

The Companies (Auditor's Report) Order, 2015 - A Perspective



The users of the auditor's report have always been innumerable. With the growth of domestic and global economy, and the transformation of the manner in which businesses are now done, the contours of the users and potential users and also their information needs and expectations from the auditors, have grown exponentially. But what has remained unchanged, and runs common among the various users of the auditor's report is their need for information on "exercise of ethics/propriety/ due care in business by the management", in addition to the auditor's opinion on the true and fair view of the financial statements.

In India, in the case of companies, Section 227(4A) of the erstwhile Companies Act, 1956 tried to align the aforesaid "common" information need by empowering the Central Government to issue an Order thereunder, that required the statutory auditors of specified classes of companies to report on a number of additional matters, in addition to their opinion on the true and fair view of the financial statements. The first of one such Orders was the Manufacturing Companies (Auditor's Report) Order, 1975 issued by the Department of Company Affairs (as the Ministry of Corporate Affairs was then known) *vide* G.S.R. 553(E), dated 7th November, 1975. The said Order was applicable to all manufacturing, service, trading and finance companies and contained 22 reportable clauses. This Order was superceded by the Manufacturing and Other Companies (Auditor's Report) Order, 1988 by the Ministry of Corporate Affairs *vide* their

notification No. G. S. R. 909(E), dated 7th September, 1988. This 1988 Order had 27 reportable clauses for the auditors. The 1988 Order was superceded in June 2003 (amended in 2005) by the Companies (Auditor's Report) Order, 2003, issued by the Ministry of Corporate Affairs *vide* GSR (480E) dated 12th June, 2003, having 21 reportable clauses.

CARO, 2003 was in force till 31st March 2014, *i.e.*, the date upto which the Companies Act, 1956 was in force. The Companies Act, 2013 which came into force from 1st April, 2014 also contains a section, *i.e.*, Section 143(11), similar to Section 227(4A) of the Companies Act, 1956, which empowers the Central Government to specify by a general or a special Order, additional matters that the auditors of a company may be required to report upon. In exercise of this power under Section 143(11), the Ministry of Corporate Affairs on 10th April, 2015 notified the Companies (Auditor's Report) Order, 2015 (CARO, 2015).

A plain reading of such successive Orders highlights how the Government, through these Orders, tried to harness the services of the statutory auditors to provide the stakeholders with information on such critical aspects of a company's functioning that can give a fair amount of idea to the stakeholders, about how the Directors of the



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CARO, 2003 was in force till 31st March 2014, i.e., the date upto when the Companies Act, 1956 was in force. The Companies Act, 2013 which came into force from 1st April, 2014, also contains a section, i.e., Section 143(11), similar to Section 227(4A) of the Companies Act, 1956, which empowers the Central Government to specify, by a general or a special order, additional matters that the auditors of a company may be required to report upon. In exercise of this power under Section 143(11), the Ministry of Corporate Affairs on 10th April, 2015 notified the Companies (Auditor's Report) Order, 2015 (CARO, 2015).

Company are discharging their stewardship role. For example, in each of these Orders, the statutory auditors are required to report, in one way or the other, on the checks and controls on fixed assets and inventory. Similarly, information on transactions with related parties is understandably another area on which the various versions of the Orders have sought information from the statutory auditors. Compliance with regulatory requirements, to the extent that it relates to public deposits, has also been on the radar of these Orders. Existence of internal audit is an important component of internal controls put in place by the management and is expected to help the latter in improving its stewardship practices. Hence, almost all the Orders have required the statutory auditors to report on the existence of internal audit system in the company.

The changes brought in each of the Orders could be seen from the Government and other stakeholders' experience, and perspective of the probable sore points in the functioning of the companies, particularly relating to application of funds raised from financial institutions and capital markets, as also information asymmetry on these matters. Some of the matters included in the CARO, 2003 are a pointer in this direction, such as:

- whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company;
- whether term loans were applied for the purpose for which the loans were obtained;
- whether the funds raised on short-term basis have been used for long term investment; If yes, the nature and the amount is to be indicated;
- whether the management has disclosed the end use of money raised by public issues and the same has been verified;
- whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

The stress, it seems, is to keep a tab on the financiers and investors' interests.

CARO, 2015 has been issued after an engaging consultation with the Institute of Chartered Accountants of India. While deliberating on the possible reporting clauses for CARO 2015, it was noted that since the issuance of CARO, 2003, the financial reporting and auditing environment in India has matured considerably. On the one hand, over the twelve year long period since 2003, there is in place, a comprehensive suite of Accounting Standards developed by the Institute of Chartered Accountants of India (ICAI), following a rigorous due process that includes public consultation, and finally approved and notified for implementation by companies by the National Advisory Committee on Accounting Standards under Section 211(3C) of the Companies Act, 1956. Also, while these Standards continue to be in force for the time being under the Companies Act, 2013, ICAI has invested considerable time and resources for development of IndAS to be notified under the Companies Act, 2013 in due course. Similarly, the Schedule III of the Companies Act, 2013 and the Rules issued thereunder contain far more and comprehensive disclosures required to be given alongwith the financial statements than the Schedule VI of the Companies Act, 1956.

In the same vein, over these 12 years, the Institute of Chartered Accountants of India has, through its Auditing and Assurance Standards Board, developed and issued full-fledged suite of auditing standards in harmonisation with the International Standards on Auditing issued by the International Auditing and Assurance Standards Board. These, in turn, are supported by a number of Implementation Guides issued by the Board. Further, the auditor's reporting requirements, particularly, those relating to expressing an opinion on the adequacy and operating effectiveness of internal financial controls {Sec 143(3)(i)} and reporting on frauds to the Central Government {Sec 143(12)}, are comprehensive enough to cover, as a part of an audit, the matters required to be separately reported upon under CARO, 2003. The following table gives an overview of how

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the provisions of CARO 2003 (which incidentally, is the base for CARO 2015) are, in principle, covered by the various financial statements disclosure requirements of the Companies Act, 2013, and hence by implication, by the audits. Some of them are covered in one way or the other by the additional reporting required, pursuant to Section 143(1) and

(3) of the Act. Also, some of the clauses have come to be integrated with the principles and procedures outlined in the Standards on Auditing mandated by ICAI. Similarly, quite a few of the provisions of the Companies Act, 1956 on which these clauses of CARO 2003 were based, are now no longer in force.

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| (i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets; | <p>Internal Financial Controls as defined in the Explanation to Section 134(5)(e) of the Companies Act, 2013 are defined to mean:</p> <p><i>“Policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.”</i></p> <p>Section 143(3)(i) requires auditors to report on the operating effectiveness of Internal Financial Controls. Since fixed assets are a financial statement item, while reporting on IFCs, the statutory auditor would look into these aspects also. Hence, separate reporting as envisaged in CARO 2003 is not required. In case of any major observations, the same would be adequately brought out by the auditor in his report u/s 143(3)(i).</p> <p>In addition:</p> <ul style="list-style-type: none"> • The auditor is required to state u/s 143(3)(b) if the company has maintained proper books of account. Fixed assets records are an integral part of the books of account. Further, u/s 143(3)(h), the auditor should state any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith. • The auditor is required to state that they have taken into consideration the provisions of the Companies Act when forming their opinion on the financial statements. Any material deviation in the maintenance of the fixed assets records will be appropriately considered for reporting in the audit report, where required. |
| (b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account; | <ul style="list-style-type: none"> • Given the fact that the auditors are now also required to report on the operating effectiveness of Internal Financial Controls (IFCs), since fixed assets are a financial statement item, while reporting on IFCs, the statutory auditor would look into these aspects also. In case of any major observations, the same would be appropriately dealt with by the auditor in his report u/s 143(3)(i). • In an audit of financial statements, the Standards on Auditing (“SAs”) issued by the ICAI, which is deemed to be the auditing standards as required to be complied with under Section 143(10), require the auditors to address the “existence” assertion in relation to Fixed Assets. Sufficient appropriate audit evidence in accordance with SA 500 “Audit Evidence” may be obtained either by physically inspecting the assets or obtaining a report from another auditor of verification conducted by them. In case there are any material discrepancies noted at the time of such inspection, the auditor shall deal with the same in accordance with SA 450 “Evaluation of Misstatements Identified during the Audit” and accordingly in the audit report. |
| (c) if a substantial part of fixed assets have been disposed off during the year, whether it has affected the going concern; | <ul style="list-style-type: none"> • ICAI has issued Standard on Auditing (SA) 570, “Going Concern” which requires the auditors to assess the appropriateness of going concern in the preparation of the financial statements by the management. Specifically, the auditor is required to: <ul style="list-style-type: none"> (a) To obtain sufficient appropriate audit evidence about the appropriateness of management’s use of the going concern assumption in the preparation and presentation of the financial statements; (b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern; and (c) To determine the implications for the auditor’s report. • Further, the auditor is required to report u/s 143(3)(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company. As such, if there is a disposal of fixed assets that affects the going concern assumption, the said matter will be appropriately reported by the auditor in the audit report as required u/s 143(3)(f), as required. |

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| (ii)(a) whether physical verification of inventory has been conducted at reasonable intervals by the management; | <ul style="list-style-type: none"> • Since Inventory is a financial statement item, while reporting on IFCs, the statutory auditor would look into this aspects also while evaluating the operating effectiveness of the internal financial controls. Hence, separate reporting as envisaged in CARO 2003 is not required. In case of any major observations, the same would be appropriately dealt with by the auditor in his report u/s 143(3)(i), as required. • Besides, in an audit of financial statements, the SAs require the auditor to address the “existence” assertion in relation to Inventory. Sufficient appropriate audit evidence in accordance with SA 500 “Audit Evidence” may be obtained by physically inspecting the inventory. In case there are any material discrepancies noted at the time of such inspection, the auditor shall deal with the same in accordance with SA 450 “Evaluation of Misstatements Identified during the Audit” and accordingly in the audit report. <p>These aforesaid audit procedures will be carried out by the auditor notwithstanding any reporting requirement to that effect in CARO.</p> |
| (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; | <p>In addition to what has been stated above in respect of the auditor’s responsibility to report on internal financial controls, it may be noted that:</p> <ul style="list-style-type: none"> • The duties and responsibilities of the auditor while attending a stock taking by the management are governed by the principles laid down in the Standard on Auditing (SA) 501, “Audit Evidence—Specific Considerations for Selected Items”, issued by the ICAI. The auditor should establish the reasonableness and adequacy of procedures adopted for physical verification of inventories having regard to the nature of inventories, their locations, quantities and feasibility of conducting the physical verification. • The scope of reporting under the aforesaid standard is more comprehensive than the requirement of CARO. |
| (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; | <ul style="list-style-type: none"> • Since Inventory is a financial statement item, while reporting on IFCs, the statutory auditor would look into these aspects also. Hence separate reporting as envisaged in CARO 2003 is not required. In case of any major observations, the same would be appropriately dealt with by the auditor in his report u/s 143(3)(i), as required. <p>In addition:</p> <ul style="list-style-type: none"> • Auditor’s are required to state u/s 143(3)(b) if the company has maintained proper books of account. Inventory records are an integral part of the books of account. Further, u/s 143(3)(h), the auditor should state any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith. • Auditor’s are required to state that they have taken into consideration the provisions of the Companies Act when forming their opinion on the financial statements. Any material deviation in the maintenance of inventory records will be appropriately dealt with by the auditors in the audit report, as required. |
| (iii) (a) has the company granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under Section 301 of the Act. If so, give the number of parties and amount involved in the transactions; and | <ul style="list-style-type: none"> • Section 143(1) of the Companies Act, 2013 requires the auditor to report “<i>whether loans and advances made by the Company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the Company or its members.</i>” • Also, as per Schedule III to the Companies Act, 2013, <i>General Instructions for Preparation of Balance Sheet</i>, clause L, <i>Long Term Loans and Advances</i> and clause M, <i>Other Non-current Assets</i>, require following disclosures in the balance sheet/notes to accounts: “L. Long Term Loans and Advances: (i) Long term loans shall be classified as: (c) Loans and advances to related parties (giving details thereof) (iv) Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a members should be separately stated. M. Other Non-current Assets |

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| (b) whether the rate of interest and other terms and conditions of loans given by the company, secured or unsecured, are <i>prima facie</i> prejudicial to the interest of the company; and | <p><i>Other non-current assets shall be classified as:</i></p> <p>.....</p> <p>(iii).....</p> <p><i>(c) debts due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a members should be separately stated."</i></p> |
| (c) whether receipt of the principal amount and interest are also regular; and | <ul style="list-style-type: none"> As per SA 550 "Related Parties" the auditors should obtain sufficient appropriate evidence about the assertion made by the management that the related party transactions were conducted on terms equivalent to those prevailing in an arm's length transaction. Hence, obtaining information about loans/other transactions with related parties as per the Act including whether those are at arm's length would be part of the audit process performed by the auditor in accordance with SA 550. |
| d) if overdue amount is more than rupees one lakh, whether reasonable steps have been taken by the company(for recovery of the principal and interest; | <ul style="list-style-type: none"> Sections 185 and 186 of the Act has laid down more stringent requirements with respect to related party transactions as compared to the erstwhile Companies Act, 1956, including severe punishment of imprisonment and fine upon contravention with such requirement. As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements" the auditor is required to consider compliance with laws and regulations applicable to the company and report it in accordance with SA 705 on "Modifications to the Opinion in the Independent Auditor's Report". Moreover, listed companies and certain other class of companies as may be prescribed are required to submit, along with their board's report, a report of secretarial audit as per Section 204 of the Act. Such audit requires a more comprehensive reporting with respect to compliance with laws and regulations than a statutory audit. |
| (e) has the company taken any loans, secured or unsecured from companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and the amount involved in the transactions; and | <ul style="list-style-type: none"> As per SA 550 "Related Parties" the auditors should obtain sufficient appropriate evidence about the assertion made by the management that the related party transactions were conducted on terms equivalent to those prevailing in an arm's length transaction. Hence, obtaining information about loans/ other transactions with related parties as per the Act including whether those are at arm's length would be part of the audit process performed by the auditor in accordance with SA 550. As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements" the auditor is required to consider compliance with laws and regulations applicable to the company and report it in accordance with SA 705 on "Modifications to the Opinion in the Independent Auditor's Report". Moreover, listed companies and certain other class of companies as may be prescribed are required to submit, along with their board's report, a report of secretarial audit as per Section 204 of the Act. Such audit requires a more comprehensive reporting with respect to compliance with laws and regulations than a statutory audit. <p>Since the Act now specifies a more comprehensive statutory compliance and reporting requirement than those suggested by CARO with respect to related party transactions, reporting under this clause of CARO will only lead to reporting the same matter multiple times.</p> |
| (f) whether the rate of interest and other terms and conditions of loans taken by the company, secured or unsecured, are <i>prima facie</i> prejudicial to the interest of the company; and | <ul style="list-style-type: none"> As per Schedule III to the Companies Act, 2013, clause C, Long Terms Borrowings and Clause F, Short Terms Borrowings, following disclosures are required in the balance sheet: <p><i>C. Long-term Borrowings</i></p> <p>(i)(e) <i>Loans and advances from related parties</i></p> <p>(vi) <i>Terms of repayment of term loans and other loans shall be stated</i></p> <p>(vii) <i>Period and amount of continuing default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.</i></p> <p><i>F. Short-term Borrowings</i></p> <p>(i)(b) <i>Loans and advances from related parties</i></p> <p>(iv) <i>Period and amount of continuing default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.</i></p> |
| (g) whether payment of the principal amount and interest are also regular. | <ul style="list-style-type: none"> As per SA 550 "Related Parties" the auditors should obtain sufficient appropriate evidence about the assertion made by the management that the related party transactions were conducted on terms equivalent to those prevailing in an arm's length transaction. Hence, obtaining information about loans/ other transactions with related parties as per the Act including whether those are at arm's length would be part of the audit process performed by the auditor in accordance with SA 550. As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements" the auditor is required to consider compliance with laws and regulations applicable to the company and report it in accordance with SA 705 on "Modifications to the Opinion in the Independent Auditor's Report". Moreover, listed companies and certain other class of companies as may be prescribed are required to submit, along with their board's report, a report of secretarial audit as per Section 204 of the Act. Such audit requires a more comprehensive reporting with respect to compliance with laws and regulations than a statutory audit. <p>Since the Act now specifies a more comprehensive statutory compliance and reporting requirement than those suggested by CARO with respect to related party transactions, reporting under this clause of CARO will only lead to reporting the same matter multiple times.</p> |

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| (iv) is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system. | <ul style="list-style-type: none"> Section 143(3)(i) of the Act requires reporting on internal financial controls which shall be applicable from 1 April 2015 and is significantly larger and wider than the reporting on internal controls under the CARO. Under CARO, the reporting on internal controls was limited to the adequacy of controls over purchase of inventory and fixed assets and sale of goods and services. As such, CARO did not require reporting on all controls relating to financial reporting and also did not require reporting on the “adequacy and operating effectiveness” of such controls. Companies have started working towards adoption of such internal financial controls which shall form the basis for such reporting requirement for the forthcoming financial years. |
| (v) (a) whether the particulars of contracts or arrangements referred to in Section 301 of the Act have been entered in the register required to be maintained under that section; and (b) whether transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time; (This information is required only in case of transactions exceeding the value of five lakh rupees in respect of any party and in any one financial year). | <ul style="list-style-type: none"> In conducting an audit of financial statements, the auditor is required to consider the legal and regulatory framework applicable to the company. This includes maintenance of various registers such as the register of contracts and arrangements in which the directors are interested. In case of non-compliance, the auditor will evaluate the impact of the same as per SA 250 “Consideration of Laws and Regulations in an Audit of Financial Statements” and report it in accordance with SA 705 on “Modifications to the Opinion in the Independent Auditor’s Report”. An audit of financial statements is conducted in accordance with the SAs issued by the ICAI. As per SA 550 “Related Parties” the auditors should obtain sufficient appropriate evidence about the assertion made by the management that the related party transactions were conducted on terms equivalents to those prevailing in an arm’s length transaction. Hence, obtaining information about transactions made in pursuance of such contracts or arrangements with related parties as per the Act including whether those are at arm’s length would be part of the audit process performed by the auditor in accordance with SA 550. Section 188 of the Act has laid down more stringent requirements with respect to related party transactions as compared to the erstwhile Companies Act, 1956. |
| (vi) in case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India and the provisions of Sections 58A, 58AA or any other relevant provisions of the Act and the rules framed there under, where applicable, have been complied with. If not, the nature of contraventions should be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal whether the same has been complied with or not? | <ul style="list-style-type: none"> In conducting an audit of financial statements, the auditor is required to consider the legal and regulatory framework applicable to the company. Testing the company’s compliance with regulatory requirements applicable to the company is imperative in an audit of financial statements. In case of non-compliance, the auditor will evaluate the impact of the same as per SA 250 “Consideration of Laws and Regulations in an Audit of Financial Statements” and report it in accordance with SA 705 on “Modifications to the Opinion in the Independent Auditor’s Report”. Auditor’s are required to state that they have taken into consideration the provisions of the Companies Act when forming their opinion on the financial statements. Any material deviation in the acceptance of deposits by a company will therefore be appropriately dealt with by the auditors in the audit report, as required. The Companies Act, 2013 requires the auditor to certify separately the returns to be filed by a company in case they accept public deposits. In addition, acceptance of deposits is governed by the Reserve Bank of India, which also requires separate certification by the auditors. |

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| <p>(vii) in the case of listed companies and/or other companies having a paid-up capital and reserves exceeding ₹ 50 lakh as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crore rupees for a period of three consecutive financial years immediately preceding the financial year concerned, whether the company has an internal audit system commensurate with its size and nature of its business;</p> | <ul style="list-style-type: none"> • In terms of section 138 of the Companies Act, 2013 read with the Companies (Accounts) Rules, 2014 prescribed thereunder, specified classes of companies are, in any case, mandatorily required to be subjected to internal audit. • Also the thresholds specified in the Rules are different from those specified under this clause. |
| <p>(viii) where maintenance of cost records has been prescribed by the Central Government under clause (d) of sub-Section (1) of Section 209 of the Act, whether such accounts and records have been made and maintained;</p> | <ul style="list-style-type: none"> • Cost records are maintained by the class of companies as prescribed under Cost Records and Audit Rules, 2014. The specific requirement of reporting on the maintenance of cost records will be performed by the Cost auditor as part of his duties and the scope of his work is more comprehensive than that of the statutory auditor. • Auditor's are required to state u/s 143(3)(b) if the company has maintained proper books of account. Cost records are an integral part of the books of account. Further, u/s 143(3)(h), the auditor should state any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith. • In many companies, the volume of cost records is extremely huge and moreover, cost records contain information that is no way related to financial statements. Hence, a statutory auditor cannot reasonably be expected to report on them. • Statutory auditors can only do a prima facie examination of the cost records, as had been mentioned in the Statement on the Companies (Auditor's Report) Order, 2003, issued by ICAI. |
| <p>(ix) (a) is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income-tax, Sales-tax, Wealth Tax, Service Tax, Custom Duty, Excise Duty, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.</p> | <ul style="list-style-type: none"> • Under Schedule III to the Companies Act, 2013, clause G, Other Current Liabilities, the following disclosure is required under sub clause (j): "other payables (specify)" • Instead of requiring a separate reporting by the statutory auditor under CARO, companies could be required to give more detailed disclosures under this head regarding statutory dues as stated in the clause(ix)(a) of CARO 2003. • In an audit of financial statements, an auditor is required to consider the legal and regulatory framework applicable to the company. This includes testing of compliance with various statutory regulations applicable to the company. In case of non-compliance, the auditor will evaluate the impact of the same as per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements" and report it in accordance with SA 705 on "Modifications to the Opinion in the Independent Auditor's Report". • Section 143(3)(j) read with Rule 11 of the Companies (Audit and Auditors') Rules 2014 requires the auditor to report as to whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement. Dues of sales tax/income tax/custom tax etc. on account of dispute are covered under the definition of "pending litigations" and will instigate reporting under said Section. • Further, the auditors are required to report on the payment of statutory dues under other legislations too such as the Tax Audit report under the Income-tax Act, etc. • Section 134(5)(f) of the Companies Act, 2013 casts a responsibility on the Board of Directors for ensuring an adequate system for compliance with laws and regulations applicable to a company and the operating effectiveness of such system and stating this responsibility in the Board report. As such if there are significant delays in remittance of statutory dues which are material, the same may need to be appropriately dealt with by the Board in terms of Section 134(5)(f). |

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| (b) in case dues of Income tax/ Sales tax /Wealth tax/ Service tax/ Custom duty/ Excise duty/ cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the Department shall not constitute a dispute). | <ul style="list-style-type: none"> • In this case, two scenarios can be there: (i) Amount is disputed but has been provided for by the company in the financial statements Or (ii) Disputed amount is not acknowledged as debt against the Company and reflected as a Contingent Liability in terms of clause T of Schedule III to the Companies Act 2013 • In both the scenarios, companies can be required to make additional disclosures. • Further, the auditor, in terms of the reporting requirements u/s 143(3)(j) is required to state whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statements. Since disputed taxes are pending litigations, this matter will in any case be appropriately dealt with by the auditor in the audit report u/s 143(3)(j), as required. |
| (x) whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year; | <ul style="list-style-type: none"> • Pursuant to the requirements of SA 570, "Going Concern," the auditor in any case looks into the aspect of erosion of net worth as a matter that indicates a doubt about the going concern. Also, information in respect of cash losses is available through the Cash Flow Statement. • Further, the Cash Flow Statement is now required to be prepared and reported on as part of the financial statements, which statement states the cash operating profits and cash flow from operations. |
| (xi) whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported; | <ul style="list-style-type: none"> • In terms of Schedule III to the Companies Act, 2013 - "General Instructions for Preparation of Balance Sheet" (Clause C-Long Term Borrowings, point (vii), period and amount of continuing default as on balance sheet date in repayment of loans and interest, shall be specified in each case. • This reporting in the balance sheet applies to all the categories of Long Term Borrowings given in Clause C, including Bonds/Debentures, Term Loans from Banks and Other Parties, etc. |
| (xii) whether adequate documents and records are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities; If not, the deficiencies to be pointed out. | <ul style="list-style-type: none"> • Section 143(1)(a) of the Companies Act, 2013 requires the auditor to inquire whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members. In case the auditor observes any deviation, the same will be reportable u/s 143(3). |
| (xiii) whether the provisions of any special statute applicable to chit fund have been duly complied with? In respect of Nidhi/ mutual benefit fund/societies; | <ul style="list-style-type: none"> • The Government has issued the Nidhi Rules, 2014 pertaining to Chapter XXVI, Nidhis, of the Act. Rule 5.d of the aforesaid Rule requires a Nidhi to maintain a Net Owned Fund ratio of 1:20. • Further, Rule 22 of the aforesaid Rules, the auditor of a Nidhi company is required to give a certificate (annual) that "the company has complied with all the provisions contained in the rules" and this certificate is to be annexed to the audit report. Also, any non-compliance with the Rules has to be specified in the Certificate. |
| (a) whether the net-owned funds to deposit liability ratio is more than 1:20 as on the date of balance sheet; | |

| Clause | Covered by |
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| (b) whether the company has complied with the prudential norms on income recognition and provisioning against sub-standard/doubtful/loss assets; | <ul style="list-style-type: none"> The Government has issued the Nidhi Rules, 2014 pertaining to Chapter XXVI, Nidhis, of the Act. Rule 20 of the aforesaid Rule lay down the requirements in respect of "Prudential Norms". Further, Rule 22 of the aforesaid Rules, the auditor of a Nidhi company is required to give a certificate (annual) that "the company has complied with all the provisions contained in the rules" and this certificate is to be annexed to the audit report. Also, any non-compliance with the Rules has to be specified in the Certificate |
| (c) whether the company has adequate procedures for appraisal of credit proposals/requests, assessment of credit needs and repayment capacity of the borrower; | <ul style="list-style-type: none"> The Government has issued the Nidhi Rules, 2014 pertaining to Chapter XXVI, Nidhis, of the Act. Rule 15 of the aforesaid Rule lay down the conditions subject to which a Nidhi can grant a loan. Further, Rule 22 of the aforesaid Rules, the auditor of a Nidhi company is required to give a certificate (annual) that "the company has complied with all the provisions contained in the rules" and this certificate is to be annexed to the audit report. Also, any non-compliance with the Rules has to be specified in the Certificate. |
| (d) whether the repayment schedule of various loans granted by the nidhi is based on the repayment capacity of the borrower; | <ul style="list-style-type: none"> The Government has issued the Nidhi Rules, 2014 pertaining to Chapter XXVI, Nidhis, of the Act. Rule 15 of the aforesaid Rule lay down the conditions subject to which a Nidhi can grant a loan as also the repayment terms. Further, Rule 22 of the aforesaid Rules, the auditor of a Nidhi company is required to give a certificate (annual) that "the company has complied with all the provisions contained in the rules" and this certificate is to be annexed to the audit report. Also, any non-compliance with the Rules has to be specified in the Certificate. |
| (xiv)if the company is dealing or trading in shares, securities, debentures and other investments, whether proper records have been maintained of the transactions and contracts and whether timely entries have been made therein; also whether the shares, securities, debentures and other investments have been held by the company, in its own name except to the extent of the exemption, if any, granted under Section 49 of the Act; | <ul style="list-style-type: none"> In an audit of financial statements, the SAs require the auditor to address the "existence" assertion in relation to Investment. Sufficient appropriate audit evidence in accordance with SA 500 "Audit Evidence" may be obtained by physically verifying the investments or through confirmations. In case there are any material discrepancies noted at the time of such inspection, the auditor shall deal with the same in accordance with SA 450 "Evaluation of Misstatements Identified during the Audit" and accordingly in the audit report. Auditor's are required to state that they have taken into consideration the provisions of the Companies Act when forming their opinion on the financial statements. Any material deviation in the account balance of investments <i>vis-à-vis</i> the requirements of the Companies Act, 2013 will in any case be appropriately dealt with by the auditor in the audit report, as required. |
| (xv)whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company; | <ul style="list-style-type: none"> Section 143(3)(f) requires the auditor to comment on financial transactions or matters that have an adverse effect on the functioning of the Company. Guarantee given for loans taken by others from banks or financial institutions fall under the purview of "financial transactions" and any such transaction which is prejudicial to the interest of the company and material to the financial statements could be commented upon under this section, as required. In addition in terms of Rule 11(b) of the Companies (Audit and Auditor's) Rules, 2014, the auditor is required to report 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. This would include guarantees too. |
| (xvi)whether term loans were applied for the purpose for which the loans were obtained; | <ul style="list-style-type: none"> Under the Companies Act, 2013, financial statements include a Cash Flow Statement which would reflect the source of funds through long-term borrowings and the utilisation of funds in investing activities. Based on this users of the financial statements can determine if the term loans were utilised for the purpose they were obtained. |

| Clause | Covered by |
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| (xvii) whether the funds raised on short-term basis have been used for long term investment; If yes, the nature and amount is to be indicated; | <ul style="list-style-type: none"> As a part of audits of financial statements, the auditors in any case make assessment of the appropriateness of "Going Concern" in terms of the requirements of SA 570. Excessive reliance on short term borrowings to finance long term assets is one of the factors that may cast a doubt about going concern assumption. Thus, a separate reporting in CARO for this purpose is not required. Further, under the Companies Act, 2013, financial statements include a Cash Flow Statement which would reflect the long-term source of funds and the utilisation of funds for long-term purposes. Based on this users of the financial statements can determine if the short-term funds were used for long-term purposes. |
| (xviii) whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under Section 301 of the Act and if so whether the price at which shares have been issued is prejudicial to the interest of the company; | <ul style="list-style-type: none"> An audit of financial statements is conducted in accordance with the SAs issued by the ICAI. As per SA 550 "Related Parties" the auditors should obtain sufficient appropriate evidence about the assertion made by the management that the related party transactions were conducted on terms equivalents to those prevailing in an arm's length transaction. Hence, obtaining information about transactions made in pursuance of such preferential allotment of shares to related parties as per the Act including whether those are at arm's length would be part of the audit process performed by the auditor in accordance with SA 550. Further, the Companies Act, 2013 specifies the requirements for preferential allotment of shares, such that they are not prejudicial to the interests of the Company. Since the auditors are required to state that they have taken into consideration the provisions of the Companies Act when forming their opinion on the financial statements, any material deviation in compliance with the preferential allotment norms <i>vis-à-vis</i> the requirements of the Companies Act, 2013 will therefore be reported in the audit report. |
| (xix) whether security or charge has been created in respect of debentures issued; | <ul style="list-style-type: none"> In terms of Schedule III to the Companies Act, 2013 - "General Instructions for Preparation of Balance Sheet" (Clause C-Long Term Borrowings, point(ii) specifically requires the following disclosure in the Balance Sheet: <i>"(ii) Borrowings shall be further sub-classified as secured and unsecured. Nature of security shall be specified separately in each case."</i> |
| (xx) whether the management has disclosed on the end use of money raised by public issues and the same has been verified; | <ul style="list-style-type: none"> In terms of Schedule III to the Companies Act, 2013 - "General Instructions for Preparation of Balance Sheet", clause V, the following disclosure is required in the balance sheet: <i>"Where in respect of an issue of securities made for a specific purpose, the whole or part of the amount has not been used for the specific purpose at the balance sheet date, there shall be indicated by way of a note how such unutilized amounts have been used or invested."</i> Further, as per the Listing Agreement, where a company has raised money by way of public issues, it is required to prepare a statement of funds utilised for purpose other than those stated in offer document/prospectus/notice and this needs to be certified by the Statutory Auditor of the Company. |
| (xxi) whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated. | <ul style="list-style-type: none"> Section 143(12) of the Companies Act 2013 and the Rules thereunder lay down responsibilities of the statutory auditor with respect to reporting of frauds to the Central Government. |

In the above background, CARO, 2015, contains only 12 reporting clauses. In fact, all except one of these have been taken from CARO, 2003. The only exception is Clause (vii)(c) of paragraph 3, which requires the auditors to report whether the amount required to be transferred to investor education and protection fund, in accordance with the relevant provisions of the Companies Act, 1956 (1 of 1956) and rules made thereunder has been transferred to

CARO, 2015 has been issued after an engaging consultation with the Institute of Chartered Accountants of India. While deliberating on the possible reporting clauses for CARO 2015, it was noted that since the issuance of CARO, 2003, the financial reporting and auditing environment in India has matured considerably.

CARO, 2015, contains only 12 reporting clauses. In fact, all except one of these have been taken from CARO, 2003 itself. The only exception is clause (vii)(c) of paragraph 3 which requires the auditors to report whether the amount required to be transferred to investor education and protection fund in accordance with the relevant provisions of the Companies Act, 1956 (1 of 1956) and rules made there under, has been transferred to such fund within time.

such fund within time. This clause, in fact, is also appearing as sub-Rule (c) of Rule 11 of the Companies (Audit and Auditors) Rules, 2014. As is clear, none of the clauses of CARO 2015 would require the companies to have any new information systems in place to generate the necessary information. At the same time, the auditors too would not be required to undertake any new or additional procedures to report on the information in CARO, 2015. As a result, the statutory auditors can continue to draw guidance from the relevant paragraphs of the existing Statement on Companies (Auditor's Report) Order, 2003, issued by ICAI. The Institute of Chartered Accountants of India has already issued an Announcement providing guidance to the members in this regard. This Announcement is available on the website of the Institute *i.e.*; www.icaai.org.

It would also be noted that CARO, 2015 has not brought in any changes with regard to exemption thresholds prescribed by CARO, 2003 for the private companies, in terms of paid up capital and reserves, outstanding loan from any bank or financial institution and turnover. In addition to continuing to keep the banking, insurance and companies licensed to operate under Section 8 of the Companies Act, 2013, out of the purview of the Order, on a cost-benefit consideration of additional reporting requirements, one person companies {as defined under Section 2(62)} and small companies {as defined under Section 2(85) of the Companies Act, 2013} have also been exempted from CARO, 2015.

An important point to note in this regard is that Section 129(4) of the Companies Act, 2013 envisages a *mutatis mutandis* application of the provisions relating to preparation and audit of standalone financial statements, to the consolidated financial statements as well. One interpretation of this

requirement is that the use of the words "*mutatis mutandis*" implies that the provisions are to be applied to the extent possible and practicable with suitable changes. Hence, the auditor of the CFS should not be required to report on any matters other than the true and fair view of the CFS. On the other hand is the interpretation, that all the reporting requirements under Section 143(1),(2),(3) and (11) apply equally to the auditors of CFS. Accordingly, the auditor of the consolidated financial statements would need to also make a report on Section 143(11). This, however, seems a very impractical interpretation of the provision of Section 129(4) as the "Group" *per se* is not a legal entity in respect of which the clauses of CARO 2015 can be reported upon. It is only the components of the Group that would have any separate legal entity. So, the only recourse available to the auditor of CFS would be to base his comments on the reports of the auditors of the components, that too only such components which are Indian companies, since the other components' auditors would not be required to make any report under CARO 2015. Of course, the concepts of materiality and exercise of professional skepticism remain the bedrock of such reporting. In the absence of any consensus view on the interpretation of Section 129(4), particularly, regulators seemingly taking the latter interpretation, the CFS auditors seem to be left with no choice than report on CARO 2015 also.

In the above background, it may not be an exaggeration to say that the present regime of Companies Act, 2013 and the Rules, contain tighter provisions relating to the duties of the directors, independent directors, audit committee, related party transactions, *etc.*, that are aimed at ensuring greater transparency and fairness for the stakeholders, in the running of the day to day affairs of a company. The relevance of any such

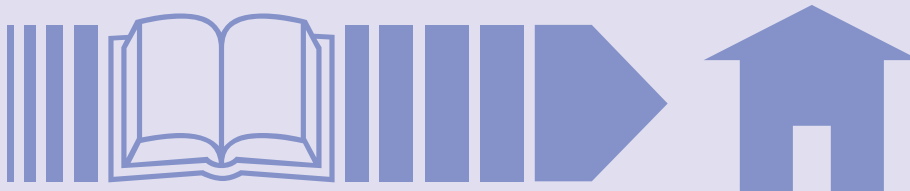
None of the clauses of CARO 2015 would require the companies to have any new information systems in place to generate the necessary information. At the same time, the auditors too would not be required to undertake any new or additional procedures to report on the information in CARO, 2015. As a result, the statutory auditors can continue to draw guidance from the relevant paragraphs of the existing Statement on Companies (Auditor's Report) Order, 2003, issued by ICAI.

separate Order needs to be relooked, to provide such information which was hitherto not available or cannot be made available, through the financial statements and accompanying notes or through auditors' report under Section 143(3)(1), (2) and (3) of the Companies Act, 2013.

At this juncture, it may also be worthwhile to note that, at the international level, a number of critical changes have been brought in the auditor's report of listed entities to make it more robust in terms of providing more sensitive and focussed information about the auditee and the audit to the users of the auditor's report. These changes have been brought in by the International Auditing and Assurance Standards Board after a lengthy process of consultation with the various stakeholders on their information needs and expectations from auditor's report.

The resultant ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, therefore requires a dedicated section in the auditor's report

viz., "Key Audit Matters" (or KAM). These KAM are those matters that, in the auditor's professional judgment, were of the maximum significance in the audit of the financial statements of the current period. KAM are selected by the auditor from areas of higher assessed risk of material mis-statement, or significant risks identified in accordance with ISA 315, or significant auditor judgements relating to areas in the financial statements that involved significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty, or the effect on the audit of significant events or transactions that occurred during the period. The Auditing and Assurance Standards Board has already started on the project of examining this ISA 701 and its implementation challenges in India, including how it can be calibrated with the Order issued under Section 143(11) of the Companies Act, 2013 to avoid duplication and make the auditor's report more meaningful. ■



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