CHAPTER - 5
Company Audit

Question 1

PQ & Co. is an audit firm with P and Q as partners. For the financial year 2019-20, the firm has been appointed as statutory auditor of M/s Mango Orchards Hotel Ltd. The audit firm is a regular customer of the hotel and the partners usually stay in the same hotel at various locations in the course of travelling for their various professional assignments. Normally, payments for such stay are settled against quarterly bills raised by the company. Give your comment with respect to the Companies Act, 2013.

Answer

Indebtedness to the Company: According to the section 141(3)(d)(ii) of the Companies Act, 2013, a person who is indebted to the company for an amount exceeding ₹ 5,00,000 shall be disqualified to act as an auditor of such company and further under section 141(4) he shall vacate his office of auditor when he incurs this disqualification subsequent to his appointment.

Further a person or a firm who directly or indirectly has business relationship with a company or its subsidiary or its holding or associate company, is also not qualified to be appointed as auditor of the company. But here business relationship does not include commercial transactions which are in the ordinary course of the business of the company at arm’s length price.

However, where the person has liquidated his debt before the appointment date, there is no disqualification to be construed for such appointment.

In the given case, PQ & Co., an audit firm with P & Q as partners is appointed as statutory auditor of M/s Mango Orchards Hotel Ltd. and the audit firm is a regular customer of the hotel and the partners usually stay in the same hotel at various locations. They also settle the payments for such stay against quarterly bills raised by the company.

Assuming the balance amount at any time during the year due to the hotel does not exceed the prescribed limits of rupees 5,00,000, PQ & Co., is not disqualified to be appointed as statutory auditor of M/s Mango Orchards Hotel Ltd as per section 141(3)(d)(ii), in the absence of the same the auditor shall be disqualified to act as an auditor and shall vacate his office of auditor when he incurs this disqualification subsequent to the appointment.

Since in term of section 141(3)(e) of Companies Act, 2013 PQ & Co. is not a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed, the auditor shall not be disqualified to act as an auditor and shall not required to vacate his office of auditor.

Question 2

R and M is an audit firm having partners CA. R, CA. M and CA. G. Mr. S is the relative of CA. R holding shares of STP Ltd. having a face value of ₹ 1,51,000. Whether CA. R and CA. M are qualified to be appointed as auditors of STP Ltd.?

Answer

Holding of Shares by Relative of Partner: As per section 141(3)(d)(i) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Further as per proviso to this Section, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of ₹ 1,00,000.
In the instant case, R and M is an audit firm having partners CA. R, CA. M and CA. G. Mr. S is a relative of CA. R and he is holding shares of STP Ltd. of face value of ₹ 1,51,000.

Therefore, R and M, audit firm along with its partners CA. R, CA. M and CA. G will be disqualified for appointment as an auditor as the relative of CA. R is holding the securities in STP Ltd. which is exceeding the limit mentioned in proviso to section 141(3)(d)(i).

Thus, CA. R and CA. M will be disqualified to be appointed as auditors of STP Ltd.

**Question 3**

Navy and Cavy Associates, a Chartered Accountant firm, has been appointed as Statutory Auditor of Poor Ltd. for the financial year 2019-20. Mr. Savy, the relative of Mr. Navy, a partner in Navy and Cavy Associates, is indebted for ₹ 6,00,000 to Wealthy Ltd., a subsidiary company of Poor Ltd. Comment.

**Answer**

Indebtness to the Subsidiary Company: As per sub-section (3)(d)(ii) of Section 141 of the Companies Act, 2013 along with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 5 lakhs.

Also, as per sub-section (4) of Section 141 of the Companies Act, 2013, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub- section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

In the present case, Mr. Savy, the relative of Mr. Navy, a partner in Navy and Cavy Associates, has been indebted to Wealthy Ltd., a subsidiary company of Poor Ltd., for ₹ 6 lakhs.

Therefore, the firm, Navy and Cavy Associates would be disqualified to be appointed as statutory auditor of Poor Ltd. as per section 141(3)(d)(ii), which is the holding company of Wealthy Ltd., because Mr. Savy, the relative of Mr. Navy, a partner in Navy and Cavy Associates, has been indebted to Wealthy Ltd. for an amount exceeding the minimum approved limit.

**Question 4**

Mr. Pratiq, a practicing Chartered Accountant, has been appointed as an auditor of Opus Ltd. He is holding securities of the company having face value of ₹ 89,000 only.

(i) You are required to state, whether Mr. Pratiq is qualified to be appointed as an auditor of Opus Ltd.

(ii) Would your answer be different, if instead of Mr. Pratiq; Mr. Quresh, the step-father of Mr. Pratiq, is holding the securities?

**Answer**

Disqualification due to Holding of Securities: According to section 141(3)(d)(i) of the Companies Act, 2013 read with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or
interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

However, as per the proviso to this Section, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of ₹ 1,00,000.

Further, the term “relative” has been defined under the Companies Act, 2013 which means anyone who is related to another as members of a Hindu Undivided Family; husband and wife; Father (including step-father), Mother (including step-mother), Son (including step-son), Son's wife, Daughter, Daughter's husband, Brother (including step-brother), Sister (including step-sister).

**In the present situation,**

(i) Mr. Pratiq is holding securities in Opus Ltd., which is not allowed as per the provisions of section 141(3)(d)(i) of the Act. Therefore, Mr. Pratiq will be disqualified to be appointed as an auditor of Opus Ltd.

(ii) Mr. Quresh, the step-father of Mr. Pratiq, is holding the securities in Opus Ltd.

It may be noted that step-father is included in the definition of the term “relative” as per the Companies Act, 2013. Further, proviso to section 141(3)(d)(i) of the Act allows a relative of the auditor to hold securities in the company of face value not exceeding of ₹ 1,00,000.

Here, Mr. Quresh is holding securities for face value of ₹ 89,000 which is below the limit as prescribed under the said proviso.

Therefore, Mr. Pratiq will not be disqualified to be appointed as an auditor of Opus Ltd.

**Question 5**

CA Adroit was indebted to Anfractuous (P) Ltd. for a sum of ₹ 6,00,000 as on 01.04.2019. However, CA Adroit having come to know that he might be appointed as auditor of the company, he squared up the amount on 10.7.2019. Later on, he was appointed as an auditor of the company for the year ended 31.03.2020 at the Annual General Meeting held on 16.07.2019.

Subsequently, one of the shareholders complains that the appointment of CA Adroit as an auditor is invalid because he incurred disqualification under section 141 of the Companies Act, 2013.

**Comment.**

**Answer**

Indebtness to the Company: According to the section 141(3)(d)(ii) of the Companies Act, 2013, a person who is indebted to the company for an amount exceeding ₹ 5,00,000 shall be disqualified to act as an auditor of such company and further under section 141(4) he shall vacate his office of auditor when he incurs this disqualification subsequent to his appointment.

However, where the person has liquidated his debt before the appointment date, there is no disqualification to be construed for such appointment.

In the given case, CA Adroit was indebted to Anfractuous (P) Ltd. for a sum of 6,00,000 as on 01.04.2019. He was appointed as an auditor of the company for the year ended 31.03.2020 at the Annual General Meeting held on 16.07.2019. He also repaid the loan amount fully to the company on 10.7.2019 i.e. before the date of his appointment.

Hence, the appointment of CA Adroit as an auditor is valid and the shareholder’s complaint is not acceptable.
Question 6

Ram and Hanuman Associates, Chartered Accountants in practice have been appointed as Statutory Auditor of Krishna Ltd. for the accounting year 2019-20. Mr. Hanuman, a partner of the Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd., a subsidiary company of Krishna Ltd. Comment.

Answer

Auditor Holding Securities of a Company: As per sub-section (3)(d)(i) of Section 141 of the Companies Act, 2013 along with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Provided that the relative may hold security or interest in the company of face value not exceeding rupees one lakh.

Also, as per sub-section (4) of Section 141 of the Companies Act, 2013, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

In the present case, Mr. Hanuman, Chartered Accountant, a partner of M/s Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd. which is a subsidiary of Krishna Ltd. Therefore, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd. as per section 141(3)(d)(i), which is the holding company of Shiva Ltd., because Mr. Hanuman one of the partner is holding equity shares of its subsidiary.

Question 7

Mr. Y, a practising Chartered Accountant, has been appointed as an auditor of M/s Z Ltd on 12th June, 2019 for the year ended 31st March, 2020. The following persons have done following transactions in securities of M/s Z Ltd.:

- Daughter of Mr. Y: Purchase of Securities on 10th September, 2019 of face value of ₹ 45,000 (market value ₹ 90,000)

- Husband of daughter of Mr. Y: Purchase of Securities on 10th December, 2019 of face value of ₹ 90,000 (market value ₹ 1,90,000).

All the above securities were sold on 10th March, 2020 for ₹ 3,00,000. Discuss the implications of the above on the appointment of Mr. Y.

Answer

Implications of relatives' securities holding on the Appointment of the Auditor: According to Section 141(3)(d)(i) of the Companies Act, 2013, read with Rule 10, an auditor is disqualified to be appointed as an auditor if the auditor or his relative holds securities or interest in the company of face value exceeding ₹100,000.

Further the definition of relative also includes daughter and a daughter's husband. Both are covered in the definition of relative as defined by the Companies Act 2013.

Thus, the disqualifications will be applicable as the relative/s are holding securities of face value of more than ₹ 100,000 and market value is not important.

It is also to note that in the event of acquiring any security or interest by a relative above the threshold prescribed, the corrective action to maintain the limits as specified above can be taken by the auditor within 60 days of such acquisition or interest. The same has however not been done.
In the instant case, Daughter of Mr. Y purchased the securities on 10th September 2019 of face value of rupees 45,000 and husband of daughter of Mr. Y purchased the securities on 10th of December, 2019 of face value of rupees 90,000. Aggregating the value of holding of securities exceeds the limits mentioned in proviso to section 141(3)(d)(i) i.e. rupees 1,00,000.

Further, corrective action taken by Husband of Daughter of Mr. Y on 10th March, is also not in accordance with prescribed grace period of 60 days.

Therefore, CA. Y will be disqualified for appointment as an auditor of M/s. Z Ltd. as per section 141(3)(d)(i) and he shall vacate his office.

Question 8
Mr. Ram, a relative of a Director was appointed as an auditor of the company. Comment.

Answer
Appointment of the Auditor: Section 141 of the Companies Act 2013 (herein after referred as the Act) deals with the eligibility, qualifications and disqualifications of Auditors. Sub-section (3)(f) of the Section 141 of the Act, explicitly disqualifies a person from being appointed as an auditor of a company whose relative is a director or is in the employment of the company as a director or key managerial personnel.

Further, as per Council Guidelines, 2008 a member of the institute shall desist from expressing his opinion on financial statements of any business or enterprise in which one or more persons, who are his relatives within the meaning of AS-18, have either by themselves or in conjunction with such member, a substantial interest in the said business or enterprise. Therefore, if the director has substantial interest in the company then his relative should not accept the appointment of auditor of that company.

In the instant case, Mr. Ram is the relative of a Director of the company, therefore, he should not accept the appointment as an auditor of that company. If he accepts such appointment, he would be guilty of professional misconduct and would also be liable for punishment for contravention of the provisions of the Companies Act.

Question 9
As an auditor, how would you deal with the following situations:

(a) Nick Ltd. is a subsidiary of Ajanta Ltd., whose 20% shares have been held by Central Government, 25% by Uttar Pradesh Government and 10% by Madhya Pradesh Government. Nick Ltd. appointed Mr. Prem as statutory auditor for the year.

(b) Mr. Amar, a Chartered Accountant, bought a car financed at ₹ 7,00,000 by Chaudhary Finance Ltd., which is a holding company of Charan Ltd. and Das Ltd. He has been the statutory auditor of Das Ltd. and continues to be even after taking the loan.

Answer
(a) According to Section 139(7) of the Companies Act, 2013, the auditors of a government company shall be appointed or re-appointed by the Comptroller and Auditor General of India. As per section 2(45), a Government company is defined as any company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more
State Governments and includes a company which is a subsidiary of a Government Company as thus defined”.

In the given case Ajanta Ltd is a government company as its 20% shares have been held by Central Government, 25% by U.P. State Government and 10% by M.P. State Government. Total 55% shares have been held by Central and State governments. Therefore, it is a Government company.

Nick Ltd. is a subsidiary company of Ajanta Ltd. Hence Nick Ltd. is covered in the definition of a government company. Therefore, the Auditor of Nick Ltd. can be appointed only by C & AG.

Consequently, appointment of Mr. Prem is invalid and he should not give acceptance to the Directors of Nick Ltd.

(b) According to section 141(3)(d)(ii) of the Companies Act, 2013, a person is not eligible for appointment as auditor of any company, if he is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh.

In the given case Mr. Amar is disqualified to act as an auditor under section 141(3)(d)(ii) as he is indebted to M/s Chaudhary Finance Ltd. for more than ₹ 5,00,000. Also, according to section 141(3)(d)(ii) he cannot act as an auditor of any subsidiary of Chaudhary Finance Ltd. i.e. he is also disqualified to work in Charan Ltd. & Das Ltd. Therefore he has to vacate his office in Das Ltd. Even though it is a subsidiary of Chaudhary Finance Ltd.

Hence audit work performed by Mr. Amar as an auditor is invalid, he should vacate his office immediately and Das Ltd should appoint another auditor for the company.

Question 10

IO Ltd. is registered with Registrar of Companies on 1st of May 2019. The Company's 27% of paid up share capital is held by Central Government; 28% by State Government and the remaining 45% by public. The Board of Directors appointed RMG, Chartered Accountants as statutory auditors for the financial year 2019-20 by passing a resolution at the Board Meeting held on 25th May, 2019. Comment whether appointment is valid or not.

Answer

Appointment of First Auditor of a Government Company: According to section 139(7) of the Companies Act, 2013, the first auditor of a government company shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company. As per section 2(45) of the said Act, a Government Company is defined as any company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary company of such a Government Company.

In the given case, IO Ltd. is a government company as its 27% of paid-up share capital has been held by Central Government, 28% by State Government and remaining 45% by Public i.e. total 55% of the paid-up share capital has been held by Central Government and State Government which is more than 51% as prescribed in the Companies Act, 2013.

Therefore, the appointment of RMG, Chartered Accountants as first auditor by the Board of Directors of IO Ltd. for the financial year 2019-20 is not valid as the first auditor of a government
company can be appointed by Comptroller and Auditor-General of India. If the CAG fails to make such appointment within 60 days, the Board of Directors shall appoint within next 30 days.

**Question 11**

While auditing Y Ltd., CA Max, the statutory auditor of Y Ltd. encounters exceptional circumstances that bring into question his ability to continue performing the audit. Considering it appropriate, CA Max resigned from the office of auditor of Y Ltd. Due to the resignation of the existing auditor, the Board of Directors of Y Ltd. itself appointed CA Mini, a practicing Chartered Accountant, as the statutory auditor till the conclusion of 6th meeting.

You are required to state the provisions related to filling of casual vacancy as per the Companies Act, 2013 and comment upon the validity of appointment made by the Board.

**Answer**

Filling of Casual Vacancy: According to section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall-

(i) In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days.

   If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

(ii) In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within 30 days.

   It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period the Board of Directors shall fill the vacancy within next 30 days.

In the given case, CA Max, the statutory auditor of Y Ltd. has resigned from the office of auditor. Therefore, such casual vacancy can be filled by the Board of Directors subject to approval by the company at a general meeting convened within 3 months of the recommendation of the Board.

Thus, the appointment of CA Mini made by the Board of Directors without the approval of the company at a general meeting is invalid.

Further, if appointment is approved by the company, CA Mini cannot hold the office of auditor till the conclusion of 6th meeting i.e. the appointment cannot be made for five years. The auditor can hold office only till the conclusion of the next AGM.

**Question 12**

Malta Pvt. Ltd., a newly incorporated company dated 01.07.2019 is engaged in the manufacturing business of Cotton Shirts. On 30.07.2019, the Managing Director of Malta Pvt. Ltd. himself appointed CA Rajnath, his daughter’s husband, as the first auditor of the company.

You are required to –

(i) state the provisions of the Companies Act, 2013 relating to appointment of first auditor.

(ii) comment on the action of the Managing Director.
Answer

(i) Appointment of First Auditor: Provisions of the Companies Act, 2013 relating to appointment of first auditor are stated below-

1. Appointment of First Auditor in the case of a company, other than a Government Company- As per Section 139(6), the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

In the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

2. Appointment of First Auditor in the case of Government Company- Section 139(7) provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.

In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.

(ii) Appointment of First Auditor by the Managing Director: Apparently, there are two issues arising out of the situation given in the question, viz., first one relates to appointment of first auditor by the Managing Director; and second pertains to relation of such an auditor with the Managing Director. Regarding the first issue relating to appointment of auditor, particularly, in this case relating to appointment of first auditor, it may be noted that as per the provisions of section 139(6) of the Companies Act, 2013, the first auditor of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

As per the facts given in the case, the appointment of CA Rajnath as first auditor by the Managing Director of Malta Pvt. Ltd. by himself is in violation of section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company within one month of registration of the company.

Thus, the appointment of CA Rajnath is not valid. Under the circumstances, the second issue relating to relationship of auditor with Managing Director becomes redundant.

Question 13

Ram Ltd. is a private company. Its balance sheet shows paid up share capital of ₹ 5 crore and public borrowings of ₹ 100 crore. The company appointed M/s Shyam & Co., a chartered accountant firm, as the statutory auditor in its annual general meeting held at the end of September, 2019 for 11 years.

You are required to state the provisions related to - rotation of auditors and cooling off period as per the section 139(2) of the Companies Act, 2013 in case of an individual auditor or an audit
firm, both, and comment upon the facts of the case provided above with respect to aforesaid provisions.

Answer

Rotation of Auditor & Cooling Off Period Provisions: The provision related to Rotation of Auditor & Cooling Off Period is newly inserted by section 139(2) of the Companies Act, 2013 read with Rule 5 of the Companies (Audit & Auditors) Rules, 2014, which is discussed as under:

The provisions related to rotation of auditor are applicable to those companies which are prescribed in Companies (Audit and Auditors) Rules, 2014, which prescribes the following classes of companies excluding one person companies and small companies, namely:-

(i) all unlisted public companies having paid up share capital of ₹ 10 crore or more;
(ii) all private limited companies having paid up share capital of ₹ 50 crore or more;
(iii) all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of ₹ 50 crores or more.

As per Section 139(2) of the Companies Act, 2013, no listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint or re-appoint-

(a) an individual as auditor for more than one term of 5 consecutive years; and
(b) an audit firm as auditor for more than two terms of 5 consecutive years.

In the given case, Ram Ltd. is a private company having paid up share capital of ₹ 5 crore and public borrowings of ₹ 100 crore. The company has appointed M/s Shyam & Co., a chartered accountant firm, as the statutory auditor in its AGM held at the end of September, 2019 for 11 years.

The provisions relating to rotation of auditor will be applicable as the public borrowings exceeds ₹ 50 crore. Therefore, Ram (P) Ltd. can appoint M/s Shyam & Co. as an auditor of the company for not more than one term of five consecutive years twice i.e. M/s Shyam & Co. shall hold office from the conclusion of this meeting up to conclusion of sixth AGM to be held in the year 2024 and thereafter can be re-appointed as auditor for one more term of five years i.e. up to year 2029. The appointment shall be subject to ratification by members at every annual general meeting of the company. As a result, the appointment of M/s Shyam & Co. made by Ram Ltd. for 11 years is void.

Question 14

KSY & Co., Chartered Accountants, is an audit firm having two partners CA K and CA Y. KSY & Co. is already holding appointment as auditors of 36 public companies and none of the partners hold any company audits in their personal capacity or as partners with another firm.

KSY & Co. seeks your advice in the following situations:

(i) KSY & Co. has been offered the appointment as Auditors of 7 more Private Limited Companies. Of the seven, one is a company with a paid up share capital of ₹ 150 crores, five are "Small companies" as per the Act and one is a "Dormant Company".

(ii) Would your answer be different, if out of those 7 Private Companies, 3 Companies have paid up capital of ₹ 90 crores each?

Answer

Ceiling Limit for Holding Company Audits: As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of
more than 20 companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.

In the instant case, KSY & Co. is an audit firm having two partners, namely, CA. K and CA. Y. The total number of company audits that can be accepted by the firm is 40 (2 partners x 20 companies each partner). However, the firm is already holding appointment as auditors of 36 public companies. Thus, the remaining number of audits that can be accepted by the firm is of 4 more companies.

(i) In the given situation, KSY & Co. has been offered appointment as auditors of 7 private limited companies out of which 1 is a private limited company with paid-up share capital of ₹ 150 crores, 5 are ‘small companies’ and 1 is ‘dormant company’.

In view of above discussed provisions and explanations, KSY & Co. can hold appointment as an auditor in 5 ‘small companies’ and 1 ‘dormant company’ as these are excluded from the ceiling limit of company audits.

In addition, the firm can also accept appointment as auditor of 1 private limited company with paid-up share capital of ₹ 150 crores which will be within the maximum ceiling limit of 40 company audits.

Therefore, KSY & Co. can accept appointment for all the 7 private limited companies as asked in question.

(ii) No, answer will not be different in the given situation, where KSY & Co. has been offered appointment as auditors of 7 private limited companies out of which 3 companies have paid-up share capital of ₹ 90 crores.

In view of above discussed provisions and explanations, KSY & Co. can hold appointment as an auditor in all the private companies as 3 private companies are having paid-up share capital of ₹ 90 crores which are exempted as per the provisions of the Companies Act, 2013, therefore, excluded from the ceiling limit of company audits and other 4 private companies will also be within the maximum ceiling limit of 40 company audits even if the paid-up share capital is ₹ 100 crore or more.

Question 15

"ABC & Co." is an Audit Firm having partners “Mr. A”, “Mr. B” and “Mr. C”, Chartered Accountants. “Mr. A”, “Mr. B” and “Mr. C” are holding appointment as an Auditor in 4, 6 and 10 Companies respectively.

(i) Provide the maximum number of Audits remaining in the name of “ABC & Co.”

(ii) Provide the maximum number of Audits remaining in the name of individual partner i.e. Mr. A, Mr. B and Mr. C.

(iii) Can ABC & Co. accept the appointment as an auditor in 60 private companies having paid-up share capital less than ₹ 100 crore which has not committed default in filing its financial statements under section 137 or annual return under section 92 of the Companies Act with the Registrar, 2 small companies and 1 dormant company?

(iv) Would your answer be different, if out of those 60 private companies, 45 companies are having paid-up share capital of ₹ 110 crore each?

Answer

Fact of the Case: In the instant case, Mr. A is holding appointment in 4 companies, whereas Mr. B is having appointment in 6 Companies and Mr. C is having appointment in 10 Companies. In aggregate all three partners are having 20 audits.
**Provisions and Explanations:** As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a partner or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar).

As per section 141(3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.

**Conclusion:**

(i) Therefore, ABC & Co. can hold appointment as an auditor of 40 more companies:

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\begin{align*}
\text{Total Number of Audits available to the Firm} & = 20 \times 3 = 60 \\
\text{Number of Audits already taken by all the partners} & \\
\text{In their individual capacity} & = 4+6+10 = 20 \\
\text{Remaining number of Audits available to the Firm} & = 40
\end{align*}
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(ii) With reference to above provisions an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g) - already holding appointments as an auditor. Hence (1) Mr. A can hold: $20 - 4 = 16$ more audits. (2) Mr. B can hold $20-6 = 14$ more audits and (3) Mr. C can hold $20-10 = 10$ more audits.

(iii) In view of above discussed provisions, ABC & Co. can hold appointment as an auditor in all the 60 private companies having paid-up share capital less than ₹ 100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar), 2 small companies and 1 dormant company as these are excluded from the ceiling limit of company audits given under section 141(3)(g) of the Companies Act, 2013.

(iv) As per fact of the case, ABC & Co. is already having 20 company audits and they can also accept 40 more company audits. In addition they can also conduct the audit of one person companies, small companies, dormant companies and private companies having paid up share capital less than ₹ 100 crores (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar). In the given case, out of the 60 private companies ABC & Co. is offered, 45 companies having paid-up share capital of ₹110 crore each.

Therefore, ABC & Co. can also accept the appointment as an auditor for 2 small companies, 1 dormant company, 15 private companies having paid-up share capital less than ₹ 100 crore (private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar.) and 40 private companies having paid-up share capital of ₹ 110 crore each in addition to above 20 company audits already holding.

**Question 16**

C Ltd. appointed CA Innocent as a statutory auditor for the company for the current financial year. Further the company offered him the services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors.
Answer

Services not to be Rendered by the Auditor: Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:

(i) accounting and book keeping services;
(ii) internal audit;
(iii) design and implementation of any financial information system;
(iv) actuarial services;
(v) investment advisory services;
(vi) investment banking services;
(vii) rendering of outsourced financial services;
(viii) management services; and
(ix) any other kind of services as may be prescribed.

Further section 141(3)(i) of the Companies Act, 2013 also disqualify a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

In the given case, CA Innocent was appointed as an auditor of C Ltd. He was offered additional services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors. The auditor is advised not to accept the services as these services are specifically notified in the services not to be rendered by him as an auditor as per section 144 of the Act.

Question 17

What are the steps to be taken by a firm of Chartered Accountant to ensure that its appointment as Statutory Auditor of a Company is valid?

Answer

Validity of Appointment as a Statutory Auditor: To ensure that the appointment is valid, the incoming auditor should take the following steps before accepting his appointment:

(i) Ceiling limit: Ensure that a certificate has been issued under section 139 of the Companies Act, 2013 so that the total number of company audits held by the firm (including the new appointment) will not exceed the specified number.

(ii) Resolution at AGM: Verify that at AGM of the Company, a proper resolution is passed. Inspect general meeting minutes book to see that the appointment is duly recorded.

(iii) Compliance with law: Satisfy that the legal procedure contemplated in section 139 and 140 of the said Act, dealing with the appointment and removal of existing auditor, have been followed. Also check whether section 139(5) and 139(7) (in case of a government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments- appointment by the Comptroller and Auditor General of India) are attracted and complied with.

(iv) Code of conduct: Communicate with the previous auditor, if any, in writing, to ascertain if there are any professional reasons for not accepting the appointment.
**Question 18**

Subject to the provisions of sub-rule (1) of Rule 3 of The Companies (Audit and Auditors) Rules, 2014 where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment.

Explain manner and procedure of selection and appointment of auditors as per Rule 3 of CAAR 2014.

**Answer**

Rule 3 of CAAR 2014 prescribes the following manner and procedure of selection and appointment of auditors.

1. In case of a company that is required to constitute an Audit Committee under section 177, the committee, and, in cases where such a committee is not required to be constituted, the Board, shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company.

   It may be noted that while considering the appointment, the Audit Committee or the Board, as the case may be, shall have regard to any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India or any competent authority or any Court.

2. The Audit Committee or the Board, as the case may be, may call for such other information from the proposed auditor as it may deem fit.

3. Subject to the provisions of sub-rule (1), where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment.

4. If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the annual general meeting.

5. If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.

6. If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, the Board shall record reasons for its disagreement with the committee and send its own recommendation for consideration of the members in the annual general meeting; and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the annual general meeting.

7. The auditor appointed in the annual general meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting.
Question 19
The Auditor of M/s Quick Limited succumbed to the pressure of the management in certifying the financials with an over stated figure of turnover by not adhering to the cut-off principles of the time scale for the transactions of the year. On taking cognizance of this act of the auditor, the Tribunal under the Companies Act, 2013 initiated the proceedings against him. Briefly list the powers of the Tribunal in this respect including those relating to making orders against the Auditor found to be guilty.

Answer
Power of Tribunal in case Auditor acted in a Fraudulent Manner: As per sub-section (5) of the section 140 of the Companies Act, 2013, the Tribunal either suo motu or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

However, if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447 of the said Act.

It is hereby clarified that in the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

Question 20
CA. G, was appointed by DP Ltd., as Statutory Auditor. While doing the audit of DP Ltd., CA. G observed that certain loans and advances were made without proper securities; certain trade receivables and trade payables were adjusted inter se; and personal expenses were charged to revenue. As a company auditor comment on the, reporting responsibilities of CA. G.

Answer
Duty of Auditor to Inquire on certain matters: Section 143(1) of the Companies Act, 2013 requires the auditor to make an enquiry in respect of specified matters during the course of his audit. Since the law requires the auditor to make an enquiry, the Institute opined that the auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If the auditor is satisfied as a result of enquiries, he has no further duty to report that he is so satisfied. It is to be noted that the auditor is required to make only enquiries and not investigate into the matters referred to therein.

The opinion of the Research Committee of the Institute of Chartered Accountants of India on section 143(1) of the Companies Act, 2013 is worth considering and reproduced below:

"The auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. In such a case, the content of the Auditor's Report will remain exactly the same as the auditor has to inquire and apply his mind to the information elicited by the enquiry, in deciding whether or not any reference needs to be made in his report. In our opinion, it is in this light that the auditor has to consider his duties under section 143(1)."
Clause (a) of Section 143(1) 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".

If the auditor finds that the loans and advances have not been properly secured, he may enter an adverse comment in the report but cannot probably doubt the true view of the accounts by reference to this fact so long the loans and advances are properly described and presented in terms of Part I of Schedule III to the Companies Act. Further the auditor to inquire whether or not the terms on which the loans or advances have been made are prejudicial to the interests of the company or its members. If it is, he should qualify his report.

If trade receivables and trade payables are adjusted inter se, this amounts to merely book entries. The auditor, as per clause (b) of section 143(1), should enquire "whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company". This proposition has got to be inquired into by reference to the effects of the book entries, unsupported by transactions, on the legitimate interests of the company. The auditor has to exercise his judgment based on certain objective standards.

Regarding Personal Expenses, Clause (e) of section 143(1) requires the auditor to inquire: "Whether personal expenses have been charged to revenue account". The charging to revenue of such personal expenses, either on the basis of the company's contractual obligations, or in accordance with accepted business practice, is perfectly normal and legitimate or does not call for any special comment by the auditor. Where, however, personal expenses not covered by contractual obligations or by accepted business practice are incurred by the company and charged to revenue account, it would be the duty of the auditor to report thereon. It suffices to say that if the auditor finds that personal expenses have been charged to revenue and if the amounts are material, he should qualify his report also.

Question 21
In the audit of ABC Private Limited, auditor came across cases of payments to Directors, whereby, expenses of a personal nature were reimbursed. As an auditor, how would you deal with the same?

Answer
Reimbursement of Personal Expenses of Director:
All payments to Directors as remuneration or perquisites whether in the case of a public or private company are required to be authorised both in accordance with the Companies Act and Articles of Association of the company. Articles may provide that such remuneration require sanction of the shareholders either by ordinary or special resolution while in some cases it may require only approval of Directors. If the terms of appointment of a Director include payment of expenses of a personal nature, then such expenses can be incurred by the company; otherwise, no such expense can be incurred or reimbursed by the company. In the instant case the auditor has to ensure that the above is complied with, without which, if such expenses are paid, he has to disclose the fact in his report, as also in the accounts. In this regard attention is invited to section 143(1)(e) of the Companies Act, 2013 wherein auditor has to inquire into whether personal expenses have been charged to revenue.

Question 22
Director of T Ltd. draws an advance of US$ 200 per day in connection with the foreign trip undertaken on behalf of the company. On his return he files a declaration stating that entire advance was expended without any supporting or evidence. T Ltd. books the entire expenses on the basis of such declaration. As the auditor of T Ltd. how do you deal with this?
Answer

Audit Evidence: SA 500 “Audit Evidence” states that an auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base his option.

Section 143(1)(e) the Companies Act, 2013 requires an auditor to enquire whether personal expenses have been charged to revenue account.

In the context of the facts of case, ascertain whether the payment made by the company for the foreign trip form an “allowance” or “reimbursement”. An allowance is a fixed sum of money allowed or the basis of specified criteria. No evidence supporting the expenditure is required for payment of allowance to the director. On the other hand, if the payment is reimbursement should be against actual expenditure.

The director concerned should provide proof of expenditure. Since the director has given only a declaration, the auditor should ascertain other relevant facts as to whether the advance paid is pursuant to the policy of the company which is based on approximate estimation of the expenditure normally incurred by a person of the status of a director and the same is applicable to persons of a similar status within the company. If the auditor considers the advance taken is reasonable then the declaration can be considered adequate, otherwise he may have to call for additional documentary evidences.

Question 23

A Ltd. is a Chennai based company. The total turnover of the company is ₹ 10 crores for the year 2019-20. The company has a branch office at an area which was recently affected by flood. The transportation services are not available due to destruction caused by flood. The branch office recorded turnover of ₹ 1,50,000 in the Financial Year 2019-20. No audit of branch has been carried out. The statutory auditor of the company has made no reference of the above branch in his report.

Comment.

Answer

Branch Audit: As per section 143(8) of the Companies Act, 2013 if a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company’s auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.

In the given situation, A Ltd. is a Chennai based company, having total turnover of ₹ 10 Crore. The company is having a branch office at an area which is recently affected by flood. Therefore, the company has to get its branch audited. In case no branch audit has been carried out, company's auditor is required to mention this fact in the audit report and deal appropriately. Thus, no reference of above branch in statutory auditor’s report is not correct.

Question 24

Bhishm Limited decided to appoint Mr. Rajvir, chartered accountant, as the branch auditor for the audit of its Lucknow branch accounts for the year 2019-20. The decision to appoint branch auditor
was taken by way of Board Resolution in the meeting of Board of Directors of the company, held in April 2019, subject to shareholders’ approval in AGM of the company scheduled to be held in June 2019. Meanwhile, the Principal Auditor of the company raised an objection that the branch auditor cannot be appointed without his consent. Advise, whether the objection raised by company auditor is valid.

**Answer**

**Appointment of Branch Auditor:** Section 143 (8) of the Companies Act, 2013, prescribes the duties and powers of the company’s auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company’s auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139.

In case of subsequent appointment of auditor, section 139(1) of the Act provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting.

In the instant case, Bhishm Limited decided to appoint Mr. Rajvir, chartered accountant, as the branch auditor for the audit of its Lucknow branch accounts and the decision to appoint branch auditor was taken by way of Board Resolution in the meeting of Board of Directors of the company subject to shareholders’ approval in AGM of the company.

Thus, objection raised by company auditor is not valid as per section 143(8) of the companies Act, 2013 and the Board has authority to appoint branch auditor but should be approved by shareholders in General Meeting.

**Question 25**

RAJ Ltd has a branch office which maintains its separate set of books of accounts. The statutory audit of RAJ Ltd and its branch office is conducted by two separate firms of Chartered Accountants. RAJ Ltd being the company with Head Office, its statutory auditors, always intervene in the work of the statutory auditors of branch office. Due to this, the audit completion takes longer period. Due to the company’s internal policies, they need to continue with two separate auditors for head office and branch office. Please explain the aspects related to reporting and responsibilities of parent auditor (auditor of HO) and branch office auditors.

**Answer**

Sub-section (8) of Section 143 of the Companies Act, 2013, prescribes the duties and powers of the company’s auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company’s auditor) under Companies Act, 2013 or by any other person qualified for appointment as an auditor of the company under Companies Act, 2013 and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company’s auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company’s auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed.

The branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

Further as per Rule 12 of the Companies (Audit and Auditors) Rules, 2014, the branch auditor shall
submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

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; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in SA 600, "Using the Work of another Auditor". It makes clear that in certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. 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 there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. 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. The principal auditor 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

(b) advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor’s procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor’s knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

Question 26

As a Statutory Auditor, how would you deal with the following:

P Ltd. of whom you are the Statutory Auditor appoints M/s XYZ as Branch Auditors for one of its branches. M/s XYZ conducted the audit of the branch without visiting the branch and instead getting the books at the H.O. M/s XYZ has submitted their Branch Audit Report to you.

Answer

Branch Auditor's Report: As per provisions of the Companies Act, 2013, the accounts of a branch office of a company are required to be audited either by the company's auditor or by any other person qualified for appointment as auditor of the company. It is not necessary for branch auditor M/s XYZ to visit the branch and conduct the audit only at branch's premises. It is a matter of professional judgement for the branch auditor to decide as to whether he needs to visit the branch. At the same time, the statutory auditor has the right to visit branch offices and to have access to the books of accounts and vouchers maintained at the branch office in this case.

In any case, the principal auditor i.e. the statutory auditor of Head Office P Ltd. is entitled to rely on the work of branch auditor unless there are special circumstances to make it essential for him to
visit the branch and examine the books of account and voucher records. As per basic principles governing an audit, the principal auditor is entitled to rely upon the work performed by others provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. As per SA 600, "Using the work of another auditor", the principal auditor is not required to evaluate professional competence because branch auditor happens to be member of ICAI. The statutory auditor is also required to deal with the Branch Auditor’s report in the manner, he considers necessary. Therefore, the statutory auditor is required to deal with M/s XYZ’s report in the manner it considers fit under the circumstances.

**Question 27**

In the books of accounts of M/s OPQ Ltd. huge differences are noticed between the control accounts and subsidiary records. The Chief Accountant informs that this is common due to huge volume of business done by the company during the year. As a Statutory Auditor, how would you deal?

**Answer**

Difference between Control Accounts and Subsidiary Records: The huge differences found between control accounts and subsidiary records in the books of M/s OPQ Ltd. indicate that there may be material misstatements requiring detailed examination by the auditor to ascertain the cause. The contention of Chief Accountant cannot be accepted simply because the company has done huge volume of business. Such a phenomenon indicates that recording of transactions is not being done properly or the accounting system in the company which might have several branches spread over the country fails to capture all transactions in time. It would also be interesting to see whether it is a recurring phenomenon or such reconciliation could not be done at a subsequent date. Having regard to all these circumstances, it appears from the facts of the case that these differences indicate the possibility of some kind of material misstatements. As per SA 240, "The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements", when the auditor identifies a misstatement, the auditor shall evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence. When the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud the auditor shall evaluate the implications for the audit.

**Question 28**

Miranda Spinning Mills Ltd. is a sick company and has accumulated losses of ₹ 10 crores. The company has ₹ 12 crores in its share Premium Account. The Management desires to adjust the accumulated losses against the share premium balance. Advise the company giving your reasons.

**Answer**

Application of Share Premium Account: Section 52 of the Companies Act, 2013 (herein after referred as the Act) deals with the application of premium received on issue of shares. Sub-section (1) of the said section provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to an account called "Securities Premium Account" and the provisions of this Act relating to reduction of share capital of a company except as provided in this section shall apply as if the securities premium account was the paid up share capital of the company. Sub-section (2) of the said section provides that notwithstanding anything contained in
sub-section (1), securities premium account may be applied by the company for issue of bonus shares; writing off the preliminary expenses; writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; in providing for the premium payable on redemption of any redeemable preference shares or any debentures of the company; for the purchase of its own shares or other securities. In view of these provisions of the Companies Act, 2013, it is not permitted to adjust its accumulated losses against the securities premium account.

**Question 29**

Pirana Ltd. issued 10,000 shares of face value of ₹ 10 each at a premium of ₹ 490 each in May, 2019. The company received the stated minimum amount in the prospectus and transferred a sum equal to the aggregate amount of the premium received on shares (i.e. ₹ 49 lakhs) to the ‘Securities Premium Account’. Unfortunately, in the month of July, the godown of the company caught fire and stock worth ₹ 45 lakhs burnt to ashes.

Now, the management desires to adjust the loss due to fire against the said premium account. Comment.

**Answer**

Application of Securities Premium Account: Section 52 of the Companies Act, 2013 (herein after referred as the Act) deals with the application of premium received on issue of shares. The said section provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to an account called “Securities Premium Account” and the provisions of this Act relating to reduction of share capital of a company except as provided in this section shall apply as if the securities premium account was the paid up share capital of the company.

However, as per section 52, the securities premium account may be applied for the following purposes:

(i) towards the issue of fully paid bonus shares;
(ii) in writing off the preliminary expenses;
(iii) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures;
(iv) in providing for the premium payable on the redemption of any redeemable preference shares or debentures; or
(v) for the purchase of its own shares or other securities under section 68 of the Companies Act, 2013.

In the given case, the management of Pirana Ltd. desires to adjust the loss due to fire against the securities premium account.

In view of the above provisions of the Companies Act, 2013, it may be noted that the company is not permitted to adjust its loss against the securities premium account.

**Question 30**

For the year ended on 31st March, 2020, P Ltd. proposed to pay a dividend of 25% on its equity shares and it further proposed to transfer 20% of Net profit for that year after tax to its reserves. Its auditor objected to the same stating that 10% is the maximum permissible limit to transfer to reserves.
Question 31

ABC Limited is in the practice of maintaining consistent dividend payment over a minimum of 14%. The Financial year 2019-20 was so very bad for the Company that it was not possible for the Company to maintain the payment of consistent dividend as above. The Management, being hopeful of recovery of its performance in next year, felt that the depreciation of the year to the extent of 75% alone be charged to the Statement of Profit and Loss and the remaining 25% be kept in a separate account code in the Balance Sheet- ‘Debit Balances Adjustable against Revenue account’. The Management was of the view that it would be in fair practice of accounting if the depreciation for asset is charged before the expiry of the life of assets and the amount parked in asset code as above would unfaillingly be adjusted to Revenue before the close of next financial year anyway. Analyse the issues involved and state how the Auditor should decide on this matter.

Answer

Provision of Depreciation: Section 123(1) of the Companies Act, 2013 provides that dividend cannot be declared or paid by a company for any financial year except out of profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of Section 123(2), or out of the profits or the company for any previous financial year or years arrived at after providing for depreciation in the manner aforementioned and remaining undistributed, or out of both. Further, it is the duty of auditor to check whether the depreciation was provided according to provision of AS10 / IND AS 16/Schedule II to the Act.

In the instant case, ABC Limited is in the practice of maintaining consistent dividend payment over a minimum of 14%. Due to bad financial condition, company has not provided for dividend for the year 2019-20. In addition to this management has also taken decision to charge 75% of the depreciation in the statement of Profit and Loss whereas 25% of the depreciation amount kept in a separate account code in the Balance Sheet – ‘Debit Balances Adjustable against Revenue Account’.

Contestion of management that it would be in fair practice of accounting where the depreciation of asset is charged before the expiry of the life of assets and the amount parked in asset code would unfaillingly be adjusted to revenue before the close of next financial year is not tenable.

The practice of the company in not charging the depreciation and accumulating 25% of it in a debit balance for being written of in the next year is not an acceptable accounting treatment. If dividend is declared in such situation, it would mean payment out of capital.
Therefore, the auditor of the company should ensure the compliance of provisions of section 123 and Schedule II. In case the management does not comply with the provisions and does not charge the 100% depreciation the auditor of the company shall suggest the management for the same and if management refuses, the auditor should qualify his report accordingly.

**Question 32**

IT Limited has prepared the financial statements for the year 2019-20 and mentioned in the significant accounting policies that depreciation on tangible fixed assets is provided on the straight line method over the useful lives of the assets as estimated by the management. The company has ignored the useful lives of assets mentioned in Schedule II of the Companies Act, 2013. As statutory auditor of the company how would you deal with this?

**Answer**

Providing Depreciation ignoring Schedule II to the Companies Act, 2013: Section 129 of the Companies Act, 2013, requires that the financial statements shall give a true and fair view of the state of affairs of the company and are in compliance with Accounting Standards.

Further, as per Schedule II to the Companies Act, 2013 on ‘Useful Lives to Compute Depreciation’, the useful life of an asset shall not ordinarily be different from the useful life specified therein.

However, if such a company uses a useful life of the asset which is different from the above limits, it shall disclose the justification for the same in its financial statement.

In the given case, IT Limited has mentioned in the significant accounting policies that the depreciation on tangible fixed assets is provided on the straight line method over the useful lives of the assets as estimated by the management and ignored the useful lives of the assets as provided under Schedule II to the Companies Act, 2013.

Therefore, the statutory auditor of the company should ensure that the management has disclosed the justification for consideration of different useful life of the assets from that as indicated under Schedule II. If the justification has not been provided then the auditor of the company shall suggest the management for the same and if management refuses, the auditor should qualify his report accordingly.

**Question 33**

IFFCO Company follows the method of providing depreciation as per Section 123 of the Companies Act, 2013 using the useful lives prescribed as per Schedule II of the Companies Act, 2013. It has provided depreciation on computers which are used during all the 3 shifts using the rates stipulated for continuous process plant since these assets are used for 24 hours (3 shifts).

**Comment.**

**Answer**

IFFCO Company followed the method of providing depreciation as per section 123 of the Companies Act, 2013 using the useful lives prescribed as per Schedule II of the Companies Act, 2013 is correct, however, they have provided depreciation using the rates stipulated for continuous process plant is not correct.

As per Schedule II Computers does not fall in continuous process plant category. Further, computers are included as NESD in Part 2 of Schedule II, which is category of assets in respect of which no extra shift depreciation is permitted.
Therefore, though computers are used for 24 hours i.e. triple shift but no extra shift depreciation is permitted on the same. In the instant case, the Company has provided depreciation on computers which are used during all the 3 shifts using the rates stipulated for continuous process plant as per its accounting policy is incorrect and would be misleading resulting into material misstatement and hence impacting true and fair view.

The auditor, therefore, should discuss with the management to make necessary changes in respect of same and if not agreed to, the auditor may qualify the report accordingly.

**Question 34**

As Auditor of Act Fast Ltd. what steps will you take to ensure that the dividend has been paid only out of profit?

**Answer**

The auditor may take the following steps to ensure that the dividend has been paid only out of profits:

1. Check whether the dividend was declared out of profits arrived at after providing for depreciation as per Section 123(2) of the Companies Act, 2013 (herein after referred as the Act).

2. Check whether-
   (i) the depreciation was provided according to provision of Schedule II to the Act.
   (ii) a board resolution recommending dividend was passed.
   (iii) the dividend was declared only in the Annual General Meeting.
   (iv) no dividend declared in general meeting exceeds the amount recommended by the Board.
   (v) amount paid or credited as paid on a share in advance of calls is not treated for the purpose of this regulation as paid on the share.
   (vi) register of members was closed as per the provisions of section 91 of the Act.
   (vii) dividend has been paid in the prescribed manner within 30 days of time to the registered holder or their order for the compliance of Section 127 of the Act.
   (viii) Amount of dividend deposited in a separate bank account within five days from the date of declaration of dividend.
   (ix) intimation sent to Stock Exchange in the case of listed company.
   (x) were there any complaints of non-payment/delayed payment of dividend? If so, whether corrective action was taken.

**Question 35**

AARK Ltd is a large-sized listed company having annual turnover of INR 4000 crores. The company also has a plan to get listed on New York Stock Exchange next year. The company has paid good amount of dividend during the year to its shareholders which is significantly higher as compared to earlier years. The statutory auditors would like to focus on this aspect at the time of their statutory audit.

Please advise the relevant procedures that the statutory auditors should perform in respect of this area.

**Answer**

The Auditor should obtain appropriate audit evidence as regard to audit of payment of dividends.
The procedures include the following:

(i) Check that all the rules and regulations concerning the declaration or payment of dividends have been complied with.

(ii) Examine that the accounting and disclosure procedure has been complied with related to the declaration and payment of dividend like depreciation has been provided before declaration, disclosure has been made by way of notes to the accounts etc.

(iii) Scrutinize that the dividends have been declared or paid only out of distributable profit i.e. profits for the current year for which dividend is declared, or accumulated profits of the previous years, or money provided by the Central or State Government as per Section 123(1) of the Companies Act, 2013.

(iv) Inspect that the dividend has been paid only out of “free reserves” i.e. the reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend except- any amount representing unrealized gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or any change in carrying amount of an asset or of a liability recognized in equity, including surplus in statement of profit and loss on measurement of the asset or the liability at fair value, as laid down under third proviso to Section 123(1) read with Section 2(43) of the Companies Act, 2013.

(v) If dividend has been paid out of accumulated profits, earned by it in previous years and transferred to the reserves, in case of inadequacy or absence of profits in any financial years, verify that the rules related to such distribution has been complied i.e. the maximum amount allowable to be distributed as a dividend in case of inadequate or no profit as required by second proviso to Section 123(1) of the Companies Act, 2013.

(vi) Verify that the dividend recommended by the Board has been approved by the members at the annual general meeting.

(vii) Verify that the dividend has been transferred to the separate scheduled bank account within 5 days from the declaration of such dividend as required by Section 123(4) of the Companies Act, 2013.

(viii) Verify that the dividend has been paid within 30 days from the declaration. If in case the dividend has not been claimed or paid within 30 days from the declaration, verify that the unpaid or unclaimed dividend amount has been transferred to a special account called unpaid dividend account as per Section 124(1) of the Companies Act, 2013.

(ix) Verify that the company has prepared a statement within a period of 90 days of making any transfer of an amount to the Unpaid Dividend Account containing the names, their last known addresses and the unpaid dividend to be paid to each person, and have placed it on the website of the company, if any, and also on any other website approved by the Central Government for this purpose as required under Section 124(2) of the Companies Act, 2013.

(x) Check the procedures that have been followed for the payment of unclaimed dividend out of unpaid dividend account.

(xi) Verify that, if any money transferred to Unpaid Dividend Account has remained unpaid or unclaimed for a period of 7 years from the date of such transfer then, whether it has been transferred by the company along with interest accrued, if any, thereon to the Investor Education and Protection Fund established under section 125(1) of the Companies Act, 2013 and a statement regarding such transfer has also been sent to the authority which administers such fund.

(xii) In case the company has outsourced the activity to the Service Organisation, check that all the compliances with laws, regulations, accounting and disclosure related to the dividends have been made appropriately.
Question 36
The Board of Directors of ACP Ltd. has recommended the dividend of 15% on paid up share capital of ₹ 450 crore for the year ended 31st March, 2020, at their meeting held on 1st of May, 2020 when the accounts for the financial year 2019-20 were approved. The Board of Directors when they met on 7th July, 2020 for the review of first quarter accounts, they realized that results were negative for the first quarter. Therefore, the Board has decided to rescind their decision to recommend dividend.

The notice for AGM to be held on 14.8.2020 was sent on 15th July, 2020 without any recommendation for dividend.

At the AGM, the members asked the management how they can rescind the declaration of dividend once recommended. Comment.

Answer
Decision to rescind the Recommended Dividend: Dividend is firstly recommended by the Board. Thereafter, the members in the Annual General Meeting (AGM) may declare the dividend by passing ordinary resolution. The members may reduce the rate or amount recommended by the Board, but they cannot increase it.

Section 123 of the Companies Act, 2013, provides that the dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year arrived at after providing for depreciation in prescribed manner.

Further, as per section 127 of the Act, dividends once declared become the liability of the company and must be paid within 30 days from the date of declaration. Any failure to do so attract a penalty for the various persons associated with the management.

Here in the instant case, Board of Directors of ACP Ltd. has recommended the dividend in their meeting. Such dividend is not declared in AGM. Further, Board has decided to rescind the decision before the date of Annual General Meeting. Thus, the dividend which is only recommended and not declared does not attract penal provisions.

Therefore, Board of Directors may rescind their decision to recommend dividend.

Question 37
As a Statutory Auditor, how would you deal with the following:

While adopting the accounts for the year, the Board of Directors of Sunrise Ltd. decided to consider the Interim Dividend declared @15% as final dividend and did not consider transfer of Profit to reserves.

Answer
(a) Declaration of Interim Dividend: Section 123(3) of the Companies Act, 2013 provides that the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the Statement of Profit and Loss and out of profits of the financial year in which such interim dividend is sought to be declared. The amount of dividend including interim dividend should be deposited in a separate bank account within five days from the declaration of such dividend for the compliance of Section 123(4) of the said Act.

Based on Section 2(35) of the said Act, it can be said that since interim dividend is also a dividend, companies should provide for depreciation as required by Section 123 before declaration of interim dividend. However, the first proviso to Section 123(1) provides that a
company may, before the declaration of any dividend in any financial year, transfer such
percentage of its profit for that financial year as it may consider appropriate to the reserves
of the company irrespective of the size of the declared dividend i.e. the company is not
mandatorily required to transfer the profit to the reserves, it is an option available to the
company to transfer such percentage.

In the instant case, the Board has decided to pay interim dividend @15% of the paid-up
capital. Assuming that the company has complied with the depreciation requirement, the
interim dividend can be declared without transferring such percentage of its profits as it may
consider appropriate to the reserves of the company.

Question 38
When can a company be said to have ‘Not maintained’ proper books of account? What is the role
of the statutory auditor for the same?

Answer
Proper Books of Account Not Maintained: Section 128(1) of the Companies Act, 2013 requires that
every company shall prepare and keep at its registered office books of account and other relevant
books and papers and financial statement for every financial year which give a true and fair view of
the state of the affairs of the company, including that of its branch office or offices, if any, and
explain the transactions effected both at the registered office and its branches and such books shall
be kept on accrual basis and according to the double entry system of accounting.

The provisions mentioned above are required to be followed by the company to maintain proper
books of accounts. The Auditor is required to check that the company has complied with all the
provisions related to maintenance of books of accounts etc.

Further, the books have to be maintained under accrual system and if the statutory auditor finds
the books are not maintained accordingly, he will have to modify his report.

According to Section 143(3)(b), the auditor’s report shall also state 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.

If answer is in negative or with qualification, the report shall state the reasons there for.

Question 39
Z Ltd. has flexi deposit linked current account with various banks. Cheques are issued from the
current account and as per the requirements of funds, the flexi deposits are encashed and
transferred to current accounts. As of 31st March, 2020 certain cheques issued to vendors are not
presented for payment resulting in the credit balance in the books of the company. The
management wants to present the book overdraft under current liabilities and flexi deposits under
cash & bank balances. Comment.

Answer
Presentation of Book Overdraft as per Schedule III to the Companies Act, 2013:
The instructions in accordance with which current assets being “cash and cash equivalents” should
be made out to Part I of Schedule III to the Companies Act, 2013 states as follows:
(i) Cash and cash equivalents shall be classified as:
   (a) Balances with banks;
   (b) Cheques, drafts on hand;
   (c) Cash on hand;
   (d) Others (specify nature).

(ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.

(iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.

(iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

(v) Bank deposits with more than 12 months maturity shall be disclosed separately.

From the facts of the case it is evident that in substance the position is that the composite bank balance including the balance in flexi deposit accounts are positive, even though physical set-off has not been made as on the balance sheet date. Further the bank has got the right to set off of flexi deposits against the cheques issued and hence it would be more informative and useful to the readers of the financial statements to disclose the book credit balance as a set-off from the flexi deposit accounts. The disclosure of the said book credit balance as book overdraft under the head current liabilities as proposed by the management is not correct.

Question 40

Comment on the following with reference to Schedule III to the Companies Act, 2013:

(i) A company has disclosed performance guarantee and counter guarantees as Contingent Liabilities.

(ii) The parent company has recognized in the current year’s financial statement, dividend declared by its subsidiary after the balance sheet date.

Answer

(i) A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations.

However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance sheet. For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premia, deferred payments to foreign suppliers, letters of credit, etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all, but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premia when demanded or to make deferred payments when due.

Hence, such performance guarantees and counter-guarantees should not be disclosed as contingent liabilities.

(ii) The Schedule III does not prescribe to recognise dividend declared by subsidiary company as given in the scenario. Accordingly, dividend income from subsidiary companies should be recognised in accordance with AS-9, i.e. only when they have a right to receive the same on or before the Balance sheet date. Normally, the right to receive is established only when the dividend is approved by the shareholder at the AGM of the investee company. Therefore,
Question 41

As an auditor of a company registered under section 8 of the Companies Act, 2013, you find that as per the notification of the Ministry of Corporate Affairs regarding applicability of Indian Accounting Standards (Ind-AS), the company has to prepare its financial statements for the year ended 31st March, 2020 under Ind-AS. The management of the company is, however, of the strong view that being a section 8 company having charitable objects, Ind-AS cannot apply to the company. The financial statements are, therefore, prepared by the management under the earlier GAAP and a note for the same is given in the financial statements. How would you report on these financial statements?

Answer

Applicability of IND AS: Section 129(1) of the Companies Act, 2013, governs the requirements to be satisfied by financial statements. The provisions thereunder which should be complied with are:

- financial statements shall, give a true and fair view of the state of affairs of the company or companies as at the end of financial year, comply with the notified accounting standards under section 133 and be in such form or forms specified in Schedule III to the Companies Act, 2013 and
- the items contained in such financial statements shall be in accordance with the accounting standards.

Further, as per section 133 of the Companies Act, 2013, the Central Government has notified Companies (Indian Accounting Standards) Rules, 2015 dated 16.02.2015 in exercise of the powers conferred by section 133. The said rules list the Indian Accounting Standards (Ind AS) and the class of companies required to comply with the Ind AS while preparation of their financial statements.

Here, it may be noted that the companies covered under Section 8 are required to comply the provisions of the Companies Act, 2013, unless and until any exemption is provided. Therefore, companies registered under Section 8 are not exempted from the requirements of section 133 and section 129 of the Companies Act, 2013.

In the given case, only contention of management that being a section 8 company having charitable object, Ind-AS cannot apply to the company, therefore financial statements prepared under the earlier GAAP and a note for the same is given, is not tenable.

However, the auditor is required to ensure the applicable monetary limits w.r.t Ind-AS and need to advise the management to prepare the financial statements as per Ind-AS accordingly. In case of non-compliance the auditor should report accordingly.

Question 42

MG & Co. Ltd. seeks your advice while preparing financial statements the general instructional to be followed while preparing Balance Sheet under Companies Act, 2013 in respect of current assets and liabilities.

Answer

General Instructions for Preparation of Balance Sheet:

(i) General Instruction in respect of Current Assets: An asset shall be classified as current when it satisfies any of the following criteria-
(1) it is expected to be realized in, or is intended for sale or consumption in, the company’s normal operating cycle;
(2) it is held primarily for the purpose of being traded;
(3) it is expected to be realized within twelve months after the reporting date; or
(4) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

(ii) General Instruction in respect of Current Liabilities: A liability shall be classified as current when it satisfies any of the following criteria-
(1) it is expected to be settled in the company’s normal operating cycle;
(2) it is held primarily for the purpose of being traded;
(3) it is due to be settled within twelve months after the reporting date; or
(4) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

Question 43
The Balance Sheet of G Ltd. as at 31st March, 20 is as under. Comment on the presentation in terms of Schedule III.

<table>
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<tr>
<th>Heading</th>
<th>Note No.</th>
<th>31st March, 20</th>
<th>31st March, 19</th>
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<tr>
<td><strong>Equity &amp; Liabilities</strong></td>
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<td>Share Capital</td>
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<td>Share application money refundable</td>
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<td><strong>Non-Current Liabilities</strong></td>
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<tr>
<td>Deferred tax liability (Arising from</td>
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<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>Indian Income Tax)</td>
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<td><strong>Current Liabilities</strong></td>
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<td>Trade Payables</td>
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<tr>
<td><strong>Total</strong></td>
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<td>XXX</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
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<td></td>
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<tr>
<td><strong>Non-Current Assets</strong></td>
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<td>Fixed Assets-Tangible</td>
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<td>XXX</td>
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<tr>
<td>CWIP (including capital advances)</td>
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<td>XXX</td>
<td>XXX</td>
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<tr>
<td><strong>Current Assets</strong></td>
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<td>Trade Receivables</td>
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<tr>
<td>Deferred Tax Asset (Arising from</td>
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<td>Indian Income Tax)</td>
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<td>Debit balance of Statement of Profit and Loss</td>
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</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>XXX</td>
<td>XXX</td>
</tr>
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</table>
Answer

Following Errors are noticed in presentation as per Schedule III:

(i) Share Capital and Reserve & Surplus are to be reflected under the heading “Shareholders’ funds”, which is not shown while preparing the balance sheet. Although it is a part of Equity and Liabilities, yet it must be shown under head “shareholders’ funds”. The heading “Shareholders’ funds” is missing in the balance sheet given in the question.

(ii) Reserve & Surplus is showing zero balance, which is not correct in the given case. Debit balance of statement of Profit & Loss should be shown as a negative figure under the head ‘Surplus’. The balance of ‘Reserves and Surplus’, after adjusting negative balance of surplus shall be shown under the head ‘Reserves and Surplus’ even if the resulting figure is in the negative.

(iii) Schedule III requires that Employee Stock Option outstanding should be disclosed under the heading “Reserves and Surplus”.

(iv) Share application money refundable shall be shown under the sub-heading “Other Current Liabilities”. As this is refundable and not pending for allotment, hence it is not a part of equity.

(v) Deferred Tax Liability has been correctly shown under Non-Current Liabilities. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.

(vi) Under the main heading of Non-Current Assets, Property, Plant and Equipment are further classified as under:
   (a) Tangible assets
   (b) Intangible assets
   (c) Capital work in Progress
   (d) Intangible assets under development.

   Keeping in view the above, the CWIP shall be shown under Property, Plant and Equipment as Capital Work in Progress. The amount of Capital advances included in CWIP shall be disclosed under the sub-heading “Long term loans and advances” under the heading Non-Current Assets.

   Subsequent to the notification of Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, the words “Fixed assets” shall be substituted with the words “Property, Plant and Equipment”.

(e) Deferred Tax Asset shall be shown under Non-Current Asset. It should be the net balance of Deferred Tax Asset after adjusting the balance of deferred tax liability if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.

(f) Subsequent to the notification of Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, Trade Payables should be disclosed as follows:

   (A) total outstanding dues of micro enterprises and small enterprises; and
   (B) total outstanding dues of creditors other than micro enterprises and small enterprises.”

Question 44

As an Auditor give your comments for the following disclosures made by a Company which adopted Ind AS for compilation of Financial Statements:
(i) In the Balance Sheet, the sub-head inventories contained an item "goods in transit" in which a consolidated amount aggregating the cost of raw materials in transit and loose tools billed on company but delivery not made to company had been specified.

(ii) Provision for doubtful debts of trade debtors was grouped in, "Provisions" under current liabilities.

(iii) In Statement of Profit and Loss, prior period income was shown under "Other Income".

(iv) Sale proceeds of scrap incidental to manufacture were included in "Other Income".

(v) Payment towards a one time voluntary retirement scheme introduced during the year was included in "Employee Benefit Expense".

**Answer**

(i) **Goods in Transits:** As per Division II of Schedule III of the Companies Act, 2013, cost of raw material in transit shall be disclosed as sub-head of raw material and loose tools billed on the company would be shown as separate sub-head of Loose tools under heading of Inventories i.e. part of Current Asset. Thus, disclosure of consolidated amount aggregating the cost of raw material in transit and loose tools is not correct.

(ii) **Provision for Doubtful Debts of Trade Debtors was grouped in “Provisions” under current liabilities:** The term ‘doubtful debts’ is an adjustment to the carrying amounts of assets, hence no provision is created separately for it as per Ind-AS 37 "Provisions, Contingent Liabilities and Contingent Assets". Thus, provision should be shown net in trade receivable.

(iii) **In Statement of Profit and Loss, Prior Period Income was shown under Other Income:** As per Ind-AS 8 "Accounting Policies, Changes in Accounting Estimates and Errors", Prior Period Income should not be shown in statement of profit and loss. The entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

(iv) **Sale Proceeds of Scrap incidental to manufacture were included in “Other Income”:** As per Ind-AS 2 "Inventories", sale proceeds of scrap incidental to manufacture should be deducted from the cost of the main product. Thus, disclosure of sale proceeds of scrap as other income is not correct.

(v) **Payment towards a one time VRS during the year included in Employee Benefit Expenses:** As per Ind-AS 19 "Employee Benefits", if the termination benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the termination benefit is recognized, the entity shall apply the requirements for short-term employee benefits, in case it is not expected to be settled before twelve months the entity shall apply the requirements for long term employee benefits. In the instant case, it should be shown as short term employee benefits in place of Employee Benefit Expenses. Thus, treatment of such payment as employee benefit expenses is not correct.

**Question 45**

Director (Finance) of Beta Ltd. is of the opinion that total trade payables mentioned in the financial statement is sufficient disclosure in the Balance Sheet as per Part I of Schedule III to the Companies Act, 2013. They did not mention details regarding Micro, Small and Medium Enterprises (MSME). Give your view as statutory auditor of the Company and state the details required to be disclosed in notes regarding MSME.

**Answer**

**Details required to be disclosed in Notes regarding MSME:** Opinion of Director (Finance) of Beta Ltd. that total trade payables mentioned in the financial statement is sufficient disclosure in
the Balance Sheet as per Part I of Schedule III to the Companies Act, 2013, is not correct. The following details relating to Micro, Small and Medium Enterprises shall be disclosed by Beta Ltd. in the notes:

(i) **the principal amount and the interest due** thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year;

(ii) **the amount of interest paid by the buyer** as per Micro, Small and Medium Enterprises Development Act, 2006, along with the amount of the payment made to the supplier beyond the appointed day during each accounting year;

(iii) **the amount of interest due and payable** for the period of delay in making payment (which have been paid but beyond the appointed day during the year) but without adding the interest specified under the Micro, Small and Medium Enterprises Development Act, 2006;

(iv) **the amount of interest accrued** and remaining unpaid at the end of each accounting year; and

(v) **the amount of further interest remaining due** and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure as per Micro, Small and Medium Enterprises Development Act, 2006.

**Question 46**

X Ltd. paid 25 lakhs as advance to Y Ltd. towards the purchase of a printing machinery on 15.1.20 with delivery instructions to deliver the same in the last week of June, 20. Further on 2.2.20 X Ltd. purchased two diesel generator sets from Y Ltd. for ₹ 30 lakhs on 90 days Credit term. In the accounts for 2019-20, X Ltd. intends to adjust the advance paid against Credit purchase and show the net amount of ₹ 5 lakhs as due from them. As the statutory auditor, how would you deal with this?

**Answer**

Adjustment of Advances: Since X Ltd. has paid advance amount to the supplier of machinery to be used in the project, such advance amount should be grouped under the head 'Capital Work in Progress'. This is as per requirement of Schedule III to the Companies Act, 2013 and the existing accounting practice.

If the advance is for purchase of other machinery, it should be grouped under a separate head – say 'Advance Payment for Capital Expenditure' and should be disclosed as next item to Fixed Assets in the Balance Sheet.

In view of the above, the proposal of X Ltd., to show the net balance in the personal account of Y Ltd., is not correct. Such proposal will conceal the two material items in the balance sheet – one, expenditure towards capital asset and the other current liability for purchase of the generator set.

Hence, the auditor should advise X Ltd. to show these two items separately. If X Ltd. does not accept the advice, the auditor should qualify his report with suitable quantification of amount involved.

**Question 47**

ABC Ltd., is consistently following Accounting Standards as required under section 133 of the Companies Act, 2013. During your tax audit under section 44AB of the Income Tax Act, 1961, the Board of Directors informed you that profits of the Company is properly arrived at and the Accounting Standards applicable to it have been followed consistently and as such, there need not be any adjustments to be made as per Income Computation and Disclosure Standards notified...
under section 145 of Income Tax Act, 1961. Based on the requirements of Law in this regard, examine the validity of the stand of Management in this regard.

Answer

Income Computation and Disclosure Standards (ICDS): Section 145 of the Income Tax Act, 1961 deals with the Method of Accounting: Under section 145(1), income chargeable under the heads “Profits and gains of business or profession” or “Income from other sources” shall be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee.

Further, Section 145(2) empowers the Central Government to notify in the Official Gazette from time to time, income computation and disclosure standards to be followed by any class of assessee or in respect of any class of income.

Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by all assesses (other than an individual or a HUF who is not required to get his accounts of one previous year audited in accordance with the provisions of section 44AB), following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head “Profit and gains of business or profession” or “Income from other sources”, from the A.Y. 2017-18.

In the instant case, ABC Ltd. is consistently following Accounting Standards in compliance with section 133 of the Companies Act, 2013 but not complying with the provisions of Income Computation and Disclosure Standards notified under section 145 of the Income Tax Act, 1961. Contention of the management that they are following Accounting Standards and need not to make any adjustments as per ICDS, is not correct. Thus, ABC Ltd. is required to adjust the profits in compliance with ICDS.

Question 48

Beneath minerals Limited is a Public Sector Company engaged in extraction of minerals from land. It has to pump out water in the first layer of the soil if the minerals are to be excavated. The Company pumps out water and diverts the water through a water course constructed by it to nearby villages and the water is allowed to be used by villagers for drinking purposes. The cost of construction of water course amounted to ₹ 5.25 crores and the Company had disclosed this amount as CSR expenses in the Statement of Profit and Loss. Comment.

Answer

Corporate Social Responsibility Expenses: Company (Corporate Social Responsibility Policy) Rules, 2014 mandated the corporate entities that the expenditure incurred for Corporate Social Responsibility (CSR) should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

In the instant case, Beneath minerals Limited is a public sector company which is engaged in extraction of mineral from land, for that it has to pump out water in the first layer of the soil if the minerals are to be excavated. The company pumps out water and diverts the water through a water course constructed by it to nearby villages and the water is allowed to be used by villagers for drinking purposes. Company has disclosed the cost of construction of water course as CSR expenses in the statement of Profit and Loss, which is not correct as this expenditure incurred for the construction of water course is included in the ordinary course of activities of business.

Therefore, the treatment done by showing the cost of construction of water course as CSR expense is not correct.
Question 49

Pearl Ltd. is an exporter of precious and semi-precious stones. The turnover of the company is ₹ 150 crore, out of which ₹ 105 crore is from export business and remaining ₹ 45 crore from domestic sales. Amount received from export business is all in foreign currency. Directors of Pearl Ltd. are of the opinion that cost audit is not applicable to their company as maximum revenue has been generated from export business. Give your opinion.

Answer

Cost Audit Rules not to apply in certain cases: The requirement for cost audit shall not be applicable to a company whose revenue from exports, in foreign exchange, exceeds seventy-five per cent of its total revenue, which is operating from SEZ and which is engaged in the generation of electricity for captive consumption through captive generating plant. (as per Rule 3 of the Companies (Cost Records and Audit) Rules, 2014).

In the instant case, Pearl Ltd. is an exporter of precious and semi-precious stones and the turnover of the company is rupees 150 crore out of which rupees 105 crore i.e. 70% is from export business and remaining rupees 45 crore i.e. 30% from domestic sales. It is neither operating from SEZ nor involved in captive power generation.

Thus, opinion of director is not tenable as revenue from exports in foreign exchanges is below prescribed limit. Therefore, cost audit is applicable on Pearl Ltd. as per Rule 3 of the Companies (Cost Records and Audit) Rules, 2014. Pearl Ltd. has to appoint cost auditor to get the cost accounts of the company audited.

Question 50

MKc LLP is a newly set up LLP (Limited Liability Partnership). The operations of the LLP have been picking up and management is currently in the process of setting up processes and procedures in place. As per the understanding of the management of the LLP, its accounts would not be required to be audited mandatory because of its operations but still the management has decided that they would get the accounts audited voluntarily. In this regard, the management would like to understand some of the aspects which they should consider not only limited to audit but also about the maintenance of books of accounts as per the relevant laws. Please advise.

Answer

An LLP shall be under obligation to maintain annual accounts reflecting true and fair view of its state of affairs. The accounts of every LLP shall be audited in accordance with Rule 24 of LLP Rules 2009. Such rules, inter-alia, provides that any LLP, whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty five lakh rupees, is not required to get its accounts audited. However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rule.

Appointment of Auditor: The auditor may be appointed by the designated partners of the LLP –

1. At any time for the first financial year but before the end of first financial year,
2. At least thirty days prior to the end of each financial year (other than the first financial year),
3. To fill the causal vacancy in the office of auditor,
4. To fill the casual vacancy caused by removal of auditor.

The partners may appoint the auditors if the designated partners have failed to appoint them.

LLPs are required to maintain books of accounts which shall contain -

1. Particulars of all sums of money received and expended by the LLP and the matters in respect of which the receipt and expenditure takes place,
2. A record of the assets and liabilities of the LLP,
3. Statements of costs of goods purchased, inventories, work-in-progress, finished goods and costs of goods sold,
4. Any other particulars which the partners may decide.

The auditor should read the LLP agreement & note the following provisions
(a) Nature of the business of the LLP
(b) Amount of capital contributed by each partner
(c) Interest – in respect of additional capital contributed
(d) Duration of partnership
(e) Drawings allowed to the partners
(f) Salaries, commission etc payable to partners
(g) Borrowing powers of the LLP
(h) Rights & duties of partners
(i) Method of settlement of accounts between partners at the time of admission, retirement, admission etc.
(j) Any loans advanced by the partners
(k) Profit sharing ratio.
**CARO, 2016**

**Question 51**

Evolution Pvt. Ltd. borrowed a sum of ₹ 110 lakh from Banks and Financial Institutions, subsequently, the company defaulted in repayment of its loans, to the extent of 50%. The management of the company contends that that it being a private limited company, the Companies (Auditor's Report) Order [CARO], 2016 is not applicable.

You are required to state the list of companies to which CARO is not applicable and state whether it will be applicable on Evolution Pvt. Ltd.

**Answer**

Applicability of Companies (Auditor's Report) Order [CARO], 2016: The CARO, 2016 is an additional reporting requirement Order which has been issued by the Central Government in consultation with the Institute of Chartered Accountants of India under section 143(11) of the Companies Act, 2013.

The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013. However, the Order specifically exempts the following class of companies-

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

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

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

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

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

In the given case, Evolution Pvt. Ltd. has outstanding loan of rupees 110 lakhs from Banks and Financial Institutions together, which is exceeding the limit prescribed under Order for applicability of exemption.

**Therefore, CARO, 2016 will be applicable on Evolution Pvt. Ltd.**

**Question 52**

E-Tech Pvt. Ltd., which has an aggregate outstanding loan of ₹ 20 lakhs from Banks and ₹ 30 lakhs from Financial Institutions, defaulted in repayment thereof to the extent of 50%. The company holds that it being a private limited company, the Companies (Auditor’s Report) Order, 2016 is not applicable.

You are required to state the list of companies to which CARO is not applicable and state how would you deal with the given situation as an auditor of the company.

**Answer**

Applicability of Companies (Auditor’s Report) Order, 2016 [CARO, 2016]: The CARO, 2016 is an additional reporting requirement Order which has been issued by the Central Government in
consultation with the Institute of Chartered Accountants of India under section 143(11) of the Companies Act, 2013.

The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013. However, the Order specifically exempts the following class of companies-

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
(ii) an insurance company as defined under the Insurance Act, 1938 (4 of 1938);
(iii) a company licensed to operate under section 8 of the Companies Act;
(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act and a small company as defined under clause (85) of section 2 of the Companies Act; and
(v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

In the given case, E-Tech Pvt. Ltd. has outstanding loan of ₹ 50 lakhs (₹ 20 lakhs + ₹ 30 lakhs) from Banks and Financial Institutions together, which is not exceeding the limit prescribed under Order for applicability of exemption.

Therefore, contention of the E Tech Pvt. Ltd., is correct that CARO, 2016 will not be applicable on it.

**Question 53**

Asta Pvt. Ltd. has fully paid capital of ₹ 140 lakh. During the year, the company had borrowed ₹ 15 lakh each from a bank and a financial institution independently. It has the turnover (Net of excise ₹ 50 lakh which is credited to a separate account) of ₹ 475 lakh. Will Companies (Auditor's Report) Order, 2016 be applicable to Astha Pvt. Ltd.?

**Answer**

Applicability of CARO, 2016: The CARO, 2016 specifically exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

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

Thus, in view of rupees 140 lakh paid up capital which is exceeding the prescribed limit for exemption, CARO, 2016 will be applicable to Astha Pvt. Ltd.
Question 54

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

Answer

Applicability of CARO, 2016: The CARO, 2016 specifically exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

In the given case, paid up capital and reserves of T Pvt. Ltd. is less than ₹ 1 crore and has no loan outstanding exceeding ₹ one crore from any bank or financial institution. Further, its total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) is not exceeding rupees ten crore during the financial year as per the financial statements.

Thus CARO 2016 will not be applicable to T Pvt. Ltd.

Question 55

A Term Loan was obtained from a bank for ₹ 80 lakh for acquiring R&D equipment, out of which ₹ 15 lakh was used to buy a car for use of the concerned director who was overlooking the R&D activities. Under CARO, 2016, as a statutory auditor, how would you report?

Answer

Utilisation of Term Loans: According to clause (ix) of Para 3 of CARO, 2016, the auditor is required to report “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 & subsequent rectification, if any, as may be applicable”.

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

In the instant case, term loan taken for the purpose of R&D equipment has been utilized for the purchase of car which has no relation with R&D equipment.

Therefore, car though used for R&D Director cannot be considered as R&D equipment. The auditor should state the fact in his report as per Paragraph 3 clause ix of the CARO 2016, that out of the term loan taken for R&D equipment, ₹ 15 lakh was not utilised for the purpose of acquiring R&D equipment.

Question 56

Physical verification of only 50% of items of inventory has been conducted by the company. The balance 50% will be conducted in next year due to lack of time and resources. Under CARO, 2016, as a statutory auditor, how would you report?
**Answer**

Physical Verification of Inventory: Clause (ii) of Para 3 of CARO, 2016 requires the auditor to report on whether physical verification of inventory has been conducted at reasonable intervals by the management. Physical verification of inventory is the responsibility of the management which should verify all material items at least once in a year and more often in appropriate cases. The auditor in order to satisfy himself about verification at reasonable intervals should examine the adequacy of evidence and record of verification.

In the given case, the above requirement of CARO, 2016 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory verification is not reasonable. He may consider the impact on financial statement and report accordingly.

**Question 57**

LM Ltd. had obtained a Term Loan of ₹ 300 lakhs from a bank for the construction of a factory. Since there was a delay in the construction activities, the said funds were temporarily invested in short term deposits. Under CARO, 2016, as a statutory auditor, how would you report?

**Answer**

Term Loan Invested in Short Term Deposits: As per clause (ix) of Para 3 of CARO, 2016, an auditor need to state in his report that whether the term loans were applied for the purpose for which the loans were obtained.

In the present case, the term loan obtained by LM Ltd. have not been put to use for construction activities and temporarily invested the same in short term deposit.

Here, the auditor should report the fact in his report that pending utilization of the term loan for construction of a factory, the funds were temporarily used for the purpose other than the purpose for which the loan was sanctioned as per clause (ix) of Para 3 of CARO, 2016.

**Question 58**

The long term borrowings from the parent has no agreed terms and neither the interest nor the principal has been repaid so far. Under CARO, 2016, as a statutory auditor, how would you report?

**Answer**

As per clause (xiii) of para 3 of CARO 2016 the auditor is required to report, “whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards”.

In the present case, the auditor is required to report as per clause xiii of para 3 of CARO 2016 regarding receipt of long term borrowing from Parent Company which qualifies as a transaction with the related party.

**Question 59**

The Company is in the process of selling its office along with the freehold land available at Chandigarh and is actively on the lookout for potential buyers. Whilst the same was purchased at ₹ 25 Lakhs in 2008, the current market value is ₹ 250 Lakhs,
This property is pending to be registered in the name of the Company, due to certain procedural issues associated with the Registration though the Company is having a valid possession and has paid its purchase cost in full. The Company has disclosed this amount under Fixed Assets though no disclosure of non-registration is made in the notes forming part of the accounts. Under CARO, 2016, as a statutory auditor, how would you report?

**Answer**

As per clause (i) (c) of para 3 of CARO 2016 the auditor is required to report, “whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof.”

In the present case, the Company has office along with freehold land in Chandigarh. Though company has paid its purchase cost in full however, this property is pending to be registered in the name of the company i.e. title deed is not in the name of Company since 2008. Therefore, the auditor is required to report the same in accordance with clause (i)(c) of para 3 of CARO 2016.

The reporting under this clause, where the title deeds of the immovable property are not held in the name of the Company, may be made incorporating following details, in the form of a table or otherwise in case of land:

- total number of cases,
- whether leasehold / freehold,
- gross block and net block, (as at Balance Sheet date), and
- remarks, if any.

**Question 60**

An amount of ₹ 3.25 Lakhs per month is paid to M/s. WE CARE Associates, a partnership firm, which is a 'related party' in accordance with the provisions of the Companies Act, 2013 for the marketing services rendered by them. Based on an independent assessment, the consideration paid is higher than the arm’s length pricing by ₹ 0.25 Lakhs per month. Whilst the transaction was accounted in the financial statements based on the amounts’ paid, no separate disclosure has been made in the notes forming part of the accounts highlighting the same as a ‘related party’ transaction. Under CARO, 2016, as a statutory auditor, how would you report?

**Answer**

As per clause (xiii) of para 3 of CARO 2016, the auditor is required to report, “whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;”

Therefore, the duty of the auditor, under this clause is to report (i) Whether all transactions with the related parties are in compliance with section 177 and 188 of the Companies Act, 2013 (“Act”); (ii) Whether related party disclosures as required by relevant Accounting Standards (AS 18, as may be applicable) are disclosed in the financial statements.

In the present case, the auditor is required to report as per clause xiii of para 3 of CARO 2016, as one of related party transaction amounting 3.25 lakhs per month i.e. in lieu of marketing services has been noticed of which amount ₹ 0.25 lakh per month is exceeding the arm’s length price has not been disclosed highlighting the same as related party transactions as per AS 18. Thus, the auditor is required to report accordingly.
Question 61
The Internal Auditor of the Company has identified a fraud in the recruitment of employees by the HR department wherein certain sums were alleged to have been taken as kick-back from the employees for taking them on board with the Company. After due investigation, the concerned HR Manager was sacked. The amount of such kickbacks is expected to be in the range of ₹12 Lakhs. Under CARO, 2016, as a statutory auditor, how would you report?

Answer
As per clause Clause (x) of para 3 of CARO 2016 the auditor is required to report, “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.”

In the instant case, a fraud has been identified in recruitment of employees by the HR Department wherein certain sums were alleged to have been taken as kickback from the company of amounting rupees approx. 12 lakh. The auditor is required to report on the same in accordance with clause (x) of para 3 of CARO 2016.

Question 62
OK Ltd. has taken a term loan from a nationalized bank in 2015 for ₹ 200 lakhs repayable in five equal instalments of ₹ 40 lakhs from 31st March, 2016 onwards. It had repaid the loans due in 2016 & 2017, but defaulted in 2018, 2019 & 2020. As the auditor of OK Ltd. what is your responsibility assuming that company has sought reschedulement of loan?

Answer
Reporting for Default in Repayment of Dues: As per clause (viii) of Para 3 of CARO, 2016, the auditor of a company has to report whether the Company has defaulted in repayment of its dues to a financial institution or bank or debentures holders and if yes, the period and amount of default to be reported.

In this case, OK Ltd. has defaulted in repayment of dues for three years. Application for rescheduling will not change the default position. Hence the auditor has to report in his audit report that the Company has defaulted in its repayment of dues to the bank to the extent of ₹ 120 lakhs.

Question 63
X Ltd closed its manufacturing operations and sold all its manufacturing fixed assets during the financial year ended 31st March, 2020. However, it intends continue its operations as a trading company. In respect of other fixed assets, the company carried out a physical verification as at the end of 31st March, 2020 and found a material discrepancy to the tune of ₹ 1 lac, which was written off and is disclosed separately in the Statement of Profit and Loss. Kindly incorporate the above in your audit report.

Answer
Disclosure in Audit Report: As per SA 570 “Going Concern”, when the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements-
(i) Adequately describe the principal events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and management’s plans to deal with these events or conditions; and

(ii) Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern.

The auditor is further required to specifically include certain matters as per CARO, 2016 under section 143 of the Companies Act, 2013. According to clause (i)(b) of Para 3 of CARO, the auditor has to comment whether the fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account.

In the given case, X Ltd. has sold out its manufacturing fixed assets during the year. However, it intends to continue its operations as a trading company. Therefore, selling of manufacturing fixed assets does not affect the going concern assumption of the company. Additionally, while carrying out physical verification of fixed assets, a material discrepancy to the tune of ₹ 1 lac was found, which was written off and disclosed separately in the Statement of Profit and Loss. Hence, this fact needs to be disclosed in the Audit Report as follows:

Para in the Audit Report-
We have made our viewpoint from the facts of the case and on the basis of guidance drawn from AS 1. We report as under-

As per Accounting Standard (AS) 1, “Disclosure of Accounting Policies”, “the enterprise is normally viewed as a going concern that is as continuing its operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations.” Although the company has disposed off its manufacturing fixed assets during the financial year ending on 31-03-2020, it is still a going concern in the form of a trading company. We also report that on physical verification of other fixed assets, a material discrepancy to the tune of ₹ 1 Lac was noticed and that the same has been properly dealt with in the books of account.

Question 64

Big and Small Ltd. received a show cause notice from central excise department intending to levy a demand of ₹ 25 lakhs in December 2019. The company replied to the above notice in January 2020 contending that it is not liable for the levy. No further action was initiated by the central excise department upto the finalization of the audit for the year ended on 31st March, 2020. As the auditor of the company, what is your role in this?

Answer

Compliance of Laws and Regulations & Reporting Requirements: As per SA 250 “Consideration of Laws and Regulations in an Audit of Financial Statement”, the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labour laws.

During the audit, the auditor shall remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor’s attention. Then the auditor shall discuss the matter with management and, where appropriate, those charged with governance. If management
or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor’s judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice. In case, if the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, as per AS 29 "Provisions, Contingent liabilities and Contingent Assets", future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the event will occur.

Furthermore, the auditor’s report under section 143 of the Companies Act, 2013 has to specifically include certain matters specified in Para 3 of CARO, 2016.

One of such matter is non-payment of dues to Government, on account of any dispute. As per clause (vii)(b) of Para 3 of CARO, 2016, in case dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.

In the present case of Big and Small Ltd., issuance of show cause notice by Excise Department does not tantamount to demand payable by the Company. In so far as the Company has replied to the notice and no further correspondence was received from the Department. This show cause notice may be an alert or indication of non-compliance for the auditor. So auditor need to discuss with management and apply additional procedure. If the auditor concludes that there is non-compliance then provision for the same should be made as per AS 29. The auditor should also report the amount of dues not deposited on account of dispute and the forum where dispute is pending, in his audit report. If the management does not accept the request, the auditor should qualify the audit report accordingly or vice versa.

**Question 65**

C Limited has defaulted in repayments of dues to a financial institution during the financial year 2019-20 and the same remained outstanding as at March 31, 2020. However, the Company settled the total outstanding dues including interest in April, 2020 subsequent to the year end and before completion of the audit. Discuss how you would deal with this matter and draft a suitable Auditor’s Report.

**Answer**

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

Further, as per clause (viii) of Para 3 of CARO, 2016, the auditor of a company has to state in his report whether the Company has defaulted in repayment of dues to a financial institution or bank or debentures holders and if yes, the period and amount of default to be reported.

In the given case, C Ltd. has defaulted in repayments of dues to a financial institution during the financial year 2019-20 which remain outstanding as at March 31, 2020. However, the company has settled the total outstanding dues including interest in April, 2020 but, the dues were outstanding as at March 31, 2020. Therefore, it needs to be reported in the notes to accounts.

The draft report for above matter is as under:
"The company has taken a loan during the year, from a financial institution amounting to ₹ XXXX @ X% p.a. which is repayable by monthly installment of ₹ XXXX for XX months.

The company has defaulted in repayment of dues including interest to a financial institution during the financial year 2019-20 amounting to ₹ XXXX which remained outstanding as at March 31, 2020. The period of default is XXX days. However, the outstanding sum was settled by the company in April, 2020."

Question 66

During the course of audit of CT Ltd. for the financial year 2019-20, it has noticed that ₹ 2.00 lakhs of employee contribution and ₹ 9.50 lakhs of employer contribution towards employee state insurance contribution have been accounted in the books of accounts in respective heads. Whereas, it was found that ₹ 4.00 lakhs only has been deposited with ESIC department during the year ended 31st March, 2020. The Finance Manager informed the auditor that due to financial crunch they have not deposited the amount due, but will deposit the amount overdue along with interest as and when financial position improves. Comment as a statutory auditor.

Answer

Non-Compliance of Laws and Regulations & Reporting Requirements: As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement", it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity’s operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity’s financial statements. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, the auditor is required to report under clause (vii)(a) of Para 3 of CARO, 2016 whether the company is regular in depositing undisputed statutory dues including employees’ state insurance 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.

In the instant case, even though accrual principles have been followed, disclosure of non-payment is necessary. The auditor should disclose the fact of non-payment of rupees 7.50 lakhs in his report.

Question 67

Paragraph 3(x) of CARO, 2016 requires the auditor to report 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. The clause does not require the auditor to discover such frauds.

The scope of auditor’s inquiry under this clause is restricted to frauds ‘noticed or reported’ during the year. Comment.

Answer
Paragraph 3(x) of CARO, 2016 states that: 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

This clause requires the auditor to report 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 auditor is required to state the amount involved and the nature of fraud. The clause does not require the auditor to discover such frauds. The scope of auditor’s inquiry under this clause is restricted to frauds ‘noticed or reported’ during the year. The use of the words “noticed or reported” indicates that the management of the company should have the knowledge about the frauds by the company or on the company by its Officer and employees that have occurred during the period covered by the auditor’s report. It may be noted that this clause of the Order, by requiring the auditor to report whether any fraud by the company or on the company by its Officer or employees has been noticed or reported, does not relieve the auditor from his responsibility to consider fraud and error in an audit of financial statements. In other words, irrespective of the auditor's comments under this clause, the auditor is also required to comply with the requirements of Standard on Auditing (SA) 240, "The Auditor's Responsibility Relating to Fraud in an Audit of Financial Statements".

Question 68
As per Paragraph 3(vi) of CARO, 2016, auditor is required to report whether maintenance of cost records has been specified by the Central Government under sub-section (1) of Section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained. Explain audit procedure and reporting in relation to this clause.

Answer
Audit Procedures and Reporting - Paragraph 3(vi) of CARO, 2016

(i) The Order requires the auditor to report whether cost accounts and records have been made and maintained. The word “made” applies in respect of cost accounts (or cost statements) and the word “maintained” applies in respect of cost records relating to materials, labour, overheads, etc. The auditor has to report under the clause irrespective of whether a cost audit has been ordered by the central government. The auditor should obtain a written representation from the management stating (a) whether cost records are required to be maintained for any product(s) or services of the company under section 148 of the Act, and the Companies (Cost Records and Audit) Rules, 2014; and (b) whether cost accounts and records are being made and maintained regularly. The auditor should also obtain a list of books/records made and maintained in this regard. The Order does not require a detailed examination of such records. The auditor should, therefore, conduct a general review of the cost records to ensure that the records as prescribed are made and maintained. He should, of course, make such reference to the records as is necessary for the purposes of his audit.

(ii) It is necessary that the extent of the examination made by the auditor is clearly brought out in his report. The following wording is, therefore, suggested:

“We have broadly reviewed the books of account maintained by the company pursuant to the Rules made by the Central Government for the maintenance of cost records under section 148 of the Act, and are of the opinion that prima facie, the prescribed accounts and records have been made and maintained.”

(iii) Where the auditor finds that the records have not been written or are not prima facie complete, it will be necessary for the auditor to make a suitable comment in his report.
Question 69

C Limited has defaulted in repayments of dues to a financial institution during the financial year 2019-20 and the same remained outstanding as at March 31, 2020. However, the Company settled the total outstanding dues including interest in April, 2020 subsequent to the year end and before completion of the audit. Discuss how you would deal with this matter and draft a suitable Auditor's Report.

Answer

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

Further, as per clause (viii) of Para 3 of CARO, 2016, the auditor of a company has to state in his report whether the Company has defaulted in repayment of dues to a financial institution or bank or debentures holders and if yes, the period and amount of default to be reported.

In the given case, C Ltd. has defaulted in repayments of dues to a financial institution during the financial year 2019-20 which remain outstanding as at March 31, 2020. However, the company has settled the total outstanding dues including interest in April, 2020 but, the dues were outstanding as at March 31, 2020. Therefore, it needs to be reported in the notes to accounts.

The draft report for above matter is as under:

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

The company has defaulted in repayment of dues including interest to a financial institution during the financial year 2018-19 amounting to ₹ XXXX which remained outstanding as at March 31, 2020. The period of default is XXX days. However, the outstanding sum was settled by the company in April, 2020."

Question 70

In the case of companies carrying on the business of a non-banking financial institution, the auditor needs to report under CARO, 2016 whether the registration has been obtained under section 45-IA of the Reserve Bank of India Act, 1934, if required.

You are required to state in brief the audit procedure to be followed while reporting under above mentioned circumstances.

Answer

Reporting under CARO, 2016 for Registration under RBI Act, 1934: As per Clause (xvi) of paragraph 3 of the CARO, 2016, the auditor is required to report whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934. If so, whether the registration has been obtained.

Audit Procedures and Reporting:

(i) The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the Non-Banking Financial Companies.

(ii) The financial statements should be examined to ascertain 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 income.
(iii) Whether the company has net owned funds as required for the registration as NBFC. Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented.

**Question 71**

What are the reporting requirements in the audit report under the Companies Act, 2013 / CARO, 2016 for the following situations?

(i) A fraud has been committed against the company by an officer of the company.

(ii) A fraud has been committed against the company by a vendor of the company.

(iii) The company has committed a major fraud on its customer and the case is pending in the court.

(iv) A fraud has been reported in the cost audit report but not noticed by statutory auditor in his audit.

**Answer**

**Reporting Requirements in the Audit Report under the Companies Act, 2013 / CARO 2016:**

According to Clause (x) of Para 3 of CARO 2016, the auditor is required to report 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 auditor is required to state the amount involved and the nature of fraud.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is rupees 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than rupees 1 crore) within such time and in such manner as may be prescribed.

(i) **Fraud Committed against the Company by an Officer of the Company:** Fraud committed against the company by an officer of the company has to be reported in accordance with Clause (x) of Para 3 of CARO 2016, and as per section 143(12) of the Companies Act, 2013.

(ii) **Fraud committed against the company by a vendor of the Company:** In case employees or management are involved in fraud committed by vendor, reporting has to be done in accordance with CARO 2016 and as per section 143 (12) of the Companies Act, 2013. Suspected fraud by vendors, customers and other third parties should be dealt with in accordance with SA 240. Therefore, reporting has to be done in accordance with SA 240, “The Auditor’s Responsibilities relating to Fraud in an audit of Financial Statements”.

(iii) **Company has committed major fraud on its customer of which case is pending in the court:** Major fraud committed by the company on its customer has to be reported in accordance with Clause (x) of Para 3 of CARO 2016.

(iv) **Fraud reported in Cost Audit Report but not noticed by Statutory Auditor:** As per Clause (x) of Para 3 of CARO 2016, all frauds noticed or reported during the year shall be reported indicating the nature and amount involved as specified the fraud by the company or on the company by its officers or employees are only covered.

Here in the given scenario, a fraud has been reported in the cost audit report but not noticed by Statutory Auditor in his audit. Hence the statutory auditor has to report the nature and amount involved in the audit report as per section 143 of the Companies Act, 2013.