

The Companies (Auditor's Report) Order, 2016

Presentation

By

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Duties under Section 143 of the CA, 2013

- Subsection (1) – Six enquiries to be made.
- Sub section (2)– to make a report to the members on financial statements.
- Sub section (3) – Auditors Report to state on specified matters and such other matters as may be prescribed in Rules.
- Sub-section (11) – Central govt.'s power to ask auditors to report on specified matters.
- Sub-section (12) – Reporting of fraud by auditors.

CARO, 2016

- The Central Government, in exercise of the powers conferred, under section 143(11) issued the Companies (Auditor's Report) Order, 2016, *vide* Order No. S.O. 1228(E) dated 29th March, 2016.
- Applicable for audits of financial statements for periods beginning on or after April 1, 2015.
- This Order is in supersession of the earlier the Companies (Auditor's Report) Order, 2015.

Statement vs Guidance Note

- Guidance Note on the Companies (Auditor's Report) Order, 2016.
- It supersedes earlier Statement on the Companies (Auditor's Report) Order ,2003 .

Authority attached to 'Statement'

- Statements have been issued with a view to securing compliance by members on matters which in the opinion of the Council, are critical for the proper discharge of their functions.
- Statements are mandatory in nature.
- If for any reason, a member has not been able to perform an audit in accordance with such 'statements', his report should draw attention to the material departure there from.

Authority attached to 'Guidance Notes'

- Guidance Notes are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance to resolve issues which may pose difficulty.
- Guidance Notes are recommendatory in nature.

Date of Application

- Order applies for the financial year commencing on or after 1st April 2015.
- Accordingly the reporting under this Order shall be applicable for the financial year 2015-16 and onwards.
- In case the auditor has to report on the financial statements for the financial year prior to 2015-16, then the relevant earlier Order shall be applicable.

Financial Year

- Section 2(41) – means the period ending on the 31st March every year
 - Exception could be made by a Tribunal if a company being holding or subsidiary of a company incorporated abroad and is required to maintain accounts for a different financial year outside India
- Existing companies to align within two years (from 1.4.2014)

Applicability to foreign company

- The Order also applies to foreign companies
- Sec 2(42) “foreign company” means:
 - “Any company or body corporate incorporated outside India which -
 - (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
 - (b) conducts any business activity in India in any other manner.”
- Chapter X of the Act requires a foreign company to get its financial statement audited accordingly the Order would be applicable.

Companies to whom CARO, 2016 is not applicable

- (i) a banking company
- (ii) an insurance company
- (iii) a company licensed to operate under section 8 of the Act;
- (iv) a One person Company as defined under clause (62) of section 2 of the Act
- (v) a Small Company as defined under clause (85) of the section 2 of the Act and
- (vi) a specified private limited company.

Applicability to private company

- a private limited company which is not
 - 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 Schedule III to the Act, (including revenue from discontinuing operations) exceeding rupees ten crores during the financial year.
- A private limited company, in order to be exempt from the applicability of the Order, must satisfy all the conditions mentioned above collectively.

Specified private limited company

Particulars	CARO,2015	CARO,2016
Holding or subsidiary of a public company	No such condition	Should not be.
Paid up capital and Reserve & Surplus	Not exceeding Rs. 50 Lakhs	Not exceeding Rs 1 Crore
Total Borrowings from Banks or financial Institutions	Not exceeding Rs 25 Lakhs	Not exceeding Rs. 1 Crore
Total Revenue as per Schedule III	Not exceeding Rs 5 Crores	Not exceeding Rs 10 Crores

Paid-up Capital , Reserve & Surplus

- “paid-up share capital” as, “that part of the subscribed share capital for which consideration in cash or otherwise has been received. This includes bonus shares allotted by the corporate enterprise”.
- Paid-up share capital would include both equity share capital as well as the preference share capital.
- While calculating the paid-up capital, amount of calls unpaid should be deducted from and the amount originally paid-up on forfeited shares should be added to the figure of paid-up capital.
- Share application money received should not be considered as part of the paid-up capital.
- As per schedule III of Companies Act 2013 “Reserves & Surplus” as disclosed in the financial statements should be considered in evaluating the threshold.

Borrowings from banks and financial institutions

- Borrowings from banks or financial institutions can be long term or short term and are normally in the form of term loans, demand loans, export credits, cash credits, overdraft facilities, bills purchased or discounted.
- Non-fund based credit facilities, to the extent such facilities have devolved and have been converted into fund-based credit facilities, should also be considered as outstanding borrowings.
- In case of term loans, interest accrued and due is considered as a borrowing whereas interest accrued but not due is not considered as a borrowing.
- Borrowing is to be seen at any point of time during the financial year.

Financial institution

- Sub section (39) of section 2 of the Act defines the term “financial institution” to include a scheduled bank, and any other financial institution defined or notified under the Reserve Bank of India Act, 1934.
- the term “financial institution” shall also cover a non-banking financial company (NBFC).
- Further, private banks or foreign banks are banking institutions under the Banking Regulation Act, 1949. Therefore, loans taken from a private bank or a foreign bank would also be taken into consideration while examining the applicability of the Order.

Revenue

- The term, “revenue”, has been defined by the Order as total revenue disclosed in Schedule III of the Act. Accordingly, the total revenue would include other income as per Schedule III.
- Here revenue will also include revenue from discontinuing operations as specified in the Order.

Revenue- Schedule III

- I. Revenue from operations xxx xxx
- II. Other income xxx xxx
- III. Total Revenue (I + II) xxx xxx
- In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from—
 - (a) Sale of products;
 - (b) Sale of services;
 - (c) Other operating revenues *Less*:
 - (d) Excise duty.
- Other income shall be classified as:
 - (a) Interest Income (in case of a company other than a finance company);
 - (b) Dividend Income;
 - (c) Net gain/loss on sale of investments;
 - (d) Other non-operating income (net of expenses directly attributable to such income)

Reporting requirements

- The Order specify the applicability of the matters by the words “as may be applicable”, reporting on the matters specified in Paragraph 3 and 4 of the Order are to be made only on those matters which are applicable to the Company.
- Where an auditor is expressing any unfavourable or adverse opinion, he should indicate such fact and shall also to give reasons for any unfavourable or qualified answer.
- Further, where the auditor is unable to express an opinion on any such matter which is applicable to the company, he is also required to indicate in his report such fact together with the reasons as to why he is unable to express any opinion.

Reporting in the main Audit Report

- As required by the Companies (Auditor's Report) Order, 2016 issued by the Central Government of India in terms of sub-section (11) of Section 143 of the Companies Act, 2013, we enclosed in the Annexure a statement on the matters specified in Para 3 and 4 of the Order.
- “Further to our comments in the Annexure, we state that.....”

Reporting in CARO Report

- For statement of facts, use the following as preface to the reporting para:
 - “In terms of the information and explanations sought by us and given by the company and the books and records examined by us in the normal course of audit and to the best of our knowledge and belief, we state that.....”
- For expression of opinion, use the following preface to the reporting para:
 - “In our opinion” or “In our opinion and according to the information and explanations given to us during the course of the audit...”

Period of compliance

Q. The period in relation to which the auditor should comment or report upon the matters specified in the Order?

A. Order should be judged with reference to the whole accounting year and not merely with reference to the position existing at the balance sheet date or the date at which he makes his report.

- The auditor might consider, the state of affairs existing at the balance sheet date or at the date when he makes his report to give a more complete picture.

CARO, 2015 vs CARO,2016

- Clauses for reporting:
 - 12 in CARO,2015
 - 16 in CARO, 2016
- In CARO,2016
 - 7 new clauses
 - 2 new sub-clauses
 - 3 clauses of CARO,2015 did not get place
 - 2 sub-clauses of CARO,2015 did not get place
 - 4 clauses of CARO, 2015 have been modified
 - 4 sub-clauses of CARO,2015 have been modified.

Para 3(1)(c): Whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof

- Does the company have any immovable properties (land and buildings)?
- Whether the title deeds of these immovable properties are in the name of the company?
- Whether the details as per title deeds reconcile with the details in Fixed assets register, if not, is there any material difference to be reported ?
- In case the title deeds are lost, assess whether the certified copies of such documents are available with the company and what actions have been taken by the management in this regard?
- (ii) In case the title deeds are mortgaged with the lenders, assess if the confirmation from the lenders is obtained for the same.

Title deeds of immovable properties- related issues

- Immovable property held as investment?
- Immovable property held as stock -in- trade?
- Property held under POA?
- Leased hold property?
- Property acquired under hire-purchase?
- Property in joint names?
- Property under litigation?
- Property possessed by lending institutions as part of recovery proceedings?

Para 3(ii)

- whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account.
- Earlier requirement was:
 - (a) whether physical verification of inventory has been conducted at reasonable intervals by the management;
 - (b) are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported;
 - (c) whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account;

Para 3(iii)

- *Whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,*
 - a) Whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;
 - b) Whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;
 - c) If the amount is overdue, state the total amount overdue for more than 90 days, and whether reasonable steps have been taken by the company for recovery of the principal and interest.

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

- Whether the terms of the above loans are prima facie prejudicial, due consideration to be given to the factors mentioned below:
 - terms & condition of the loan
 - repayment, rate of interest, restrictive covenants etc.,
 - company's financial standing, its ability to lend, and terms of its borrowings
 - borrower's financial standing
 - the nature of the security,
 - prevailing rate of interest, etc.

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

- (a) Whether the schedule of repayment of principal and payment of interest has been stipulated in the loan agreements /mutually agreed letter of arrangement at the time of sanction?
- (b) Whether repayment of principal amount and interest thereon are received regularly on the due date or immediately thereafter?
- (c) If not, the fact and details should be obtained.

c) If the amount is overdue, state the total amount overdue for more than 90 days, and whether reasonable steps have been taken by the company for recovery of the principal and interest

- Following documents may be seen for verification of reasonableness of steps taken by the company for recovery of principal and accrued interest on loan granted:
 - Facts of each case including amounts involved
 - Issue of reminder
 - Sending of advocates or solicitor's notice
- In absence of legal steps whether auditor is satisfied that reasonable steps have been taken
- Obtain management's representation regarding steps that have been taken for recovery of total amount overdue more than ninety days.

Para 3(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.*

Compliance of Section 185

- (i) Loan to, guarantee or provision of security in connection with any loan taken by
 - directors or
 - such other person in whom the director is interested,
- (ii) Whether any of the transaction is attracting the provisions of section 185?
- (iii) Whether any of such transactions are covered under the exceptions?

Compliance of sec 186

- (i) Obtain the details of loans and investment made by the Company including opening balances,
- (ii) Enquire whether company has made investment through more than two layers of investment companies?
- (iii) Enquire whether the company has exceeded the limit of sixty per cent of its paid-up share capital, free reserves and securities premium account or one hundred per cent of its free reserves and securities premium account, whichever is more?
- (iv) If so, whether prior approval by means of a special resolution passed at a general meeting has been obtained?
- (v) Whether the rate of interest charges is more or at par to the rates specified in subsection (7) of section 186 of the Act, if not, the reasons thereof.

Para 3(vii)

- Reporting not required in respect of wealth tax.
- Comment on amount required to be transferred to investor education and protection fund is not required in CARO reporting.

Para 3(viii)

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

Para 3(viii)

- Financial Institution includes Public Financial Institutions, as well as Non- Banking Institutions .
- “Government” means the Central Government, a State Government ,a Union Territory and their departments department but shall not Government Company/public Sector Undertaking/ Boards/ Authority/ Corporation.
- the auditor should report the period and amount of all defaults existing at the balance sheet date irrespective of when those defaults have occurred.

Para 3(ix)

- *Whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not,*
 - *the details together with delays or default and*
 - *subsequent rectification, if any, as may be applicable, be reported;*

Para 3(ix)- moneys raised by way of initial public offer or further public offer (including debt instruments)

- Examine offer document to get an understanding of the proposed end-use of money raised from public.
- Verify that the amount of end-use of money disclosed in the financial statements by the management
- Verify that it is not materially different from the proposed and actual end use.
- Verify information disclosed under LODR and certified by the monitoring agency.
- Obtain a representation from the management as to the completeness of the disclosure with regard to the end-use of money raised as well as actual end utilization of money

Para 3(ix)- *moneys raised by way of term loans*

- Cash credit, overdraft and call money accounts/deposits are not covered.
- Term loan obtained from entities/persons other than banks/financial institutions would also have to be examined.
- Examine the terms and conditions subject to which the company has obtained the term loans.
- obtain sufficient appropriate audit evidence regarding the utilisation of the amounts raised
- compare the purpose for which term loans were sanctioned with the actual utilisation of the loans.

Para 3(x)- Whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

- Examine the following to ascertain whether any fraud has been reported or noticed by the management?
 - Internal Audit Report
 - Enquiry from the management
 - Enquiry from officers of the company
 - Minute Books
 - Any reporting u/s 143(12)
- The scope of auditor's inquiry under this clause is restricted to frauds 'noticed or reported' during the year.

Para 3 (xi)

- *Whether Managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with schedule V to the Companies Act? If not,*
 - *state the amount involved and*
 - *steps taken by the Company for securing refund of the same*
- The default may be reported incorporating the following details:-
 - (i) Amount paid/ provided in excess of the limits prescribed
 - (ii) Amount due for recovery as at Balance Sheet date
 - (iii) Steps taken to secure the recovery of the amount

Para 3(xii)

- Whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability.
- Section 406 (1) of the Act defines “Nidhi” to mean
 - a company which has been incorporated as a Nidhi
 - with the object of cultivating the habit of thrift and savings amongst its members,
 - receiving deposits from, and lending to, its members only,
 - for their mutual benefit, and
 - which complies with such rules as are prescribed by the Central Government for regulation of such class of companies.

Para 3 (xiii)

- *Whether all transactions with the related parties are in compliance with section 177 and 188 of Companies Act, 2013 where applicable and*
- *the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;*

Compliance of section 188

- Obtain a list of companies, firms or other parties, the particulars of which are required to be entered in the register maintained under section 189
- Related party transactions refereed in sub sec (1)
- Rule 15 of the Companies (Meeting of Board and its Powers) rules, 2014- transactions above prescribed threshold
- Transaction in the ordinary course of business and on arm's length basis
- Board Resolution and prior approval of general meeting
- Related party would not participate in resolution.

Compliance of section 177

- Listed companies and other specified companies to have 'audit committee'
- Audit committee to approve and subsequent modification of transactions with related parties

AS - 18 RELATED PARTY DISCLOSURES

- **Related party** - parties considered to be related if at **any time** during reporting period one party has **ability to control** other party or exercise **significant influence** over other party in making **financial and/or operating decisions**.
- **Related party transaction** - a transfer of **resources or obligations** between related parties, regardless of **whether or not price charged**.

Para 3(xiv)

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

Para 3(xiv)

- Section 2(42)- 'Private Placement' has been to mean any offer of securities or invitation to subscribe securities to a select group of persons by a company.
- Compliance of section 42.
- Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 also need to be complied with.
- Form PAS-4, Private Placement Offer Letter requires the company to provide particulars in respect of the purposes and objects of the offer. Accordingly, the auditor should compare such information with the actual utilization of the monies as per the books of account of the Company and report accordingly.

Para 3 (xv)

- Whether the company has entered into any non-cash transactions with a director (of the company ,its holding, subsidiary or associate) or persons connected with him and if so,
- whether the provisions of section 192 of Companies Act, 2013 have been complied with:
- Non- cash transaction - acquisition of asset by or from company
- “Persons connected with him”.
- Resolution of the company in general meeting.
- Valuation is duly calculated by a registered valuer.

Para 3(xvi):Whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained?

- The Reserve Bank of India restrict companies from carrying on the business of a non-banking financial institution without obtaining the certificate of registration.
- *whether company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross?*
- Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented

CFS and CARO, 2016

- The Order specifically provides that it shall not apply to the auditor's report on consolidated financial statements.

Qualification in CARO,2016 and Main Report

- If any of the comments on matters specified in the Order are adverse, the auditor should consider whether his comments have a bearing on the true and fair view presented by the financial statements and, therefore, might warrant a modification in the report under sub-sections (2), (3) and (4) of section 143.

THANK YOU

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