Question 1

Under the applicable Standards on Auditing, in what circumstances does the report of the statutory auditor require modifications? What are the types of modifications possible to the said report?

Answer

Modifications in Audit Report: As per SA 705, “Modifications to the Opinion in the Independent Auditor’s Report”, the auditor shall modify the opinion in the auditor’s report when:

(a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor’s report in accordance with SA 705.

Types of Modification to the Auditor’s Opinion: As per SA 705, “Modifications to the Opinion in the Independent Auditor’s Report”, modified opinion may be defined as a qualified opinion, an adverse opinion or a disclaimer of opinion.

Types of modifications possible to the said report are below-mentioned:

(i) Qualified Opinion: The auditor shall express a qualified opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

(ii) Adverse Opinion: The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
Disclaimer of Opinion: The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

Question 2

X Ltd closed its manufacturing operations and sold all its manufacturing fixed assets during the financial year ended 31st March, 2016. However, it intends to 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, 2016 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 31-03-2016, 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 3
XYZ Pvt. Ltd. has submitted the financial statements for the year ended 31-3-16 for audit. The audit assistant observes and brings to your notice that the company’s records show following dues:

Income Tax relating to Assessment Year 2012-13 ₹ 125 lacs - Appeal is pending before Hon’ble ITAT since 30-9-14.

Customs duty ₹ 85 lakhs - Demand notice received on 15-9-15 but no action has been taken to pay or appeal.

As an auditor, how would you bring this fact to the members?

Answer
Non-Compliance of Laws and Regulations: 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. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

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 on certain matters specified in Para 3 of CARO, 2016 under section 143 of the Companies Act, 2013.

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, there is Income Tax demand of ₹ 125 Lacs and the company has gone for an appeal, it needs considerations as to whether the entire demand is disputed, because it is difficult to presume that the demand by Income Tax authority is without any basis. Therefore, as per AS 29 “Provisions, Contingent Liabilities and Contingent Assets”, partly to the extent the company considers that the demand is based on some logical basis, that amount may be provided for and the remaining may be disclosed as the contingent liability. Further, it should be brought to notice of the members by reporting.

Additionally, the demand notice has been received for Customs duty of ₹ 85 lakhs and is outstanding on the closure of financial year, for which no action has been taken by the management. Therefore, it should also be brought to notice of the members by reporting.

Question 4

(a) OK Ltd. has taken a term loan from a nationalized bank in 2011 for ₹ 200 lakhs repayable in five equal instalments of ₹ 40 lakhs from 31st March, 2012 onwards. It had repaid the loans due in 2012 & 2013, but defaulted in 2014, 2015 & 2016. As the auditor of OK Ltd. what is your responsibility assuming that company has sought reschedulement of loan?

(b) Big and Small Ltd. received a show cause notice from central excise department intending to levy a demand of ₹ 25 lakhs in December 2015. The company replied to the above notice in January 2016 contending that it is not liable for the levy. No further action was initiated by the central excise department up to the finalization of the audit for the year ended on 31st March, 2016. As the auditor of the company, what is your role in this?

(c) 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

(a) 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.

(b) 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.
(c) **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 opinion.

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 5**

*PQR Ltd., a listed company and having an average annual turnover of more than ₹5 crores has no Internal Audit System. Give your views.*

**Answer**

**Internal Audit System**: As per section 138 of the Companies Act, 2013, the following class of companies (prescribed in rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely-

1. every listed company;
2. every unlisted public company having-
   - paid up share capital of fifty crore rupees or more during the preceding financial year; or
   - turnover of two hundred crore rupees or more during the preceding financial year; or
   - outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
   - outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
3. every private company having-
   - turnover of two hundred crore rupees or more during the preceding financial year; or
(ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In the instant case, PQR Ltd is a listed company and having an average annual turnover of more than ₹ 5 crores. As the company is a listed company, the provisions related to internal audit shall be applicable to the company. The turnover limit given has no relevance here. Therefore, the auditor will have to mention in his report the fact of not having such internal audit system by the Company.

Question 6
As a Statutory Auditor, how would you deal with the following:

(a) PQR Ltd. has not deposited Provident Fund contribution of ₹10 lakhs with the authorities till the year-end.

(b) 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.

Answer

(a) 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. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

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 Section 128 of the Companies Act, 2013, a company has to maintain proper books of account on accrual basis and according to the double entry system of accounting.

Additionally, as per Section 43B of the Income Tax Act, 1961, there are certain expenses, which includes any sum payable by the assessee as an employer by way of contribution to any provident fund, which are allowed only on its actual payment.

The auditor is, therefore, required to report under clause (vii)(a) of Para 3 of CARO, 2016 whether the company is regular in depositing undisputed statutory dues including...
provide provident fund 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 ₹ 10 lakhs in his report.

(b) 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 7

Write a short note on Emphasis of matter paragraph in Audit Reports.

Answer

Emphasis of Matter Paragraph in Audit Reports: An auditor’s report can be modified for matters that do not affect the auditor’s opinion. An “emphasis of matter” paragraph is such a type of modification in an audit report. In certain circumstances, such a paragraph is added to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such a paragraph does not affect the auditor’s opinion.

SA 706 “Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report”, deals with additional communication in the auditor’s report when the auditor considers it necessary to draw users’ attention to a matter presented or disclosed in the financial statements that, in the auditor’s judgment, is of such importance that it is fundamental to users’ understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor’s report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements.

Specific requirements for the auditor to include Emphasis of Matter paragraphs in the auditor’s report in certain circumstances. These circumstances include:

- When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.
- To alert users that the financial statements are prepared in accordance with a special
• **When facts become known to the auditor after the date of the auditor’s report and the auditor provides a new or amended auditor’s report (i.e., subsequent events).**

Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

• **An uncertainty relating to the future outcome of exceptional litigation or regulatory action.**

• **A significant subsequent event that occurs between the date of the financial statements and the date of the auditor’s report.**\(^1\)

• **Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.**

• **A major catastrophe that has had, or continues to have, a significant effect on the entity’s financial position.**

However, a widespread use of Emphasis of Matter paragraphs may diminish the effectiveness of the auditor’s communication about such matters.

**Question 8**

*What are the features of a qualified Audit Report?*

**Answer**

**The Features of a Qualified Report are-**

(i) **Clarity:** The Auditor must express the nature of qualification, in a clear and unambiguous manner.

(ii) **Explanation:** Where the Auditor answers any of the statutory affirmations in the negative or with a qualification, his report shall state the reasons for such answer.

(iii) **Placement:** All qualifications should be contained in the Auditor’s Report. When there are notes which are subject matter of a qualification, the same should preferably be annexed to the Auditors’ Report. However, a reference to the notes to Accounts in the Auditors’ Report does not automatically become a qualification.

(iv) **Except for:** A quantified opinion should be expressed as “except for” for the effects of the matter to which qualification related. It would not be appropriate to use phrases such as “with the foregoing explanation” or “subject to” in the opinion paragraph as these are not sufficiently clear or forceful.

(v) **Quantification:** It is also necessary that the auditor should quantify, wherever possible, the effect of individual as well as the total effect of all qualifications on statement of profit and loss and/or state of affairs these qualifications on the financial statements in a clear and unambiguous manner. In circumstances where it is not possible to quantify the effect of the qualifications accurately the auditor may do so on the estimates made by the

\(^1\) SA 560, paragraph 6
management after carrying out such audit tests as are possible and clearly indicate that
the figures given are based on the estimates of the management.

(vi) **Nature of qualification**: Vague statements the effect of which on accounts cannot be
ascertained like ‘the trade receivables balances are subject to confirmation’, ‘no provision
for taxation has been made in view of the loss during the year’ etc., should be avoided.

(vii) **Violation of law**: Where the company has committed an irregularity resulting in a breach
of law, the Auditor should bring the same to the notice of the shareholders by properly
qualifying his report.

(viii) **Notes – Report Relationship** – Where notes of a qualificatory nature appear in the
accounts, the Auditors should state all qualifications independently in their report so that
the user can assess the significance of these qualifications.

(ix) **Draft Report**: The auditor may discuss matters of qualification with the management or
those charged with governance of the company to acquire their views. It is not necessary
that the Auditor should accept the management's view and modify his opinion. But it
would enable the Auditor to accurately draft the qualifications in his Final Report.

**Question 9**

Discuss the various aspects to be considered by the Statutory Auditor before qualifying his
report.

**Answer**

**Aspects to be Considered Before Qualifying the Audit Report**: SA 705 “Modifications to the
Opinion in the Independent Auditor’s Report” specifies that auditor’s report may need
modification on account of certain matters which may or may not affect the auditor’s opinion.
There may be certain circumstances when an auditor may not be able to express an unqualified
opinion because the effort of such circumstances in the auditor’s judgment is, or may be material
to the financial statements, for example, there is a limitation on the scope of the auditor’s work or
there is a disagreement with management regarding the acceptability of the accounting policies
selected, the method of their application or the adequacy of financial statement disclosures.

The auditor shall express a qualified opinion when-

(i) The auditor, having obtained sufficient appropriate audit evidence, concludes that
misstatements, individually or in the aggregate, are material, but not pervasive, to the
financial statements; or

(ii) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the
opinion, but the auditor concludes that the possible effects on the financial statements of
undetected misstatements, if any, could be material but not pervasive.

Further, while qualifying a report, it is important to appreciate as to which of the various items
of statement of fact or statement of opinion require a qualification in respect of audit under the
Companies Act, 2013. The auditor may also see whether the matters constituting the
qualification involve a material contravention of any requirements of the Companies Act, 2013
which have a bearing on the accounts.
Finally, whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s), individually and in aggregate, on the financial statements should be mentioned in the auditor's report. A quantified opinion should be expressed as “except for” for the effects of the matter to which qualification related.

Question 10

Write a short note on Certificate for Special Purpose vs. Audit Report.

Answer

Certificate for Special Purpose vs. Audit Report: A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. The term ‘certificate’ is, therefore, used where the auditor verifies the accuracy of facts. An auditor may thus, certify the circulation figures of a newspaper or the value of imports or exports of a company. An auditor’s certificate represents that he has verified certain figures and is in a position to vouch safe their accuracy as per his examination of documents and books of account. A report, on the other hand, is a formal statement usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor’s opinion thereon. Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein. On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill. The ‘report’ involves expression of opinion which may differ from one professional to another. There is no question of exactitude in case of a report since the information contained therein is based on estimates and involves judgement element.

Question 11

Compare and explain the following:

(i) Reporting to Shareholders vs. Reporting to those Charged with Governance

(ii) Audit Qualification vs. Emphasis of Matter.

Answer

(i) Reporting to Shareholders vs. Reporting to those Charged with Governance:

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<thead>
<tr>
<th>REPORT</th>
<th>Reporting to Shareholders</th>
<th>Reporting to those Charged with Governance</th>
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<tr>
<td></td>
<td>• Section 143 of the Companies Act, 2013 deals with the provisions relating to reporting to Shareholders. Thus, it is a Statutory Audit Report which is addressed to the members.</td>
<td>• Standard on Auditing 260 deals with the provisions relating to reporting to those Charged with Governance.</td>
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</table>
8.12 Advanced Auditing and Professional Ethics

- Statutory Audit Report is on true and fair view and as per prescribed Format.
- Statutory Audit Reports are in public domain.
- It is a reporting on matters those charged with governance like scope of audit, audit procedures, audit modifications, etc.
- Reporting to those Charged with Governance is an internal document i.e. private report.

(ii) Audit Qualification vs. Emphasis of Matter:

<table>
<thead>
<tr>
<th>REPORT</th>
<th>Audit Qualification</th>
<th>Emphasis of Matter</th>
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<tbody>
<tr>
<td>• Standard on Auditing 705 “Modifications to the Opinion in the Independent Auditor’s Report”, deals with the provisions relating to Audit Qualification.</td>
<td>• Standard on Auditing 706 “Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report” deals with the provisions relating to Emphasis of Matter.</td>
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</tr>
<tr>
<td>• Audit Qualifications are also known as “subject to report” or “except that report”.</td>
<td>• Emphasis of Matter is a paragraph which is included in auditor’s report to draw users’ attention to important matter(s) which are already disclosed in Financial Statements and are fundamental to users’ for understanding of Financial Statements.</td>
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<td>• Audit Qualifications are given when auditor is having reservations on some of the items out of the financial statements as a whole i.e. Auditor’s Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements relating to if the impact of material misstatements is not pervasive on the financial statements but is present at some levels of the financial statements, qualified report is issued.</td>
<td>• Emphasis of Matter is a paragraph which is issued when there is a uncertainty relating to future outcome of exceptional litigation, regulatory action, etc.; or there is early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.</td>
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Question 12

C Limited has defaulted in repayments of dues to a financial institution during the financial year 2015-16 and the same remained outstanding as at March 31, 2016. However, the Company settled the total outstanding dues including interest in
April, 2016 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 2015-16 which remain outstanding as at March 31, 2016. However, the company has settled the total outstanding dues including interest in April, 2016 but, the dues were outstanding as at March 31, 2016. 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 2015-16 amounting to `XXXX which remained outstanding as at March 31, 2016. The period of default is XXX days. However, the outstanding sum was settled by the company in April, 2016.”

Question 13

XYZ Ltd. Co. gave a donation of `50,000 each to a Charitable Society running a school and a trust set up for the service of Blind during financial year ending on 31st March, 2016. The average net profits of the company for the last three years were 15 lakhs. Comment.

Answer

Donation to Charitable Institutions: Section 181 of the Companies Act, 2013 provides that the Board of Directors of a company may contribute to bona fide charitable and other funds with prior permission of the company in general meeting for such contribution in case any amount the aggregate of which, in any financial year, exceed five per cent of its average net profits for the three immediately preceding financial years.

Facts of the case: In the instant case, the company has given donation of ` 50,000/- each to the two charitable organisations which amounts to ` 1,00,000. Assuming that the charitable organisations are not related to the business of the company, the average profits of the last 3 years is ` 15 lakhs and the 5% of this works out to ` 75,000. Hence the maximum of donation
could be ₹ 75,000 only. For excess of ₹ 25,000 the company is required to take prior permission in general meeting which is not been taken.

Conclusion: By paying donations of ₹ 1,00,000 which is more than ₹ 75,000, the Board has contravened the provisions of Section 181 of the Companies Act, 2013. Hence the auditor should qualify his report accordingly.

Question 14

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 15

(a) Astha 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.?

(b) Under CARO, 2016, as a statutory auditor, how would you report on the following:

(i) 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.

(ii) Physical verification of only 50% of items of inventory has been conducted by the company. The balance 50% will be conducted in next year due to lack of time and resources.

Answer

(a) 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.

(b) Reporting under CARO, 2016

(i) 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 and subsequent rectification, if any, as may be applicable”.

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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.

(iii) 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 16

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 Schedule 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 17

Write a short note on Obligation of the Statutory Auditor to report frauds to the Central Government during the audit carried out under the Companies Act, 2013

Answer

Obligation of the Statutory Auditor to report frauds to the Central Government during the audit carried out under the Companies Act, 2013

As per sub-section (12) of section 143 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 of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.

In this regard, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 has been prescribed. Sub-rule (1) of the Rule 13 states that if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

The manner of reporting the matter to the Central Government is as follows:

(a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;

(b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;

(c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
(d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;

(e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and

(f) the report shall be in the form of a statement as specified in Form ADT-4.

Question 18

During the course of audit of CT Ltd. for the financial year 2015-16, 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, 2016. 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.