MADE BY AUDITOR:

The auditor shall evaluate whether the financial statements are prepared in accordance with the applicable financial reporting framework.

While evaluating the auditor shall also consider:

1. The qualitative aspects of entities accounting practices.
2. Specific evaluations while forming an opinion.

##### 1. Qualitative aspects of Entities Accounting Practices:

- a) While evaluating accounting systems, the auditor may find existence of management bias and lack of neutrality over accounting practices.
- b) These situations may cast significant doubt on reliability of financial statements which may be materially misstated.
- c) The indicators of management bias or lack of neutrality are as follows:
  - i) Selective correction of misstatements brought to the notice of management by auditor.  
E.g.: Correcting only those misstatements which increases reported earnings and ignoring the other misstatements that decrease the earnings.
  - ii) Possible management bias over selecting appropriate accounting estimates.
  - iii) Infrequent changes in accounting policies without any proper reason.

##### 2. Specific evaluations while forming opinion:

The auditor shall take into account the following specific factors while forming an opinion:

- a) Whether the financial statements adequately disclose the significant accounting policies selected and applied;
- b) Whether the accounting policies selected and applied are consistently and are in accordance with the applicable financial reporting framework and are appropriate;

- c) Whether the accounting estimates made by management are reasonable;
- d) Whether the information presented in the financial statements is relevant, reliable, comparable, and understandable and not misleading;
- e) Whether the terminology used in the financial statements, including the title of each financial statement, is appropriate.

#### D. WHEN A MODIFIED OPINION IS ISSUED?

- a) If the auditor concludes that, based on the Sufficient and appropriate audit evidence obtained, the financial statements as a whole are **NOT** free from material misstatement; **or**
- b) Is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

#### E. CONTENTS OF THE AUDITOR'S REPORT:

1. Title
2. Addressee
3. Opinion Para
4. Basis for Opinion
5. **Going Concern (SA 570)**
6. **Key Audit Matters (SA 701)**
7. **Emphasis and Other Matter Para (SA 706)**
8. Responsibilities of management for the Financial Statements.
9. Auditor's Responsibilities for the Audit of the Financial Statements.
10. Report on Other Legal and regulatory requirements
11. Signature of the Auditor
12. Place of Signature
13. Date of the Auditor's Report.

Applicable as per the relevant standard

#### F. DETAILED EXPLANATION TO FEW CONTENTS OF AUDIT REPORT:

##### 1. **Opinion Paragraph / Auditor's Opinion:**

- a) Description about financial statements of the entity under audit.
- b) Description about title of components of financial statements.
- c) Reference to notes and significant accounting policies.
- d) Reference to the period covered by the above financial statements.

##### 2. **Basis for Opinion Paragraph:**

- a) Description about conduct of audit as per standards on auditing.
- b) Description in brief of auditor's responsibilities and reference to such paragraph.
- c) Statement that the auditor complied with the ethical requirements of law and code of ethics.
- d) Statement as to whether the auditor obtained sufficient appropriate audit evidence for the opinion expressed by him.

##### 3. **Responsibilities for financial statements:**

Refer to "Preconditions to audit" under SA 210 - Given in First chapter.

#### SIMILAR QUESTIONS:

1. An auditor is required to make specific evaluation while forming an opinion in an audit report. State them. A. Write Point C (2).	N18(N) - 4M
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2. An auditor issues unqualified opinion when he concludes that the financial statements give true and fair view. A. Write Point B.	N16 - 2M
3. In order to form the audit opinion as required by SA 700, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Explain the conclusions that the auditor shall take into account. Also explain the objective of auditor as per SA 700. A. Write Point C (2).	MTP N18(N)
4. The Auditor is fully satisfied with the audit of an entity in respect of its systems and procedures and wants to issue a report without any hesitation. What type of opinion can be give and state give reasoning. A. Write Point B.	M18(O) - 4M
5. The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Explain. A. Write Point F (3).	RTP N18(N)
6. What is the basis on which the judgement is formed by Auditor to express his opinion after the audit? A. Write Point C (2).	M18(O) - 6M
7. The objective of audit is to obtain absolute assurance and to report on the financial statements. Comment A. Write Point A.	M18(N&O)-2M
8. The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices including indicators of possible bias in management's judgments. Advice about qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. A. Write Point C (1).	M18(N) - 5M, MTP M18(N)

### SA 701 COMMUNICATING KEY AUDIT MATTERS IN THE AUDITOR'S REPORT

#### A. DEFINITION OF KEY AUDIT MATTER:

The matters which in auditor's Judgment are of most significant in the audit of the financial statements of the current period and these are selected from the matters communicated with those charged with governance.

Further the KAM shall not pertain to previous years audit matters.

#### B. PURPOSE OF KEY AUDIT MATTER (OBJECTIVE):

1. The purpose of communicating key audit matters is to enhance the communicative value of auditor's report by providing greater transparency about the audit that was performed.
2. Communicating key audit matters in the auditor's report is:
  - a) NOT a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make;
  - b) NOT a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705;
  - c) NOT a separate opinion on individual matters.

**C. APPLICABILITY:**

This SA applies to

- a) Audits of complete sets of general purpose financial statements of listed entities.
- b) Circumstances when the auditor otherwise decides to communicate KAM in the auditor's report.
- c) When the auditor is enquired by law or regulation to communicate KAM in the auditor's report.

**D. PROHIBITION ON KEY AUDIT MATTERS (KAM):**

SA 705 prohibits the auditor from communicating key audit matters when the auditor disclaims an opinion on the financial statements

**E. FACTORS FOR DETERMINING KEY AUDIT MATTERS:**

The auditor shall take into account the following factors while determining the Key Audit Matters:

1. Areas of higher assessed risk of material misstatement or significant risks identified in accordance with SA 315
2. Areas where significant judgments are involved that are made by management or any person connected there with.
3. The effect of significant events or transactions that occurred during the period.

**F. COMMUNICATION WITH TCWG**

The auditor shall communicate with TCWG:

- a) Those matters the auditor has determined to be the key audit matters; or
- b) The auditor's determination that there are no key audit matters to communicate in the auditor's report.

**G. CIRCUMSTANCES WHERE A KEY AUDIT MATTER SHALL NOT BE COMMUNICATED:**

In the following circumstances the auditor shall not communicate KAM:

- a) Law or regulation prohibits such disclosure about the matter; or
- b) The auditor determines that the matter should not be communicated in the auditor's report because of the possible adverse consequences.
- c) If the auditor concluded that the matter is highly confidential or sensitive at the interest of the company.

**SIMILAR QUESTIONS:**

1. Explain clearly the purpose of communicating key audit matters. A. Write Point B.	RTP N18(N)
2. The statutory auditor of ABC LTD is of the opinion that communicating key audit matters in the auditor's report constitutes a substitute for disclosure in the financial statements. A. Write Point A and B (2) (a).	M18 - 2M
3. Communicating key audit matters in the auditor's report is a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation. A. Write Point A and B (2) (a).	M18 - 2M
4. When a KAM shall not be communicated in the auditor's report? A. Write about Meaning and Point C and E	
5. When certain matters shall not be communicated under KAM even though the auditor is not expressing disclaimer of opinion? A. Write meaning and Point E.	

<p>6. What are the factors determining the KAM's? A. Write Meaning and Point D.</p>	
<p>7. The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters". What would the introductory language in this section of the auditor's report state. Also, state the purpose of communicating key audit matters. A. Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. (Not relevant from exam perspective) Also write about purpose of KAM.</p>	MTP M18 (N)

### SA 705 MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

#### A. CIRCUMSTANCES WHEN A MODIFICATION TO THE AUDITOR'S OPINION IS REQUIRED:

The auditor shall modify the opinion in the auditor's report when:

- a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
- b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

#### B. DIFFERENT TYPES OF AUDIT OPINIONS:

##### 1. Qualified Opinion:

The auditor shall express a qualified opinion when -

- a) The auditor concludes based on sufficient and appropriate evidence that the financial statements contains misstatements which are material but not pervasive; or
- b) If the auditor is unable to obtain sufficient and appropriate evidence and concludes that the possible effect of undetected misstatements on financial statements, if any, could be material but not pervasive.

##### 2. Adverse Opinion:

The auditor shall express an adverse opinion if he concludes based on sufficient and appropriate evidence that the financial statements contains misstatements which are material and pervasive.

##### 3. Disclaimer of Opinion:

The auditor shall disclaim the opinion when he is unable to obtain sufficient and appropriate evidence and concludes that the possible effect of undetected misstatements, if any, could be material and pervasive.

#### C. MEANING OF PERVASIVE EFFECTS:

Pervasive effects on the financial statements are those that, in the auditor's judgment:

- i) Are not confined (limited) to specific elements, accounts or items of the financial statements;
- ii) If so confined, represent or could represent a substantial proportion of the financial statements; or
- iii) In relation to disclosures, are fundamental to user's understanding of the financial statements.

**Below table shows different types of Opinions based in different situations**

Situation	Case	MMS exist?	Pervasive?	Opinion
Sufficient and appropriate evidence <u>OBTAINED</u>	A	No	NA	Unqualified Opinion
	B	Yes	No	Qualified Opinion
	C	Yes	Yes	Adverse Opinion

Situation	Case	Is it Material?	Is the possible effect Pervasive?	Opinion
Sufficient and appropriate evidence <u>NOT OBTAINED</u>	A	No	NA	Unqualified Opinion
	B	Yes	No	Qualified Opinion
	C	Yes	Yes	Disclaimer Opinion

**Observations:**

- Adverse Opinion arises only in a situation where Sufficient and appropriate evidence is Available.
- Disclaimer of Opinion arises only in a situation where sufficient and appropriate evidence is NOT Available.

In other words "Availability of sufficient and appropriate evidence and Disclaimer of Opinion are mutually exclusive"

**D. REFERENCE IN AUDIT REPORT IN CASE OF MODIFIED OPINION:**

The Opinion paragraph and Basis for opinion paragraph headings shall be appropriately modified where the auditor expresses a modified opinion:

- In case of Qualified Opinion:
  - Qualified Opinion
  - Basis for Qualified Opinion
- In case of Adverse Opinion:
  - Adverse Opinion
  - Basis for Adverse Opinion
- In case of Disclaimer Opinion:
  - Disclaimer Opinion
  - Basis for Disclaimer Opinion

**SIMILAR QUESTIONS:**

1. State the circumstances which could lead to any of the following in an auditor's report: i) A modification of opinion ii) Disclaimer of opinion iii) Adverse opinion iv) Qualified opinion A. Refer Point A	N18(O)-4M; MTP M18(O)
2. An auditor should issue disclaimer opinion when there is difference of opinion between him and the management on a particular point. A. Write Point B (3).	N18 (N&O)- 2M
3. The auditor will issue a disclaimer of opinion if he disagrees with the Management with regard to the acceptability of the Accounting Policies and the inadequacy of disclosures in the financial statements. A. Write Point B (3).	N18(O)-2M
4. If financial statements are misstated, and in the auditor's judgment such misstatement is material and pervasive, he should issue a qualified opinion. A. Write Point B (2).	M17-2M
5. The auditor shall express an unqualified opinion if the auditor is unable to obtain sufficient audit evidence regarding the opening balances. A. Write Point B (3). (As per SA 510)	N14-2M
6. If financial statements are misstated, and in the auditor's judgment such misstatement is material and pervasive, he should issue a qualified opinion. A. Refer Point 2(B)	M17 - 2M

7. What are the circumstances that may result in other than an unqualified opinion on the financial statements by an auditor? A. Write Point A.	N17 - 5M
8. The auditor shall express an adverse opinion when: a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive. A. Write Point B (1).	MTP N18(N)
9. The auditor of PQR LTD. is unable to obtain sufficient appropriate audit evidence and also auditor thinks that the possible effects of undetected misstatements on the financial statements would be both material and pervasive. The auditor perceives the situation involving multiple uncertainties there by the auditor concludes that it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements. Advise and explain the type of opinion auditor would issue in the given circumstances. You are also required to explain the meaning of pervasive in this regard. A. Write Point B (3) and Point C.	MTP M18(N)
10. The auditor shall express a qualified opinion when the auditor concludes that the financial statements are prepared in all material respects, in accordance with the applicable financial reporting framework. A. Refer Point 1	RTP N17
11. The auditor shall disclaim an opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements. A. Write Point B (2).	RTP M19(O)

## SA 706 EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

### A. DEFINITIONS:

- Emphasis of Matter paragraph:** A paragraph included in the auditor's report that refers to a matter presented or disclosed in the financial statements.
- Other Matter paragraph:** A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements. This paragraph mainly contains describing of auditors specific responsibilities such as responsibility in case of branch audit and joint audits.

### B. USAGE OF EMPHASIS OF MATTER PARAGRAPH:

Emphasis of Matter paragraph is used to draw user's attention to a matter which is important for user's understanding of F/S's in view of the auditor's judgment.

The auditor shall include an Emphasis of Matter paragraph only he has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the F/S's.

**Examples of when it is used:**

- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

**C. MANNER OF PRESENTATION OF EMPHASIS OF MATTER:**

- a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
- b) Shall express the matter being emphasized (highlighted) and give the reference to such matter in the financial statements. Accordingly this paragraph shall refer only to information presented or disclosed in the financial statements; and
- c) Also state that the auditor's opinion is not modified in respect of the matter emphasized.

**D. COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE:**

If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the wording of this Para.

**SIMILAR QUESTIONS:**

1. Define emphasis of matter paragraph and how it should be disclosed in the independent auditor's report? A. Write about Point A (1) and C.	M18-5M; MTP M18(O)
2. Other matter paragraph is paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements. A. Write Point A (2).	MTP N18(N)
3. What is an Emphasis of Matter paragraph, when it is used, and manner of its use in an audit report? A. Write Point A (1) and C.	M17 - 4M
4. When the auditor includes an Other Matter paragraph in the auditor's report, the auditor need not include the paragraph within a separate section. A. Write Point A (2).	M18(O)-2M

**ADDITIONAL REPORTING REQUIREMENTS UNDER THE COMPANIES ACT, 2013**

**Q.No.1. Explain various reporting requirements of the auditor u/s 143? (A)**

**(NEW SM)**

**A. DUTY OF AUDITOR TO INQUIRE ON CERTAIN MATTERS u/s 143(1):** It is the duty of auditor to inquire into the following matters:

1. Whether loans and advances made by the company.
  - a) On the basis of security have been properly secured and
  - b) Whether the terms on which they have been made are prejudicial to the interests of the company or its members;
2. Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
3. Whether any Shares or Securities held by the company are sold at a price less than purchase price. However this point shall not apply to banking and investment companies.
4. Whether loans and advances made by the company have been shown as deposits;
5. Whether personal expenses have been charged to revenue account;
6. Where it is stated in the books and documents of the company that any shares have been allotted for cash:
  - a) Whether cash has actually been received in respect of such allotment and
  - b) If no cash has actually been received, the position as stated in the account books and the balance sheet is correct, regular and not misleading.



**Reporting Requirements:** If the auditor got a positive response he can ignore above matters. However if there is any negative or adverse comments observed then he shall state them in his report along with reasons.

In the audit report these matters should be included under the section “reporting on legal and other regulatory requirements”.

- B. DUTY TO REPORT ON CERTAIN MATTERS u/s 143(3):** The auditor’s report shall also state
- a) Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit.
  - b) Whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
  - c) Whether the report on the accounts of any branch office of the company audited by a person other than the company’s auditors (Branch auditor) has been sent to him and How he has dealt with it in preparing his report;
  - d) Whether the company’s balance sheet and profit and loss account (Financial Statements) dealt with in the report are in agreement with the books of account and returns;
  - e) Whether, in his opinion, the financial statements comply with the accounting standards;
  - f) The observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
  - g) Whether any director is disqualified from being appointed as a director under sub- section (2) of the section 164;
  - h) Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
  - i) Whether the company has adequate internal financial controls w.r.t financial statements in place and the operating effectiveness of such controls; (Ref - Note 1)
  - j) Such other matters as may be prescribed. Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribes the other matters to be included in auditor’s report. The auditor’s report shall also include their views and comments on the following matters, namely:-
    - i) Whether the company has disclosed the impact of pending litigations on its financial position in its financial statement;
    - ii) Whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
    - iii) Whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

**Note 1:** The provisions of internal financial controls shall not apply for the following private limited companies:

- a) One Person company.
- b) Small company.
- c) A Private company satisfying the following conditions-
  - i) Turnover as per latest financial statements shall not exceed Rs. 50 Crore and
  - ii) Loans and Borrowings from banks and financial institutions shall not exceed Rs. 25 Crore.

**Audit Reporting requirements:**

- a) The auditor shall report on the above matters irrespective of positive or negative remarks observed by him.
- b) Further he shall state these matters under the section “reporting on legal and other regulatory requirements”.

**C. DUTY TO REPORT AS PER CARO 2016: SECTION 143(11):**

The auditor shall comment on another 16 matters under CARO, 2016. These matters will be discussed in the Question - 2.

**SIMILAR QUESTIONS:**

1. The auditor of X Ltd. did not report on the matters specified under <u>section 143(1)</u> of the Companies Act, 2013, as he was satisfied that no comment is required. However, the management of the company wanted the auditor to disclose the findings of enquiry thinking that it would provide a good impression on the stakeholders. Now, agreeing with the thought of the management, the auditor is thinking to disclose his findings of enquiry. Comment. A. Write Reporting requirement of Sec. 143(1).	MTP M18(O)
2. The auditor of XYZ Ltd. did not report on the matters specified in sub-section (1) of Section 143 of the Companies Act, 2013, as he was satisfied that no comment is required. Explain. A. Write Reporting requirement of Sec. 143(1).	MTP N17
3. "The auditor's report shall also state the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company." Discuss with relevance to Companies Act, 2013. A. Write Point B (f) and its reporting requirement. Further includes a brief about emphasis of matter para and Modified opinion related issues.	RTP M17

Ref: Practical Q.No's 23 to 26

**Q.No.2. Explain the provisions relating to responsibilities of an auditor to report under CARO 2016? (A) (NEW SM)**

- A. **APPLICABILITY OF THE ORDER** The Companies Auditor Report Order, 2016 (CARO) is an additional reporting requirement Order. The order applies to every company including a foreign company. However it shall not apply to following classes of companies:
1. A banking company
  2. An insurance company
  3. A company licensed to operate under section 8 of the Companies Act;
  4. A One Person Company.
  5. A Small company and
  6. A Private Limited Company:
    - a) Not being a subsidiary or holding company of a public company and
    - b) The Total Paid up capital and reserves & surplus shall not exceed Rs. 1 Crore as on the balance sheet date and
    - c) The Total Borrowings from banks and financial institutions shall not exceed Rs. 1 Crore at any point of time during the financial year and
    - d) Total Turnover calculated as per Schedule III (including revenue from discontinuing operations) shall not Exceed Rs. 10 crore during the financial year as per the financial statements.

**POINTS TO BE KEPT IN MIND WHILE CALCULATING ABOVE PARAMETERS:**

1. Paid up share capital:
  - a) **Inclusions:** It includes both equity share capital as well as the preference share capital.
  - b) **Exclusions:** It excludes share application money received pending allotment, calls in arrears and calls in advance.

**2. Reserves and surplus:**

- a) It includes all the reserves (whether capital or revenue reserves) as disclosed in the Schedule III of the companies act, 2013.
- b) Revaluation reserve, if any, should be taken into consideration while determining the applicability of CARO.
- c) The debit balance of the profit and loss account, if any, should be reduced from the figures of Reserves & Surplus same as per Schedule III.
- d) If there any excess debit balance of profit and loss account after adjustment to Reserves & Surplus, then such excess can be netted off against Paid up Capital also.
- e) Provisions are excluded whether they are made for depreciation or for Diminution in the value of assets or for any known liability.

**3. Borrowing:**

- a) Loans taken from banks and financial institutions are only to be considered.
- b) It includes all the loans irrespective of nature of loans:
  - i) Whether term loans, demand loans, working capital loans, cash credits, and overdraft, bills purchased and discounted.
  - ii) Whether loans whether secured or unsecured.
- c) The limit shall be computed with reference to the aggregate borrowings from all banks and financial institutions cumulatively but not as per each bank or financial institute basis.
- d) The limit shall be considered at any point of time during the financial year i.e. on any day during the year but need not on the date of balance sheet.
- e) Where the company has taken any overdraft facility against Fixed Deposits, the gross amount outstanding in overdraft facility (without adjusting Fixed Deposit) shall be considered for the purpose of CARO.
- f) Amounts outstanding in respect of Credit Cards also would also be considered.

**4. Turnover:**

- a) Revenue means the aggregate amount of sales affected by the company including the revenue from discontinuing operations.
- b) It includes sale of goods, services & any other operating revenues earned by the company.
- c) GST shall be deducted from the Turnover.
- d) It excludes sales returns and trade discounts, if any.

**5. Additional points:**

- a) **In the case of holding and subsidiary companies:**
  - i) The limits for applicability of CARO should be computed on the basis of standalone financial statements of holding and subsidiary companies separately but not on the basis of consolidated financial statements.
  - ii) CARO, 2016 reporting shall not apply to the Auditor's Report on Consolidated Financial Statements.
- b) **In the case of companies having branches:**
  - i) The limits for the purpose of Applicability of CARO shall be computed from the entire company's view including the amounts form all the branches but not w.r.t each branch wise.
  - ii) Once it is applicable to the company as a whole, then each and every branch of the company will be covered under CARO. Therefore, all the branch auditors of the company are also required to report on these 16 matters in their branch audit report of the concerned branches.

**MATTERS TO BE COMMUNICATED AS PER CARO:****1. Fixed Assets:**

- a) Whether the company is maintaining proper records showing full particulars including
  - i) Quantitative details and
  - ii) Situation of fixed asset.
- b) Whether these fixed assets have been physically verified by the management at reasonable intervals;
  - i) Whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of accounts.
- c) Whether the title of immovable properties are held in the name of the company. If not provide the details of the same.

**2. Inventories:**

- a) Whether physical verification of inventory has been conducted at reasonable intervals by the management.
- b) Whether any material discrepancies if any, were noticed on physical verification and if so, whether the same have been properly dealt with in the books of accounts.

**3. Loans to Directors and Interested parties:**

- a) Whether the company granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintains under section 189 of the Co.'s Act, 2013.
  - i) If so, verify the number of parties and the amount involved in the transaction?
  - ii) Whether the terms & conditions of grant of such loans are not prejudicial to the company's interest.
- b) Whether the repayment of principal & payment of interest has been regularly received on or before the due dates.
- c) If amount is overdue and if such amount overdue for more than 90 days, whether reasonable steps have been taken by the company for recovery of the principal and interest.

**Note:** it should be noted that CARO 2016 consider loans granted but not loans taken.

4. **Loans, Investments, Guarantees made by company:** In respect of loans, Investments, Guarantees, and securities provided by company, whether provisions of section 185 & 186 have been complied with? If not, provide the details thereof.

**Note:** This point also deals only with loans made and not loans received.

5. **Deposits:** In case the company has accepted deposits from the public,

- a) Verify the compliance with the following:
  - i) the provisions of Sections 73 to 76 of the Co.'s Act, 2013 or
  - ii) whether the directives issued by the RBI and
  - iii) An order passed by CLB or any court or any other Tribunal, if any.
- b) If there is any Non-compliance, the nature of contraventions should be stated;

**6. Cost Records:**

- a) Whether maintenance of cost records has been prescribed by the Central Government under sub section (1) of section 148 of the Co.'s Act, 2013 is applicable.
- b) If applicable, whether such accounts and records have made and maintained.

**7. Statutory Dues:****a) Undisputed dues:**

- i) Is the company regular in depositing undisputed statutory dues e.g. provident fund, ESI, Income Tax, service tax and any other statutory dues with the appropriate authorities and
- ii) 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 by the auditor. (Only Information and not opinion)

**b) Disputed dues:**

In case dues have not been deposited on account of any dispute, the auditor shall indicate

- i) The amounts involved in dispute and
- ii) The forum where dispute is pending.

**Note:** A mere representation to the concerned department shall not constitute a dispute.

**8. Default in repayment of dues:****a) Whether the company has defaulted in repayment of borrowings of loans to**

- i) a financial institution or
- ii) Bank or
- iii) Debenture holders.

**b) If yes, the period and amount of default to be reported each lender wise.****9. Application of funds:****a) Whether the money raised by way of initial or further public offer (including debt instruments) & term loans were utilized for the purposes for which those are raised.****b) If not, the details along with the defaults, delays & subsequent rectifications, if any, to be reported.****10. Reporting of Frauds:****a) Whether any fraud by or on the company by its officers or employees has been noticed or reported during the year;****b) If yes, the nature and the amount involved is to be indicated.****11. Managerial Remuneration:****a) Whether managerial remuneration has been paid or provided in accordance with the provisions of section 197 read with Schedule V?****b) If paid in excess, state the amount involved & steps taken by company for refund of the same.****12. Nidhi Company:****a) Whether Nidhi Company has complied with the net owned funds (i.e. net worth) to deposits in the ratio of **1:20** to meet out the liability.**

i.e. for every one rupee of net owned funds, Nidhi company cannot accept more than 20 rupees of deposits.

**b) Whether Nidhi Company is maintaining 10% Unencumbered term deposits as specified in Nidhi Rules, 2014 to meet out the liability****13. Related Party Transaction: Whether all transaction with related parties are****a) In compliance with section 177 & 188 where applicable, &****b) Details have been disclosed in the financial statements etc., as required by applicable accounting standards.****14. Preferential allotment:****a) Whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review &**

- b) If so, verify the following:
- Compliance with section 42 of the act. and
  - The amount raised have been used for the purpose for which they are raised.
- c) If not provide the details in respect of the amount involved & nature of non-compliance

**15. Non-Cash Transaction:** Whether Company has entered into any Non-Cash Transactions with directors & if so provisions of section 192 have been complied with.

**16. Non-Banking Financial Institution:**

- Whether the company is required to be registered under section 45-IA of Reserve Bank of India Act 1934, and
- If so, whether the registration has been obtained.

**Audit Reporting:**

- The reporting under the above matters is mandatory. Means whether it is positive or negative the auditor must comment.
- Where the response obtained for the above matters is negative, the auditor shall give reasons thereof.
- Also, where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons why it is not possible for him to give his opinion on the same.

Ref: Practical Q No's 1 to 21

**SIMILAR QUESTIONS:**

1. State the matters to be included in the auditor's report as per CARO 2016, regarding: i) Private placement of preferential issues. ii) Utilisation of IPO and further public offer. A. Refer Point 14 & Point 9	M18(N) - 2M
2. Discuss which class of companies are specifically exempt from the applicability of CARO 2016. A. Write about Applicability.	N16 - 6M; MTP M18(O)
3. 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, 2016. A. Refer Point 7 & Point 8	RTP M18 (N&O)
4. State the matters to be included in the auditor's report as per CARO, 2016 regarding i) Fixed Assets ii) Statutory dues A. Refer Point 1 & Point 2	MTP N18
5. State the matters to be included in the auditor's report as per CARO, 2016 regarding- i) In case the company has accepted deposits ii) Nidhi company A. Refer Point 5 & Point 12	MTP M18
6. State the matters to be included in the auditor's report as per CARO, 2016 regarding i) Default in repayment of loans or borrowing to a financial institution, bank etc. ii) Fraud by the company or on the Company by its officers or employees. A. Refer Point 8 & Point 10	MTP M18

<p>7. The scope of auditor's inquiry under clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016 is restricted to frauds 'noticed or reported' during the year. Explain.</p> <p>A. Refer Point 10</p>	RTP M18(N)
<p>8. CARO, 2016 is intended to limit the duties and responsibilities of auditors.</p> <p>A. False, CARO objective is to make the audit report more informative. It deals nothing with rights and duties of the auditor and his limitations. It is just a additional responsibility to report on certain specified matters.</p>	MTP N18(O)

### SA 600 USING THE WORK OF ANOTHER AUDITOR

#### A. DEFINITIONS:

1. **Principal auditor:** The auditor has a responsibility of reporting on the financial information of an ENTITY when that financial information includes the financial information of one or more components audited by another auditor.
2. **Other auditor:** An auditor, other than the principal auditor, with responsibility for reporting on the financial information of a COMPONENT which is included in the financial information audited by the principal auditor.
3. **Component:** A division, branch, subsidiary, joint venture, associated enterprises or other entity whose financial information is included in the financial information audited by the principal auditor.

#### B. ACCEPTANCE AS PRINCIPAL AUDITOR: (SELF STUDY)

The auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor.

For this purpose the auditor would consider

- a) The materiality of the portion of the financial information which the principal auditor audits;
- b) The principal auditor's degree of knowledge regarding the business of the components;
- c) The risk of material misstatements in the financial information of the components audited by the other auditor.

#### C. THE PRINCIPAL AUDITOR'S PROCEDURES:

Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless

- i) There are special circumstances to make it essential for him to visit the component and/or
- ii) To examine the books of account and other records of the said component.

When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

- a) Advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit.
- b) Would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit; and
- c) Advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

#### D. REPORTING CONSIDERATIONS:

1. When the principal auditor concludes, based on his procedures, that the work of the other auditor cannot be used and the principal auditor has not been able to perform sufficient additional procedures regarding the financial information of the component audited by the other auditor, the principal auditor should express a qualified opinion or disclaimer of opinion because there is a limitation on the scope of audit.

2. Further if the other auditor expresses a modified opinion in his report, the principle auditor shall consider whether such modification is relevant and significant for the entity as a whole. If so, the principle auditor shall also express a modified opinion.

#### E. DIVISION OF RESPONSIBILITY:

- i) The principal auditor would not be responsible in respect of the work entrusted to the other auditors, except in circumstances which should have aroused his suspicion about the reliability of the work performed by the other auditors.
- ii) When the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report should state clearly the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/ branches/ subsidiaries or other components audited by other auditors.
- iii) Further such division of responsibility shall be indicated under "Other matter Paragraph" as per SA 706.

#### SIMILAR QUESTIONS:

<p>1. When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole. Explain</p> <p>A. Write SA Number and Heading. Also write meaning of Principal and Other auditor. Then Point C.</p>	RTP N18(N)
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### SA 610 USING THE WORK OF INTERNAL AUDITOR

#### A. OBJECTIVES:

The objectives of the external auditor are:

- a) To determine whether the work of the internal audit function or direct assistance from internal auditors can be used.
- b) If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit (Type 1); and
- c) If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work (Type 2).

#### B. DEFINITIONS:

1. **Internal audit function:** It is a function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.
2. **Direct assistance:** Direct assistance means the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

#### C. USING THE WORK PERFORMED BY INTERNAL AUDITOR (Type 1):

##### 1. Evaluation Process:

The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by evaluating the following:

- a) Whether the internal audit functions organizational status and relevant policies and procedures support the objectivity of the internal auditors;
- b) The level of competence of the internal audit function; and
- c) Whether the internal audit function applies a systematic and disciplined approach, including quality control.



**2. Prohibition on Type 1 Work:**

The external auditor shall not use the work of the internal audit function if the external auditor determines that:

- a) The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;
- b) The function lacks sufficient competence; or
- c) The function does not apply a systematic and disciplined approach, including quality control.

**D. USING INTERNAL AUDIT FUNCTION TO PROVIDE DIRECT ASSISTANCE (Type 2):****1. Evaluation Process:**

The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by evaluating the following:

- a) Whether the internal auditors possess objectivity and independence.
- b) Whether the internal auditors are having necessary skill and competence.

**2. Prohibition on Type 2:**

The external auditor shall not use an internal auditor to provide direct assistance if:

- a) There are significant threats to the objectivity of the internal auditor; or
- b) The internal auditor lacks sufficient competence to perform the proposed work.

**E. AREAS WHERE IAF CANNOT BE USED FOR DIRECT ASSISTANCE:**

The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:

- a) Areas involve making of significant judgments in the audit.
- b) Areas relate to higher assessed risks of material misstatement.
- c) Areas relate to work with which the internal auditors have been already involved.

**F. OBTAIN WRITTEN AGREEMENT FROM IAF WHILE USING AS DIRECT ASSISTANCE:**

Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:

- a) **Obtain written agreement from Management:** That the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and
- b) **Obtain written agreement from the internal auditors:** That they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.
- c) The **external auditor shall**
  - i) Direct, supervise and review the work performed by internal auditors on the engagement in accordance with SA 220.
  - ii) Verify the audit evidence for the work performed by the internal auditors and ensure the evidence is sufficient and appropriate.

**G. DOCUMENTATION:**

If the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor shall include in the audit documentation:

1. The basis for the decision regarding the nature and extent of the work performed by the internal auditors;
2. Who reviewed the work performed and the date and extent of that review in accordance with SA 230.

3. The written agreements obtained from an authorized representative of the entity and the internal auditors of this SA; and
4. The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.

**SIMILAR QUESTION:**

1. Discuss with reference to SAs: The degree of reliance that a statutory auditor can place on the work of the internal auditor is a matter of individual judgement.
- A. Write about SA Number and Heading and then Point C (1).

**PRACTICAL QUESTIONS**

**Q.No.1.** Keshav Pvt Ltd has a balance of Rs.30 Lakhs as Capital Reserve, Rs. 30 Lakhs as Revenue Reserves, Rs.40 Lakhs as Revaluation Reserve and Rs.20 Lakhs as Paid-Up Share Capital as on 31st March. Comment on the applicability of CARO to this Company.

1. Reserves includes **all types of Reserves** (Capital Reserves, Revenue Reserves, Revaluation Reserve, etc.)
2. Here, Paid-Up Capital + Reserves = Rs.20 Lakhs (Paid - Up Capital) + Rs.100 Lakhs (Capital Reserve + Revenue Reserve + Revaluation Reserve) = Rs 120 Lakhs. Hence, CARO is applicable for this Company, since this exceeds the limit of Rs 1 Crore.

**Q.No.2.** Mahath Pvt. Ltd provides the following information for the financial year ending 31<sup>st</sup> March. Comment whether CARO is Applicable for this Company.

	(Amount in Rs Lakhs)
Paid Up Share Capital	70.00
Capital Reserve	14.00
Revaluation Reserve	20.00
General Reserve	20.00
Profit and Loss (Dr.)	24.00

1. As per Schedule III Requirements, Debit balance of P&L A/c, should be **reduced from the figure of Reserves**.
2. In the present case,
 

a) Paid-Up Capital		= Rs.70 Lakhs
b) Reserves	= 14 + 20 + 20	= Rs.54 Lakhs
Less: P&L (Dr.)		= <u>(Rs.24 Lakhs)</u>
		= <u>Rs.30 Lakhs</u>

**Paid Up Capital + Reserves = Rs.100 Lakhs**

3. Since Aggregate of Paid Up Capital and Reserves **does not exceed** Rs. 1 Crore, CARO is **not applicable** for this Company. (assuming other 3 conditions of exemption are satisfied.)

**Q.No.3.** Anand Pvt. Ltd. is incorporated on 1st July 2015. During the year ended 31st March 2016, it had issued Shares (fully paid up) of Rs.80 Lakhs, had borrowed Rs.25 Lakhs each from 2 Financial Institutions and its Total Revenue (Net of Excise of Rs.50 Lakhs which is credited to a separate account) is Rs.975 Lakhs. Will CARO be applicable to Anand Pvt. Ltd.?

**Analysis:**

Condition	Analysis
a) Not a Holding or Subsidiary of a Public Company	Assumed satisfied

b) Paid up Capital and R&S on B/s date $\leq$ Rs.1 Crore	Satisfied, since Rs.80 Lakhs $\leq$ Rs.1 Crore.
c) Bank / Financial Institutions Borrowings at any time $\leq$ Rs.1 Crore	Satisfied, since $25 \times 2 =$ Rs. 50 Lakhs $\leq$ Rs.1 Crore.
d) Total Revenue $\leq$ Rs.10 Crores	If Excise Duty is taken / credited to a separate account, it shall <b>not</b> form part of the Total Revenue. So, Total Revenue for this Co. = Rs.9.75 Crores, i.e. $\leq$ Rs.10 Crores.

**Conclusion:** CARO does not apply to Anand Pvt Ltd, since **all** the conditions relating to exemption are satisfied.

**Q.No.4.** Tarun Pvt Ltd's Paid Up Capital and Reserves are less than Rs.100 Lakhs and it has no Borrowings from any Bank or Financial Institution. Its Sales are Rs.12 Crores before deducting Trade Discount Rs. 20 Lakhs and Sales Returns Rs.190 Lakhs. The services rendered by the Company amounted to Rs.20 Lakhs. Comment on applicability of CARO to this Company.

**Principles:** Total Revenue = [Sales Rs.12 Crores (-) Trade Discount Rs.20 Lakhs (-) Returns Rs. 190 Lakhs] + Services Income Rs.20 Lakhs = Net Rs.10.10 Crores

**Analysis:**

Condition	Analysis
a) Not a Holding or Subsidiary of a Public Company	Assumed satisfied
b) Paid up Capital and R&S on B/s date $\leq$ Rs.1 Crore	Satisfied, since it is given as $\leq$ Rs.1 Crore.
c) Bank / Financial Institutions Borrowings at any time, $\leq$ Rs.1 Crore	Satisfied, since there are no Borrowings.
d) Total Revenue $\leq$ Rs.10 Crores	Not satisfied, Since Total Revenue $>$ Rs.10 Crores.

**Conclusion:** CARO applies to Tarun Pvt Ltd, since the Total Revenue **exceeds** Rs. 10 Crores.

**Q.No.5.** Samraksha Pvt. Ltd. is the Holding Company of Suraksha Ltd. and the following are the details w.r.t Samraksha Pvt Ltd:

Paid Up Capital and Reserves	Rs. 30 Lakhs
The Borrowings from SBI is	Rs. 60 Lakhs
Total Revenue from Operations (including from Discontinuing Operations)	Rs. 8 Crores
The Auditors of Samraksha Pvt Ltd is of the view that CARO is not applicable since it is a Private Limited Company satisfying the condition relating to Paid up Capital, Borrowings and Total Revenue. Is their contention valid?	
Whether CARO reporting is applicable for reporting on Consolidated Financial Statements?	

**Principle:** Refer Q. No. 2 on the 4 conditions, all of which have to be satisfied by a Private Limited Company, to be exempt from CARO Reporting.

**Analysis:** In this case, Samraksha Pvt. Ltd. is the **Holding Company** of Suraksha Ltd, a Public Company.

**Conclusion:**

- Hence, CARO is applicable for Samraksha Pvt Ltd. [Monetary Limits in other 3 conditions are **not relevant** in this case].
- CARO 2016 Reporting shall **not apply** to the Auditor's Report on Consolidated Financial Statements.

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To **MASTER MINDS**, Guntur

**Q.No.6. APPLICABILITY OF CARO 2016**

The following particulars are given in relation to private companies.

Sales	9 crores
Excise duty collected and accounted separately	50 lakhs
Sales tax collected and accounted separately	75 lakhs
Sales return	20 lakhs
Commission paid to third party	30 lakhs

Excise Duty and Sales Tax are recorded separately. Hence should not be considered for turnover. Sales Return should be deducted from sales. Commission on the sales should not be considered. Therefore, CARO 2016 is not applicable.

**Q.No.7.** For the year 2015-16, the company has taken a loan of 110 lakh from a bank on 01-06-2015. It repays the loan on 30-06-2015. On the balance sheet date, no amount is due. Is CARO applicable?

CARO 2016 will be applicable if the condition is satisfied at any time during the year.

**Q.No.8.** CA Vishwam is appointed as the Branch Auditor of VVK Ltd. Is he required to comply with the CARO when issuing his Branch Audit Report, or is CARO applicable only with respect to the Audit Report issued by the Principal Auditor?

The Report submitted by the Branch Auditor should contain a statement on all the matters specified in CARO, to enable the Company's Auditor to consider the same.

Hence, CARO is **applicable** for Branch Audits also.

**Q.No.9.** Mittal Pvt Ltd provides the following information for the Financial Year 2015-16. Comment whether CARO is applicable for this Company.

a) Paid-up Share Capital and Reserves:	Rs.100 Lakhs
b) Borrowings from Banks:	Rs. 98 Lakhs
c) Total Revenue:	Rs. 12 Crores

**Principle:** Refer **6th conditions**, all of which have to be satisfied by a Private Limited Company, to be exempt from CARO Reporting.

**Analysis:**

Condition	Analysis
Not a Holding or Subsidiary of a Public Company	Assumed satisfied
Paid up Capital and Reserves & Surplus on B/S date $\leq$ Rs. 1 Crore	Satisfied, since it is equal to Rs.1 Crore
Banks / Financial Institution Borrowings at any time, $\leq$ Rs.1 Crore	Satisfied, since it is less than Rs.1 Crore.
Total Revenue $\leq$ Rs.10 Crores	Not satisfied, i.e. $>$ Rs. 10 Crores

**Conclusion:** CARO is **applicable** in the above case, since Total Revenue condition is attracted.

**Q.No.10.** Vayu Pvt. Ltd has a Turnover of Rs.8 Crores for the Financial Year 2015-16. The Outstanding Balance of Loans from Banks and Financial Institutions is Rs.24 Lakhs throughout the year. The Company had a Capital of Rs.120 Lakhs at the beginning of the year and on 15.09.2015 the Company made a Buy Back of Shares worth Rs.30 Lakhs resulting in a Share Capital of Rs.90 Lakhs as on 31st March 2016. Comment whether CARO is applicable for the Company.

**Analysis:**

Condition	Analysis
a) Not a Holding or Subsidiary of a Public Company	Assumed satisfied
b) Paid up Capital and R&S on B/s date $\leq$ Rs.1 Crore	Satisfied, since the condition is with respect

	to B/s date. Net Amount Rs.90 Lakhs is $\leq$ Rs.1 Crore.
c) Bank / Financial Institution Borrowings at any time, $\leq$ Rs.1 Crore	Satisfied, since Rs.24 Lakhs $\leq$ Rs.1 Crore
d) Total Revenue $\leq$ Rs.10 Crores	Satisfied, since Rs.8 Crores $\leq$ Rs.10 Crores.

**Conclusion:** Since all 4 conditions are satisfied, CARO is **not** applicable in this case.

**Q.No.11. APPLICABILITY OF CARO 2016**

The following particulars are given in relation to private companies.

Paid up capital:	Rs. 1.5 crore.
Debit balance in profit and loss account:	Rs. 60 lakhs

Debit Balance of profit and loss account can be set off. CARO 2016 will not be applicable.

**Q.No.12.** BK Ltd, a Benefit Fund, registered under NBFC Regulations, is in existence for the past two decades. On 31st December 2015, this Company is converted into a Bank. You have been appointed as an Auditor for the Financial Year 2015-16. Comment whether CARO is applicable for this Company.

1. Banking Companies are exempted from CARO Reporting Requirements.
2. As on the date of B/Sheet, the Company is a Banking Company. Hence, CARO is **not applicable**, irrespective of the fact that the Company was converted from NBFC during the year.

**Q.No.13.** CA Bhava is appointed as the Auditor of BB Pvt Unlimited, a Company registered under Companies Act, with Unlimited Liability. For Financial Year 2015-16, the Company had a total Revenue of Rs.8 Crores, Borrowings from Banks and FI of Rs.86 Lakhs and Paid - Up Capital with Reserves of Rs.97 Lakhs. Explain whether his Audit Report must include CARO.

1. The term "Private **Limited** Company" as used in the exemption from CARO, should be construed to mean a Company registered as a "Private Company" [as defined in Sec.2(68)], **and** which has a **Limited Liability**.
2. So, CARO would be **applicable to Private Unlimited Companies**, irrespective of the size of their Paid-Up Capital and Reserves, Total Revenue, Borrowings from Banks/Financial Institutions.
3. Hence, in the present case, Total Revenue / Capital Base / Borrowings Criterion need not be considered for the Company and CARO is **applicable** fully to BB Pvt. Unlimited.

**Q.No.14.** Guru Pvt. Ltd has 2 Branches - in Chennai and in Mumbai. Each Branch has a separate Statutory Auditor and the Company, as a whole, has a Central Statutory Auditor. Comment which of these Auditors must comply with CARO.

Details	Chennai Branch	Mumbai Branch	Total (Figures in Rs.)
Paid up Capital and Reserves	40 Lakhs	70 Lakhs	110 Lakhs
Borrowings from Banks	10 Lakhs	26 Lakhs	36 Lakhs
Total Revenue	3 Crores	6 Crores	9 Crores

**Principles:**

- a) Conditions to be satisfied for being exempt from CARO are laid down for the Company taken as a whole.
- b) So, if CARO is applicable to the Company as a whole, then **each and every Branch** of the Company will also be automatically covered under CARO (irrespective of the fact that the Branch's transactions are within the limits).

- c) The Branch Auditor has the same reporting responsibilities in respect of the Branch, as those of the Company Auditor in respect of the Company. The comments of the Branch Auditor in respect of the Branch are dealt with by the Central Statutory Auditor of the Company while finalizing his report under CARO.

**Analysis:** In the given case, the Company has a Paid up Capital and Reserves of Rs.110 Lakhs, which exceeds the exemption limit Rs.100 Lakhs / 1 Crore. CARO is applicable for the Company.

**Conclusion:** So, in this case, all the 3 Auditors. (2 Branch Auditors + Central Statutory, Auditor) must comply with CARO.

**Q.No.15.** H Private Ltd had taken Overdrafts from SBI & HSBC with a limit of Rs. 40 Lakhs each against the security of Fixed Deposit it had with those Banks and an Unsecured Overdraft from a Financial Institution of Rs.29 Lakhs. The said loans were outstanding as at 31st March. The Paid Up Capital and Reserves of the Company as at that date was Rs. 80 Lakhs and its Total Revenue during the financial year ended on 31st March was Rs.6 Crores. The Management of the Company is of the opinion that CARO is not applicable to it because Total Revenue and Paid-Up Capital were within the limits prescribed and Borrowings against the Fixed Deposit cannot be considered. The Company further contended that Borrowings Limit is to be reckoned per Bank or Financial Institution and not cumulatively. Comment.

**Principles w.r.t. Borrowings:**

- a) **Borrowings against FD:** Amount Outstanding must be included in determining the limit. It should not be netted off against the amount of Fixed Deposit
- b) **“Borrowings from any Bank”:** Total Borrowings from all Banks & Financial Institutions should be considered cumulatively, and **not** on “per Bank / FI basis”. Thus, all Loans / Borrowings (secured or unsecured) should be included.

**Analysis:** Total Borrowings in this case = Rs.40 + Rs.40 + Rs.29 = Rs.109 Lakhs = Rs.1.09 Crores.

**Conclusion:** Since Borrowings > Rs.1 Crore, CARO Reporting is applicable to the Company.

**Q.No.16.** In the current financial year, AP Pvt. Ltd has borrowed Rs.1.20 Crores on 15<sup>th</sup> June and repaid the entire loan before 31<sup>st</sup> March. Comment on the applicability of CARO to this Company.

- For the purpose of applicability of CARO, Balance Outstanding from a Bank or Financial Institution shall be construed **at any point of time**, during the year and not as at the end of the year (i.e. 31st of March).
- Where the Company had Borrowings from a Bank in excess of Rs. **1 Crore** during the year, but the year-end balance of the same is NIL, the Company would be still covered by CARO, notwithstanding that it fulfills all other conditions for exemption from the Order. In the present case, AP Pvt Ltd will be covered under CARO.

**Q.No.17.** As the statutory auditor of B Ltd. to whom CARO, 2016 is applicable, how would you report in the following situation? 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.

- Physical verification of inventory is the responsibility of the management.
- As per the requirements of CARO, 2016, the auditor is required to state in the report Whether inventories have been physically verified by the management at reasonable intervals and 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.
- The auditor should satisfy himself about verification by the management at reasonable intervals.
- In the given case, physical verification of only 50% (in value) of items of inventory has been conducted by the company. Hence the above requirement of CARO, 2016 has not been fulfilled.
- Thus the auditor should point out the procedure of inventory verification is not reasonable.

**Q.No.18.** Discuss the reporting requirements under CARO 2016 where a company has defaulted in compliance of section 73 of the companies Act with regard to deposits.

Refer to clause (v) of CARO. 2016

**Q.No.19.** During audit of XYZ Ltd., the auditor came across certain loans to firms covered in the register maintained under section 189 of the Companies Act 2013. Auditor noticed that a total of Rs. 3 lacs, in this connection, was overdue for over three months, yet no step had been taken by the company. Comment.

Refer to Clause (iii) (c) of CARO, 2016.

**Q.No.20.** ABC Ltd. has entered into a purchase contract with its director. The auditor noticed that it has been made on arm's length price. On enquiry he came to know that know resolution was passed thereof. Comment as per CARO, 2016.

Refer to Clause (Xiii) of CARO, 2016

**Q.No.21.** Discuss the matters to be included in the auditor's report regarding fixed assets and inventories as per CARO, 2016.

Refer Clause (i) and (ii) of CARO, 2016.

**Q.No.22.** The Auditor is fully satisfied with the audit of an entity in respect of its system and procedures and wants to issue a report without any hesitation. What type of opinion can he give and state reasoning. **(M18(O) - 4M)**

**Unqualified Opinion:**

1. An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements.
2. An unqualified opinion indicates, implicitly, that any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements.
3. An unqualified opinion also indicates that:
  - a) The financial statements have been prepared using the generally accepted accounting principles, which have been consistently applied;
  - b) The financial statements comply with relevant statutory requirements and regulations; and
  - c) There is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

**Q.No.23.** Mr. X, a director of M/S KP Private Ltd, is also a director of another company viz., M/s GP Private Ltd., which has not filed the financial statements and annual return for last three years 2013-14 to 2015-16. Mr. X is of the opinion that he is not disqualified u/s 164(2) of the companies act, 2013, and auditor should not mention disqualification remark in his audit report. **(OLD PM, MTP M16)**

**Provision:**

**Disqualification of a Director Under Section 164(2) of the Companies Act, 2013:** Section 143(3)(g) of the Companies Act, 2013 imposes a specific duty on the auditor to report whether any director is disqualified from being appointed as director under section 164(2) of the Companies Act, **CA Inter\_41e\_Auditing and Assurance\_Audit reporting** **6.23**

2013. As per provisions of Section 164(2), if a director is already holding a directorship of a company which has not filed the financial statements or annual returns for any continuous period of three financial years shall not be eligible to be reappointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

**Analysis:** In this case, Mr. X is a director of M/s KP Private Ltd. as well as of M/s GP Private Ltd., and, M/s GP Private Ltd., has not filed the financial statements and annual return for last three years. Hence the provisions of section 164(2) are applicable to him and as such he is disqualified from directorship of both the companies.

**Conclusion:** Therefore, the auditor shall report about the disqualification under section 143(3)(g) of the Companies Act, 2013.

**Q.No.24.** Mr. Y is the auditor of X Pvt Ltd in which there are four shareholders only, who are also the directors of the company. On account of bad trade and for reducing the expenses in all directions, the directors asked Mr. Y to accept a reduced fee and for that he has been offered not to carry out such full audit as he has done in the past. Y accepted the suggestions of the directors. (OLD PM)

**Analysis:** Y may agree to temporary reduction in audit fees, if he so wishes, in view of the suggestions made by the directors (perhaps in accordance with the decision of the company taken in general meeting). But his duties as a company auditor are laid down by law and no restriction of any kind can restrict the scope of his work either by the director or even by the entire body shareholders.

Since the scope is determined by relevant Act, but remuneration is purely a matter of personal contract between auditor and client.

**Conclusion:** Under the circumstances, Y is violating the provisions of the Companies Act, 2013.

**Q.No.25.** The members of C. Ltd. preferred a complaint against the auditor stating that he has failed to send the Audit report to them. (OLD PM)

**Provision:** Section 143 of the Companies Act, 2013 lays down the powers and duties of auditor. As per provisions of the law, it is no part of the auditor's duty to send a copy of his report to members of the company. The auditor's duty concludes once he forwards his report to the company. It is the responsibility of company to send the report to every member of the company.

**Conclusion:** Hence in the given case, the auditor cannot be held liable for the failure to send the report to the shareholders.

**Q.No.26.** The auditor of Trilok Ltd. did not report on the matters specified in sub-section (1) of section 143 of the Companies Act, 2013, as he was satisfied that no comment is required. (OLD PM, MTP N17)

**Provision:** Refer Q.No.1 in Class room discussion

**Conclusion:** Therefore, the auditor of Trilok Ltd. is correct in non-reporting on the matters specified in Section 143(1).

**Conclusion:** Therefore, the auditor shall report about the disqualification under section 143(3)(g) of the Companies Act, 2013.

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To **MASTER MINDS**, Guntur

**THE END**