III.824 Auditing Pronouncements

Appendix-III

List of Financial Institutions Covered Under the Companies (Acceptance of Deposit) Rules, 2014

1. Sub section (39) of section 2 of Companies Act, 2013 defines the term “financial institution” as, it includes a scheduled bank, and any other financial institution defined or notified under the Reserve Bank of India Act, 1934 (2 of 1934). The term financial institution has been defined under Section 45I clause (c) of the RBI Act 1934 as under:-

45I (c) “financial institution” means any non-banking institution which carries on as its business or part of its business any of the following activities, namely:–

(i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own:

(ii) the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature:

(iii) letting or delivering of any goods to a hirer under a hire-purchase agreement as defined in clause (c) of section 2 of the Hire-Purchase Act, 1972:

(iv) the carrying on of any class of insurance business;

(v) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kurries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;

(vi) collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lumpsum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person, 2 [but does not include any institution, which carries on as its principal business,—

(a) agricultural operations; or

(aa) industrial activity; or]

(b) the purchase or sale of any goods (other than securities) or the providing of any services; or

(c) the purchase, construction or sale of immovable property, so however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons;
Explanation.– For the purposes of this clause, “industrial activity” means any activity specified in sub-clauses (i) to (xviii) of clause (c) of section 2 of the Industrial Development Bank of India Act, 1964;

Further “non-banking institution” has been defined under clause (e) of Section 45-I of RBI Act 1934 as under:-

45-I (e) “non-banking institution” means a company, corporation or cooperative society.

Further “non-banking financial company” has been defined under clause (f) of Section 45-I of RBI Act 1934 as under:-

45-I (f) “non-banking financial company” means—

(i) a financial institution which is a company;

(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;

(iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify;

2. Section 2(72) of the Companies Act, 2013 defines “public financial institutions “as follows:

(i) the Life Insurance Corporation of India, established under section 3 of the Life Insurance Corporation Act, 1956;

(ii) the Infrastructure Development Finance Company Limited, referred to in clause (vi) of sub-section (1) of section 4A of the Companies Act, 1956 so repealed under section 465 of this Act;

(iii) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002;

(iv) institutions notified by the Central Government under sub-section (2) of section 4A of the Companies Act, 1956 so repealed under section 465 of this Act;

(v) such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India:

Provided that no institution shall be so notified unless—
III.826 Auditing Pronouncements

(A) it has been established or constituted by or under any Central or State Act; or

(B) not less than fifty-one per cent of the paid-up share capital is held or controlled 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;

3. Sub-section (72) of section 2 of the Act, empowers the Central Government to notify in the Official gazette such other institution as it may think fit to be a public financial institution. The Central Government has so far notified the following 58 public financial institutions:


5. The Oriental Fire and General Insurance Company Limited, formed and registered under the Companies Act, 1956.


7. The Shipping Company and Investment Company of India Limited.

8. Tourism Finance Corporation of India Limited, formed and registered under the Companies Act, 1956.

9. IFCI Venture Capital Funds Limited formed and registered under the Companies Act, 1956.


15. Indian Railway Finance Corporation Limited, formed and registered under the Companies Act, 1956.
27. Madhya Pradesh Financial Corporation.
32. Tamil Nadu Industrial Investment Corporation Limited.
33. Uttar Pradesh Financial Corporation.
34. West Bengal Financial Corporation.
37. Housing and Urban Development Corporation Limited.
38. Export and Import Bank of India.
40. National Co-operative Department Corporation (NCDC).
42. The Pradeshiya Industrial Development and Investment Corporation Limited.
43. Rajasthan State Industrial Development and Investment Corporation Limited.
44. The State Industrial and Investment Corporation of Maharashtra Limited.
45. West Bengal Industrial Development Corporation Limited.
46. Tamil Nadu Industrial Development Corporation Limited.
47. The Punjab State Industrial Development Corporation Limited (PSIDC).
48. Edc Limited
49. Tamil Nadu Power Finance And Infrastructure Development Corporation Limited
50. Tamilnadu Urban Finance And Infrastructure Development Corporation Limited
51. Kerala State Power And Infrastructure Finance Corporation Limited
52. Jammu And Kashmir Development Financial Corporation Limited
53. Kerala State Industrial Development Corporation Limited
54. India Infrastructure Finance Company Limited
55. Gujarat Industrial Investment Corporation Limited.
56. Andhra Pradesh Industrial Development Corporation Limited.
57. Karnataka Urban Infrastructure Development and Finance Corporation Limited
58. L&T Infrastructure Finance Company Limited.

Appendix IV

This checklist does not form part of the Guidance Note and is only illustrative in nature. Members are expected to exercise their professional judgment while making its use.
Part-III: Guidance Notes III.829

depending upon facts and circumstances of each case and read this check list in conjunction with the Guidance Note on Companies (Auditor’s Report) Order 2016.

**An Illustrative Checklist on Companies (Auditor’s Report) Order, 2016**

*Client :*

*Audit Period :*

*Manager In-Charge:*

<table>
<thead>
<tr>
<th>Clause no.</th>
<th>Particulars</th>
<th>Remarks</th>
<th>Working Paper Reference</th>
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<tr>
<td>3(i)(a)</td>
<td>Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets; (a) Whether records of Fixed Assets (tangible, intangible and leased assets) are maintained showing the following particulars: (i) Sufficient description (distinctive numbers, purchase agreement, documents, records and registration references, etc.) of the asset to make identification possible. (ii) Classification, that is, the head under which it is shown in the accounts, e.g., plant and machinery, office equipment, etc. component-wise, as applicable (iii) Location/situation. (iv) Quantity, i.e., number of units. (v) Original cost. (vi) Year of purchase. (vii) Adjustment for revaluation or for any increase or decrease in cost, e.g., on revaluation of foreign exchange liabilities. (viii) Date of revaluation, if any. (ix) Rate and basis of depreciation, useful life, particulars regarding amortisation and impairment (x) Depreciation, amortisation and impairment for the current year.</td>
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(xi) Accumulated depreciation, amortisation and impairment loss.
(xii) Particulars regarding sale, discarding, demolition, destruction etc.
(xiii) Particulars of fixed assets that have been retired from active use and held for disposal.
(xiv) Particulars of fixed assets that have been fully depreciated or amortised or impaired.

(b) Whether aggregate original cost, depreciation or amortisation to date and impairment loss, if any, as per the register/records agrees with General Ledger balances? If not, note the disagreements in respect of each class of assets.

Conclusion:

3(i)(b) Whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

(a) (i) Whether Fixed Assets were physically verified at any time during the year or earlier years according to a phased program?
(ii) What is the periodicity of physical verification and whether the same is reasonable?
(iii) Whether assets physically verified agreed/reconciled with book figures?
If not, note the discrepancies against each class of assets in terms of value, and state how the discrepancies have been dealt with.
(iv) Instructions to officials for carrying out physical verification to include procedures, timing, competency of team members, count sheets/tags, formats etc.

(b) Physically verify few items from the fixed asset register & vice versa.
(c) Whether management representation is obtained confirming that:

♦ fixed assets are physically verified by the company in accordance with the policy of the company.
♦ periodicity of the physical verification of fixed assets.
♦ details of the material discrepancies noticed during the physical verification of the fixed assets.
♦ If no discrepancies were noted during physical verification, the same should be clearly mentioned.

Conclusion:

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

(a) Does the company have any immovable properties (land and buildings)?
Has the Company identified the land and building on the basis of Fixed Asset Register.

(b) Whether the title deeds of these immovable properties are in the name of the company?
Whether the details as per title deeds reconcile with the details in Fixed assets register, if not, is there any material difference to be reported here

(c) Has the management provided details of immovable properties not held in company's name (for example, location, description, and reasons for not being held in the company's name?)

(i) In case the title deeds are lost, assess whether the certified copies of such documents are available with the company and what actions have been taken by the management in this regard?
(ii) In case the title deeds are mortgaged with the lenders, assess if the confirmation from the lenders is obtained for the same.

(iii) The discrepancies observed should be reported in the CARO report.

3(ii) Whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account;

(a) Has the management physically verified the inventory, as defined in AS 2? Inventory normally includes-

- Raw materials and Components
- Packing materials
- Maintenance supplies
- Work in progress
- Finished Goods
- Stores and Spares
- Consumables and Loose tools

(b) Whether evidence of physical verification has been seen and reasonableness of periodicity of physical verification evaluated? If yes, verify:

- written instructions issued by the management.
- duly authenticated physical verification sheets.
- duly authenticated summary sheets/consolidation sheet
- internal memo etc. regarding issues arising on physical verification.
- any other documents evidencing physical verification.

(c) Whether the original physical verification sheets have been reviewed and selected items traced into the final inventories? (including the more valuable ones as per ABC...
classification)

(d) Whether the comparison of final inventories with stock has been done? Whether records and other corroborative evidence, e.g. inventory statements submitted to banks?

(e) In case of continuous stock taking method, whether management:
   (i) maintains adequate and up-to-date stock records;
   (ii) has established adequate procedures for physical verification of inventories, so that in the normal circumstances, the programme of physical verification will cover all material items of inventory at least once during the year; and
   (iii) check/examine thoroughly and corrects all material differences between the book records and the physical counts.

(f) Whether stock register is updated and value of inventory extracted from it tally with the books of account.

(g) If any material discrepancies were found as compared to stock records, what were the extent of discrepancies (in terms of value) and how the same have been dealt with in the books of account as well as in the stock records?

Conclusion:

3(iii)(a) Whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so, whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;

(i) Has the Company granted any loans (Secured or Unsecured) to companies, firms, limited liability partnerships or other parties covered in the register maintained under
Section 189 of the Companies Act 2013?

(ii) Where the company has granted any loans to parties covered in the register maintained under section 189 of the Act and squared off during the year, obtain details of such transactions.

(iii) Whether the terms of the above loans are prima facie prejudicial, due consideration to be given to the factors mentioned below:

♦ terms & condition of the loan repayment, rate of interest, restrictive covenants etc.,
♦ company’s financial standing, its ability to lend, and terms of its borrowings
♦ borrower’s financial standing
♦ the nature of the security,
♦ prevailing rate of interest, etc.

Conclusion:

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

(a) Whether the schedule of repayment of principal and payment of interest has been stipulated in the loan agreements / mutually agreed letter of arrangement at the time of sanction?

(b) Whether repayment of principal amount and interest thereon are received regularly on the due date or immediately thereafter?

(c) If not, the fact and details should be Obtained.

Conclusion:

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

(a) Whether list of overdue amount has been prepared & recorded and reasonable steps taken for recovery of amount of loan which is overdue more than ninety days?
(b) Following documents may be seen for verification of reasonableness of steps taken by the company for recovery of principal and accrued interest on loan granted:
   ♦ Facts of each case including amounts involved
   ♦ Issue of reminder
   ♦ Sending of advocates or solicitor’s notice
   In absence of legal steps whether auditor is satisfied that reasonable steps have been taken

(c) Obtain management’s representation regarding steps that have been taken for recovery of total amount overdue more than ninety days.

Conclusion:

3(iv) In respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.

(a) Where Companies has given loans to directors etc.:
   (i) Whether any loans given to directors or any other person in whom the director is interested, or given any guarantee or provided any security in connection with any loan taken by directors or such other person?
   (ii) Whether any of the transaction is attracting the provisions of section 185?
   (iii) Whether any of such transactions are covered under the exceptions provided under section 185? If so, obtain the relevant evidences ensuring such exemption.

(b) Where company has made loan/ investment
   (i) Obtain the details of loans and investment made by the Company including opening balances
(ii) Whether company has made investment through more than two layers of investment companies?

(iii) Whether the company has exceeded the limit of sixty per cent of its paid-up share capital, free reserves and securities premium account or one hundred per cent of its free reserves and securities premium account, whichever is more?

(iv) If so, whether prior approval by means of a special resolution passed at a general meeting has been obtained?

(v) Whether the rate of interest charges is more or at par to the rates specified in subsection (7) of section 186 of the Act, if not, the reasons thereof.

Conclusion:

3(v) In case, the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act, 2013 and the rules framed thereunder, where applicable, have been complied with? If not, the nature of such contraventions be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other tribunal, whether the same has been complied with or not?

(a) If the Company has accepted deposits from the public state whether:

(i) The directives issued by the Reserve Bank of India have been complied with and also that:

(ii) The provisions of Section 73 to 76 of the Companies Act, 2013 and the rules framed there under have been complied with.

(iii) List out contraventions, if any.

(b) Where an order has been passed by the CLB or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal in respect of above, examine the steps taken by the company to comply with
the order, and if not, report briefly stating there in the nature of contravention and the fact that Company has not complied with the order.

Conclusion:

3(vi) 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.

(a) Whether cost accounting records have been prescribed for the company under section 148(1) of the Companies Act, 2013? If so verify whether proper cost accounts and records are made and maintained by the Company as specified.

Conclusion:

3(vii)(a) Whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on 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;

(a) Whether a list of statutory dues which company is required to deposit regularly has been obtained.

(b) In case where there are no arrears on the balance sheet date but the company has been irregular during the year in depositing the statutory dues, the fact should be stated.

(c) Whether the Company has been generally regular in depositing statutory dues or otherwise, indicate the same.

Note: A matter is disputed where there is a positive evidence or action on the part of the company to show that it has not accepted the demand for payment of tax or duty, e.g., where it has gone into appeal.
(d) Whether penalty and/or interest levied under the respective law is included under amounts payable.

(e) Ensure that disclosure is restricted to the actual arrears and should not include the amounts which have not fallen due for deposit and have been shown as arrears at the balance sheet date.

(f) Whether the information about arrears of outstanding statutory dues is provided in the format:
   - Name of the Statute
   - Nature of the dues
   - Amount (Rs.)
   - Period to which amount relates
   - Due date
   - Date of Payment

(g) Whether a written representation with reference to the date of the balance sheet from the management obtained:
   - specifying the cases and the amounts considered disputed;
   - containing a list of the cases and the amounts in respect of the statutory dues which are undisputed and have remained outstanding for a period of more than six months from the date they became payable;
   - containing a statement as to the completeness of the information provided by the management.

(h) Whether any register of significant laws with which the entity has to comply within its particular industry and a record of complaints in respect of non-compliance been maintained

Conclusion:

3(vii)(b) Where 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. (A mere representation to the concerned department shall not be treated as a dispute.)

(a) Review internal audit report, minutes of the meeting of the board of Directors and audit committee

(b) Ensure that information about arrears of disputed statutory dues is provided in the format:

- Name of the Statute
- Nature of the dues
- Amount (Rs.)
- Period to which amount relates
- Forum where dispute is pending

Conclusion:

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

(a) Whether all defaults existing at the balance sheet date are reported irrespective of when those defaults have occurred.

(b) In case of defaults to banks, financial institutions, and government, whether lender wise details reported?

(c) If application of reschedulement of loan has been made/accepted or default has been made good during the accounting period, whether the fact has been stated.

(d) Whether the disputes between the company and the lender on various issues give rise to disclaimer stating the fact there is a dispute between the company and the lender and auditor is unable to determine whether there is a default in repayment of dues to the lender concerned.
Conclusion:

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

(a) Whether the company raised money by way of initial public offer or further public offer of equity shares, convertible securities and debt securities?

(b) Examine the terms and conditions stated in the offer document subject to which the company has raised the above mentioned money.

(c) Whether the end use of the money raised (as mentioned above) is capable of being determined? If not state the fact.

(d) Whether the said end-use of money disclosed in the financial statements by way of a Note is significantly different from the actual end use? If so, state the fact.

(e) Examine the various documents submitted to SEBI, offer document and also examine the report of board of directors, if available, to find out whether funds raised have been utilized for the purpose for which they were raised.

(f) Whether a representation of the management has been obtained as to the completeness of the disclosures with regard to the end-use of moneys raised by initial public offer and further public offer?

(g) Whether the fund flow statement has been reviewed where one to one correlation is not possible.

(h) Whether the company has taken any term loan?

(i) Examine the terms and conditions subject to which the company has obtained the term
loans including purpose for which term loans were sanctioned?

(j) Compare the purpose for which term loans were sanctioned with the actual utilisation of the loans and obtain sufficient appropriate audit evidence regarding the utilisation of the amounts raised.

(k) In case during a construction phase surplus funds were temporarily invested, however, subsequently the same are utilised for the stated objectives, mention the fact that the funds were temporarily used for the purpose other than for which the loan was sanctioned but were ultimately utilised for the stated end-use.

(l) Whether term loans taken were not applied for stated purpose during the year for any reason? If yes, mention the facts and amount. Also disclose the fact about utilization of term loan of earlier year in current year.

(m) Whether the fund flow statement has been reviewed where one to one correlation was not possible.

Conclusion:

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

(a) Has SA 240 been complied with? (Attach the check list for compliance of SA 240 with this check list also).

(b) Examine the following to ascertain whether any fraud has been reported or noticed by the management?
   ♦ the reports of the internal Audit
   ♦ the auditor should enquire from the management about any frauds by the company or any fraud on the company by
III.842 Auditing Pronouncements

its officers or employees, that it has noticed or that have been reported to it.
♦ discuss the matter with other employees including officers of the company.
♦ examine the minutes book of the board meeting, audit committee etc., of the company in this regard.

(c) Where any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported, determine the nature and amount of frauds and disclose the same. Obtain management representation to this effect.

(d) Whether any fraud has been reported by the auditor during the year under section 143(12)? If so, determine whether that same would be reported under this clause?

Conclusion:

3 (xi) whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same;

(a) Has the company paid or provided for any managerial remuneration?

(b) Obtain from management the details of managerial remuneration paid/ provided by the Company

Ensure that the computation of managerial remuneration is done in accordance with the provisions of section 197 read with Schedule V of Companies Act, 2013 The remuneration does not include :
♦ Sitting Fees (within prescribed limits) (sub section 2 and 5 of Section 197)
♦ Remuneration for professional services rendered (Sub section 4 of Section 197)

(c) Obtain a general understanding of Section 197 read with Schedule V to the Act. Ascertain the
system and procedures of the company to ensure compliance with the provisions of section 197 and Schedule V

(d) Based on the understanding so gained, perform a reasonable test check of compliance with the aforesaid requirements of the Act.

(e) Examine the steps taken by the company to comply with requirements of the Act with respect to managerial remuneration. Examine the correspondence and documents filed with the Registrar of Companies, Company Law Board, legal correspondence for orders passed, minutes of the meetings of the Board and shareholders.

(f) Examine whether the Company has obtained requisite approvals mandated by section 197 read with Schedule V to the Act.

(g) Obtain a listing of managerial remuneration rejected/partially approved. Examine the same with underlying documents and obtain understanding of the steps taken by the Company for refund of unapproved managerial remuneration for reporting along with the amount involved. Assess if the management has waived recovery of the excess amount paid over and above the prescribed limit.

(h) Consider the implications of non-compliances above also in the auditors' opinion on the financial statements.

In case of non-compliance, the amount involved would be the total amount involved which is in excess of the limit prescribed even though during the year the company may have recovered or partially recovered such amount. Obtain, examine and record the steps taken to secure the refund also

3(xii) Whether the Nidhi Company has complied with the Net Owned Funds to
Deposits in the ratio of 1:20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

(a) Is the Company a nidhi company?
Assess if the Company is registered as a Nidhi Company as per provisions of Section 406 of the Companies Act 2013 or Section 620A of the Companies Act, 1956.

(b) To check compliance with the following:
   a) Whether the net owned funds to deposits ratio is more than 1:20 to meet out the liability as on the date of balance sheet?
   b) Examine whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability

Whether the calculation of net owned funds is done as per Rule 3(d) which includes equity share capital, and free reserves as reduced by accumulated losses and intangible assets appearing in the last audited balance sheet:
Assess if the proceeds of issue of preference shares have been included in the net owned funds.
Ensure that ratio is computed by using the figures of net owned funds and deposit liability computed in accordance with as stated under this clause.

Conclusion:

3 (xiii) 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;

(a) Obtain a statement containing details of transactions with related parties
Obtain a list of companies, firms or other parties, the particulars of which are required to be entered in the register maintained under
section 189 of the Act.
Obtain declarations made by the directors in Form MBP-1 i.e., general notice received from a director under Rule 9(1) of The Companies (Meetings of Board and Power) Rules, 2014
Verify the entries made in the register under section 189 with such statement from management and declarations received from directors.
Assess the additions/ deletions to such list for appropriateness based on relevant declarations

(b) Obtain understanding of requirements of section 177 and 188 of the Act in relation to related party transactions

(c) Perform reasonable check to ascertain completeness and accuracy of details in the statement.

(d) Ascertain the system and procedures of the company to ensure compliance with the provisions of section 177 and 188 of the Act Including the assessment of identification of related parties and whether the transaction is at arm’s length and basis of such conclusion.

(e) Based on the understanding so gained, perform a reasonable test check of compliance with the aforesaid requirements of the Act.

(f) Examine minutes of meetings of the audit committee and agreements underlying related party transactions to ascertain audit committee approval for the transactions.

(g) Examine the minutes of Board meetings to ascertain whether requisite approvals of Board is obtained for certain related party transactions as required under section 188 of the Act.
(h) Where shareholders' approval is required, check whether the requisite approvals have been obtained as required under Section 188 of the Act.

(i) Examine whether related party disclosures are made in the financial statements as per the requirements of Accounting Standard 18.

(j) Examine whether disclosure related to contracts or arrangements with related parties as mandated by section 188 are made in Board's report. Including the assessment of identification of related parties and whether the transaction is at arm's length and basis of such conclusion.

(k) Consider the implications of non-compliances above also in the auditors' opinion on the financial statements.

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

(a) Has the Company made any preferential allotment or private placement of shares or fully convertible debentures during the year.

(b) Obtain a statement containing the specific terms of offer for private placement, including purpose for which funds were raised, and the details of subsequent application-amounts, dates and the purpose.

(c) Ascertain whether the offer and allotment of securities referred in 1 above are in compliance with the requirements mandated by section 42 of the Act.

(d) Based on the understanding so gained, perform a reasonable test check of
(e) Consider the implications of non-compliances above also in the auditors' report on the financial statements.

Note: Reporting under this Clause is required also in instances where the amounts have been raised in earlier year(s) and is being utilized under the year under review.

3 (xv) **Whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with;**

(a) Obtain a statement containing list of directors of the company, its holding company, subsidiary and associate companies and persons connected with the directors

(b) Scrutinise the following books of account, records and documents could provide source of such audit evidence to the auditor as to the existence of such non-cash transactions as well as persons connected with the Directors:

(i) Form No. MBP 1, Notice of Interest by Director, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014

(ii) Form No. MBP 2, Register of Loans, Guarantee, Security and Acquisition Made by the Company, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014

(iii) Form No. MBP 4, Register of Contracts with Related Party and Contracts and Bodies etc. in which Directors are Interested, filed pursuant to the Companies (Meetings of Board and Its Powers) Rules, 2014

(iv) Movements in the Fixed Asset Register

(v) Minutes book of the General Meeting
and Meetings of Directors
(vi) Report on Annual General Meeting pursuant to Companies (Management and Administration) Rules, 2014
Minutes of meetings of Board of Directors and Audit committee
(c) Obtain a statement from management containing transactions between the Company and director(s) referred to above
(d) Perform reasonable check to ascertain non-cash transactions
(e) Obtain understanding of requirements of section 192 of the Act.
(f) Based on the understanding so gained, perform a reasonable test check of compliance with the aforesaid requirements of the Act.
(g) Consider the implications of non-compliances above also in the auditors’ opinion on the financial statements.

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

(a) Examine the financial statements of the Company and assess whether the company has financial assets and financial income
Note: According to the RBI press release 1998-99/1269 dated 08.04.1999, a company will be treated as NBFC if its financial assets are more than 50% of its total assets (netted off by intangible assets) and income from financial assets should be more than 50% of its gross income.
(b) Check whether the company has financing activity as a principal business of the Company.
(c) Obtain understanding of the requirements of section 45-IA of RBI Act, 1934 with regard to
registration of the company with RBI

(d) Examine whether the Company is carrying out NBFC activity / Core investment company.

(e) Examine the steps taken by the company to comply with requirements of the RBI Act, 1934 with respect to registration as a NBFC. Also examine the correspondence and documents filed with the RBI, minutes of the Board meeting.

(f) Examine whether the Company has obtained Certificate of Registration from RBI in terms of section 45-IA of the RBI Act, 1934.

(g) Consider the implications of non-compliances above also in the auditors’ opinion on the financial statements.

Discussed with………………
Designation………………
Date……………………

Appendix V

Text of Sections 185 and 186 of the Companies Act, 2013 and Relevant Extract of the Rules

Text of Section 185 of the Companies Act, 2013

(1) Save as otherwise provided in this Act, no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person:

Provided that nothing contained in this sub-section shall apply to—

15 MCA vide its Notification No. GSR 464(E) dated 5-6-2015 provides that in case of private companies section 185 shall not apply to a private company –

(a) in whose share capital no other body corporate has invested any money;
(b) if the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and
(c) such a company has no default in repayment of such borrowings subsisting at the time of making transactions under this section.

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III.850 Auditing Pronouncements

(a) the giving of any loan to a managing or whole-time director—
   (i) as a part of the conditions of service extended by the company to all its
       employees; or
   (ii) pursuant to any scheme approved by the members by a special
        resolution; or

(b) a company which in the ordinary course of its business provides loans or
gives guarantees or securities for the due repayment of any loan and in
respect of such loans and interest is charged at a rate not less than the bank
rate declared by the Reserve Bank of India; or

(c) any loan made by a holding company to its wholly owned subsidiary company
or any guarantee given or security provided by a holding company in respect
of any loan made to its wholly owned subsidiary company; or

(d) any guarantee given or security provided by a holding company in respect of
loan made by any bank or financial institution to its subsidiary company:

   Provided that the loans made under clauses (c) and (d) are utilised by the
subsidiary company for its principal business activities.

Explanation.—For the purposes of this section, the expression “to any other person
in whom director is interested” means—

(a) any director of the lending company, or of a company which is its holding
company or any partner or relative of any such director;

(b) any firm in which any such director or relative is a partner;

(c) any private company of which any such director is a director or member;

(d) any body corporate at a general meeting of which not less than twenty five
per cent. of the total voting power may be exercised or controlled by any such
director, or by two or more such directors, together; or

(e) any body corporate, the Board of directors, managing director or manager,
whereof is accustomed to act in accordance with the directions or instructions
of the Board, or of any director or directors, of the lending company.

(2) If any loan is advanced or a guarantee or security is given or provided in
contravention of the provisions of sub-section (1), the company shall be punishable
with fine which shall not be less than five lakh rupees but which may extend to
twenty-five lakh rupees, and the director or the other person to whom any loan is
advanced or guarantee or security is given or provided in connection with any loan
taken by him or the other person, shall be punishable with imprisonment which may
extend to six months or with fine which shall not be less than five lakh rupees but
which may extend to twenty-five lakh rupees, or with both.
Text of Section 186 of the Companies Act, 2013 and Relevant Extract of the Rules

(1) Without prejudice to the provisions contained in this Act, a company shall unless otherwise prescribed, make investment through not more than two layers of investment companies:

Provided that the provisions of this sub-section shall not affect,—

(i) a company from acquiring any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country;

(ii) a subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

(2) No company shall directly or indirectly —

(a) give any loan to any person or other body corporate;

(b) give any guarantee or provide security in connection with a loan to any other body corporate or person; and

(c) acquire by way of subscription, purchase or otherwise, the securities of any other body corporate, exceeding sixty per cent. of its paid-up share capital, free reserves and securities premium account or one hundred per cent. of its free reserves and securities premium account, whichever is more.

(3) Where the giving of any loan or guarantee or providing any security or the acquisition under sub-section (2) exceeds the limits specified in that sub-section, prior approval by means of a special resolution passed at a general meeting shall be necessary.

(4) The company shall disclose to the members in the financial statement the full particulars of the loans given, investment made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security.

(5) No investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained:

Provided that prior approval of a public financial institution shall not be required where the aggregate of the loans and investments so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate, along
with the investments, loans, guarantee or security proposed to be made or given does not exceed the limit as specified in sub-section (2), and there is no default in repayment of loan instalments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution.

(6) No company, which is registered under section 12 of the Securities and Exchange Board of India Act, 1992 and covered under such class or classes of companies as may be prescribed, shall take inter-corporate loan or deposits exceeding the prescribed limit and such company shall furnish in its financial statement the details of the loan or deposits.

(7) No loan shall be given under this section at a rate of interest lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

(8) No company which is in default in the repayment of any deposits accepted before or after the commencement of this Act or in payment of interest thereon, shall give any loan or give any guarantee or provide any security or make an acquisition till such default is subsisting.

(9) Every company giving loan or giving a guarantee or providing security or making an acquisition under this section shall keep a register which shall contain such particulars and shall be maintained in such manner as may be prescribed.

(10) The register referred to in sub-section (9) shall be kept at the registered office of the company and —

(a) shall be open to inspection at such office; and

(b) extracts may be taken therefrom by any member, and copies thereof may be furnished to any member of the company on payment of such fees as may be prescribed.

(11) Nothing contained in this section, except sub-section (1), shall apply—

(a) to a loan made, guarantee given or security provided by a banking company or an insurance company or a housing finance company in the ordinary course of its business or a company engaged in the business of financing of companies or of providing infrastructural facilities;

(b) to any acquisition—

(i) made by a non-banking financial company registered under Chapter IIIB of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities:

Provided that exemption to non-banking financial company shall be in respect of its investment and lending activities;

(ii) made by a company whose principal business is the acquisition of
securities; of shares allotted in pursuance of clause (a) of sub-section (1) of section 62.

(iii) made by a banking company or an insurance company or a housing finance company, making acquisition of securities in the ordinary course of its business.

(12) The Central Government may make rules for the purposes of this section.

(13) If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

Explanation.—For the purposes of this section,—

(a) the expression “investment company” means a company whose principal business is the acquisition of shares, debentures or other securities;

(b) the expression “infrastructure facilities” means the facilities specified in Schedule VI.

Rules 11, 12 and 13 of the Companies (Meeting of Board and its Powers) Rules, 2014

Rule 11. Loan and investment by a company under section 186 of the Act.-

(1) Where a loan or guarantee is given or where a security has been provided by a company to its wholly owned subsidiary company or a joint venture company, or acquisition is made by a holding company, by way of subscription, purchase or otherwise of, the securities of its wholly owned subsidiary company, the requirement of sub-section (3) of section 186 shall not apply.

Provided that the company shall disclose the details of such loans or guarantee or security or acquisition in the financial statement as provided under sub-section (4) of section 186.

(2) For the purposes of clause (a) of sub-section (11) of section 186, the expression “business of financing of companies” shall include, with regard to a Non-Banking Financial Company registered with the Reserve Bank of India, “business of giving of any loan to a person or providing any guaranty or security for due repayment of any loan availed by any person in the ordinary course of its business”.

(3) No company registered under section 12 of the Securities and Exchange Board of India Act, 1992 and also covered under such class or classes of companies which may be notified by the Central Government in consultation with the Securities and
Exchange Board, shall take any inter-corporate loan or deposits, in excess of the limits specified under the regulations applicable to such company, pursuant to which it has obtained certificate of registration from the Securities and Exchange Board of India.

Rule 12. Register.-

(1) Every company giving loan or giving guarantee or providing security or making an acquisition of securities shall, from the date of its incorporation, maintain a register in Form MBP 2 and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made as aforesaid.

(2) The entries in the register shall be made chronologically in respect of each such transaction within seven days of making such loan or giving guarantee or providing security or making acquisition.

(3) The register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.

(4) The entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

(5) For the purpose of sub-rule (4), the register can be maintained either manually or in electronic mode.

(6) The extracts from the register maintained under sub-section (9) of section 186 may be furnished to any member of the company on payment of such fee as may be prescribed in the Articles of the company which shall not exceed ten rupees for each page.

Rule 13. Special Resolution.-

(1) Where the aggregate of the loans and investment so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate along with the investment, loan, guarantee or security proposed to be made or given by the Board, exceed the limits specified under section 186, no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorised by a special resolution passed in a general meeting.

Explanation.-For the purpose of this sub-rule, it is clarified that it would sufficient compliance if such special resolution is passed within one year from the date of notification of this section.

(2) A resolution passed at a general meeting in terms of sub-section (3) of section 186 to give any loan or guarantee or investment or providing any security or the
Part-III: Guidance Notes  III.855

acquisition under sub section (2) of section 186 shall specify the total amount up to
which the Board of Directors are authorised to give such loan or guarantee, to
provide such security or make such acquisition:

Provided, that the company shall disclose to the members in the financial statement
the full particulars in accordance with the provision of sub-section (4) of section 186.

Clarification with regard to section 185 and 186 of the Companies Act 2013 - loans
and advances to employees-

Ministry of Corporate Affairs vide General Circular No, 04/2015 dated 10th March, 2015
has clarified that loans and/or advances made by the companies to their employees, other
than the managing or whole time directors (which is governed by section 185) are not
governed by the requirements of section 186 of the Companies Act, 2013. This clarification
will, however, be applicable if such loans/advances to employees are in accordance with
the conditions of service applicable to employees and are also in accordance with the
remuneration policy, in cases where such policy is required to be formulated.

Appendix VI

Text of the Companies (Cost Records and Audit) Rules, 2014

1. Short title and commencement.- (1) These rules may be called the Companies
   (Cost Records and Audit) Rules, 2014.
   (2) They shall come into force on the date of publication in the Official Gazette.

2. Definitions: In these rules, unless the context otherwise requires –
   (a) “Act” means the Companies Act, 2013 (18 of 2013);
   (aa) “Central Excise Tariff Act Heading” means the heading as referred to in the
   additional notes in the first schedule to the Central Excise Tariff Act,1985;
   (b) “Cost Accountant in practice” means a cost accountant as defined in clause (b) of
   sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of
   1959), who holds a valid certificate of practice under sub-section (1) of section 6 of
   that Act and who is deemed to be in practice under sub-section (2) of section 2
   thereof, and includes a firm or limited liability partnership of cost accountants;
   (c) “cost auditor” means a Cost Accountant in practice, as defined in clause (b), who is
   appointed by the Board;
   (d) “cost audit report” means the report duly audited and signed by the cost auditor
   including attachment, annexure, qualifications or observations etc. to cost audit
   report;
(e) “cost records” means books of account relating to utilisation of materials, labour and other items of cost as applicable to the production of goods or provision of services as provided in section 148 of the Act and these rules;

(f) “form” means a form annexed to these rules;

(g) “institute” means the Institute of Cost Accountants of India constituted under the Cost and Works Accountants Act, 1959 (23 of 1959);

(h) all other words and expressions used in these rules but not defined, and defined in the Act or in the Companies (Specification of Definition Details) Rules, 2014 shall have the same meanings as assigned to them in the Act or in the said rules.

3. Application of cost records.—For the purposes of subsection (1) of section 148 of the Act, the class of companies, including Foreign Companies defined clause (42) of section 2 of the Act, engaged in the production of the goods or providing services, specified in the table below, having an overall turnover from all its products and services of rupees thirty five crore or more during the immediately preceding financial year, shall include cost records for such products or services in their books of account, namely:—

Note - Readers may refer the table as given in the Rules for further details.

4. Applicability for cost audit.—

(1) Every company specified in item (A) of the rule of rule 3 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees fifty crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees twenty five crore or more.

(2) Every company specified in item (B) of rule 3, shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees one hundred crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees thirty five crore or more.

(3) The requirement for cost audit under these rules shall not apply to a company which is covered in rule 3 and—

(i) whose revenue from exports, in foreign exchange, exceeds, seventy five percent of its total revenue; or

(ii) which is operating from a special economic zone.

5. Maintenance of records.—
(1) Every company under these rules including all units and branches thereof, shall, in respect of each of its financial year commencing on or after the 1st day of April, 2014, maintain cost records in form CRA-1.

Provided that in case of company covered in serial numbers 12 and serial numbers 24 to 32 of item (B) of rule 3, the requirement under this rule shall apply in respect of each of its financial year commencing on or after 1st day of April, 2015.

(2) The cost records referred to in sub-rule (1) shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

(3) The cost records shall be maintained in such manner so as to enable the company to exercise, as far as possible, control over the various operations and costs to achieve optimum economies in utilization of resources and these records shall also provide necessary data which is required to be furnished under these rules.

6. Cost audit.-

(1) The category of companies specified in rule 3 and the thresholds limits laid down in rule 4, shall within one hundred and eighty days of the commencement of every financial year, appoint a cost auditor.

(2) Every company referred to in sub-rule (1) shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

(3) Every cost auditor appointed as such shall continue in such capacity till the expiry of one hundred and eighty days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

(3A) Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Director within thirty days of occurrence of such vacancy and the company shall inform the central government in Form CRA-2 within thirty days of such appointment of cost auditor;

(4) Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in form CRA-3.
(5) Every cost auditor shall forward his report to the Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report particularly any reservation or qualification contained therein.

(6) Every company covered under these rules shall, within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in form CRA-4 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

(7) The provisions of sub-section (12) of section 143 of the Act and the relevant rules made thereunder shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules.

Appendix VII

Text of Section 197 of Companies Act, 2013 and Relevant Extract of the Rules and Schedule V

197. (1) The total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed eleven per cent of the net profits of that company for that financial year computed in the manner laid down in section 198 except that the remuneration of the directors shall not be deducted from the gross profits:

Provided that the company in general meeting may, with the approval of the Central Government, authorise the payment of remuneration exceeding eleven per cent of the net profits of the company, subject to the provisions of Schedule V:

Provided further that, except with the approval of the company in general meeting,—

(i) the remuneration payable to any one managing director; or whole-time director or manager shall not exceed five per cent of the net profits of the company and if there is more than one such director remuneration shall not exceed ten per cent of the net profits to all such directors and manager taken together;

(ii) the remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed,—
(A) one per cent of the net profits of the company, if there is a managing or whole-time director or manager;

(B) three per cent of the net profits in any other case.

(2) The percentages aforesaid shall be exclusive of any fees payable to directors under sub-section (5).

(3) Notwithstanding anything contained in sub-sections (1) and (2), but subject to the provisions of Schedule V, if, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including any managing or whole time director or manager, by way of remuneration any sum exclusive of any fees payable to directors under sub-section (5) hereunder except in accordance with the provisions of Schedule V and if it is not able to comply with such provisions, with the previous approval of the Central Government.

(4) The remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of this section, either by the articles of the company, or by a resolution or, if the articles so require, by a special resolution, passed by the company in general meeting and the remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity:

Provided that any remuneration for services rendered by any such director in other capacity shall not be so included if—

(a) the services rendered are of a professional nature; and

(b) in the opinion of the Nomination and Remuneration Committee, if the company is covered under sub-section (1) of section 178, or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

(5) A director may receive remuneration by way of fee for attending meetings of the Board or Committee thereof or for any other purpose whatsoever as may be decided by the Board:

Provided that the amount of such fees shall not exceed the amount as may be prescribed:

Provided further that different fees for different classes of companies and fees in respect of independent director may be such as may be prescribed.
(6) A director or manager may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other.

(7) Notwithstanding anything contained in any other provision of this Act but subject to the provisions of this section, an independent director shall not be entitled to any stock option and may receive remuneration by way of fees provided under sub-section (5), reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.

(8) The net profits for the purposes of this section shall be computed in the manner referred to in section 198.

(9) If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed by this section or without the prior sanction of the Central Government, where it is required, he shall refund such sums to the company and until such sum is refunded, hold it in trust for the company.

(10) The company shall not waive the recovery of any sum refundable to it under sub-section (9) unless permitted by the Central Government.

(11) In cases where Schedule V is applicable on grounds of no profits or inadequate profits, any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, whether the provision be contained in the company’s memorandum or articles, or in an agreement entered into by it, or in any resolution passed by the company in general meeting or its Board, shall not have any effect unless such increase is in accordance with the conditions specified in that Schedule and if such conditions are not being complied, the approval of the Central Government had been obtained.

(12) Every listed company shall disclose in the Board’s report, the ratio of the remuneration of each director to the median employee’s remuneration and such other details as may be prescribed.

(13) Where any insurance is taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel:

Provided that if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration.
(14) Subject to the provisions of this section, any director who is in receipt of any commission from the company and who is a managing or whole-time director of the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board’s report.

(15) If any person contravenes the provisions of this section, he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

**Rule 4 and 5 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.**

Rule 4. Sitting fees.- A company may pay a sitting fee to a director for attending meetings of the Board or committees thereof, such sum as may be decided by the Board of directors thereof which shall not exceed one lakh rupees per meeting of the Board or committee thereof:

Provided that for Independent Directors and Women Directors, the sitting fee shall not be less than the sitting fee payable to other directors.

Rule 5. Disclosure in Board’s report.- (1) Every listed company shall disclose in the Board’s report-

(i) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year;

(ii) the percentage increase in remuneration of each director, Chief Financial Officer, Chief Executive Officer, Company Secretary or Manager, if any, in the financial year;

(iii) the percentage increase in the median remuneration of employees in the financial year;

(iv) the number of permanent employees on the rolls of company;

(v) the explanation on the relationship between average increase in remuneration and company performance;

(vi) comparison of the remuneration of the Key Managerial Personnel against the performance of the company;

(vii) variations in the market capitalisation of the company, price earnings ratio as at the closing date of the current financial year and previous financial year and percentage increase over decrease in the market quotations of the shares of the company in comparison to the rate at which the company came out with the last public offer in
case of listed companies, and in case of unlisted companies, the variations in the net worth of the company as at the close of the current financial year and previous financial year;

(viii) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;

(ix) comparison of the each remuneration of the Key Managerial Personnel against the performance of the company;

(x) the key parameters for any variable component of remuneration availed by the directors;

(xi) the ratio of the remuneration of the highest paid director to that of the employees who are not directors but receive remuneration in excess of the highest paid director during the year; and

(xii) affirmation that the remuneration is as per the remuneration policy of the company.

Explanation.- For the purposes of this rule, (i) the expression “median” means the numerical value separating the higher half of a population from the lower half and the median of a finite list of numbers may be found by arranging all the observations from lowest value to highest value and picking the middle one;

(ii) if there is an even number of observations, the median shall be the average of the two middle values.

(2) The Board’s report shall include a statement showing the name of every employee of the company, who-

(i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than sixty lakh rupees;

(ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than five lakh rupees per month;

(iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.
(3) The statement referred to in sub-rule (2) shall also indicate -

(i) designation of the employee;

(ii) remuneration received;

(iii) nature of employment, whether contractual or otherwise;

(iv) qualifications and experience of the employee;

(v) date of commencement of employment;

(vi) the age of such employee;

(vii) the last employment held by such employee before joining the company;

(viii) the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of sub-rule (2) above; and

(ix) whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager:

Provided that the particulars of employees posted and working in a country outside India, not being directors or their relatives, drawing more than sixty lakh rupees per financial year or five lakh rupees per month, as the case may be, as may be decided by the Board, shall not be circulated to the members in the Board’s report, but such particulars shall be filed with the Registrar of Companies while filing the financial statement and Board Reports:

Provided further that such particulars shall be made available to any shareholder on a specific request made by him in writing before the date of such Annual General Meeting wherein financial statements for the relevant financial year are proposed to be adopted by shareholders and such particulars shall be made available by the company within three days from the date of receipt of such request from shareholders:

Provided also that, in case of request received even after the date of completion of Annual General Meeting, such particulars shall be made available to the shareholders, within seven days from the date of receipt of such request.

Schedule V

PART II - REMUNERATION

Section I.— Remuneration payable by companies having profits:
Subject to the provisions of section 197, a company having profits in a financial year may pay remuneration to a managerial person or persons not exceeding the limits specified in such section.

Section II.— Remuneration payable by companies having no profit or inadequate profit without Central Government approval:

Where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may, without Central Government approval, pay remuneration to the managerial person not exceeding the higher of the limits under (A) and (B) given below:

\[(A):\]

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<tbody>
<tr>
<td>Where the effective capital is</td>
<td>Limit of yearly remuneration payable shall not exceed (Rupees)</td>
</tr>
<tr>
<td>(i) Negative or less than 5 crores</td>
<td>30 lakhs</td>
</tr>
<tr>
<td>(ii) 5 crores and above but less than 100 crores</td>
<td>42 lakhs</td>
</tr>
<tr>
<td>(iii) 100 crores and above but less than 250 crores</td>
<td>60 lakhs</td>
</tr>
<tr>
<td>(iv) 250 crores and above</td>
<td>60 lakhs plus 0.01% of the effective capital in excess of Rs. 250 crores:</td>
</tr>
</tbody>
</table>

Provided that the above limits shall be doubled if the resolution passed by the shareholders is a special resolution.

Explanation.—It is hereby clarified that for a period less than one year, the limits shall be pro-rated.

\[(B):\] In the case of a managerial person who was not a security holder holding securities of the company of nominal value of rupees five lakh or more or an employee or a director of the company or not related to any director or promoter at any time during the two years prior to his appointment as a managerial person, — 2.5% of the current relevant profit:

Provided that if the resolution passed by the shareholders is a special resolution, this limit shall be doubled:
Provided further that the limits specified under this section shall apply, if—

(i) payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under sub-section (1) of section 178 also by the Nomination and Remuneration Committee;

(ii) the company has not made any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in the preceding financial year before the date of appointment of such managerial person;

(iii) a special resolution has been passed at the general meeting of the company for payment of remuneration for a period not exceeding three years;

(iv) a statement along with a notice calling the general meeting referred to in clause (iii) is given to the shareholders containing the following information, namely:—

I. General Information:
   (1) Nature of industry
   (2) Date or expected date of commencement of commercial production
   (3) In case of new companies, expected date of commencement of activities as per project approved by financial institutions appearing in the prospectus
   (4) Financial performance based on given indicators
   (5) Foreign investments or collaborations, if any.

II. Information about the appointee:
   (1) Background details
   (2) Past remuneration
   (3) Recognition or awards
   (4) Job profile and his suitability
   (5) Remuneration proposed
   (6) Comparative remuneration profile with respect to industry, size of the company, profile of the position and person (in case of expatriates the relevant details would be with respect to the country of his origin)
III.866 Auditing Pronouncements

(7) Pecuniary relationship directly or indirectly with the company, or relationship with the managerial personnel, if any.

III. Other information:

(1) Reasons of loss or inadequate profits
(2) Steps taken or proposed to be taken for improvement
(3) Expected increase in productivity and profits in measurable terms.

IV. Disclosures:

The following disclosures shall be mentioned in the Board of Director’s report under the heading “Corporate Governance”, if any, attached to the financial statement:—

(i) all elements of remuneration package such as salary, benefits, bonuses, stock options, pension, etc., of all the directors;
(ii) details of fixed component and performance linked incentives along with the performance criteria;
(iii) service contracts, notice period, severance fees;
(iv) stock option details, if any, and whether the same has been issued at a discount as well as the period over which accrued and over which exercisable.

Section III.— Remuneration payable by companies having no profit or inadequate profit without Central Government approval in certain special circumstances:

In the following circumstances a company may, without the Central Government approval, pay remuneration to a managerial person in excess of the amounts provided in Section II above:—

(a) where the remuneration in excess of the limits specified in Section I or II is paid by any other company and that other company is either a foreign company or has got the approval of its shareholders in general meeting to make such payment, and treats this amount as managerial remuneration for the purpose of section 197 and the total managerial remuneration payable by such other company to its managerial persons including such amount or amounts is within permissible limits under section 197.

(b) where the company—

(i) is a newly incorporated company, for a period of seven years from the date of its incorporation, or

(ii) is a sick company, for whom a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction or National Company Law
Tribunal, for a period of five years from the date of sanction of scheme of revival, it may pay remuneration up to two times the amount permissible under Section II.

(c) where remuneration of a managerial person exceeds the limits in Section II but the remuneration has been fixed by the Board for Industrial and Financial Reconstruction or the National Company Law Tribunal:

Provided that the limits under this Section shall be applicable subject to meeting all the conditions specified under Section II and the following additional conditions:—

(i) except as provided in para (a) of this Section, the managerial person is not receiving remuneration from any other company;

(ii) the auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice, certifies that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person as well as the quantum of remuneration and such certificate is filed along with the return as prescribed under sub-section (4) of section 196.

(iii) the auditor or Company Secretary or where the company has not appointed a secretary, a secretary in whole-time practice certifies that there is no default on payments to any creditors, and all dues to deposit holders are being settled on time.

(d) a company in a Special Economic Zone as notified by Department of Commerce from time to time which has not raised any money by public issue of shares or debentures in India, and has not made any default in India in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in any financial year, may pay remuneration up to Rs. 2,40,00,000 per annum.

Section IV.— Perquisites not included in managerial remuneration:

1. A managerial person shall be eligible for the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II and Section III:—

(a) contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income-tax Act, 1961(43 of 1961);

(b) gratuity payable at a rate not exceeding half a month’s salary for each completed year of service; and

(c) encashment of leave at the end of the tenure.
2. In addition to the perquisites specified in paragraph 1 of this section, an expatriate managerial person (including a non-resident Indian) shall be eligible to the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II or Section III—

(a) *Children’s education allowance:* In case of children studying in or outside India, an allowance limited to a maximum of Rs. 12,000 per month per child or actual expenses incurred, whichever is less. Such allowance is admissible up to a maximum of two children.

(b) *Holiday passage for children studying outside India or family staying abroad:* Return holiday passage once in a year by economy class or once in two years by first class to children and to the members of the family from the place of their study or stay abroad to India if they are not residing in India, with the managerial person.

(c) *Leave travel concession:* Return passage for self and family in accordance with the rules specified by the company where it is proposed that the leave be spent in home country instead of anywhere in India.

*Explanation I.*— For the purposes of Section II of this Part, “effective capital” means the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after one year (excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in case of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities), accumulated losses and preliminary expenses not written off.

*Explanation II.*— (a) Where the appointment of the managerial person is made in the year in which company has been incorporated, the effective capital shall be calculated as on the date of such appointment;

(b) In any other case the effective capital shall be calculated as on the last date of the financial year preceding the financial year in which the appointment of the managerial person is made.

*Explanation III.*— For the purposes of this Schedule, “family” means the spouse, dependent children and dependent parents of the managerial person.

*Explanation IV.*— The Nomination and Remuneration Committee while approving the remuneration under Section II or Section III, shall—
(a) take into account, financial position of the company, trend in the industry, appointee’s qualification, experience, past performance, past remuneration, etc.;

(b) be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and the shareholders.

Explanation V.— For the purposes of this Schedule, “negative effective capital” means the effective capital which is calculated in accordance with the provisions contained in Explanation I of this Part is less than zero.

Explanation VI.— For the purposes of this Schedule:

(A) “current relevant profit” means the profit as calculated under section 198 but without deducting the excess of expenditure over income referred to in sub-section 4(l) thereof in respect of those years during which the managerial person was not an employee, director or shareholder of the company or its holding or subsidiary companies.

(B) “Remuneration” means remuneration as defined in clause (78) of section 2 and includes reimbursement of any direct taxes to the managerial person.

Section V. —Remuneration payable to a managerial person in two companies:

Subject to the provisions of sections I to IV, a managerial person shall draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person.

PART III

Provisions applicable to Parts I and II of this Schedule

1. The appointment and remuneration referred to in Part I and Part II of this Schedule shall be subject to approval by a resolution of the shareholders in general meeting.

2. The auditor or the Secretary of the company or where the company is not required to appointed a Secretary, a Secretary in whole-time practice shall certify that the requirement of this Schedule have been complied with and such certificate shall be incorporated in the return filed with the Registrar under sub-section (4) of section 196.

PART IV

The Central Government may, by notification, exempt any class or classes of companies from any of the requirements contained in this Schedule.
Appendix VIII

Text of Nidhi Rules, 2014

1. **Short title and commencement.**—(1) These Rules may be called Nidhi Rules, 2014. (2) They shall come into force on the 1st day of April, 2014.

2. **Application.**—These rules shall apply to,—
   (a) every company which had been declared as a Nidhi or Mutual Benefit Society under sub-section (1) of Section 620A of the Companies Act, 1956;
   (b) every company functioning on the lines of a Nidhi company or Mutual Benefit Society but has either not applied for or has applied for and is awaiting notification to be a Nidhi or Mutual Benefit Society under sub-section (1) of Section 620A of the Companies Act, 1956; and
   (c) every company incorporated as a Nidhi pursuant to the provisions of Section 406 of the Act.

3. **Definitions.**—(1) In these rules, unless the context otherwise requires,—
   (a) “Act” means the Companies Act, 2013 (18 of 2013);
   (b) “Doubtful Asset” means a borrowal account which has remained a Non-performing asset for more than two years but less than three years;
   (c) “Loss Asset” means a borrowal account which has remained a Non-performing asset for more than three years or where in the opinion of the Board, a shortfall in the recovery of the loan account is expected because the documents executed may become invalid if subjected to legal process or for any other reason;
   (d) “Net Owned Funds” means the aggregate of paid up equity share capital and free reserves as reduced by accumulated losses and intangible assets appearing in the last audited balance sheet:

   Provided that the amount representing the proceeds of issue of preference shares shall not be included for calculating Net Owned Funds.
   (e) “Non-Performing Asset” means a borrowal account in respect of which interest income or instalment of loan towards repayment of principal amount has remained unrealised for twelve months;
   (f) “Standard Asset” means the asset in respect of which no default in repayment of principal or payment of interest has occurred or is perceived and
which has neither shown signs of any problem relating to re-payment of principal sum or interest nor does it carry more than normal risk attached to the business;

(g) “Sub-Standard Asset” means a borrowal account which is a Non-performing asset:

Provided that reschedulement or re-negotiation or re-phasing of the loan instalment or interest payment shall not change the classification of an asset unless the borrowal account has satisfactorily performed for at least twelve months after such reschedulement or renegotiation or rephasing.

(2) Words and expressions used herein, but not defined in these rules and defined in the Act or in the Companies (Specification of definitions details) Rules, 2014 shall have the same meaning as assigned to them in the Act or in the said Rules.

4. Incorporation and incidental matters.—(1) A Nidhi to be incorporated under the Act shall be a public company and shall have a minimum paid up equity share capital of five lakh rupees.

(2) On and after the commencement of the Act, no Nidhi shall issue preference shares.

(3) If preference shares had been issued by a Nidhi before the commencement of this Act, such preference shares shall be redeemed in accordance with the terms of issue of such shares.

(4) Except as provided under the proviso to sub-rule (e) to rule 6, no Nidhi shall have any object in its Memorandum of Association other than the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit.

(5) Every Company incorporated as a “Nidhi” shall have the last words ‘Nidhi Limited’ as part of its name.

5. Requirements for minimum number of members, net owned fund etc.—(1) Every Nidhi shall, within a period of one year from the commencement of these rules, ensure that it has—

(a) not less than two hundred members;

(b) Net Owned Funds of ten lakh rupees or more;

(c) unencumbered term deposits of not less than ten per cent of the outstanding deposits as specified in rule 14; and
(d) ratio of Net Owned Funds to deposits of not more than 1:20.

(2) Within ninety days from the close of the first financial year after its incorporation and where applicable, the second financial year, Nidhi shall file a return of statutory compliances in Form NDH-1 along with such fee as provided in Companies (Registration Offices and Fees) Rules, 2014 with the Registrar duly certified by a company secretary in practice or a chartered accountant in practice or a cost accountant in practice.

(3) If a Nidhi is not complying with clauses (a) or (d) of sub-rule (1) above, it shall within thirty days from the close of the first financial year, apply to the Regional Director in Form NDH-2 along with fee specified in Companies (Registration Offices and Fees) Rules, 2014 for extension of time and the Regional Director may consider the application and pass orders within thirty days of receipt of the application.

Explanation.—For the purpose of this rule “Regional Director” means the person appointed by the Central Government in the Ministry of Corporate Affairs as a Regional Director;

(4) If the failure to comply with sub-rule (1) of this rule extends beyond the second financial year, Nidhi shall not accept any further deposits from the commencement of the second financial year till it complies with the provisions contained in sub-rule (1), besides being liable for penal consequences as provided in the Act.

6. General restrictions or prohibitions.—No Nidhi shall—

(a) carry on the business of chit fund, hire purchase finance, leasing finance, insurance or acquisition of securities issued by any body corporate;

(b) issue preference shares, debentures or any other debt instrument by any name or in any form whatsoever;

(c) open any current account with its members;

(d) acquire another company by purchase of securities or control the composition of the Board of Directors of any other company in any manner whatsoever or enter into any arrangement for the change of its management, unless it has passed a special resolution in its general meeting and also obtained the previous approval of the Regional Director having jurisdiction over such Nidhi;

Explanation.—For the purposes of this sub-rule, “control” shall have the same meaning assigned to it in clause (27) of section 2 of the Act;
(e) carry on any business other than the business of borrowing or lending in its own name:

Provided that Nidhis which have adhered to all the provisions of these rules may provide locker facilities on rent to its members subject to the rental income from such facilities not exceeding twenty per cent of the gross income of the Nidhi at any point of time during a financial year.

(f) accept deposits from or lend to any person, other than its members;

(g) pledge any of the assets lodged by its members as security;

(h) take deposits from or lend money to any body corporate;

(i) enter into any partnership arrangement in its borrowing or lending activities;

(j) issue or cause to be issued any advertisement in any form for soliciting deposit:

Provided that private circulation of the details of fixed deposit Schemes among the members of the Nidhi carrying the words “for private circulation to members only” shall not be considered to be an advertisement for soliciting deposits.

(k) pay any brokerage or incentive for mobilising deposits from members or for deployment of funds or for granting loans.

7. **Share capital and allotment.**—(1) Every Nidhi shall issue equity shares of the nominal value of not less than ten rupees each:

Provided that this requirement shall not apply to a company referred to in sub-rules (a) and (b) of rule 2.

(2) No service charge shall be levied for issue of shares.

(3) Every Nidhi shall allot to each deposit holder at least a minimum of ten equity shares or shares equivalent to one hundred rupees:

Provided that a savings account holder and a recurring deposit account holder shall hold at least one equity share of rupees ten.

8. **Membership.**—(1) A Nidhi shall not admit a body corporate or trust as a member.

(2) Except as otherwise permitted under these rules, every Nidhi shall ensure that its membership is not reduced to less than two hundred members at any time.
A minor shall not be admitted as a member of Nidhi:

Provided that deposits may be accepted in the name of a minor, if they are made by the natural or legal guardian who is a member of Nidhi.

9. **Net owned funds.**—Every Nidhi shall maintain Net Owned Funds (excluding the proceeds of any preference share capital) of not less than ten lakh rupees or such higher amount as the Central Government may specify from time to time.

10. **Branches.**—(1) A Nidhi may open branches, only if it has earned net profits after tax continuously during the preceding three financial years.

(2) Subject to the provisions contained in sub-rule (1), a Nidhi may open up to three branches within the district.

(3) If a Nidhi proposes to open more than three branches within the district or any branch outside the district, it shall obtain the prior permission of the Regional Director and an intimation is to be given to the Registrar about opening of every branch within thirty days of such opening.

(4) No Nidhi shall open branches or collection centres or offices or deposit centres, or by whatever name called outside the State where its registered office is situated.

(5) No Nidhi shall open branches or collection centres or offices or deposit centres, or by whatever name called unless financial statement and annual return (up to date) are filed with the Registrar.

(6) A Nidhi shall not close any branch unless it—

(a) publishes an advertisement in a newspaper in vernacular language in the place where it carries on business at least thirty days prior to such closure, informing the public about such closure;

(b) fixes a copy of such advertisement or a notice informing such closure of the branch on the notice board of Nidhi for a period of at least thirty days from the date on which advertisement was published under clause (a); and

(c) gives an intimation to the Registrar within thirty days of such closure.

11. **Acceptance of deposits by Nidhis.**—(1) A Nidhi shall not accept deposits exceeding twenty times of its Net Owned Funds (NOF) as per its last audited financial statements.
(2) In the case of companies covered under clauses (a) and (b) of rule 2 and existing on or before 26th July, 2001 and which have accepted deposits in excess of the aforesaid limits, the same shall be restored to the prescribed limit by increasing the Net Owned Funds position or alternatively by reducing the deposit according to the table given below:

**TABLE**

<table>
<thead>
<tr>
<th>Ratio of Net Owned Funds to Deposits (as on 31.3. 2013)</th>
<th>Date by which the company has to achieve prescribed ceiling of 1:20</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) More than 1:20 but up to 1:35</td>
<td>By 31.3. 2015</td>
</tr>
<tr>
<td>b) More than 1:35 but up to 1:45</td>
<td>By 31.3. 2016</td>
</tr>
<tr>
<td>c) More than 1:45</td>
<td>By 31.3. 2017</td>
</tr>
</tbody>
</table>

(3) The companies which are covered under the Table in sub-rule (2) above shall not accept fresh deposits or renew existing deposits if such acceptance or renewal leads to violation of the prescribed ratio.

(4) The ratio specified in sub-rule (2) above shall also apply to incremental deposits.

12. **Application form for deposit.**—(1) Every application form for placing a deposit with a Nidhi shall contain the following particulars, namely:—

(a) Name of Nidhi;
(b) Date of incorporation of Nidhi;
(c) The business carried on by Nidhi with details of branches, if any;
(d) Brief particulars of the management of Nidhi (name, addresses and occupation of the directors, including DIN);
(e) Net profits of Nidhi before and after making provision for tax for the preceding three financial years;
(f) Dividend declared by Nidhi during the preceding three financial years;
(g) Mode of repayment of the deposit;
(h) Maturity period of the deposit;
(i) Interest payable on the deposit;
(j) The rate of interest payable to the depositor in case the depositor withdraws the deposit prematurely;

(k) The terms and conditions subject to which the deposit may be accepted or renewed;

(l) A summary of the financials of the company as per the latest two audited financial statements as given below:

(i) Net Owned Funds
(ii) Deposits accepted
(iii) Deposits repaid
(iv) Deposits claimed but remaining unpaid
(v) Loans disbursed against—
   (a) immovable property;
   (b) deposits; and
   (c) gold and jewellery
(vi) Profit before tax
(vii) Provision for tax
(viii) Profit after tax
(ix) Dividend per share

(m) any other special features or terms and conditions subject to which the deposit is accepted or renewed.

(2) The application form shall also contain the following statements, namely:—

(a) in case of Non-payment of the deposit or part thereof as per the terms and conditions of such deposit, the depositor may approach the Registrar of companies having jurisdiction over Nidhi; (b) in case of any deficiency of Nidhi in servicing its depositors, the depositor may approach the National Consumers Disputes Redressal Forum, the State Consumers Disputes Redressal Forum or District Consumers Disputes Redressal Forum, as the case may be, for redressal of his relief;
(c) a declaration by the Board of Directors to the effect that the financial position of Nidhi as disclosed and the representations made in the application form are true and correct and that Nidhi has complied with all the applicable rules;

(d) a statement to the effect that the Central Government does not undertake any responsibility for the financial soundness of Nidhi or for the correctness of any of the statement or the representations made or opinions expressed by Nidhi; (e) the deposits accepted by Nidhi are not insured and the repayment of deposits is not guaranteed by either the Central Government or the Reserve Bank of India; and (f) a verification clause by the depositor stating that he had read and understood the financial and other particulars furnished and representations made by Nidhi in his application form and after careful consideration he is making the deposit with Nidhi at his own risk and volition.

(3) Every Nidhi shall obtain proper introduction of new depositors before opening their accounts or accepting their deposits and keep on its record the evidence on which it has relied upon for the purpose of such introduction.

(4) For the purposes of introduction of depositors, a Nidhi shall obtain documentary evidence of the depositor in the form of proof of identity and address as under:

(a) Proof of Identity (any one of the following)
   (i) Passport
   (ii) Unique Identification Number
   (iii) Income-tax PAN card
   (iv) Elector Photo Identity Card
   (v) Driving licence
   (vi) Ration card

(b) Proof of address (any one of the following)
   (i) Passport
   (ii) Unique Identification Number
   (iii) Elector Photo Identity Card
   (iv) Driving licence
   (v) Ration card
III.878 Auditing Pronouncements

(vi) Telephone bill
(vii) Bank account statement
(viii) Electricity bill

(documents referred to serial numbers (vi), (vii) and (viii) above shall not be more than two months old)

13. **Deposits.**—(1) The fixed deposits shall be accepted for a minimum period of six months and a maximum period of sixty months.

(2) Recurring deposits shall be accepted for a minimum period of twelve months and a maximum period of sixty months.

(3) In case of recurring deposits relating to mortgage loans, the maximum period of recurring deposits shall correspond to the repayment period of such loans granted by Nidhi.

(4) The maximum balance in a savings deposit account at any given time qualifying for interest shall not exceed one lakh rupees at any point of time and the rate of interest shall not exceed two per cent above the rate of interest payable on savings bank account by nationalised banks.

(5) A Nidhi may offer interest on fixed and recurring deposits at a rate not exceeding the maximum rate of interest prescribed by the Reserve Bank of India which the Non-Banking Financial Companies can pay on their public deposits.

(6) A fixed deposit account or a recurring deposit account shall be foreclosed by the depositor subject to the following conditions, namely:—

(a) a Nidhi shall not repay any deposit within a period of three months from the date of its acceptance;

(b) where at the request of the depositor, a Nidhi repays any deposit after a period of three months, the depositor shall not be entitled to any interest up to six months from the date of deposit;

(c) where at the request of the depositor, a Nidhi makes repayment of a deposit before the expiry of the period for which such deposit was accepted by Nidhi, the rate of interest payable by Nidhi on such deposit shall be reduced by two per cent from the rate which Nidhi would have ordinarily paid, had the deposit been accepted for the period for which such deposit had run:
Provided that in the event of death of a depositor, the deposit may be repaid prematurely to the surviving depositor or depositors in the case of joint holding with survivor clause, or to the nominee or to legal heir with interest up to the date of repayment at the rate which the company would have ordinarily paid, had such deposit been accepted for the period for which such deposit had run.

14. **Un-encumbered term deposits.**—Every Nidhi shall invest and continue to keep invested, in unencumbered term deposits with a Scheduled commercial bank (other than a co-operative bank or a regional rural bank), or post office deposits in its own name an amount which shall not be less than ten per cent of the deposits outstanding at the close of business on the last working day of the second preceding month:

Provided that in cases of unforeseen commitments, temporary withdrawal may be permitted with the prior approval of the Regional Director for the purpose of repayment to depositors, subject to such conditions and time limit which may be specified by the Regional Director to ensure restoration of the prescribed limit of ten per cent.

15. **Loans.**—(1) A Nidhi shall provide loans only to its members.

(2) The loans given by a Nidhi to a member shall be subject to the following limits, namely:—

(a) two lakh rupees, where the total amount of deposits of such Nidhi from its members is less than two crore rupees;

(b) seven lakh fifty thousand rupees, where the total amount of deposits of such Nidhi from its members is more than two crore rupees but less than twenty crore rupees;

(c) twelve lakh rupees, where the total amount of deposits of such Nidhi from its members is more than twenty crore rupees but less than fifty crore rupees; and

(d) fifteen lakh rupees, where the total amount of deposits of such Nidhi from its members is more than fifty crore rupees:

Provided that where a Nidhi has not made profits continuously in the three preceding financial years, it shall not make any fresh loans exceeding fifty per cent of the maximum amounts of loans specified in clauses (a), (b), (c) or (d).
Provided further that, a member shall not be eligible for any further loan if he has borrowed any earlier loan from the Nidhi and has defaulted in repayment of such loan.

(3) For the purposes of sub-rule (2), the amount of deposits shall be calculated on the basis of the last audited annual financial statements.

(4) A Nidhi shall give loans to its members only against the following securities, namely:

(a) gold, silver and jewellery:
Provided that the re-payment period of such loan shall not exceed one year.

(b) immovable property:
Provided that the total loans against immovable property [excluding mortgage loans granted on the security of property by registered mortgage, being a registered mortgage under section 69 of the Transfer of Property Act, 1882 (IV of 1882)] shall not exceed fifty per cent of the overall loan outstanding on the date of approval by the board, the individual loan shall not exceed fifty per cent of the value of property offered as security and the period of repayment of such loan shall not exceed seven years.

(c) fixed deposit receipts, National Savings Certificates, other Government Securities and insurance policies:
Provided that such securities duly discharged shall be pledged with Nidhi and the maturity date of such securities shall not fall beyond the loan period or one year whichever is earlier:
Provided further that in the case of loan against fixed deposits, the period of loan shall not exceed the unexpired period of the fixed deposits.

16. **Rate of interest.**—The rate of interest to be charged on any loan given by a Nidhi shall not exceed seven and half per cent above the highest rate of interest offered on deposits by Nidhi and shall be calculated on reducing balance method:

Provided that Nidhi shall charge the same rate of interest on the borrowers in respect of the same class of loans and the rates of interest of all classes of loans shall be prominently displayed on the notice board at the registered office and each branch office of Nidhi.

17. **Rules relating to Directors.**—(1) The Director shall be a member of Nidhi.
(2) The Director of a Nidhi shall hold office for a term up to ten consecutive years on the Board of Nidhi.

(3) The Director shall be eligible for re-appointment only after the expiration of two years of ceasing to be a Director.

(4) Where the tenure of any Director in any case had already been extended by the Central Government, it shall terminate on expiry of such extended tenure.

(5) The person to be appointed as a Director shall comply with the requirements of sub-section (4) of Section 152 of the Act and shall not have been disqualified from appointment as provided in section 164 of the Act.

18. Dividend.- A Nidhi shall not declare dividend exceeding twenty five per cent or such higher amount as may be specifically approved by the Regional Director for reasons to be recorded in writing and further subject to the following conditions, namely:—

(a) an equal amount is transferred to General Reserve;

(b) there has been no default in repayment of matured deposits and interest; and

(c) it has complied with all the rules as applicable to Nidhis.

19. Auditor.—(1) No Nidhi shall appoint or re-appoint an individual as auditor for more than one term of five consecutive years.

(2) No Nidhi shall appoint or re-appoint an audit firm as auditor for more than two terms of five consecutive years: Provided that an auditor (whether an individual or an audit firm) shall be eligible for subsequent appointment after the expiration of two years from the completion of his or its term:

Explanation: For the purposes of this proviso:

(i) in case of an auditor (whether an individual or audit firm), the period for which he or it has been holding office as auditor prior to the commencement of these rules shall be taken into account in calculating the period of five consecutive years or ten consecutive years, as the case may be;

(ii) appointment includes re-appointment.

20. Prudential norms.—(1) Every Nidhi shall adhere to the prudential norms for revenue recognition and classification of assets in respect of mortgage loans or jewel loans as contained hereunder.
(2) Income including interest or any other charges on non-performing assets shall be recognised only when it is actually realised and any such income recognised before the asset became non-performing and which remains unrealised in a year shall be reversed in the profit and loss account of the immediately succeeding year.

(3) (a) In respect of mortgage loans, the classification of assets and the provisioning required shall be as under:

<table>
<thead>
<tr>
<th>NATURE OF ASSET</th>
<th>PROVISION REQUIRED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard Asset</td>
<td>No provision</td>
</tr>
<tr>
<td>Sub-standard Asset</td>
<td>10% of the aggregate outstanding amount</td>
</tr>
<tr>
<td>Doubtful Asset</td>
<td>25% of the aggregate outstanding amount</td>
</tr>
<tr>
<td>Loss Asset</td>
<td>100% of the aggregate outstanding amount</td>
</tr>
</tbody>
</table>

Provided that a Nidhi may make provision for exceeding the percentage specific herein.

(b) The estimated realisable value of the collateral security to which a Nidhi has valid recourse may be reduced from the aggregate outstanding amount, if the proceedings for the sale of the mortgaged property have been initiated in a court of law within the previous two years of the interest, income or instalment remaining unrealised.

(4) In case of companies which were incorporated on or before 26-07-2001, such companies shall make provisions in respect of loans disbursed and outstanding as on 31-03-2002 for income reversal and non-performing assets as per table given below:

<table>
<thead>
<tr>
<th>For the year ended</th>
<th>Extent of provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-03-2015</td>
<td>Un-provided balance on equal basis over the three years as specified in the preceding column.</td>
</tr>
<tr>
<td>31-03-2016</td>
<td></td>
</tr>
<tr>
<td>31-03-2017</td>
<td></td>
</tr>
</tbody>
</table>

(5) (a) The Notes on the financial statements of a year shall disclose-

(i) the total amount of provisions, if any, to be made on account of income reversal and non-performing assets remaining unrealised;

(ii) the cumulative amount provided till the previous year;
(iii) the amount provided in the current year; and
(iv) the balance amount to be provided.

(b) Such disclosure shall continue to be made until the entire amount to be provided has been provided for.

(6) In respect of loans against gold or jewellery—

(a) the aggregate amount of loan outstanding against the security of gold or jewellery shall either be recovered or renewed within three months from the due date of repayment;

(b) if the loan is not recovered or renewed and the security is not sold within the aforesaid period of three months, the company shall make provision in the current year’s financial statements to the extent of unrealised amount or the aggregate outstanding amount of loan including interest as applicable;

(c) no income shall be recognised on such loans outstanding after the expiry of the three months period specified in (a) above or sale of gold or jewellery, whichever is earlier; and

(d) the loan to value ratio shall not exceed 80 per cent.

Explanation.- For the purposes of this rule, the term ‘loan to value ratio’ means the ratio between the amount of loan given and the value of gold or jewellery against which such loan is given.

21. **Filing of half yearly return.**—Every company covered under rule 2 shall file half yearly return with the Registrar in Form NDH-3 along with such fee as provided in Companies (Registration Offices and Fees) Rules, 2014 within thirty days from the conclusion of each half year duly certified by a company secretary in practice or chartered accountant in practice.

22. **Auditor’s certificate.**—The Auditor of the company shall furnish a certificate every year to the effect that the company has complied with all the provisions contained in the rules and such certificate shall be annexed to the audit report and in case of non-compliance, he shall specifically state the rules which have not been complied with.

23. **Power to enforce compliance.**—(1) For the purposes of enforcing compliance with these rules, the Registrar of companies may call for such information or returns from Nidhi as he deems necessary and may engage the services of chartered
accountants, company secretaries in practice, cost accountants, or any firm thereof from time to time for assisting him in the discharge of his duties.

(2) In respect of any Nidhi which has violated these rules or has failed to function in terms of the Memorandum and Articles of Association, the concerned Regional Director may appoint a Special Officer to take over the management of Nidhi and such Special Officer shall function as per the guidelines given by such Regional Director:

Provided that an opportunity of being heard shall be given to the concerned Nidhi by the Regional Director before appointing any Special Officer.

24. **Penalty for non-compliance.**- If a company falling under rule 2 contravenes any of the provisions of the rules prescribed herein, the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees, and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first during which the contravention continues.

**Appendix IX**

**Text of Section 42 of the Companies Act, 2013**

42. **Offer or invitation for subscription of securities on private placement**

(1) Without prejudice to the provisions of section 26, a company may, subject to the provisions of this section, make private placement through issue of a private placement offer letter.

(2) Subject to sub-section (1), the offer of securities or invitation to subscribe securities, shall be made to such number of persons not exceeding fifty or such higher number as may be prescribed, [excluding qualified institutional buyers and employees of the company being offered securities under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62], in a financial year and on such conditions (including the form and manner of private placement) as may be prescribed.

Explanation I.—If a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an

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16 Ministry of Corporate Affairs vide its notification no. GSR 465(E) dated 5th June, 2015 has specified that Section 42 except sub-section (l), explanation (ll) to sub-section (2), sub-sections (4), (6), (t), (9) and (10) shall not apply to Nidhis.
offer to the public and shall accordingly be governed by the provisions of Part I of this Chapter.

Explanation II.—For the purposes of this section, the expression—

(i) "qualified institutional buyer" means the qualified institutional buyer as defined in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 as amended from time to time.

(ii) "private placement" means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in this section.

(3) No fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company.

(4) Any offer or invitation not in compliance with the provisions of this section shall be treated as a public offer and all provisions of this Act, and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be required to be complied with.

(5) All monies payable towards subscription of securities under this section shall be paid through cheque or demand draft or other banking channels but not by cash.

(6) A company making an offer or invitation under this section shall allot its securities within sixty days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within fifteen days from the date of completion of sixty days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of twelve per cent. per annum from the expiry of the sixtieth day:

Provided that monies received on application under this section shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—

(a) for adjustment against allotment of securities; or

(b) for the repayment of monies where the company is unable to allot securities.

(7) All offers covered under this section shall be made only to such persons whose names are recorded by the company prior to the invitation to subscribe, and that such persons shall receive the offer by name, and that a complete record of such offers shall be kept by the company in such manner as may be prescribed and
complete information about such offer shall be filed with the Registrar within a period of thirty days of circulation of relevant private placement offer letter.

(8) No company offering securities under this section shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an offer.

(9) Whenever a company makes any allotment of securities under this section, it shall file with the Registrar a return of allotment in such manner as may be prescribed, including the complete list of all security-holders, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

(10) If a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the amount involved in the offer or invitation or two crore rupees, whichever is higher, and the company shall also refund all monies to subscribers within a period of thirty days of the order imposing the penalty.

Appendix X

Rule 14 of the Companies (Prospectus & Allotment of Securities) Rules, 2014


14. Private Placement.—

(1) (a) For the purposes of sub-section (1) of section 42, a company may make an offer or invitation to subscribe to securities through issue of a private placement offer letter in Form PAS-4.

(b) A private placement offer letter shall be accompanied by an application form serially numbered and addressed specifically to the person to whom the offer is made and shall be sent to him, either in writing or in electronic mode, within thirty days of recording the names of such persons in accordance with sub-section (7) of section 42:

Provided that no person other than the person so addressed in the application form shall be allowed to apply through such application form and any application not conforming to this condition shall be treated as invalid.

(2) A company shall not make a private placement of its securities unless —
(a) the proposed offer of securities or invitation to subscribe securities has been previously approved by the shareholders of the company, by a Special Resolution, for each of the Offers or Invitations:

Provided that in the explanatory statement annexed to the notice for the general meeting the basis or justification for the price (including premium, if any) at which the offer or invitation is being made shall be disclosed:

Provided further that in case of offer or invitation for non-convertible debentures, it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitation for such debentures during the year.

Provided also that in case of an offer or invitation for non-convertible debenture referred to in the second proviso, made within a period of six months from the date of commencement of these rules, the special resolution referred to in the second proviso may be passed within the said period of six months from the date of commencement of these rules.

(b) such offer or invitation shall be made to not more than two hundred persons in the aggregate in a financial year:

Provided that any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees stock option as per provisions of clause (b) of sub-section (1) of section 62 shall not be considered while calculating the limit of two hundred persons;

Explanation.– For the purposes of this sub-rule, it is hereby clarified that –

(i) the restrictions under sub-clause (b) would be reckoned individually for each kind of security that is equity share, preference share or debenture;

(ii) the requirement of provisions of sub-section (3) of section 42 shall apply in respect of offer or invitation of each kind of security and no offer or invitation of another kind of security shall be made unless allotments with respect to offer or invitation made earlier in respect of any other kind of security is completed;

(c) the value of such offer or invitation per person shall be with an investment size of not less than twenty thousand rupees of face value of the securities;

(d) the payment to be made for subscription to securities shall be made from the bank account of the person subscribing to such securities and the company shall keep the record of the Bank account from where such payments for subscriptions have been received:
Provided that monies payable on subscription to securities to be held by joint holders shall be paid from the bank account of the person whose name appears first in the application.

(3) The company shall maintain a complete record of private placement offers in Form PAS-5:

Provided that a copy of such record along with the private placement offer letter in Form PAS-4 shall be filed with the Registrar with fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and where the company is listed, with the Securities and Exchange Board within a period of thirty days of circulation of the private placement offer letter.

Explanation.- For the purpose of this rule, it is hereby clarified that the date of private placement offer letter shall be deemed to be the date of circulation of private placement offer letter.

(4) A return of allotment of securities under section 42 shall be filed with the Registrar within thirty days of allotment in Form PAS-3 and with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 along with a complete list of all security holders containing-

(i) the full name, address, Permanent Account Number and E-mail ID of such security holder;

(ii) the class of security held;

(iii) the date of allotment of security;

(iv) the number of securities held, nominal value and amount paid on such securities; and particulars of consideration received if the securities were issued for consideration other than cash.

(5) The provisions of clauses (b) and (c) of sub-rule (2) shall not be applicable to –

(a) non-banking financial companies which are registered with the Reserve Bank of India under Reserve Bank of India Act, 1934; and

(b) housing finance companies which are registered with the National Housing Bank under National Housing Bank Act, 1987,

if they are complying with regulations made by Reserve Bank of India or National Housing Bank in respect of offer or invitation to be issued on private placement basis:

Provided that such companies shall comply with sub-clauses (b) and (c) of
Part-III: Guidance Notes III.889

sub-rule (2) in case the Reserve Bank of India or the National Housing Bank have not specified similar regulations.

Appendix XI

Text of Section 45-IA of the Reserve Bank of India Act, 1934

45-IA. Requirement of Registration and Net Owned Fund

(1) Notwithstanding anything contained in this Chapter or in any other law for the time being in force, no non-banking financial company shall commence or carry on the business of a non-banking financial institution without–

(a) obtaining a certificate of registration issued under this Chapter; and

(b) having the net owned fund of twenty-five lakh rupees or such other amount, not exceeding two hundred lakh rupees, (Rs. 200 Lakhs since April 1999) as the Bank may, by notification in the Official Gazette, specify.

(2) Every non-banking financial company shall make an application for registration to the Bank in such form as the Bank may specify:

Provided that a non-banking financial company in existence on the commencement of the Reserve Bank of India (Amendment) Act, 1997 shall make an application for registration to the Bank before the expiry of six months from such commencement and notwithstanding anything contained in sub-section (1) may continue to carry on the business of a non-banking financial institution until a certificate of registration is issued to it or rejection of application for registration is communicated to it.

(3) Notwithstanding anything contained in sub-section (1), a non-banking financial company in existence on the commencement of the Reserve Bank of India (Amendment) Act, 1997 and having a net owned fund of less than twenty-five lakh rupees may, for the purpose of enabling such company to fulfil the requirement of the net owned fund, continue to carry on the business of a non-banking financial institution–

(i) for a period of three years from such commencement; or

(ii) for such further period as the Bank may, after recording the reasons in writing for so doing, extend, subject to the condition that such company shall, within three months of fulfilling the requirement of the net owned fund, inform the Bank about such fulfilment:
III.890 Auditing Pronouncements

Provided that the period allowed to continue business under this sub-section shall in no case exceed six years in the aggregate.

(4) The Bank may, for the purpose of considering the application for registration, require to be satisfied by an inspection of the books of the non-banking financial company or otherwise that the following conditions are fulfilled:—

(a) that the non-banking financial company is or shall be in a position to pay its present or future depositors in full as and when their claims accrue;

(b) that the affairs of the non-banking financial company are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;

(c) that the general character of the management or the proposed management of the non-banking financial company shall not be prejudicial to the public interest or the interest of its depositors;

(d) that the non-banking financial company has adequate capital structure and earning prospects;

(e) that the public interest shall be served by the grant of certificate of registration to the non-banking financial company to commence or to carry on the business in India;

(f) that the grant of certificate of registration shall not be prejudicial to the operation and consolidation of the financial sector consistent with monetary stability, economic growth and considering such other relevant factors which the Bank may, by notification in the Official Gazette, specify; and

(g) any other condition, fulfilment of which in the opinion of the Bank, shall be necessary to ensure that the commencement of or carrying on of the business in India by a non-banking financial company shall not be prejudicial to the public interest or in the interest of the depositors.

(5) The Bank may, after being satisfied that the conditions specified in sub-section (4) are fulfilled, grant a certificate of registration subject to such conditions which it may consider fit to impose.

(6) The Bank may cancel a certificate of registration granted to a non-banking financial company under this section if such company—

(i) ceases to carry on the business of a non-banking financial institution in India; or
Part-III: Guidance Notes

(ii) has failed to comply with any condition subject to which the certificate of registration had been issued to it; or

(iii) at any time fails to fulfil any of the conditions referred to in clauses (a) to (g) of sub-section (4); or

(iv) fails—

(a) to comply with any direction issued by the Bank under the provisions of this chapter; or

(b) to maintain accounts in accordance with the requirements of any law or any direction or order issued by the Bank under the provisions of this Chapter; or

(c) to submit or offer for inspection its books of account and other relevant documents when so demanded by an inspecting authority of the Bank; or

(v) has been prohibited from accepting deposit by an order made by the Bank under the provisions of this Chapter and such order has been in force for a period of not less than three months:

Provided that before cancelling a certificate of registration on the ground that the non-banking financial company has failed to comply with the provisions of clause (ii) or has failed to fulfil any of the conditions referred to in clause (iii) the Bank, unless it is of the opinion that the delay in cancelling the certificate of registration shall be prejudicial to public interest or the interest of the depositors or the non-banking financial company, shall give an opportunity to such company on such terms as the Bank may specify for taking necessary steps to comply with such provision or fulfillment of such condition;

Provided further that before making any order of cancellation of certificate of registration, such company shall be given a reasonable opportunity of being heard.

(7) A company aggrieved by the order of rejection of application for registration or cancellation of certificate of registration may prefer an appeal, within a period of thirty days from the date on which such order of rejection or cancellation is communicated to it, to the Central Government and the decision of the Central Government where an appeal has been preferred to it, or of the Bank where no appeal has been preferred, shall be final:

Provided that before making any order of rejection of appeal, such company shall be given a reasonable opportunity of being heard.

Explanation.— For the purposes of this section,—
(I) “net owned fund” means—

(a) the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance-sheet of the company after deducting therefrom—

(i) accumulated balance of loss;
(ii) deferred revenue expenditure; and
(iii) other intangible assets; and

(b) further reduced by the amounts representing—

(1) investments of such company in shares of—

(i) its subsidiaries;
(ii) companies in the same group;
(iii) all other non-banking financial companies; and

(2) the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with,—

(i) subsidiaries of such company; and
(ii) companies in the same group,

to the extent such amount exceeds ten per cent of (a) above.

(II) “subsidiaries” and “companies in the same group” shall have the same meanings assigned to them in the Companies Act, 1956.

Appendix XII

Text of Sections 73 to 76 of the Companies Act, 2013

Prohibition on acceptance of deposits from public

73. (1) On and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under this Chapter:
Provided that nothing in this sub-section shall apply to a banking company and non-banking financial company as defined in the Reserve Bank of India Act, 1934 and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

(2) A company may, subject to the passing of a resolution in general meeting and subject to such rules as may be prescribed in consultation with the Reserve Bank of India, accept deposits from its members on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest, as may be agreed upon between the company and its members, subject to the fulfilment of the following conditions, namely:

(a) issuance of a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in such form and in such manner as may be prescribed;

(b) filing a copy of the circular along with such statement with the Registrar within thirty days before the date of issue of the circular;

(c) depositing such sum which shall not be less than fifteen per cent of the amount of its deposits maturing during a financial year and the financial year next following, and kept in a scheduled bank in a separate bank account to be called as deposit repayment reserve account;

(d) providing such deposit insurance in such manner and to such extent as may be prescribed;

(e) certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits; and

(f) providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company:

Provided that in case where a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as ‘unsecured deposits’ and shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.
(3) Every deposit accepted by a company under sub-section (2) shall be repaid with interesting accordance with the terms and conditions of the agreement referred to in that sub-section.

(4) Where a company fails to repay the deposit or part thereof or any interest thereon under sub-section (3), the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.

(5) The deposit repayment reserve account referred to in clause (c) of sub-section (2) shall not be used by the company for any purpose other than repayment of deposits.

Repayment of deposits, etc., accepted before commencement of this Act

74. (1) Where in respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall—

(a) file, within a period of three months from such commencement or from the date on which such payments are due, with the Registrar a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment, notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law; and

(b) repay within one year from such commencement or from the date on which such payments are due, whichever is earlier.

(2) The Tribunal may on an application made by the company, after considering the financial condition of the company, the amount of deposit or part thereof and the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit.

(3) If a company fails to repay the deposit or part thereof or any interest thereon within the time specified in sub-section (1) or such further time as may be allowed by the Tribunal under sub-section (2), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.
Part-III: Guidance Notes

III.895

Damages for fraud

75. (1) Where a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified in sub-section (1) of that section or such further time as may be allowed by the Tribunal under sub-section (2) of that section, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in sub-section (3) of that section and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

(2) Any suit, proceedings or other action may be taken by any person, group of persons or any association of persons who had incurred any loss as a result of the failure of the company to repay the deposits or part thereof or any interest thereon.

Acceptance of deposits from Public by certain companies

76. (1) Notwithstanding anything contained in section 73, a public company, having such net worth or turnover as may be prescribed, may accept deposits from persons other than its members subject to compliance with the requirements provided in sub-section (2) of section 73 and subject to such rules as the Central Government may, in consultation with the Reserve Bank of India, prescribe:

Provided that such a company shall be required to obtain the rating (including its net worth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency for informing the public the rating given to the company at the time of invitation of deposits from the public which ensures adequate safety and the rating shall be obtained for every year during the tenure of deposits:

Provided further that every company accepting secured deposits from the public shall within thirty days of such acceptance, create a charge on its assets of an amount not less than the amount of deposits accepted in favour of the deposit holders in accordance with such rules as may be prescribed.

(2) The provisions of this Chapter shall, *mutatis mutandis*, apply to the acceptance of deposits from public under this section.

*Appendix XIII*

Text of the Companies (Acceptance of Deposits) Rules, 2014
III.896 Auditing Pronouncements

1. **Short title, commencement and application.** - (1) These rules may be called the Companies (Acceptance of Deposits) Rules, 2014.

   (2) They shall come into force on the 1st day of April, 2014.

   (3) These rules shall apply to a company other than –

   (i) a banking company;

   (ii) a non-banking financial company as defined in the Reserve Bank of India Act, 1934 (2 of 1934) registered with the Reserve Bank of India;

   (iii) a housing finance company registered with the National Housing Bank established under the National Housing Bank Act, 1987 (53 of 1987); and

   (iv) a company specified by the Central Government under the proviso to sub-section (1) of section 73 of the Act.

2. **Definitions.** - (1) In these rules, unless the context otherwise requires, ___

   (a) “Act” means the Companies Act, 2013 (18 of 2013);

   (b) “Annexure” means the Annexure attached to these rules;

   (c) “deposit” includes any receipt of money by way of deposit or loan or in any other form, by a company, but does not include –

   (i) any amount received from the Central Government or a State Government, or any amount received from any other source whose repayment is guaranteed by the Central Government or a State Government, or any amount received from a local authority, or any amount received from a statutory authority constituted under an Act of Parliament or a State Legislature;

   (ii) any amount received from foreign Governments, foreign or international banks, multilateral financial institutions (including, but not limited to, International Finance Corporation, Asian Development Bank, Commonwealth Development Corporation and International Bank for Industrial and Financial Reconstruction), foreign Governments owned development financial institutions, foreign export credit agencies, foreign collaborators, foreign bodies corporate and foreign citizens, foreign authorities or persons resident outside India subject to the provisions of Foreign Exchange Management Act, 1999 (42 of 1999) and rules and regulations made there under;

   (iii) any amount received as a loan or facility from any banking company or from the State Bank of India or any of its subsidiary banks or from a
banking institution notified by the Central Government under section 51 of the Banking Regulation Act, 1949 (10 of 1949), or a corresponding new bank as defined in clause (d) of section 2 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970) or in clause (b) of section (2) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980) , or from a co-operative bank as defined in clause (b-ii) of section 2 of the Reserve Bank of India Act, 1934 (2 of 1934) ;

(iv) any amount received as a loan or financial assistance from Public Financial Institutions notified by the Central Government in this behalf in consultation with the Reserve Bank of India or any regional financial institutions or Insurance Companies or Scheduled Banks as defined in the Reserve Bank of India Act, 1934 (2 of 1934);

(v) any amount received against issue of commercial paper or any other instruments issued in accordance with the guidelines or notification issued by the Reserve Bank of India;

(vi) any amount received by a company from any other company;

(vii) any amount received and held pursuant to an offer made in accordance with the provisions of the Act towards subscription to any securities, including share application money or advance towards allotment of securities pending allotment, so long as such amount is appropriated only against the amount due on allotment of the securities applied for;

Explanation.- For the purposes of this sub-clause, it is hereby clarified that –

(a) Without prejudice to any other liability or action, if the securities for which application money or advance for such securities was received cannot be allotted within sixty days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within fifteen days from the date of completion of sixty days, such amount shall be treated as a deposit under these rules.

“Provided that unless otherwise required under the Companies Act, 1956 (1 of 1956) or the Securities and Exchange Board of India Act, 1992 (15 of 1992) or rules or regulations made there
under to allot any share, stock, bond, or debenture within a specified period, if a company had received any amount by way of subscriptions to any shares, stock, bonds or debentures before the 1st April, 2014 and disclosed it in the balance sheet for the financial year ending on or before the 31st March, 2014 against which the allotment is pending on the 31st March, 2015, the company shall, by the 1st June 2015, either return such amounts to the persons from whom these were received or allot shares, stock, bonds or debentures or comply with these rules."

(b) any adjustment of the amount for any other purpose shall not be treated as refund.

(viii) any amount received from a person who, at the time of the receipt of the amount, was a director of the company: or a relative of the director of the private company

Provided that the director of the company or relative of the director of the private company, as the case may be from whom money is received, furnished, to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others and the company shall disclose the details of money so accepted in the Board’s Reports;

(ix) any amount raised by the issue of bonds or debentures secured by a first charge or a charge ranking pari passu with the first charge on any assets referred to in Schedule III of the Act excluding intangible assets of the company or bonds or debentures compulsorily convertible into shares of the company within five years:

Provided that if such bonds or debentures are secured by the charge of any assets referred to in Schedule III of the Act, excluding intangible assets, the amount of such bonds or debentures shall not exceed the market value of such assets as assessed by a registered valuer;

(x) any amount received from an employee of the company not exceeding his annual salary under a contract of employment with the company in the nature of non-interest bearing security deposit;

(xi) any non-interest bearing amount received or held in trust;

(xii) any amount received in the course of, or for the purposes of, the business of the company,
(a) as an advance for the supply of goods or provision of services accounted for in any manner whatsoever provided that such advance is appropriated against supply of goods or provision of services within a period of three hundred and sixty five days from the date of acceptance of such advance:

Provided that in case of any advance which is subject matter of any legal proceedings before any court of law, the said time limit of three hundred and sixty five days shall not apply:

(b) as advance, accounted for in any manner whatsoever, received in connection with consideration for an immovable property under an agreement or arrangement, provided that such advance is adjusted against such property in accordance with the terms of agreement or arrangement;

(c) as security deposit for the performance of the contract for supply of goods or provision of services;

(d) as advance received under long term projects for supply of capital goods except those covered under item (b) above:

Provided that if the amount received under items (a), (b) and (d) above becomes refundable (with or without interest) due to the reasons that the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then the amount received shall be deemed to be a deposit under these rules:

Explanation.- For the purposes of this sub-clause the amount referred to in the proviso shall be deemed to be deposits on the expiry of fifteen days from the date they become due for refund.

(xiii) any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to fulfillment of the following conditions, namely:

(a) the loan is brought in pursuance of the stipulation imposed by the lending institutions on the promoters to contribute such finance;

(b) the loan is provided by the promoters themselves or by their relatives or by both; and
(c) the exemption under this sub-clause shall be available only till the loans of financial institution or bank are repaid and not thereafter;

(xiv) any amount accepted by a Nidhi company in accordance with the rules made under section 406 of the Act.

Explanation.- For the purposes of this clause, any amount.

(a) received by the company, whether in the form of instalments or otherwise, from a person with promise or offer to give returns, in cash or in kind, on completion of the period specified in the promise or offer, or earlier, accounted for in any manner whatsoever, or

(b) any additional contributions, over and above the amount under item (a) above, made by the company as part of such promise or offer, shall be treated as a deposit;

(d) “depositor” means,

(i) any member of the company who has made a deposit with the company in accordance with the provisions of subsection (2) of section 73 of the Act, or

(ii) any person who has made a deposit with a public company in accordance with the provisions of section 76 of the Act;

(e) “eligible company” means a public company as referred to in sub-section (1) of section 76, having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies before making any invitation to the Public for acceptance of deposits:

Provided that an eligible company, which is accepting deposits within the limits specified under clause (c) of subsection (1) of section 180, may accept deposits by means of an ordinary resolution;

(f) “fees” means fees as specified in the Companies (Registration Offices and Fees) Rules, 2014;

(g) "Form" or ‘e-Form” means a form set forth in Annexure to these rules which shall be used for the matter to which it relates;

(h) “section” means section of the Act;
(i) "trustee" means the trustee as defined in section 3 of the Indian Trusts Act, 1882 (12 of 1882).

(2) Words and expressions used in these rules but not defined and defined in the Act or in the Reserve Bank of India Act, 1934 (2 of 1934) or in the Companies (Specification of definitions details) Rules, 2014, shall have the meanings respectively assigned to them in the said Acts or in the said rules.

3. **Terms and conditions of acceptance of deposits by companies.**— (1) On and from the commencement of these rules,—

(a) no company referred to in sub-section (2) of section 73 and no eligible company shall accept or renew any deposit, whether secured or unsecured, which is repayable on demand or upon receiving a notice within a period of less than six months or more than thirty-six months from the date of acceptance or renewal of such deposit:

Provided that a company may, for the purpose of meeting any of its short-term requirements of funds, accept or renew such deposits for repayment earlier than six months from the date of deposit or renewal, as the case may be, subject to the condition that - (a) such deposits shall not exceed ten per cent of the aggregate of the paid up share capital, free reserves and securities premium account of the company, and

(b) such deposits are repayable not earlier than three months from the date of such deposits or renewal thereof.

(2) Where depositors so desire, deposits may be accepted in joint names not exceeding three, with or without any of the clauses, namely, “Jointly”, “Either or Survivor”, “First named or Survivor”, “Anyone or Survivor”.

(3) No company referred to in sub-section (2) of section 73 shall accept or renew any deposit from its members, if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal of such deposits exceeds twenty five per cent. of the aggregate of the paid up share capital, free reserves and securities premium account of the company.

(4) No eligible company shall accept or renew

(a) any deposit from its members, if the amount of such deposit together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members exceeds ten per cent of the aggregate of the
III.902 Auditing Pronouncements

paid up share capital, free reserves and securities premium account of the company;

(b) any other deposit, if the amount of such deposit together with the amount of such other deposits, other than the deposit referred to in clause (a), outstanding on the date of acceptance or renewal exceeds twenty-five per cent. Of aggregate of the paid up share capital, free reserves and securities premium account of the company.

(5) No Government company eligible to accept deposits under section 76 shall accept or renew any deposit, if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal exceeds thirty five per cent of the aggregate of its paid up share capital, free reserves and securities premium account of the company.

(6) No company referred to in sub-section (2) of section 73 or any eligible company shall invite or accept or renew any deposit in any form, carrying a rate of interest or pay brokerage thereon at a rate exceeding the maximum rate of interest or brokerage prescribed by the Reserve Bank of India for acceptance of deposits by non-banking financial companies.

Explanation:- For the purposes of this sub-rule, it is hereby clarified that the person who is authorised, in writing, by a company to solicit deposits on its behalf and through whom deposits are actually procured shall only be entitled to the brokerage and payment of brokerage to any other person for procuring deposits shall be deemed to be in violation of these rules.

(7) The company shall not reserve to itself either directly or indirectly a right to alter, to the prejudice or disadvantage of the depositor, any of the terms and conditions of the deposit, deposit trust deed and deposit insurance contract after circular or circular in the form of advertisement is issued and deposits are accepted.

(8) Every eligible company shall obtain, at least once in a year, credit rating for deposits accepted by it in the manner specified herein below and a copy of the rating shall be sent to the registrar of the companies along with the return of the deposits in form DPT-3.

<table>
<thead>
<tr>
<th>Name of the agency</th>
<th>Minimum investment grade rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) The credit rating information services of India Ltd.</td>
<td>FA- (FA Minus)</td>
</tr>
<tr>
<td>(b) ICRA Ltd.</td>
<td>MA- (MA Minus)</td>
</tr>
</tbody>
</table>
4. **Form and particulars of advertisements or circulars.**

(1) Every company referred to in sub-section (2) of section 73 intending to invite deposit from its members shall issue a circular to all its members by registered post with acknowledgement due or speed post or by electronic mode in Form DPT-1:

Provided that in addition to issue of such circular to all members in the manner specified above, the circular may be published in English language in an English newspaper and in vernacular language in a vernacular newspaper having wide circulation in the State in which the registered office of the company is situated.

(2) Every eligible company intending to invite deposits shall issue a circular in the form of an advertisement in Form DPT-1 for the purpose in English language in an English newspaper and in vernacular language in one vernacular newspaper having wide circulation in the State in which the registered office of the company is situated.

(3) Every company inviting deposits from the public shall upload a copy of the circular on its website, if any.

(4) No company shall issue or allow any other person to issue or cause to be issued on its behalf, any circular or a circular in the form of advertisement inviting deposits, unless such circular or circular in the form of advertisement is issued on the authority and in the name of the Board of directors of the company.

(5) No circular or a circular in the form of advertisement shall be issued by or on behalf of a company unless, not less than thirty days before the date of such issue, there has been delivered to the Registrar for registration a copy thereof signed by a majority of the directors of the company as constituted at the time the Board approved the circular or circular in the form of advertisement, or their agents, duly authorised by them in writing.

(6) A circular or circular in the form of advertisement issued shall be valid until the expiry of six months from the date of closure of the financial year in which it is issued or until the date on which the financial statement is laid before the company in annual general meeting or, where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in
accordance with the provisions of the Act, whichever is earlier, and a fresh circular or circular in the form of advertisement shall be issued, in each succeeding financial year, for inviting deposits during that financial year.

Explanation: For the purpose of this rule, the date of the issue of the newspaper in which the advertisement appears shall be taken as the date of issue of the advertisement and the effective date of issue of circular shall be the date of dispatch of the circular.

5. **Manner and extent of deposit insurance.**— (1) Every company referred to in sub-section (2) of section 73 and every other eligible company inviting deposits shall enter into a contract for providing deposit insurance at least thirty days before the issue of circular or advertisement or at least thirty days before the date of renewal, as the case may be.

"Provided that the companies may accept deposit without deposit insurance contract till the 31st March, 2016 or till the availability of a deposit insurance product, whichever is earlier."

Explanation- For the purposes of this sub-rule, the amount as specified in the deposit insurance contract shall be deemed to be the amount in respect of both principal amount and interest due thereon.

(2) The deposit insurance contract shall specifically provide that in case the company defaults in repayment of principal amount and interest thereon, the depositor shall be entitled to the repayment of principal amount of deposits and the interest thereon by the insurer up to the aggregate monetary ceiling as specified in the contract:

Provided that in the case of any deposit and interest not exceeding twenty thousand rupees, the deposit insurance contract shall provide for payment of the full amount of the deposit and interest and in the case of any deposit and the interest thereon in excess of twenty thousand rupees, the deposit insurance contract shall provide for payment of an amount not less than twenty thousand rupees for each depositor.

(3) The amount of insurance premium paid on the insurance of such deposits shall be borne by the company itself and shall not be recovered from the depositors by deducting the same from the principal amount or interest payable thereon.

(4) If any default is made by the company in complying with the terms and conditions of the deposit insurance contract which makes the insurance cover ineffective, the company shall either rectify the default immediately or enter into a fresh contract within thirty days and in case of non-compliance, the amount of deposits covered under the deposit insurance contract and interest payable thereon shall be repaid within the next fifteen days and if such a company does not repay the amount of
deposits within said fifteen days it shall pay fifteen per cent. interest per annum for the period of delay and shall be treated as having defaulted and shall be liable to be punished in accordance with the provisions of the Act.

6. **Creation of security.** - (1) For the purposes of providing security, every company referred to in sub-section (2) of section 73 and every eligible company inviting secured deposits shall provide for security by way of a charge on its assets as referred to in Schedule III of the Act excluding intangible assets of the company for the due repayment of the amount of deposit and interest thereon for an amount which shall not be less than the amount remaining unsecured by the deposit insurance:

Provided that in the case of deposits which are secured by the charge on the assets referred to in Schedule III of the Act excluding intangible assets, the amount of such deposits and the interest payable thereon shall not exceed the market value of such assets as assessed by a registered valuer.

Explanation. I – For the purposes of this sub-rule it is clarified that the company shall ensure that the total value of the security either by way of deposit insurance or by way of charge or by both on company’s assets shall not be less than the amount of deposits accepted and the interest payable thereon.

Explanation. II- For the purposes of proviso to sub-clause (ix) of clause (c) of sub-rule (1) of rule 2 and this sub-rule, it is hereby clarified that pending notification of sub-section (1) of section 247 of the Act and finalisation of qualifications and experience of valuers, valuation of stocks, shares, debentures, securities etc. shall be conducted by an independent merchant banker who is registered with the Securities and Exchange Board of India or an independent chartered accountant in practice having a minimum experience of ten years.

(2) The security (not being in the nature of a pledge) for deposits as specified in sub-rule (1) shall be created in favour of a trustee for the depositors on:

(a) specific movable property of the company, or

(b) specific immovable property of the company wherever situated, or any interest therein.

7. **Appointment of trustee for depositors.** - (1) No company referred to in sub-section (2) of section 73 or any eligible company shall issue a circular or advertisement inviting secured deposits unless the company has appointed one or more trustees for depositors for creating security for the deposits:
Provided that a written consent shall be obtained from the trustee for depositors before their appointment and a statement shall appear in the circular or circular in the form of advertisement with reasonable prominence to the effect that the trustees for depositors have given their consent to the company to be so appointed.

(2) The company shall execute a deposit trust deed in Form DPT-2 at least seven days before issuing the circular or circular in the form of advertisement.

(3) No person including a company that is in the business of providing trusteeship services shall be appointed as a trustee for the depositors, if the proposed trustee –

(a) is a director, key managerial personnel or any other officer or an employee of the company or of its holding, subsidiary or associate company or a depositor in the company;

(b) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(c) has any material pecuniary relationship with the company;

(d) has entered into any guarantee arrangement in respect of principal debts secured by the deposits or interest thereon;

(e) is related to any person specified in clause (a) above.

(4) No trustee for depositors shall be removed from office after the issue of circular or advertisement and before the expiry of his term except with the consent of all the directors present at a meeting of the board.

Provided that in case the company is required to have independent directors, at least one independent director shall be present in such meeting of the Board.

8. **Duties of trustees**.- It shall be the duty of every trustee for depositors to

(a) ensure that the assets of the company on which charge is created together with the amount of deposit insurance are sufficient to cover the repayment of the principal amount of secured deposits outstanding and interest accrued thereon;

(b) satisfy himself that the circular or advertisement inviting deposits does not contain any information which is inconsistent with the terms of the deposit scheme or with the trust deed and is in compliance with the rules and provisions of the Act;

(c) ensure that the company does not commit any breach of covenants and provisions of the trust deed;
(d) take such reasonable steps as may be necessary to procure a remedy for any breach of covenants of the trust deed or the terms of invitation of deposits;

(e) take steps to call a meeting of the holders of depositors as and when such meeting is required to be held;

(f) supervise the implementation of the conditions regarding creation of security for deposits and the terms of deposit insurance;

(g) do such acts as are necessary in the event the security becomes enforceable;

(h) carry out such acts as are necessary for the protection of the interest of depositors and to resolve their grievances.

9. Meeting of depositors. - The trustee for depositors shall call a meeting of all the depositors on

(a) requisition in writing signed by at least one-tenth of the depositors in value for the time being outstanding;

(b) the happening of any event, which constitutes a default or which, in the opinion of the trustee for depositors, affects the interest of the depositors.

10. Form of application for deposits.- (1) On and from the commencement of these rules, no company shall accept, or renew any deposit, whether secured or unsecured, unless an application, in such form as specified by the company, is submitted by the intending depositor for the acceptance of such deposit.

(2) The form of application referred to in sub-rule (1) shall contain a declaration by the intending depositor to the effect that the deposit is not being made out of any money borrowed by him from any other person.

11. Power to nominate. - Every depositor may, at any time, nominate any person to whom his deposits shall vest in the event of his death and the provisions of section 72 shall, as far as may be, apply to the nomination made under this rule.

12. Furnishing of deposit receipts to depositors.- (1) Every company shall, on the acceptance or renewal of a deposit, furnish to the depositor or his agent a receipt for the amount received by the company, within a period of twenty one days from the date of receipt of money or realisation of cheque or date of renewal.

(2) The receipt referred to in sub-rule (1) shall be signed by an officer of the company duly authorised by the Board in this behalf and shall state the date of deposit, the
III.908 Auditing Pronouncements

name and address of the depositor, the amount received by the company as deposit, the rate of interest payable thereon and the date on which the deposit is repayable.

13. Maintenance of liquid assets and creation of deposit repayment reserve account.- Every company referred to in sub-section (2) of section 73 and every eligible company shall on or before the 30th day of April of each year deposit the sum as specified in clause (c) of the said sub-section with any scheduled bank and the amount so deposited shall not be utilised for any purpose other than for the repayment of deposits:

Provided that the amount remaining deposited shall not at any time fall below fifteen per cent. of the amount of deposits maturing, until the end of the current financial year and the next financial year.

14. Registers of deposits.- (1) Every company accepting deposits shall maintain at its registered office one or more separate registers for deposits accepted or renewed, in which there shall be entered separately in the case of each depositor the following particulars, namely:

(a) name, address and PAN of the depositor/s;
(b) particulars of guardian, in case of a minor;
(c) particulars of the nominee;
(d) deposit receipt number;
(e) date and the amount of each deposit;
(f) duration of the deposit and the date on which each deposit is repayable;
(g) rate of interest or such deposits to be payable to the depositor;
(h) due date for payment of interest;
(i) mandate and instructions for payment of interest and for non-deduction of tax at source, if any;
(j) date or dates on which the payment of interest shall be made;
(k) details of deposit insurance including extent of deposit insurance;
(l) particulars of security or charge created for repayment of deposits;
(m) any other relevant particulars;
(2) The entries specified in sub-rule (1) shall be made within seven days from the date of issuance of the receipt duly authenticated by a director or secretary of the company or by any other officer authorised by the Board for this purpose.

(3) The register referred to in sub-rule (1) shall be preserved in good order for a period of not less than eight years from the financial year in which the latest entry is made in the register.

15. General provisions regarding premature repayment of deposits.- Where a company makes a repayment of deposits, on the request of the depositor, after the expiry of a period of six months from the date of such deposit but before the expiry of the period for which such deposit was accepted, the rate of interest payable on such deposit shall be reduced by one per cent from the rate which the company would have paid had the deposit been accepted for the period for which such deposit had actually run and the company shall not pay interest at any rate higher than the rate so reduced:

Provided that nothing contained in this rule shall apply to the repayment of any deposit before the expiry of the period for which such deposit was accepted by the company, if such repayment is made solely for the purpose of—

(a) complying with the provisions of rule 3; or

(b) providing war risk or other related benefits to the personnel of the naval, military or air forces or to their families, on an application made by the associations or societies formed by such personnel, during the period of emergency declared under article 352 of the Constitution:

Provided further that where a company referred to in under sub-section (2) of section 73 or any eligible company permits a depositor to renew his deposit, before the expiry of the period for which such deposit was accepted by the company, for availing of a higher rate of interest, the company shall pay interest to such depositor at the higher rate if such deposit is renewed in accordance with the other provisions of these rules and for a period longer than the unexpired period of the deposit.

Explanation: For the purposes of this rule, where the period for which the deposit had run contains any part of a year, then, if such part is less than six months, it shall be excluded and if such part is six months or more, it shall be reckoned as one year.

16. Return of deposits to be filed with the Registrar.- Every company to which these rules apply, shall on or before the 30th day of June, of every year, file with the Registrar, a return in Form DPT-3 along with the fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and furnish the information contained
therein as on the 31st day of March of that year duly audited by the auditor of the company.

17. **Penal rate of interest.**- Every company shall pay a penal rate of interest of eighteen per cent. per annum for the overdue period in case of deposits, whether secured or unsecured, matured and claimed but remaining unpaid.

18. **Power of Central Government to decide certain questions.** If any question arises as to the applicability of these rules to a particular company, such question shall be decided by the Central Government in consultation with the Reserve Bank of India.

19. **Applicability of sections 73 and 74 to eligible companies.**- Pursuant to provisions of sub-section (2) of section 76 of the Act, the provisions of sections 73 and 74 shall, mutatis mutandis, apply to acceptance of deposits from public by eligible companies.

Explanation.- For the purposes of this rule, it is hereby clarified that in case of a company which had accepted or invited public deposits under the relevant provisions of the Companies Act, 1956 and rules made under that Act (hereinafter known as “Earlier Deposits”) and has been repaying such deposits and interest thereon in accordance with such provisions, the provisions of clause (b) of sub-section (1) of section 74 of the Act shall be deemed to have been complied with if the company complies with requirements under the Act and these rules and continues to repay such deposits and interest due thereon on due dates for the remaining period of such deposit in accordance with the terms and conditions and period of such Earlier Deposits and in compliance with the requirements under the Act and these rules;

Provided further that the fresh deposits by every eligible company shall have to be in accordance with the provisions of Chapter V of the Act and these rules;

20. **Statement regarding deposits existing as on the date of commencement of the Act.**- For the purposes of clause (a) of sub-section (1) of section 74, the statement shall be in Form DPT-4.

21. **Punishment for contravention.**- If any company referred to in sub-section (2) of section 73 or any eligible company inviting deposits or any other person contravenes any provision of these rules for which no punishment is provided in the Act, the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first day during which the contravention continues.
Guidance Note on Reporting on Fraud under Section 143(12) of the Companies Act, 2013 (Revised 2016)

OVERVIEW

I. Persons Covered for Reporting on Fraud under Section 143(12) of the Companies Act, 2013

Sub-section 12 of Section 143 of the Companies Act, 2013 (“the 2013 Act” or “the Act”), as amended, states, “Notwithstanding anything contained in this section, 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:

Provided that in case of fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:

Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board’s report in such manner as may be prescribed."

The reporting requirement under Section 143(12) is for the statutory auditors of the company and also equally applies to the cost accountant in practice, conducting cost audit under Section 148 of the Act; and to the company secretary in practice, conducting secretarial audit under Section 204 of the Act.

However, the provisions of Section 143(12) do not apply to other professionals who are rendering other services to the company. For example, Section 143(12) does not apply to auditors appointed under other statutes for rendering other services such as tax auditor appointed for audit under Income-tax Act; Sales Tax or VAT auditors appointed for audit under the respective Sales Tax or VAT legislations.

It may also be noted that internal auditors covered under Section 138 are not specified as persons who are required to report under Section 143(12).

As per sub-rule (3) of Rule 12 of the Companies (Audit and Auditors) Rules, 2014, the provisions of sub-section (12) of Section 143 read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014 regarding reporting of frauds by the auditor shall also extend to a branch auditor appointed under Section 139 to the extent it relates to the concerned branch.

It may be noted that Section 143(12) includes only fraud by officers or employees of the company and does not include fraud by third parties such as vendors and customers.

1 The amendments to Section 143(12) have come into force on December 14, 2015.
II. Thresholds and Manner of Reporting

The Companies (Audit and Auditors) Amendment Rules, 2015, issued by the Ministry of Corporate Affairs, on 14th December 2015, amended Rule 13 of the Companies (Audit and Auditors) Rules, 2014. The amended Rule 13 has introduced the thresholds for the purpose of reporting on frauds and a differential reporting responsibilities of the statutory auditor with respect to the fraud/s above or below the notified threshold.

As per the amended Rule 13, if an auditor of a company, in the course of 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 rupees one 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 amended Rule 13 provides the following manner of reporting to the Central Government:

(a) the auditor shall report to the Board or the Audit Committee, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty-five 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 fifteen 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 forty-five 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.

In case of a fraud involving lesser than rupees one crore, the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:-

a) Nature of Fraud with description;

b) Approximate amount involved; and

c) Parties involved.

The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) of amended Rule 13 during the year shall be disclosed in the Board’s Report:-
a) Nature of Fraud with description;
b) Approximate Amount involved;
c) Parties involved, if remedial action not taken; and
d) Remedial action taken.

III. Auditors’ Responsibility for Consideration of Fraud in an Audit of Financial Statements

Section 143(12) requires an auditor to report on fraud if in the course of performance of his duties as an auditor, the auditor has reason to believe that an offence of fraud is being or has been committed in the company by its officers or employees.

It may be noted that under section 143(9) read with Section 143(10), the duty of the auditor, inter alia, in an audit is to comply with the Standards on Auditing (SAs). Further, Section 143(2) requires the auditor to make out his report after taking into account, inter alia, the auditing standards. Accordingly, the term, “in the course of performance of his duties as an auditor” implies in the course of performing an audit as per the SAs.

The definition of fraud as per SA 240 and the explanation of fraud as per Section 447 of the 2013 Act are similar, except that under Section 447, fraud includes ‘acts with an intent to injure the interests of the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.’

However, an auditor may not be able to detect acts that have intent to injure the interests of the company or cause wrongful gain or wrongful loss, unless the financial effects of such acts are reflected in the books of account/financial statements of the company. For example,

- an auditor may not be able to detect if an employee is receiving pay-offs for favoring a specific vendor, which is a fraudulent act, since such pay-offs would not be recorded in the books of account of the company;
- if the password of a key managerial personnel is stolen and misused to access confidential/restricted information, the effect of the same may not be determinable by the management or by the auditor;
- if an employee is alleged to be carrying on business parallel to the company’s business and has been diverting customer orders to his company, the auditor may not be able to detect the same since such sales transactions are not recorded in the books of the company.

Therefore, the auditor shall consider the requirements of the SAs, insofar as it relates to the risk of fraud, including the definition of fraud as stated in SA 240, in planning and performing his audit procedures in an audit of financial statements to address the risk of material misstatement due to fraud.

IV. Reporting on Suspected Offence Involving Frauds Identified/Noted during Audit/Limited Review of Interim period Financial Statements/Results, Other Attest Services and Permitted Non-attest Services
III.914  Auditing Pronouncements

Section 143 of the 2013 Act was notified and is effective from April 1, 2014. Whilst Section 143 deals with auditor’s duties and responsibilities under the Act with respect to financial statements prepared under the Act, the auditors perform other attest services in their capacity as auditors of the company. For example, (a) Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements), Regulations 2015 requires the statutory auditor to perform limited review/audit of the quarterly financial results published by the listed companies; (b) the auditor may also be engaged by the Board of directors of the company to carry out the audit of interim financial statements prepared by the management as per Accounting Standard 25 and report on such interim financial statements to the Board of Directors; (c) the auditor may also perform tax audit under the Income-tax Act, 1961; or (d) the auditor may be engaged to issue certificates, etc.

In the case of the aforesaid attest services for financial years beginning on or after 1st April, 2014, the following needs to be considered:

(a) Such attest services may not be pursuant to any requirement of the 2013 Act. They may rather be rendered to meet the specific requirements of the company (such as complying with the Regulation 33 of the SEBI(Listing Obligations and Disclosure Requirements), Regulations 2015, to meet the requirements of the Board of Directors of the company, etc.).

(b) Wherever a statute or regulation requires such attest services to be performed by the auditor of the company, the auditor should consider the requirements and provisions of Section 143(12) since any such work carried out by the auditor during such attest services could be construed as being in the course of performing his duties as an auditor, albeit not under the Companies Act, 2013.

(c) The objective and scope of such attest services and the procedures performed by the auditor may not be of the same extent and level as in the case of the audit of the financial statements prepared under the 2013 Act. For example, the quarterly results under Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements), Regulations 2015 may be subject to a limited review performed in accordance with the Standards on Review Engagements and hence would not have been performed in accordance with the SAs.

Auditors could be engaged to provide non-attest services that are not prohibited under Section 144 of the Act. It is possible that the auditor, when providing such non-attest services may become aware of a fraud that is being or has been committed in the company by its officers or employees.

A question that arises is – should the auditor report under Section 143(12) on frauds noted in the course of providing such other attest or non-attest services?

If an offence of fraud in the company by its officers or employees that is identified/noted by the auditor in the course of providing such attest or non-attest services as referred above, is of such amount/s as specified in Rule 13 of the Companies (Audit and Auditors) Rules, 2014 {as amended by the Companies (Audit and Auditors) Amendment Rules, 2015} which the auditor uses or intends to use the information that is obtained in the course of performing such attest or non-attest services when performing the audit under the 2013 Act,
then in such cases, the matter may become reportable under Section 143(12), read with the Rules thereunder, as specified in this Guidance Note.

V. Reporting on Frauds Detected by the Management or Other Persons and already Reported under Section 143(12) by Such Other Person

Paragraph 4 of SA 240 states and clarifies that the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. In the context of the 2013 Act, this position is reiterated in Section 134(5) which states that the Board report shall include a responsibility statement, *inter alia*, that the directors had taken proper and sufficient care for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities. *Based on the above, it may be considered that Section 143(12) envisages the auditor to report to the Audit Committee under section 177 of the Companies Act, 2013 or to the Board of Directors and thereafter, where applicable, to the Central Government an offence of fraud in the company by its officers or employees only if he is the first person to identify/note such instance in the course of performance of his duties as an auditor.*

Accordingly, in case a fraud has already been reported or has been identified/detected by the management or through the company’s vigil/whistle blower mechanism and has been/is being remediated/dealt with by them and such case is informed to the auditor, he will not be required to report the same under Section 143(12) since he has not per se identified the fraud.

The auditor should apply professional skepticism to evaluate/verify that the fraud was indeed identified/detected in all aspects by the management or through the company’s vigil/whistle blower mechanism so that distinction can be clearly made with respect to frauds identified/detected due to matters raised by the auditor vis-à-vis those identified/detected by the company through its internal control mechanism.

Since reporting on fraud under Section 143(12) is required even by the cost auditor and the secretarial auditor of the company, it is possible that a suspected offence involving fraud may have been reported by them even before the auditor became aware of the fraud. Here too, *if a suspected offence of fraud has already been reported under Section 143(12) by such other person, and the auditor becomes aware of such suspected offence involving fraud, he need not report the same to the Audit Committee under section 177 of the Companies Act 2013 or the Board of Directors and thereafter, where applicable, to the Central Government under the section since he has not per se identified the suspected offence of fraud.*

However, in case of a fraud which involves or is expected to involve individually, an amount of rupees one crore or more, the auditor should review the steps taken by the management/those charged with governance with respect to the reported instance of suspected offence of fraud stated above, and if he is not satisfied with such steps, he should state the reasons for his dissatisfaction in writing and request the management/those charged with governance to perform additional procedures to enable the auditor to satisfy himself that the matter has been appropriately addressed. If the management/those charged with governance fail to undertake appropriate additional
procedures within 45 days of his request, the auditor would need to evaluate if he should report the matter to the Central Government in accordance with Rule 13 of the Companies (Audit and Auditors) Amendment Rules, 2015.

VI. Reporting on Suspected Offence Involving Fraud in case of Consolidated Financial Statements

As per Section 129(4) of the 2013 Act, the provisions relating to audit of the standalone financial statements of the holding company shall also apply to the audit of the consolidated financial statements. Since the audit of the consolidated financial statements has also been made one of the duties of the auditor, a question that arises is – should the auditor report on suspected offence involving frauds that may have taken place in any of the subsidiaries, joint ventures, associates of the company?

Reporting under Section 143(12) arises only if a suspected offence of fraud is being or has been committed in the company by its officers or employees.

Accordingly, the auditor of the parent company is not required to report on frauds under Section 143(12) if they are not being or have not been committed in the parent company by the officers or employees of the parent company but relate to frauds in:

a) A component that is an Indian company, since the auditor of that Indian company is required to report on suspected offence involving frauds under Section 143 (12) in respect of such company; and

b) A foreign corporate component or a component that is not a company since the component auditors’ of such components are not covered under Section 143(12).

However, the auditor of the parent company in India will be required to report on suspected offence involving frauds in the components of the parent company, if the suspected offence of fraud in the component is being or has been committed by employees or officers of the parent company and if such suspected offence involving fraud in the component is against the parent company, if:

a) the principal auditor identifies/detects such suspected offence involving fraud in the component “in the course of the performance of his duties as an auditor” of the consolidated financial statements; or

b) the principal auditor is directly informed of such a suspected offence involving fraud in the component by the component auditor and the management had not identified/is not aware of such suspected offence involving fraud in the component; or

c) a component that is not a company since the component auditors of such components are not covered under Section 143(12).

VII. Reporting under Section 143(12) when the Suspected Offence Involving Fraud relates to periods prior to coming into effect of the 2013 Act
Requirements similar to Section 143(12) of the 2013 Act were not prescribed in the 1956 Act. Even the reporting under the Companies (Auditor’s Report) Order, 2003 (CARO) only required the auditors to report to the members on any fraud on or by the company that had been noticed or reported during the year.

As such, auditors would not have reported on frauds as envisaged under Section 143(12) in those periods prior to coming into effect of the 2013 Act. Accordingly, in case of fraud relating to earlier years to which the Companies Act, 1956 was applicable, reporting under Section 143(12) will arise only if the suspected offence of fraud is identified by the auditor in the course of performance of his duties as an auditor during the financial years beginning on or after April 1, 2014 and to the extent that the same was not dealt with in the prior financial years either in the financial statements or in the audit report or in the Board’s report under the Companies Act, 1956.

VIII. When does an Auditor Commence Reporting under Section 143(12) – Based on Suspicion - Reason to Believe – Knowledge – or on Determination of Offence?

Section 143(12) states that an auditor should report under the Section if he has “reason to believe” that an offence of fraud has or is being committed in the company by its officers or employees. Rule 13 of the Companies (Audit and Auditors) Amendment Rules, 2015 specifies the threshold for reporting as “reason to believe” and “knowledge”. The Form ADT – 4 in which the auditor is required to report to the Central Government uses the term “suspected offence involving fraud”.

It is important to understand the terms “reason to believe”, “knowledge” and “suspected offence involving fraud” to determine the point of time when the reporting requirement is triggered for an auditor under Section 143(12) read with Rule 13 of the Companies (Audit and Auditors) Amendment Rules, 2015.

- ‘Suspicion’ is a state of mind more definite than speculation, but falls short of knowledge based on evidence. It must be based on some evidence, even if that evidence is tentative – simple speculation that a person may be engaged in fraud is not sufficient grounds to form a suspicion. Suspicion is a slight opinion but without sufficient evidence.

- For ‘reason to believe’ to come into existence, it cannot be based on suspicion. There needs to be sufficient information or convincing evidence to advance beyond suspicion that it is possible someone is committing or has committed a fraud. For example, identification of fraud risk factors in itself cannot cause ‘reason to believe’ that a fraud exists.

- The term ‘reason to believe’ creates an objective test. SA 240, “The Auditor’s Responsibilities Relating to Frauds in an Audit of Financial Statements” specifies the requirements to be complied by the auditors in assessing and responding to the risk of fraud in an audit of financial statements. For example, when complying with the requirements of SA 240, an auditor might be considered to have reasons to believe that a fraud has been or is being committed if he had actual knowledge of, or possessed information which would indicate to a reasonable person, that another person was committing or had committed a fraud.
The term ‘reason to believe’ which has been used in the SAs indicate that it arises when:

- Evaluating audit evidence and information provided; or
- Evaluating misstatements, including deviations noted on audit sampling and further audit procedures carried out; or
- Exercising professional skepticism.

Rule 13 of the Companies (Audit and Auditors) Amendment Rules, 2015 has used the terms ‘reason to believe’ and ‘knowledge’ (of fraud). The condition of ‘reason to believe’ would be met if on evaluation of all the available information with the auditor and applying appropriate level of skepticism the auditor concludes that a fraud is being or has been committed on the company.

Having ‘knowledge’ means knowing ‘that’ something. In the case of reporting on fraud under Section 143(12), it occurs when the auditor has sufficient reason to believe that a fraud has been or is being committed on the company by its officers or employees. This implies that there exists a fraud.

Whilst Section 143(12) uses the term ‘offence of fraud’ and the Form ADT – 4 uses the term “suspected offence involving fraud”. As per paragraph 3 of SA 240, although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determination of whether fraud has actually occurred. Determination of “offence” is legal determination and accordingly, the auditor will not be able to legally determine that an “offence or suspected offence involving fraud” has been or is being committed against the company by its officers or employees.

Accordingly, based on a harmonious reading of Section 143(12), Rule 13 of the Companies (Audit and Auditors) Amendment Rules, 2015 and Form ADT - 4, reporting on fraud in the course of performance of duties as auditor, is applicable only when the auditor has reason to believe and has knowledge that a fraud has occurred or is occurring i.e., when the auditor has evidence that a fraud exists.

IX. Can the Auditor apply the Concept of Materiality for Reporting on Fraud?

The concept of materiality is fundamental for setting up an appropriate system of internal control, preparation of financial statements and its audit. Due to its inherent limitations, internal control systems cannot provide absolute assurance that no fraud or error has taken place. Since the auditor is required to comply with the SAs in performance of duties as an auditor, the audit will be performed applying the concept of materiality provided in the SAs.

Section 143(9) requires the auditor to comply with the SAs, which, inter alia, includes consideration of materiality, applying materiality in evaluating misstatements and disposition of the same.

The auditor should continue to apply the concept of materiality in performing the audit in accordance with SA 320 “Materiality in Planning and Performing an Audit”.

Fraud results in misstatement of financial statements. The SAs outline the procedures to be performed by an auditor in case a misstatement due to fraud is identified by the auditor. For example, paragraph A52 of SA 240 states that in evaluating and disposing the misstatements
identified, the auditor should consider the requirements of SA 450 “Evaluation of Misstatements Identified during the Audit”.

SA 450 considers the concept of materiality in classifying the manner of disposition of misstatements, including those arising from fraud. Misstatements arising from fraud, will need to be communicated to the management and/or those charged with governance as required under paragraphs A21 to A23 of SA 450 and also reported to the Central Government in accordance with the requirements specified in Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended, in case the amount involved or expected to involve is individually Rupees One Crore or more.

Materiality is applicable wherever the amount is quantifiable. Where the amount is not quantifiable, the auditor should apply professional judgement to estimate the likelihood of the amount exceeding the aforesaid limit of Rupees One Crore prescribed for reporting to the Central Government. For this purpose it can be based on management estimate or reasonable range of estimate made by the auditor. Subsequent reporting may be required if the amount initially estimated was lower than the aforesaid limit but was eventually determined to be higher than such limit. Under these circumstances, the timeline for reporting under Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015, will commence when the amount involved is determined to be in excess of such limit.

X. Should the Auditor Report under Section 143(12) in case of Corruption, Bribery, Money Laundering and Non-compliance with other Laws and Regulations

In case of corruption, bribery and money laundering, the direct effect of such act (benefit or penal consequence) is on the company.

The auditor should comply with the relevant SAs with regard to illegal acts (e.g. SA 240 and SA 250, “Consideration of Laws and Regulations in an Audit of Financial Statements”) when performing the audit. If the auditor, in the course of performance of his/her duties as the auditor, comes across instances of corruption, bribery and money laundering and other intentional non-compliances with laws and regulations, the auditor would need to evaluate the impact of the same in accordance with SA 250 to determine whether the same would have a material effect on the financial statements.

With respect to reporting under Section 143(12), consequent to corruption, bribery, money laundering and other intentional non-compliance with other laws and regulations, the auditor should consider whether such acts have been carried out by officers or employees of the company for the purpose of reporting and also take into account the requirements of SA 250, particularly paragraph 28 of SA 250 read with paragraphs A19 and A20.

For example, if the auditor comes to know that the company has filed a fraudulent return of income to evade income tax, he may have to report this fraud under Section 143(12) irrespective of whether adequate provision has been made in the books of accounts or not.

It may be noted that the proviso to Section 147(2) in the context of punishment to auditors for contravention with the provisions, inter alia, of Section 143 of the 2013 Act, states, “if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with
imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

XI. Reporting on Fraud under Section 143(12) – Decision Tree/Flow Chart

![Decision Tree/Flow Chart]

Go to next Page
SECTION I: INTRODUCTION

1. Fraud has the capacity to undermine the confidence of stakeholders in an organisation and there is a strong nexus between prevention of fraud and good corporate governance.

2. Consideration of fraud in financial reporting and the auditor’s responsibility on reporting on fraud has always been an integral part of an audit of financial statements carried out in accordance with the Standards on Auditing. Misstatements in the financial statements can arise from either fraud or error and the distinguishing factor between the two is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. The auditor is
required to consider fraud as a risk that could cause a material misstatement in the financial statements and plan and perform such procedures that mitigate the risk of material misstatement due to fraud. These requirements are specified in Standard on Auditing (SA) 240, “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”.

Requirements for Reporting on Fraud under the Companies Act, 2013

3. Section 143(12) of the Companies Act, 2013 (‘the 2013 Act’ or ‘the Act’), as amended, states that “Notwithstanding anything contained in this section, 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:

Provided that in case of fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:

Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board’s report in such manner as may be prescribed.”

Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015 specifies the manner in which the auditor is required to report on fraud to the Central Government and Form ADT 4 to these Rules (Refer Appendix 6) provides the format and information to be included in such report.

4. In terms of provisions of Section 143(14) of the 2013 Act, the reporting requirement under Section 143(12) is for auditors of the company and also equally applies to the cost accountant in practice conducting cost audit under Section 148 of the Act; as well as the company secretary in practice conducting secretarial audit under Section 204 of the Act. However, the provisions of Section 143(12) do not apply to other professionals who are rendering other services to the company. Further, Section 143(12) also does not apply to auditors appointed under other statutes for rendering services such as Tax Audit under the Income-tax Act, 1961; Sales Tax audit or VAT audit.

It may be noted that internal auditors covered under Section 138 are not specified as persons who are required to report under Section 143(12).

5. Section 143(12) includes only fraud by officers or employees of the company and does not include fraud by third parties such as vendors and customers.

Suspected fraud by vendors, customers and other third parties should be dealt with in accordance with SA 240.

2 The amendments to Section 143(12) have come into force on December 14, 2015.
Section 2(59) of the 2013 Act, defines the term “officer” to include any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act.

The 2013 Act does not define the term “employees”. However, in common parlance, the term “employees” implies those persons who are on the payroll of the company. Employees would, therefore, not include those persons who are engaged on a contract basis e.g. security, house-keeping, canteen staff, who work in the company premises on behalf of a contractor who has been given the contract to provide such services to the company. In this instance, the contract workers will be considered as vendors and not employees.

6. This Guidance Note aims to provide guidance to the auditors on matters that may arise pursuant to the reporting requirements on fraud under Section 143(12) of the Act. Section 143(12) specifically states that the auditor should report to the Audit Committee under section 177 of the Companies Act, 2013 or the Board of Directors and, where applicable, to the Central Government if he has reason to believe that an offence of fraud is being or has been committed in the company by its officers or employees if the auditor has noted it “in the course of the performance of his duties as auditor”. Accordingly, the Guidance Note should be read in conjunction with the Standards on Auditing (SAs), issued by the Institute of Chartered Accountants of India (ICAI) since Section 143(9) of the 2013 Act read with Section 143(10) casts a duty and responsibility on the auditor to comply with the SAs.

7. Reporting by the auditor on fraud is not a new concept in India. Such reporting exists under the SAs, the Companies Act, 1956, RBI Regulations, etc. The guidance provided by the ICAI in these contexts continues to be relevant and applicable even in the case of reporting by the auditor on fraud under Section 143(12) of the 2013 Act.

8. The requirements for reporting by auditors under Section 143(12) would apply even if the fraud is required to be/has been reported under any other statute or to any other Regulator. For example, in case of a fraud identified in a Bank, the auditor of the Bank should report the fraud to the RBI as per the requirements of the RBI Regulations on audit of Banks (Refer paragraph 11 below). If the Bank is a company and is governed by the provisions of the 2013 Act, in addition to the reporting to the RBI, the auditor may also be required to report the offence involving fraud to the Central Government if such instance is covered under Section 143(12) of the 2013 Act, as specified in this Guidance Note.

9. Consideration of Fraud in an Audit of Financial Statements as required by Standards on Auditing

Various SAs state the requirements for the auditor to consider the risk of fraud in an audit of financial statements and the manner of dealing with the same:

a. SA 240, inter alia, states the following:
   Paragraph 5 - ‘An auditor conducting an audit in accordance with SAs 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. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.’

Paragraph 40 - ‘If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor shall communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities’.

Paragraph 43 - ‘If the auditor has identified or suspects a fraud, the auditor shall determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity. Although the auditor’s professional duty to maintain the confidentiality of client information may preclude such reporting, the auditor’s legal responsibilities may override the duty of confidentiality in some circumstances’.

Paragraph A66 - ‘In some clients, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related legislation or regulation’.

b. Paragraphs 22 and 23 of SA 250 – “Consideration of Laws and Regulations in an Audit of Financial Statements”, requires the auditor, inter alia, to communicate to those charged with governance (the Audit Committee/Board of Directors) when there is a non-compliance with laws and regulations, that come to the auditor’s attention during the course of the audit, which he/she believes is intentional and material, without delay.

c. Paragraph 27 of SA 315 – “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment”, requires the auditor to consider the risk of fraud in determining which risks are significant risks.

10. Reporting on Fraud under Section 227 (4A) of the Companies Act, 1956 as per the Companies (Auditor’s Report) Order, 2003 (‘CARO’) (Note: The following guidance is included here only to briefly explain the erstwhile reporting requirements of the statutory auditor relating to fraud for a better understanding of and comparison with the current reporting requirements).

Clause 4 (xxi) of CARO required the auditor to report whether any fraud on or by the company has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated. The Statement on the Companies (Auditor’s Report) Order, 2003 (‘the Statement’) issued by the ICAI specified the responsibilities of the auditor when reporting under clause 4(xxii) of CARO. As per the Statement:

a. Clause 4(xxii) does not require the auditor to discover the frauds on the company and by the company. 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 on the company or by the company 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 on or by the company 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 to Consider Fraud and Error in an Audit of Financial
Statements”.

b. Although fraud is a broad legal concept, the auditor is concerned with fraudulent acts that
cause a material misstatement in the financial statements. Misstatement of the financial
statements may not be the objective of some frauds. Auditors do not make legal
determinations of whether fraud has actually occurred. Fraud involving one or more
members of management or those charged with governance is referred to as
"management fraud"; fraud involving only employees of the entity is referred to as
"employee fraud". In either case, there may be collusion with third parties outside the
entity. In fact, generally speaking, the “management fraud” can be construed as “fraud by
the company” while fraud committed by the employees or third parties may be termed as
“fraud on the company”.

c. Two types of intentional misstatements are relevant to the auditor's consideration of
fraud—misstatements resulting from fraudulent financial reporting and misstatements
resulting from misappropriation of assets.

d. Fraudulent financial reporting involves intentional misstatements or omissions of amounts
or disclosures in financial statements to deceive financial statement users. Fraudulent
financial reporting may involve:
   – Deception such as manipulation, falsification, or alteration of accounting records
     or supporting documents from which the financial statements are prepared.
   – Misrepresentation in, or intentional omission from, the financial statements of
     events, transactions or other significant information.
   – Intentional misapplication of accounting principles relating to measurement,
     recognition, classification, presentation, or disclosure.

e. Misappropriation of assets involves the theft of an entity's assets. Misappropriation of
assets can be accomplished in a variety of ways (including embezzling receipts, stealing
physical or intangible assets, or causing an entity to pay for goods and services not
received); it is often accompanied by false or misleading records or documents in order to
conceal the fact that the assets are missing.

f. Fraudulent financial reporting may be committed by the company because management
is under pressure, from sources outside or inside the entity, to achieve an expected (and
perhaps unrealistic) earnings target particularly when the consequences to management

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of failing to meet financial goals can be significant. The auditor must appreciate that a perceived opportunity for fraudulent financial reporting or misappropriation of assets may exist when an individual believes internal control could be circumvented, for example, because the individual is in a position of trust or has knowledge of specific weaknesses in the internal control system.

g. While planning the audit, the auditor should discuss with other members of the audit team, the susceptibility of the company to material misstatements in the financial statements resulting from fraud. While planning, the auditor should also make inquiries of management to determine whether management is aware of any known fraud or suspected fraud that the company is investigating.

h. The auditor should examine the reports of the internal auditor with a view to ascertain whether any fraud has been reported or noticed by the management. The auditor should examine the minutes of the audit committee, if available, to ascertain whether any instance of fraud pertaining to the company has been reported and actions taken thereon. The auditor should enquire of the management about any frauds on or by the company that it has noticed or that have been reported to it. The auditor should also discuss the matter with other employees of the company. The auditor should also examine the minutes book of the Board meeting of the company in this regard.

i. The auditor should obtain written representations from the management, stating, inter alia, (i) it acknowledges its responsibility for the implementation and operation of accounting and internal control systems that are designed to prevent and detect fraud and error; (ii) it has disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity; and (iii) it has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

j. Because management is responsible for adjusting the financial statements to correct material misstatements, it is important that the auditor obtains written representation from management that any uncorrected misstatements resulting from fraud are, in management's opinion, immaterial, both individually and in the aggregate.

11. Reporting to RBI in case of Fraud noted in Audit of Banks

The RBI issued Circular No. DBS.FGV.(F).No. BC/23.08.001/2001-02 dated May 3, 2002 relating to implementation of recommendations of the Committee on Legal Aspects of Bank Frauds (Mitra Committee) and the recommendations of the High Level Group set-up by the Central Vigilance Commission applicable to all scheduled commercial banks (excluding RRBs). Regarding responsibility and liability of accounting and auditing professionals, the said Circular provides as under:

"If an accounting professional, whether in the course of internal or external audit or in the process of institutional audit finds anything susceptible to be fraud or fraudulent activity or act of excess
power or smell any foul play in any transaction, he should refer the matter to the regulator. Any deliberate failure on the part of the auditor should render himself liable for action”.

Paragraphs 2.32 to 2.38 of Chapter 2 of Part I of the Guidance Note on Audit of Banks 2016 edition provides guidance to the auditors with respect to fraud noted in an audit of Banks and, inter alia, states as follows.

a. As per the above requirement, the member shall be required to report the kind of matters stated in the circular to the regulator, i.e., RBI. In this regard, attention of the members is also invited to Clause 1 of Part I of the Second Schedule to the Chartered Accountants Act, 1949, which states that “A chartered accountant in practice shall be deemed guilty of professional misconduct, if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of his client or otherwise than as required by any law for the time being in force.”

b. Under the said provision, if a member of the Institute *suo moto* discloses any information regarding any actual or possible fraud or foul play to the RBI, the member would be liable for disciplinary action by the Institute. However, a member is not held guilty under the said clause if the client explicitly permits the auditor to disclose the information to a third party. If the above-mentioned requirement of the Circular is included in the letter of appointment (which constitutes the terms of audit engagement) then it would amount to the explicit permission by the concerned bank (client) to disclose information to the third party, i.e., the RBI.

c. Thus, auditors while reporting such a matter to the Bank should also report the matter simultaneously to the Department of Banking Supervision, RBI, provided the terms of the audit engagement require him to do so.

d. Auditor should also consider the provisions of SA 250, “Consideration of Laws and Regulations in an Audit of Financial Statements”. Para A19 of the said Standard explains that the duty of confidentiality may be over-ridden by statute, law or by courts (for example, the auditor is required to report certain matters of non-compliance to RBI as per the requirements of the Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 1988, issued by the RBI).

e. RBI has issued a Master Circular no. DBS.CO.CFMC.BC.No. 1/23.04.001/2015-16 dated July 1, 2015 on “Frauds—Classification and Reporting” on the matters relating to classification and reporting of frauds and laying down a suitable reporting system. As per the said circular, the primary responsibility for preventing frauds is that of the Bank management. Banks are required to report frauds to the Board of Directors and also to the RBI.

f. In the aforesaid context, it may be emphasised that such a requirement does not extend the responsibilities of an auditor in any manner whatsoever as far as conducting the audit is concerned. The requirement has only extended the reporting responsibilities of the
Auditing Pronouncements

As far as conduct of audit is concerned, the auditor is expected to follow the Standards on Auditing issued by the ICAI and perform his functions within that framework. SA 240 (Revised), "The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements" states that an auditor conducting an audit in accordance with SAs 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.

The auditor should also refer to reports of internal auditors, concurrent auditors, inspectors, etc., which may point out significant weaknesses in the internal control system. Such an evaluation would also provide the auditor about the likelihood of occurrence of transactions involving exercise of powers much beyond those entrusted to an official. It must be noted that the auditor is not expected to look into each and every transaction but to evaluate the system as a whole. Therefore, if the auditor while performing his normal duties comes across any instance, he should report the matter to the RBI in addition to the Chairman/Managing Director/Chief Executive of the concerned Bank.

Responsibility of Management

12. It may be noted that the primary responsibility to establish adequate internal control systems to prevent and detect frauds and errors is that of the management of the entity. In the case of a company, the Board of Directors, in terms of the provisions of Section 134(5) of the 2013 Act, are required to, inter alia, state as a part of the directors’ responsibility statement in the Board report to the shareholders, that they had taken proper and sufficient care for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

In the case of a listed company, clause (e) of Sub-section 5 of Section 134 to the Act requires the directors’ responsibility statement to also state that the directors, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively. This clause explains the meaning of internal financial controls as “the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.”

13. Audit Committee’s Responsibility on Vigil Mechanism

Sections 177(9) and (10) of the 2013 Act requires every listed company and the specified class or classes of companies³, to establish a vigil mechanism for directors and employees to report

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³ As per Rule 7(1) of the Companies (Meetings of Board and Its Powers) Rules, 2014, the following classes of companies are also required to establish a vigil mechanism:
(i) companies which accept deposits from the public.
(ii) companies which have borrowed money from banks and public financial institutions in excess of Rs. 50 crores.
genuine concerns in the manner as prescribed under the Companies (Meetings of Board and its Powers) Rules, 2014. The vigil mechanism needs to provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases. The details of establishment of such mechanism are required to be disclosed by the company on its website, if any, and in the Board’s report.

14. **Code of Conduct for Independent Directors**

Section 149(8) of the 2013 Act deals with appointment and qualification of directors and prescribes the code of conduct for independent directors (Schedule IV to the Act). The Code provides a broad framework for, among other things, role and responsibilities of the independent directors, including:

a. paying sufficient attention and ensuring that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;

b. ascertaining and ensuring that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;

c. reporting concerns about unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy;

d. satisfying themselves on the integrity of the financial information and that the financial controls and the systems of risk management are robust and defensible;

e. safeguarding the interests of all the stakeholders, particularly, the minority shareholders;

f. ensuring that their concern about the running of the company or a proposed action are addressed by the Board and to the extent they are not resolved, insist that their concerns are recorded in the minutes of the meeting of the Board.

**Various Definitions of Fraud**

15. In the 2013 Act, the meaning of fraud has been considered in two specific sections viz. Section 143(10), where the SAs specified by the ICAI are deemed to be the auditing standards for purposes of the Act, which, *inter alia*, define fraud, and in Section 447, where punishment for fraud has been prescribed.

a. Fraud has been defined in paragraph 11(a) of SA 240 as ‘an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.’

b. *In the context of stating the provisions for punishment for fraud, Section 447 of the Act has explained the term ‘fraud’* as “fraud in relation to affairs of a company or any body corporate, includes any act, omission, concealment of fact or abuse of position committed by any person or any other person with the connivance in any manner, with
III.930 Auditing Pronouncements

intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.”

This Section further explains the terms ‘wrongful gain’ and ‘wrongful loss’ to mean the gain by unlawful means of property to which the person gaining is not legally entitled; and the loss by unlawful means of property to which the person losing is legally entitled, respectively.

16. Fraud has also been defined by various other regulators/statutes.

a. The Insurance Fraud Monitoring Framework of the IRDA defines fraud in insurance as ‘an act or omission intended to gain dishonest or unlawful advantage for a party committing the fraud or for other related parties.’

b. Reserve Bank of India, per se, has not defined the term ‘fraud’ in its guidelines on Frauds. A definition of fraud was, however, suggested in the context of electronic banking in the Report of RBI Working Group on Information Security, Electronic Banking, Technology Risk Management and Cyber Frauds, which reads as, ‘a deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the books of accounts maintained manually or under computer system in banks, resulting into wrongful gain to any person for a temporary period or otherwise, with or without any monetary loss to the bank’.

c. Fraud, under Section 17 of the Indian Contract Act, 1872, includes any of the following acts committed by a party to a contract, or with his connivance, or by his agents, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract:

• the suggestion as a fact, of that which is not true, by one who does not believe it to be true;
• the active concealment of a fact by one having knowledge or belief of the fact;
• a promise made without any intention of performing it;
• any other act fitted to deceive;
• any such act or omission as the law specially declares to be fraudulent.
**SECTION II: AUDITORS’ REPORTING ON FRAUD UNDER SECTION 143(12)**

17. Sections 143(12) to 143(15) of the 2013 Act states the provisions of the 2013 Act with regard to auditor’s reporting on fraud. Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015, provides the timeline and manner in which the auditor should report on fraud.

18. As per Section 143(12), notwithstanding anything contained in this section, 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. (emphasis added)

Provided that in case of fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:

Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board’s report in such manner as may be prescribed."

19. As per Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015:

(1) 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 Rupees One 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. (emphasis added)

(2) The auditor shall report the matter to the Central Government as under:

(a) the auditor shall report to the Board or the Audit Committee, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty-five 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 fifteen 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 forty-five 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.

(3) In case of a fraud involving lesser than the amount specified in sub-rule (1), the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:-

(a) Nature of Fraud with description;
(b) Approximate amount involved; and
(c) Parties involved.

(4) The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year shall be disclosed in the Board’s Report:-

(a) Nature of Fraud with description;
(b) Approximate Amount involved;
(c) Parties involved, if remedial action not taken; and
(d) Remedial action taken.

20. Section 143(13) states that ‘No duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in Sub-section (12) if it is done in good faith’.

Accordingly, the auditor will not be subject to professional misconduct if he discloses information acquired in the course of his professional engagement with respect to compliance with Section 143(12), since it is as required by law.

21. Further, Section 456 of the Act also, inter alia, provides that no suit, prosecution or other legal proceeding shall lie against any person in respect of anything which is in good faith done or intended to be done in pursuance of this Act or of any rules or orders made thereunder.

22. As per Section 143(15), if any auditor does not comply with the provisions of Sub-section 143(12), he shall be punishable with fine of at least one lakh rupees, which may extend to twenty-five lakh rupees.

23. As per Sub-rule (3) of Rule 12 of the Companies (Audit and Auditors) Rules, 2014, the provisions of Sub-section (12) of Section 143 read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014 regarding reporting of fraud by the auditor also extend to a branch auditor appointed under Section 139 to the extent it relates to the concerned branch.
24. **While the reporting responsibility under Section 143(12) is to the Audit Committee or the Board of Directors of the Company and / or to the Central Government, the auditor would also need to consider whether such matter also needs to be disclosed in the auditor's report under Section 143(3)(f) which requires the auditor to state his/her observations on financial transactions/matters, which have any adverse effect on the functioning of the company.**

25. It is pertinent to note that the auditor is also required to report on fraud in terms of paragraph 3 (xii) of the Companies (Auditors Report) Order, 2015 on all frauds during the year whether noticed or reported by the auditor or the Company or by any others, even if reporting as required under Section 143(12) has been made by the auditor.

**Issues for Consideration by Auditors for Reporting under Section 143(12)**

**Auditors' Responsibility for Consideration of Fraud in an Audit of Financial Statements**

26. Paragraph 10 of SA 240 states that the objectives of the auditor are:

   (a) To identify and assess the risks of material misstatement in the financial statements due to fraud;

   (b) To obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and

   (c) To respond appropriately to identified or suspected fraud.

27. Paragraph 4 of SA 240 also states and clarifies that the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

28. In the context of the 2013 Act, this position is reiterated in Section 134(5) which states that the Board report shall include a responsibility statement, *inter alia*, that the directors had taken proper and sufficient care for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

29. Section 143(9) read with Section 143(10), requires the auditor to comply with the SAs issued by ICAI. Further, Section 143(2) requires the auditor to make out his report after taking into account, *inter alia*, the auditing standards. Accordingly, the term “in the course of performance of his duties as an auditor” may be understood to mean in the course of performing an audit in accordance with the SAs.

30. Based on the above, it is reasonable to conclude that the objective of an auditor in the course of performance of duties as an auditor in accordance with the SAs, is to perform such
III.934 Auditing Pronouncements

procedures that provide sufficient appropriate audit evidence about the risks of material misstatement in the financial statements due to fraud that have been assessed by him through designing and implementing appropriate responses, and to respond appropriately to identified or suspected fraud.

31. **The definition of fraud as per SA 240 and the explanation of fraud as per Section 447 of the 2013 Act are similar, except that under Section 447, fraud includes ‘acts with an intent to injure the interests of the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.’**

However, an auditor may not be able to detect acts that have intent to injure the interests of the company or cause wrongful gain or wrongful loss, unless the financial effects of such acts are reflected in the books of account/financial statements of the company. For example,

- an auditor may not be able to detect if an employee is receiving pay-offs for favoring a specific vendor, which is a fraudulent act, since such pay-offs would not be recorded in the books of account of the company;

- if the password of a key managerial personnel is stolen and misused to access confidential/restricted information, the effect of the same may not be determinable by the management or by the auditor;

- if an employee is alleged to be carrying on business parallel to the company's business and has been diverting customer orders to his company, the auditor may not be able to detect the same since such sales transactions would not be recorded in the books of the company.

32. Therefore, for the purpose of Section 143(12) the auditor would need to consider the requirements of the SAs, insofar as they relate to the risk of fraud, including the definition of fraud as stated in SA 240, in planning and performing his audit procedures in an audit of financial statements to address the risk of material misstatement due to fraud.

Reporting on Suspected Offence involving Frauds noted during Audit/Limited Review of Interim period Financial Statements/Results and Other Attest Services

33. Section 143(12) of the 2013 Act, as amended by the Companies (Amendment) Act, 2015 is effective from December 14, 2015. Whilst Section 143 deals with auditor’s duties and responsibilities under the Act with respect to financial statements prepared under the Act, the auditors, normally, also perform other attest services in their capacity as auditors of the company. For example, Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 requires the statutory auditor to perform limited review/audit of the quarterly financial results published by the listed companies. The auditor may also be engaged by the Board of Directors of the company to carry out the audit of interim financial statements prepared by the management and report on such interim financial statements to the Board of Directors. The auditor may also have been engaged to perform tax audit under the Income-tax Act, 1961.
34. In the case of the aforesaid attest services for financial years beginning on or after 1st April, 2014, the following needs to be considered:

a. Such attest services may not be pursuant to any requirement of the 2013 Act. They may rather be rendered to meet the specific requirements of the company (such as complying with the Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, to meet the requirements of the Board of Directors of the company, etc.).

b. Wherever a statute or regulation requires such attest services to be performed by the auditor of the company, the auditor should consider the requirements and provisions of Section 143(12) since any such work carried out by the auditor during such attest services could be construed as being in the course of performing his duties as an auditor, albeit not under the Companies Act, 2013.

c. The objective and scope of such attest services and the procedures performed by the auditor may not be of the same extent and level as in the case of the audit of the financial statements prepared under the 2013 Act. For example, the quarterly results under Regulation 33 of the SEBI(Listing Obligations and Disclosure Requirements), Regulations 2015 may be subject to a limited review performed in accordance with the Standards on Review Engagements and hence would not have been performed in accordance with the SAs.

35. **If an offence of fraud in the company by its officers or employees that is identified/noted by the auditor in the course of providing such attest services as referred above, is of such amount/s as specified in Rule 13 of the Companies (Audit and Auditors) Rules, 2014 [as amended by the Companies (Audit and Auditors) Amendment Rules, 2015] which the auditor uses or intends to use when performing the audit under the 2013 Act, then in such cases, the matter may become reportable under Section 143(12), read with the Rules thereunder, as specified in this Guidance Note.**

**Reporting Responsibility in case of Suspected Offence involving Fraud noted during Performance of Permitted Non-attest Services**

36. Auditors could be engaged to provide non-attest services that are not prohibited under Section 144 of the Act. It is possible that the auditor, when providing such non-attest services may become aware of a fraud that is being or has been committed against the company by its officers or employees. A question that arises is – should the auditor report under Section 143(12) on frauds noted in the course of providing non-attest services?

37. It may be noted that reporting under Section 143(12) arises only 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.
38. If an offence of fraud in the company by its officers or employees that is identified/noted by the auditor in the course of providing such non-attest services as referred above, is of such amount/s as specified in Rule 13 of the Companies (Audit and Auditors) Rules, 2014 [as amended by the Companies (Audit and Auditors) Amendment Rules, 2015] which the auditor uses or intends to use when performing the audit under the 2013 Act, then in such cases, the matter may become reportable under Section 143(12), read with the Rules thereunder, as specified in this Guidance Note.

Reporting on Frauds detected by the Management or Other Persons and already Reported under Section 143(12) by Such Other Person

39. Paragraph 4 of SA 240 states and clarifies that the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. In the context of the 2013 Act, this position is reiterated in Section 134(5) which states that the Board report shall include a responsibility statement, inter alia, that the directors had taken proper and sufficient care for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities. Based on the above, it may be considered that Section 143(12) envisages the auditor to report to the Audit Committee or the Board of Directors and, where applicable, to the Central Government an offence involving fraud/suspected fraud against the company by its officers or employees only if he is the first person to identify/note such instance in the course of performance of his duties as an auditor.

The auditor, in the course of the performance of his duties as an auditor, is required to make inquiries with the management and the Board or Audit Committee about reported or identified/detected instances of fraud through any other internal or external sources and, consequently, the auditor may become aware of those frauds which have been/are being remediated/dealt with by them. Though the auditor becomes aware of such frauds when he/she is informed of the same by the management, he/she, per se, has not identified them on his/her own and is, therefore, not the first person to identify the fraud in those cases.

For example, in the case of Banks and NBFCs there is a requirement of reporting frauds to the Audit Committee/Board and to the Reserve Bank of India and, hence, to the extent such cases have already been identified and reported by the management, the auditor cannot be considered as the person who first identified them. Further, many companies have or are required to have a vigil/whistle blower mechanism through which instances of fraud may have already been reported.

Accordingly, in case a fraud has already been reported or has been identified/detected by the management or through the company’s vigil/whistle blower mechanism and has been/is being remediated/dealt with by them and such case is informed to the auditor, the latter will not be required to report the same under Section 143(12) since he has not per se identified the fraud.
The auditor should apply professional skepticism to evaluate/verify that the fraud was indeed identified/detected in all aspects by the management or through the company’s vigil/whistle blower mechanism so that distinction can be clearly made with respect to frauds identified/detected due to matters raised by the auditor vis-à-vis those identified/detected by the company through its internal control mechanism.

For example, in a fraud involving vendor payments, if the company identified the fraud and its nature and cause through its internal control mechanism but did not identify all the vendor accounts involved in the fraud that were identified by the auditor, it may need to be considered that the fraud was not identified in all aspects by the management and the auditor may need to report the same under Section 143(12) of the 2013 Act.

40. Since reporting on fraud under Section 143(12) is required even by the cost auditor and the secretarial auditor of the company, it is possible that a suspected offence involving fraud may have been reported by them even before the auditor became aware of the fraud. Here too, if a suspected offence involving fraud has already been reported under Section 143(12) by such other person, and the auditor becomes aware of such suspected offence involving fraud, he need not report the same to the Central Government under the section since he has not per se identified the suspected offence involving fraud.

41. In case the fraud involves or is expected to involve an amount of rupees one crore or more, the auditor should review the steps taken by the management/those charged with governance with respect to the reported instance of suspected offence involving fraud stated above, and if he is not satisfied with such steps, he should state the reasons for his dissatisfaction in writing and request the management/those charged with governance to perform additional procedures to enable the auditor to satisfy himself that the matter has been appropriately addressed (Refer paragraphs 96 to 100). If the management/those charged with governance fail to undertake appropriate additional procedures within 45 days of his request, the auditor would need to evaluate if he should report the matter to the Central Government in accordance with Rule 13 of the Companies (Audit and Auditors) Rules, 2014.

Reporting on Suspected Offence Involving Fraud in case of Consolidated Financial Statements

42. As per Section 129(4) of the 2013 Act, the provisions relating to audit of the standalone financial statements of the holding company shall also apply to the audit of the consolidated financial statements. Since the audit of the consolidated financial statements has also been made one of the duties of the auditor, a question that arises is – should the auditor report on suspected offence involving frauds that may have taken place in any of the subsidiaries, joint ventures, associates of the company?
43. In the case of an audit of consolidated financial statements, as per paragraph 1 of SA 600 “Using the Work of Another Auditor” read with paragraph 9 of SA 200, when the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report should state clearly the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors.

It may be noted that the auditors of foreign components and those components that are not companies as defined under the 2013 Act are not covered under the requirements of Section 143(12), since it applies only to the auditor of the company under the Companies Act 2013.

Accordingly, the auditor of the parent company is not required to report on frauds under Section 143(12) which are not being or have not been committed against the parent company by the officers or employees of the parent company and relate only to:

a) A component that is an Indian company, since the auditor of that Indian company is required to report on suspected offence involving fraud under Section 143(12) in respect of such company; or

b) A foreign corporate component since they are not covered by the Companies Act, 2013; or

c) A component that is not a company since the component auditors’ of such components are not covered under Section 143(12).

However, the auditor of the parent company in India will be required to report on suspected offence involving fraud in the components of the parent company, if (a) such fraud is being or has been committed by employees or officers of the parent company; (b) if such suspected offence involving fraud in the component is against the parent company; and (since the requirement for reporting under Section 143(12) arises only if the suspected offence involving fraud is being or has been committed against the company by officers or employees of the company), if:

(i) the principal auditor identifies/detects such suspected offence involving fraud in the component “in the course of the performance of his duties as an auditor” of the consolidated financial statements; or

(ii) the principal auditor is directly informed of such a suspected offence involving fraud in the component by the component auditor and the management had not identified/is not aware of such suspected offence involving fraud in the component. (Also refer paragraphs 36 to 38 above.)
Part-III: Guidance Notes  III.939

Reporting under Section 143(12) When the Suspected Offence Involving Fraud Relates to Periods prior to Coming into Effect of the 2013 Act

44. An auditor, in the current year, may identify a possible or committed fraud that relates to an earlier year covered under the 1956 Act. The question that arises is - whether such frauds should also be reported under Section 143(12).

45. Requirements similar to Section 143(12) of the 2013 Act were not prescribed in the 1956 Act. Even the reporting under CARO, 2003 only required the auditors to report to the members on any fraud on or by the company that had been noticed or reported during the year.

As such, auditors would not have reported on frauds as envisaged under Section 143(12) in those years. Accordingly, in case of fraud relating to earlier years to which the Companies Act, 1956 was applicable, reporting under Section 143(12) will arise only if the suspected offence involving fraud is identified by the auditor in the course of performance of his duties as an auditor during the financial years beginning on or after April 1, 2014 and to the extent that the same was not dealt with in the prior financial years either in the financial statements or in the audit report or in the Board’s report under the Companies Act, 1956.

When does an Auditor Commence Reporting under Section 143(12) – Based on Suspicion - Reason to Believe – Knowledge – or on Determination of Offence?

46. Section 143(12) states that an auditor should report under the Section if he has “reason to believe” that an offence involving fraud is being or has being committed in the company by its officers or employees. Similarly, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 as amended by the Companies (Audit and Auditors) Amendment Rules, 2015, also specifies the threshold for reporting as “reason to believe”. The Form ADT – 4 in which the auditor is required to report to the Central Government uses the term “suspected offence involving fraud”.

47. It is important to understand the terms “reason to believe”, “knowledge” and “suspected offence involving fraud” to determine the point of time when the reporting requirement is triggered for an auditor under Section 143(12) read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015.

• ‘Suspicion’ is a state of mind more definite than speculation, but falls short of knowledge based on evidence. It must be based on some evidence, even if that evidence is tentative – simple speculation that a person may be engaged in fraud is not sufficient grounds to form a suspicion. Suspicion is a slight opinion but without sufficient evidence.

• For ‘reason to believe’ to come into existence, it cannot be based on suspicion. There needs to be sufficient information or convincing evidence to advance beyond suspicion that it is possible someone is committing or has committed a fraud. For example,
identification of fraud risk factors in itself cannot cause ‘reason to believe’ that a fraud exists.

- The term ‘reason to believe’ creates an objective test. SA 240 specifies the requirements to be complied by the auditors in assessing and responding to the risk of fraud in an audit of financial statements. For example, when complying with the requirements of SA 240, an auditor might be considered to have reasons to believe that a fraud has been or is being committed if he had actual knowledge of, or possessed information which would indicate to a reasonable person, that another person was committing or had committed a fraud.

- The term ‘reason to believe’ which has been used in the SAs indicate that it arises when
  - Evaluating audit evidence and information provided; or
  - Evaluating misstatements, including deviations noted on audit sampling and further audit procedures carried out; or
  - Exercising professional skepticism.

- Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015, has used the terms ‘reason to believe’ and ‘knowledge’ (of fraud). The condition of ‘reason to believe’ would be met if on evaluation of all the available information with the auditor and applying appropriate level of professional skepticism the auditor concludes that a fraud is being or has been committed in the company.

- Having ‘knowledge’ means knowing ‘that’ something. In the case of reporting on fraud under Section 143(12), it occurs when the auditor has sufficient reason to believe that a fraud has been or is being committed on the company by its officers or employees. This implies that there exists a fraud.

- Whilst Section 143(12) uses the term ‘offence involving fraud’ and the Form ADT–4 uses the term “suspected offence involving fraud”. As per paragraph 3 of SA 240, although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred. Determination of “offence” is legal determination and accordingly, the auditor will not be able to determine whether under legal parlance an “offence or suspected offence involving fraud” has been or is being committed against the company by its officers or employees.

48. Accordingly, based on a harmonious reading of Section 143(12), Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015 and Form ADT - 4, reporting on fraud in the course of performance of duties as auditor, would be applicable only when the auditor has reason to
believe and has knowledge that a fraud has occurred or is occurring i.e., when the auditor has evidence that a fraud exists.

Can the Auditor apply the Concept of Materiality for Reporting on Fraud?

49. The concept of materiality is fundamental for setting up an appropriate system of internal control, preparation of financial statements and its audit. Due to its inherent limitations, internal control systems cannot provide absolute assurance that no fraud or error has taken place. Since the auditor is required to comply with the SAs in performance of duties as an auditor, the audit will be performed applying the concept of materiality provided in the SAs.

50. Section 143(9) requires the auditor to comply with the SAs, which, inter alia, includes consideration of materiality, applying materiality in evaluating misstatements and disposition of the same.

51. The auditor should continue to apply the concept of materiality in performing the audit in accordance with SA 320 “Materiality in Planning and Performing an Audit”.

52. Fraud results in misstatement of financial statements. The SAs outline the procedures to be performed by an auditor in case a misstatement due to fraud is identified by the auditor. For example, paragraph A52 of SA 240 states that in evaluating and disposing the misstatements identified, the auditor should consider the requirements of SA 450 “Evaluation of Misstatements Identified during the Audit”.

53. SA 450 considers the concept of materiality in classifying the manner of disposition of misstatements, including those arising from fraud. Misstatements arising from fraud, will need to be communicated to the management and/or those charged with governance as required under paragraphs A21 to A23 of SA 450 and also reported to the Central Government in accordance with the requirements specified in Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended, in case the amount involved or expected to involve is individually Rupees One Crore or more.

54. Materiality is applicable wherever the amount is quantifiable. Where the amount is not quantifiable, the auditor should apply professional judgement to estimate the likelihood of the amount exceeding the aforesaid limit of Rupees One Crore prescribed for reporting to the Central Government. For this purpose it can be based on management estimate or reasonable range of estimate made by the auditor.

55. Subsequent reporting may be required if the amount initially estimated was lower than the aforesaid limit but was eventually determined to be higher than such limit. Under these circumstances, the timeline for reporting under Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015, will commence when the amount involved is determined to be in excess of such limit.
III.942 Auditing Pronouncements

Should the Auditor Report under Section 143(12) in case of Corruption, Bribery, Money Laundering and Non-compliance with Other Laws and Regulations

56. In case of corruption, bribery and money laundering, the direct effect of such act (benefit or penal consequence) is on the company.

57. The auditor should comply with the relevant SAs with regard to illegal acts (e.g. SA 240 and SA 250) when performing the audit. If the auditor, in the course of performance of his/her duties as the auditor, comes across instances of corruption, bribery and money laundering and other intentional non-compliances with laws and regulations, the auditor would need to evaluate the impact of the same in accordance with SA 250 to determine whether the same would have a material effect on the financial statements.

58. With respect to reporting under Section 143(12), consequent to corruption, bribery, money laundering and other intentional non-compliance with other laws and regulations, the auditor should consider, for the purpose of reporting, whether such acts have been carried out by officers or employees of the company for the purpose of reporting and also take into account the requirements of SA 250, particularly paragraph 28 of SA 250 read with paragraphs A19 and A20 thereof.

For example, if the auditor comes to know that the company has filed a fraudulent return of income to evade income tax, he may have to report this fraud under Section 143(12) irrespective of whether adequate provision has been made in the books of accounts or not.

It may be noted that the proviso to Section 147(2) in the context of punishment to auditors for contravention with the provisions, inter alia, of Section 143 of the 2013 Act, states “if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.”
SECTION III : APPLICABILITY OF STANDARDS ON AUDITING

59. Since reporting on fraud arises only in the course of performing duties as an auditor, the auditor should, inter alia, take into consideration the requirements of the following provisions of the SAs (Refer paragraphs 60 to 73 below) for purposes of designing audit procedures which are effective in identifying and assessing the risks of material misstatement due to fraud. These are in addition to SA 240 and SA 250 which Standards are required to be mandatorily complied in entirety insofar as they relate to audit of the financial statements and also for reporting on fraud under Section 143(12), as amended by the Companies (Amendment) Act, 2015 and Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015.

60. Professional Skepticism (SA 200)

Paragraph 13(l) – An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

Paragraph A18 - Professional skepticism includes being alert to, for example:

– Audit evidence that contradicts other audit evidence obtained.

– Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.

– Conditions that may indicate possible fraud.

– Circumstances that suggest the need for audit procedures in addition to those required by the SAs.

Paragraph A19 - Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of:

– Overlooking unusual circumstances.

– Over generalising when drawing conclusions from audit observations.

– Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

Paragraph A20 - Professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example, in the case where fraud risk factors exist.
and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

**Paragraph A21** - The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud (for example, if conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document may have been falsified), the SAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.

**Paragraph A22** - The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity’s management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less-than persuasive audit evidence when obtaining reasonable assurance.

61. **Audit Documentation**

As per paragraph 44 of SA 240 and paragraph 32 of SA 315, the auditor’s documentation of the understanding of the entity and its environment and the assessment of the risks of material misstatement required by SA 315 would include:

a) The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity’s financial statements to material misstatement due to fraud; (Refer Appendix 1) and

b) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level.

As per paragraph 45 of SA 240 and paragraph 28 of SA 330, the auditor’s documentation of the responses to the assessed risks of material misstatement required by SA 330 shall include:

a) The overall responses to the assessed risks of material misstatement due to fraud at the financial statement level and the nature, timing and extent of audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud at the assertion level; and

b) The results of the audit procedures, including those designed to address the risk of management override of controls.

The auditor should document communications about fraud made to management, those charged with governance, regulators and others.
When the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the auditor shall document the reasons for that conclusion.

62. **Inquiries with those Charged with Governance**

Paragraph 20 of SA 240 states that unless all of those charged with governance are involved in managing the entity, the auditor shall obtain an understanding of how those charged with governance exercise oversight of management’s processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.

Paragraph 21 of SA 240 requires that the auditor makes inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. These inquiries are made in part to corroborate the responses to the inquiries of management. (Refer Appendix 2)

Paragraph A20 of SA 240 states that an understanding of the oversight exercised by those charged with governance may provide insights regarding the susceptibility of the entity to management fraud, the adequacy of internal control over risks of fraud, and the competency and integrity of the management.

63. **Communications with those Charged with Governance**

Paragraph 40 of SA 240 states that if the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor shall communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.

Paragraph 41 of SA 240 requires that unless all of those charged with governance are involved in managing the entity, if the auditor has identified or suspects fraud involving:

a) Management;

b) Employees who have significant roles in internal control; or

c) Others where the fraud results in a material misstatement in the financial statements.

The auditor should communicate these matters to those charged with governance on a timely basis. If the auditor suspects fraud involving management, the auditor should communicate these suspicions to those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit.

Paragraph 42 of SA 240 requires the auditor to communicate with those charged with governance any other matters related to fraud that are, in the auditor’s judgment, relevant to their responsibilities.
64. **Risk Assessment Procedures and Related Activities**

Paragraphs 5 to 24 of SA 315 require the auditor to perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity’s internal control, the auditor is required to perform procedures to obtain information for use in identifying the risks of material misstatement due to fraud.

65. **Inquiries with Management and Others within the Entity**

Paragraph 17 of SA 240 requires the auditor to make enquiries of management regarding:

a) Management’s assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments;

b) Management’s process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist;

c) Management’s communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and

d) Management’s communication, if any, to employees regarding its views on business practices and ethical behavior.

Paragraph 18 of SA 240 requires the auditor to make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. (Refer Appendix 2)

66. **Identification and Assessment of the Risks of Material Misstatement Due to Fraud**

In accordance with paragraph 25 of SA 315, the auditor needs to identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.

When identifying and assessing the risks of material misstatement due to fraud, the auditor should, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. Paragraph 47 of SA 240 specifies the documentation required when the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. As per paragraph 27 of SA 240, the auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall obtain an understanding of the entity’s related controls, including control activities, relevant to such risks.
67. **Responses to the Assessed Risks of Material Misstatement**

In accordance with paragraph 5 of SA 330, “The Auditor’s Responses to Assessed Risks”, the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.

Paragraph 29 of SA 240 requires that in determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor should:

a) Assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given significant engagement responsibilities and the auditor’s assessment of the risks of material misstatement due to fraud for the engagement;

b) Evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management’s effort to manage earnings; and

c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures.

Further, in accordance with Paragraph 6 of SA 330, the auditor is also required to design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement due to fraud at the assertion level.

68. **Evaluation of Misstatements Identified during the Audit**

Paragraph A52 of SA 240 states - “SA 450, “Evaluation of Misstatements Identified during the Audit”, and SA 700, “Forming an Opinion and Reporting on Financial Statements”, establish requirements and provide guidance on the evaluation and disposition of misstatements and the effect on the auditor’s opinion in the auditor’s report.”

Paragraph A50 of SA 240 states - Since fraud involves incentive or pressure to commit fraud, a perceived opportunity to do so or some rationalization of the act, an instance of fraud is unlikely to be an isolated occurrence. Accordingly, misstatements, such as numerous misstatements at a specific location even though the cumulative net effect is not material, may be indicative of a risk of material misstatement due to fraud.

69. **Analytical Procedures**

The use of analytical procedures as risk assessment procedures is dealt with in SA 315. Use of analytical procedures as substantive procedures (substantive analytical procedures) and as procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements is dealt with in SA 520. Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate
matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement especially risks of material misstatement due to fraud.

The auditor should apply analytical procedures at the planning stage to assist in understanding the business and in identifying areas of potential risk.

The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity (Paragraph 6 of SA 520).

If analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

(a) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and

(b) Performing other audit procedures as necessary in the circumstances. (Paragraph 7 of SA 520)

The auditor should evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud (Paragraph 22 of SA 240).

70. **Review of Accounting Estimates**

Paragraph 6 of SA 540, “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures” requires the auditor to obtain sufficient appropriate audit evidence whether in the context of the applicable financial reporting framework, the accounting estimates, including fair value accounting estimates, in the financial statements, whether recognised or disclosed, are reasonable, and related disclosures in the financial statements are adequate.

The auditor should review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud (Paragraph 32(b) of SA 240).

71. **Related Parties**

Related parties, by virtue of their ability to exert control or significant influence, may be in a position to exert dominant influence over the entity or its management. Consideration of such behavior is relevant when identifying and assessing the risk of material misstatement due to fraud (Paragraph A6 of SA 550).
If the auditor identifies fraud risk factors (including circumstances relating to the existence of a related party with dominant influence) when performing the risk assessment procedures and related activities in connection with related parties, the auditor shall consider such information when identifying and assessing the risk of material misstatement due to fraud in accordance with SA 240 (Paragraph 19 of SA 550).

If the auditor has assessed a significant risk of material misstatement due to fraud as a result of the presence of a related party with dominant influence, the auditor may, in addition to the general requirements of SA 240, perform certain audit procedures to obtain an understanding of the business relationships that such a related party may have established directly or indirectly with the entity and to determine the need for further appropriate substantive audit procedures (Paragraph A33 of SA 550).

72. **Written Representations**

SA 580, “Written Representations”, establishes requirements and provides guidance on obtaining appropriate representations from management and, where appropriate, those charged with governance in the audit. As per paragraph A57 of SA 240, in addition to acknowledging that they have fulfilled their responsibility for the preparation of the financial statements, it is important that, irrespective of the size of the entity, management and, where appropriate, those charged with governance acknowledge their responsibility for internal control designed, implemented and maintained to prevent and detect fraud.

73. **Inquiries with Internal Auditors**

SA 610, “Using the Work of Internal Auditors”, establishes requirements and provides guidance in audits of those entities that have an internal audit functions. For those entities that have an internal audit function, paragraph 19 of SA 240 states that the auditor shall make inquiries of internal audit to determine whether it has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.

**SECTION IV: TECHNICAL GUIDANCE ON REPORTING ON FRAUD UNDER SECTION 143(12)**

74. The duty of auditor with respect to fraud in the course of his performance of duties as an auditor is to comply with the requirements of SA 240 “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”.

75. Therefore, the auditor is required to carry out the following procedures as specified in SA 240:

a) To identify and assess the risks of material misstatement in the financial statements due to fraud;

b) To obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
c) To respond appropriately to identified or suspected fraud.

76. In addition to the above procedures, the auditor is required to report on fraud in accordance with Section 143(12) of the 2013 Act. For purposes of reporting under Section 143(12) to the Audit Committee/Board and the Central Government, the auditor is required to carry out certain specific procedures with respect to the identified offence involving fraud against the company by its officers or employees.

The objective of this part of the Guidance Note is to provide supplementary guidance to the SAs for consideration by auditors when complying with the requirements of Section 143(12) of the 2013 Act.

77. Modifications to terms of Engagement with regard to Reporting on Fraud under Section 143(12)

Reporting by the auditor on fraud is not a separate engagement and is a part of the performance of the duties as an auditor of the financial statements of the company under the 2013 Act.

The terms of engagement between the auditor and the client as required under SA 210 will require certain modifications to incorporate the management's responsibility with regard to fraud and the auditor's reporting responsibility for reporting under Section 143(12).

The following clauses may be added to the auditor's engagement letter with regard to reporting on fraud under Section 143(12):

As part of Auditor's Reporting Responsibilities:

In accordance with the provisions of Section 143(12) and 143(13) of the 2013 Act, if in the course of performance of my/our duties as auditor, I/we have reason to believe that an offence of fraud is being or has been committed in the Company by officers or employees of the Company, I/we will be required to report to the Central Government, in accordance with the rules prescribed in this regard which, inter alia, requires me/us to

In case of a fraud involving or expected to involve less than rupees one crore, to report the matter to the Audit Committee constituted under section 177 of the Companies Act, 2013 or to the Board immediately but not later than two days of my/our knowledge of the fraud and our report would specify the following:

- Nature of fraud
- Approximate amount involved; and
- Parties involved

In case of a fraud involving rupees one crore or more, I/we shall make a report to the Board or Audit Committee, as the case may be, seeking their reply or observations, to enable me/us to forward the same to the Central Government. Such reporting will be made in good faith and, therefore, cannot be considered as breach of maintenance of client confidentiality requirements or
be subject to any suit, prosecution or other legal proceeding since it is done in pursuance of the 2013 Act or of any rules or orders made thereunder.

Because of the inherent limitations of an audit, including the possibility of collusion or improper management override of controls, there is an unavoidable risk that material misstatements due to fraud or error may occur and not be detected, even though the audit is properly planned and performed in accordance with the SAs.

As part of Management's Responsibility:

Management is responsible for taking proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the 2013 Act for safeguarding the assets of the Company and for preventing and detecting fraud and other irregularities.

Management is responsible to provide me/us access to reports, if any, relating to internal reporting on frauds (e.g., vigil mechanism reports etc.), including those submitted by cost accountant or company secretary in practice to the extent it relates to their reporting on frauds in accordance with the requirements of Section 143(12) of the Act.

78. Fraud Risk Factors – Assessed Risk of Material Misstatement due to Fraud

SA 240 provides examples of fraud risk factors that may be faced by auditors in a broad range of situations, specifically relating to the two types of frauds relevant to the auditor’s consideration, i.e., fraudulent financial reporting and misappropriation of assets.

Examples of fraud risk factors stated in SA 240 and additional examples of fraud risk factors are given in Appendix 3 for consideration by auditors during the course of their audit.

Although the fraud risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different fraud risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. Also, the order of the examples of fraud risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

79. Audit Procedures to Address Assessed Risk of Material Misstatement due to Fraud

Based on the nature, size and circumstances of the fraud risk factors, the auditor will have to design appropriate audit procedures to address the assessed risk of material misstatement due to fraud. SA 240 provides examples of possible audit procedures to address the assessed risk of material misstatement due to fraud.
Additional examples of possible audit procedures to address the assessed risk of material misstatement due to fraud are given in Appendix 4 for consideration by auditors during the course of their audit.

Although these procedures cover a broad range of situations, they are only examples and, accordingly they may not be the most appropriate nor necessary in each circumstance.

80. Stages of Identification of Fraud

The information about possible offence involving fraud, obtained by the auditor during the course of his audit, can be classified into four stages:

a) Speculation.
b) Suspicion.
c) Reason to Believe.
d) Knowledge.

a) Speculation - “Speculation” refers to information from unrelated source which is a rumour, hearsay, gossip, assumption, guess, thought or supposition. Examples of information which could be classified as speculation are provided below:

− Rumours about management accepting kick-backs from suppliers/service providers for awarding contracts, but no proof.
− Based on specific industry risk, there is an assumption that there will be transactions involving cash and money laundering.
− Media reports indicating that the company is planning to invest in totally unrelated, high-risk business.
− Board of Directors consisting of some persons exposed to illegal acts.
− Gossip that certain business groups/entities are front end for an undisclosed owner.
− Rumour that promoters of certain companies have accounts in tax havens and are involved in circulating monies through such tax havens.

At this stage, the auditor may have to perform engagement risk assessment procedures to determine if there is any merit in the speculation and whether or not to accept or continue with the engagement and the level of staffing that will be required to address any fraud risk factors identified from the above.

b) Suspicion -‘Suspicion’ is a state of mind more definite than speculation, but falls short of knowledge based on evidence. It must be based on some evidence, even if that evidence is tentative. Suspicion is a slight opinion but without sufficient evidence.
In other words, a “suspicion” will lead to identification of fraud risk factors during the course of audit. Examples of information which could be classified as suspicion are provided below:

- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.
- There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.
- Accounting and information systems those are not effective, including situations involving significant deficiencies in internal control.
- Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations.
- Use of business intermediaries for which there appears to be no clear business justification.
- Domination of management by a single person or small group (in a non-owner managed business) without compensating controls.
- Overly complex organisational structure involving unusual legal entities or managerial lines of authority.
- The practice by management in maintaining or increasing the entity’s stock price or earnings trend.
- Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult “substance over form” questions.
- Significant related party transactions which appear to be not in the ordinary course of business or with related entities not audited or over which the auditor does not have information.

At this stage, the auditor will have to identify the information leading to “suspicion” as “fraud risk factor” and design appropriate audit procedures to address this assessed risk of misstatement due to fraud.

c) **Reason to Believe** - ‘Reason to believe’ indicates that the matter should be more than just a suspicion. ‘Suspicion’ when corroborated with supporting evidence can provide ‘reason to believe’.

Examples of information which could be classified as “reason to believe” are provided below:

- Material misstatement identified during the course of audit.
- Identification of any material weakness in the internal controls.
III.954 Auditing Pronouncements

- Significant related party transactions not at arm’s length and not supported by a proper business rationale.
- Sudden resignation of an employee belonging to the senior management and when proper reason is not assigned for his leaving.
- Resistance from the management with regard to certain disclosures in the financial statement.
- Material discrepancies between book stock and physical stock.
- Acquisition of significant assets which are unrelated to the business.
- During the course of perusal of the bank statements, when the auditor observes frequent transfer in and transfer out of funds from a particular account balance belonging to the promoter or an employee.
- Matters reported through the whistle blower mechanism on an incidence of fraud.
- Notices from regulators and government authorities on violations of laws and regulations.
- E-mail or written communication received directly by the auditor from a whistle blower.

At this stage the auditor has performed planned procedures to address the assessed risk of misstatement due to fraud. Certain evidences, which he obtained and evaluated during this process, indicate that there is a “reason to believe” that an offence involving fraud has been or is being committed. The auditor would now be required to carry out procedures as referred to in paragraphs 83 and 84 with a higher level of professional skepticism with a view to obtain more persuasive evidence to enable him to conclude whether he has “reason to believe” or has “knowledge” of fraud.

**d) Knowledge** – “Knowledge” indicates “reason to believe” with more persuasive evidence based on further procedures performed by the auditor. Examples of information which could be classified as “knowledge” are provided below:

- Material misstatement identified during the course of audit not supported by appropriate rationale/explanation from the management, indicating that the misstatement was intentional.
- Identification of any material weakness in the internal controls which has resulted in material damage/huge loss for the company.
- Significant related party transactions not at arm’s length and not supported by appropriate evidence. Management is not able to provide appropriate rationale/substantiation for undertaking such transactions and such transactions may be prejudicial to the interests of the shareholders, based on the materiality determined by the auditor.
- Sudden resignation of an employee belonging to the senior management. On performing further procedures, it is noted that the employee had committed an offence involving fraud.
Resistance from the management with regard to certain disclosures in the financial statements. On further inquiry, it comes to light that management had concealed certain information from the bankers/regulators and hence the resistance to disclose.

Material discrepancies between book stock and physical stock. On examination, the auditor noted that the unit of measures were misstated for several items as against a one-off instance, which indicates that the misstatement could be intentional.

Acquisition of significant assets which are unrelated to the business. On further inquiry with the project department, it appears that the acquisition was made to accommodate a related party or boost the sales of a related party.

During the course of perusal of the bank statements, when the auditor observes frequent transfer in and transfer out of funds from a particular account balance belonging to the promoter or an employee. On further inquiry and procedures, the auditor notes that the employee involved was the person who is involved in preparing bank reconciliation statements (BRS) and there is no review of the work performed by this staff.

Matters reported through the whistle blower mechanism on an incidence of fraud and the procedures performed by the management to investigate the reported matter were biased to protect the interests of the persons against whom the allegations were made.

At this stage, the auditor has “knowledge” of fraud and therefore, the auditor’s responsibility to report on the suspected offence of fraud to the Audit Committee constituted under section 177 / to the Board or to the Central Government, as applicable, based on the amount involved or expected to be involved, is triggered.

81. Section 143(1) of the Act requires the auditor, inter-alia, to perform the following inquiries and determine if any specific reporting to the members of the company is required under the said section:

(a) 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;

(b) Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;

(c) Where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;

(d) Whether loans and advances made by the company have been shown as deposits;

(e) Whether personal expenses have been charged to revenue account;

(f) Where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment,
and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

Any adverse comment on the above may also be considered as matters where the auditor has sufficient reason to believe that a suspected offence involving fraud is being or has been committed.

82. A decision tree summarising the action required to be carried out by an auditor at different stages of information/extent of evidence obtained is provided as part of the overview to this Guidance Note.

83. **Audit Procedures If Auditor has reasons to Believe a Fraud has Occurred or is being Carried Out**

As discussed in the earlier sections of this Guidance Note, Section 143(12) of the 2013 Act requires the auditor to report to the Audit Committee constituted under section 177 / to the Board or to the Central Government, as applicable, if he has “reason to believe” that an offence of fraud is being or has been committed in the company by officers or employees of the company, based on the amount involved or expected to be involved. Clearly, section 143(12) does not envisage reporting in Form ADT 4 by the statutory auditor during the “speculation” and “suspicion” stages. During these stages, the auditor’s procedures would be as provided under the SA 240. Having reached the stage of “reason to believe”, the auditor would be guided by the requirements of paragraphs 83 and 84 of this Guidance Note.

Examples of audit procedures which the auditor can perform when he has “reason to believe” that an offence involving fraud is being or has been committed is given below:

a. Evaluating the evidences obtained or misstatements identified with professional skepticism.

b. Introducing elements of unpredictability/surprise in carrying out specific audit procedures (for example, visiting certain sales locations normally not visited at year end to evaluate if there are any “Billed but Not Delivered” sales transactions).

c. If considered necessary, recommending to the Board or Audit Committee to involve experts such as information technology specialists, forensic experts or fair valuation experts, etc., to carry out data analytics and investigation (Refer paragraph 84 below).

d. Seeking additional audit evidence from sources outside of the entity being audited. For example, external confirmations which could be tailored to specific circumstances such as confirming the terms and conditions relating to sale, confirming the occurrence of specific transactions, etc.

e. Focussed testing on period-end and year-end journal entries by a senior member of the engagement team.
f. Carrying out a more critical evaluation and retrospective testing of accounting estimates to evaluate the reasonableness of management’s judgement and existence of management bias.

g. Consulting with experts to evaluate unusual and complex transactions.

h. Performing certain procedures specific to account balance when such evidences particularly relate to any specific class of transaction or account balance. For example, in addition to sending written confirmations, major customers and suppliers could be directly contacted in order to seek more or different information.

i. Where related party transactions are involved, critically evaluating the business rationale of the transactions and arm’s length nature of such transactions.

j. Re-performing certain critical reconciliations carried out by the entity.

84. Working with the Board or the Audit Committee in case the Auditor has Reasons to Believe a Fraud may Exist

There could be circumstances where the auditor identifies misstatements in account balance where a fraud or a significant risk factor was identified by him and therefore has reason to believe that a fraud may exist. However, the auditor may not have “knowledge” that a fraud actually exists. As per the SAs, the auditor may communicate such misstatements to the management and request them to carry out additional reviews to ensure that there are no other undetected misstatements.

The auditor may perform parallel procedures or work with the management to identify any other misstatement due to fraud within those account balances that may have remained undetected.

The outcome of such audit procedures will help the auditor conclude whether he has knowledge, that the suspected offence involving fraud has been or is being committed.

85. It may be noted that the above procedures (Refer paragraphs 83 and 84) represent enhanced audit procedures which the auditor carries out in the course of his audit with professional skepticism with the primary objective to ensure that the financial statements are not materially misstated due to fraud. The objective of the auditor is to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses.

Further, although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determination of whether fraud has actually occurred. Therefore, an auditor cannot make an assertion that an ‘offence’ involving fraud has been or is being committed against the company. Accordingly, in Form ADT – 4 the terminology used is ‘suspected offence involving fraud’.
86. Reporting to the Board or Audit Committee on Auditor’s Reason to Believe and Knowledge of Fraud against the Company by Officers or Employees of the Company

Sub-Rules (2) and (3) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 as amended by the Companies (Audit and Auditors) Amendment Rules, 2015, requires the auditor to report to the Board or the Audit Committee, as the case may be, immediately but not later than two days, after he comes to (have) knowledge of the fraud.

Sub-Rules (3) and (4) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 [as amended by the Companies (Audit and Auditors) Amendment Rules, 2015], require that in case of fraud involving an amount less than Rupees One Crore, the auditor should report the matter to the Audit Committee constituted under section 177 of the Companies Act, 2013 or the Board of Directors. The report should specify the following:

- Nature of fraud with description
- Approximate amount involved; and
- Parties involved

If the amount involved in the fraud or is expected to be involved is Rupees One Crore or more, the auditor is required to seek the reply or observations of the Board or the Audit Committee within forty-five days of such reporting.

The Rule does not prescribe the form or format in which the auditor should communicate to the Board or the Audit Committee.

87. Therefore, the auditor may use the Form ADT – 4 itself to report to the Board or Audit Committee duly filling in the necessary details, other than those relating to items (11), (12) and (14) of the Form relating to date of receipt of response from the Board or Audit Committee; the auditor’s opinion if the reply of the Board or Audit Committee was satisfactory; and the details of steps taken by the company in this regard. Refer Appendix 5 for illustrative format of reporting to the Board or the Audit Committee.

88. The auditor may send additional details of the basis on which the fraud is suspected, the period to which it relates to and the basis of estimating the amounts involved, to enable the Board or Audit Committee to pursue the matter further.

89. It may be noted that the timeline for reporting under Section 143(12) starts immediately as soon as the auditor has knowledge of the fraud. The auditor is not required to investigate the fraud so as to establish the entire magnitude, the period, the *modus operandi* and the persons involved since the requirement of Section 143(12) read with the Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015, is not that the auditor has to perform a forensic audit.

90. Obtaining Response from the Board or Audit Committee
When a fraud, individually involving or expected to involve Rupees One Crore or more, is reported by the auditor to the Board or Audit Committee, they are required to evaluate the matter, where applicable and take appropriate action on the matter, including, where required an investigation/forensic audit conducted either by appropriate internal specialists of the company or external specialists/experts, and respond to the auditor within 45 days of the date of the auditor’s communication.

The Companies (Audit and Auditors) Amendment Rules, 2015 do not specify that the auditor should obtain response from the Board or the Audit Committee in case a suspected offence of fraud involving or expected to involve an individual amount of less than Rupees One Crore is reported to them. However, as a matter of prudence and professional skepticism, the auditor should obtain the response from the Board or the Audit Committee even for such fraud, as this will enable the auditor to obtain further assurance and management’s assertion that the amount involved or expected to be involved in the fraud was less than Rupees One Crore.

91. It will be the responsibility of the Board or Audit Committee to have appropriate procedures performed, including, where required an investigation/forensic audit. The action taken by the Board or Audit Committee pursuant to receipt of communication from the auditor may involve investigation/forensic audit by their internal auditors, internal team of senior management or by an external agency. Based on the steps taken, including any investigation/forensic audit on the matter reported, they are required to reply to the auditors.

92. An investigation will include a planning stage, a period when evidence is gathered, a review process, and a report to the client. The purpose of the investigation, in the case of an alleged fraud, would be to discover if a fraud had actually taken place, to identify those involved, to quantify the monetary amount of the fraud (i.e., the financial loss suffered by the client), and to ultimately present findings to the client and potentially to court. It is normally not as in-depth as a forensic audit and in fact may not be performed by forensic auditors.

93. ‘Forensic audit’ refers to the specific procedures carried out in order to produce evidence. Specialised audit techniques are used to identify and to gather evidence to prove, for example, use of information technology and data retrieval tools, data analytics, interrogation (not interview), critical evaluation of evidence, motive, evaluating patterns of information, duration of the alleged fraud and how it was conducted and concealed by the perpetrators, etc.. Evidence may also be gathered to support other issues which would be relevant in the event of a court case. Such issues could include:

- the suspect’s motive and opportunity to commit fraud;
- whether the fraud involved collusion between several suspects;
- any physical evidence at the scene of the crime or contained in documents;
- comments made by the suspect during interviews and/or at the time of arrest; and
- attempts to destroy evidence.

Forensic audit is a very specialised engagement, which requires highly skilled team members who have experience not only of accounting and auditing techniques, but also, among other things, of the relevant legal framework.
94. Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015, does not state what should be the contents of the reply of the Board or Audit Committee in case a report on a suspected offence involving fraud is received by them from the auditor where the amount involved in the fraud or is expected to be involved is Rupees One Crore or more. However, it would be reasonable to presume that the reply of the Board or Audit Committee will include the following:

− An acknowledgement of having received the report on fraud from the auditor.
− Brief description of the fraud or suspected fraud.
− The steps taken by them pursuant to receipt of the report, including:
  a. The manner in which they have followed up on the matter reported to them;
  b. Involvement of specialists, internal and/or external, who have carried out investigation/forensic audit on their behalf;
  c. The period covered by such investigation/forensic audit;
  d. Their assessment of areas impacted by the fraud – company locations, account balances, categories of assets/liabilities/income/expenses, categories of customers/vendors, off-balance sheet items, etc.
  e. The conclusion drawn by them based on such investigation/forensic audit:
    ➢ If the Board or Audit Committee is in agreement with the auditor’s conclusion on fraud – the cause of the fraud, persons involved, estimate of amounts involved, the period to which the fraud relates to, steps taken by them to remediate the reasons which caused the occurrence of the fraud, including changes to the internal control systems or plans thereto, the action taken on the persons involved in the fraud (including filing of civil/criminal complaints with law enforcement agencies, disciplinary actions, etc.), the status of reporting the matter to any other regulator (e.g. RBI, Tax authorities, etc.).
    ➢ If the investigation/forensic audit ordered by them is in progress as on the date of the reply - the status of the investigation, the persons allegedly involved in the fraud, any preliminary amounts quantified on the fraud, steps taken in the interim including any action taken on the persons allegedly involved in the fraud (including filing of civil/criminal complaints with law enforcement agencies, disciplinary actions, etc.), the status of reporting the matter to any other regulator (e.g. RBI, Tax authorities, etc.), remediation plan to prevent further occurrences, etc.
− A copy of the investigation report/report on the forensic audit (preliminary/draft/final) or the procedures performed/being performed by them to substantiate the items stated above.

95. There may be instances where the Board or the Audit Committee does not concur with the auditor’s belief that a suspected offence involving fraud is being or has been committed. If the Board or Audit Committee is not in agreement with the auditor’s belief that a suspected offence
involving fraud has been or is being committed, the persuasive reasons therefor with supporting evidence should be provided in their reply to the auditor along with the other matters described in paragraph 94 above.

96. **Evaluating Reply of the Board or Audit Committee**

The auditor should evaluate the reply of the Board or Audit Committee received by him in response to his report to them on the suspected offence involving fraud. Such evaluation is required to enable the auditor to state if he is satisfied or not satisfied with the reply of the Board or Audit Committee on the matter reported to them.

97. Whilst Sub-Rule (2)(b) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015, requires the auditor to forward his report along with his comments on the reply received from the Board or the Audit Committee, Form ADT-4 requires the auditor to only state if he is satisfied or not satisfied with the reply of the Board or the Audit Committee. Accordingly, the comments of the auditor as specified in the Sub-rule implies the statement of the auditor in Form ADT – 4 about his satisfaction or otherwise with the reply of the Board or the Audit Committee. For this purpose, the auditor should review the reply from the Board or the Audit Committee with the supporting evidence provided to determine the reasonability of the same.

98. Where the Board or the Audit Committee has provided its reply on the basis of an investigation/forensic audit, the auditor is not expected to re-perform or carry out an independent investigation/forensic audit to validate the same. The auditor should, however, review the process followed by the investigation/forensic audit to gain comfort on:

− the scope of the investigation/forensic audit,
− the period covered,
− the persons covered,
− information gathered/obtained,
− specific scope exclusions or limitations, if any, in the investigation/forensic audit,
− the reasonableness of the amounts identified as involved based on his professional judgement and his understanding of the suspected offence involving fraud, and
− the competence, experience and seniority of the persons who conducted the investigation/forensic audit and their independence and objectivity.

99. If the Board or the Audit Committee disagrees with the belief of the auditor that a suspected offence involving fraud exists and provides evidence in this regard, the auditor would consider such evidence and perform such further procedures as may be necessary to determine if his initial belief was appropriate under the circumstances. In addition to reviewing the matters stated in paragraph 98 above with increased professional skepticism, the following additional factors should also be considered by the auditor:
III.962 Auditing Pronouncements

− Whether the evidence provided in the reply was available when the auditor initially concluded that there was a fraud or is it new evidence. If it was an evidence or information that was previously considered by the auditor, the reason why the company has considered the same evidence or information differently.
− The reliability of the evidence now provided considering the risk of bias to overlook a fraud that is existing.
− The persuasiveness of the company’s evidence or information that the suspected offence involving fraud does not exist, that is included in the company’s reply.

100. Based on the additional procedures carried out by the auditor after considering the factors stated in paragraph 99 above, pursuant to the reply of the company disagreeing with the initial belief of the auditor that a suspected offence involving fraud is being or has been committed, if the auditor is convinced that his initial suspicion was incorrect, the need for reporting the matter to the Central Government would not be applicable. This situation would arise only if the auditor did not have the evidence or information that is now provided as part of the reply or additional information has now been provided to the auditor and there is persuasive evidence now available to convince the auditor that the suspected offence involving fraud does not exist.

**Reporting to the Central Government in Form ADT-4**

101. It may be noted that Sub-rule (2)(b) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015, requires the auditor to forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations) to the Central Government within 15 days of receipt of such reply. Consequently, it is not necessary that the auditor will always have 60 days to submit the Form ADT–4 to the Central Government since if the Board or the Audit Committee replies prior to 45 days of the date of the auditor reporting to them on the suspected offence involving fraud, the Form ADT – 4 will need to be submitted within 15 days of the receipt of reply from the Board or the Audit Committee. For example, if the Board or the Audit Committee replies in 24 days, the auditor will need to report in Form ADT –4 within 39 days i.e., 15 days of receipt of reply from the company.

102. If the auditor does not receive a reply to his communication to the Board or Audit Committee within 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 within 15 days of the expiry of the 45 days.

103. If the auditor receives a reply from the Board or Audit Committee within the stipulated time of 45 days of his communication to them, the auditor should within 15 days of receipt of the reply send his report in Form ADT–4 (Refer Appendix 6) to the Central Government stating the following:
− the date on which he received the reply;
− a gist of the reply or observations of the Board or the Audit Committee to his report;
whether he is satisfied or not satisfied with the reply of the Board or Audit Committee;

details of steps, if any, taken by the company in this regard (furnishing full details with references); and

any other relevant information.

A copy of the reply received from the Board or Audit Committee should also be attached to the Form ADT–4 when submitting to the Central Government.

104. In case the auditor is not satisfied with the reply of the Board or the Audit Committee, he should state the reasons for the same in the Form ADT–4 as part of item 15 to the Form "Any other relevant information". The reasons the auditor may not be satisfied with the reply of the Board or the Audit Committee may, \textit{inter alia}, include any of the following:

- He is not satisfied with the competence or seniority/experience of the person who has carried out the investigation/forensic audit on behalf of the Board or the Audit Committee.
- If only an investigation was carried out but considering the nature, size, complexity, motive of the suspected offence involving fraud, it needed a forensic audit to be carried out, thereby impacting the comprehensiveness of the procedures performed by the Board or the Audit Committee. (Refer paragraphs 92 and 93)
- Facts produced by the auditor in his report were overlooked by the Board or the Audit Committee resulting in differing conclusions with that of the auditor.
- Based on further procedures performed and evaluation of the additional evidence or information provided, if the auditor is not convinced with the Board or the Audit Committee reply that the suspected offence involving fraud does not exist.
- Period of coverage, persons covered, and areas covered or scope of the investigation/forensic audit was not adequate or appropriate.
- If the reply of the Board or the Audit Committee does not include any of the matters referred to in paragraph 94 above and the auditor considers such matter to be significant for the Board or the Audit Committee to have considered in their reply.

105. \textbf{Management Representation}

SA 580 - "Written Representations", establishes requirements and provides guidance on obtaining appropriate representations from management. Because of the nature of fraud and the difficulties encountered by auditors in detecting material misstatements in the financial statements resulting from fraud, it is important that the auditor obtains a written representation from management and, where appropriate, those charged with governance confirming that they have disclosed to the auditor:

a) The results of management's assessment of the risk that the financial statements may be materially misstated as a result of fraud; and

b) Their knowledge of actual, suspected or alleged fraud affecting the entity.

In addition to the management representations as discussed above, the auditor will be required to obtain certain specific representations with regard to the following:
III.964 Auditing Pronouncements

a) Steps taken on fraud committed or being committed against the company.
b) Matters included in the reply to the report of the auditor on suspected fraud.

Further when management is involved or suspected to be involved, the auditor should insist that the representations need to be provided by the Board or Audit Committee of the company.

Illustrative Management Representation Letter for steps taken by the Board or the Audit Committee on fraud reported by the auditor is provided in Appendix 7.

In the exceptional circumstances where the auditor has doubts about the integrity or honesty of those charged with governance, the auditor may consider it appropriate to obtain legal advice to assist in determining the appropriate course of action.

106. Audit Documentation and Quality Control

The documentation of the audit procedures performed from identifying the fraud risk till the identification of existence of fraud is critical as this would form the basis for matters reported to the Board or the Audit Committee and thereafter to the Central Government in Form ADT-4. This would also enable the auditor to demonstrate reporting in good faith to ensure protection under Section 143(13) and Section 456.

107. Auditors should, taking into account the provisions of SA 230, inter alia, consider the following items for being maintained as part of the audit documentation in connection with reporting under Section 143(12):

a) Minutes of inquiries conducted with those charged with governance, internal auditors, senior management and relevant employees during the course of planning and minutes of engagement team discussions on fraud risk factors. (Refer paragraphs 61 and 62)
b) The fraud risk factor or suspicion which led to identification of evidences which provided the knowledge to the auditor that a suspected offence involving fraud is being or has been committed. (Refer paragraphs 80.a and 80.b)
c) Specific and additional audit procedures carried out by the auditor to address the assessed risk of material misstatement due to fraud. (Refer paragraphs 80.c, 80.d, 83 and 84)
d) Memo documenting the professional judgement exercised by the auditor at various stages of performing the planned procedures.
e) Details of evidences obtained during the course of performing the planned procedures. (Refer paragraphs 80.c, 80.d, 83 and 84)
f) Copies of correspondences with the Board or Audit Committee on the procedures/investigations carried out, to conclude on matters reported by the auditor. (Refer paragraph 84)
g) Copy of the report to the Board or Audit Committee along with attachments thereto. (Refer paragraphs 86 to 89)
h) Copy of response received from the Board or the Audit Committee along with the supporting documents provided by them in their response. (Refer paragraphs 90 to 95)
i) If an investigation/forensic audit was carried out by the Board or Audit Committee, how the auditor evaluated the competency and independence of the person who carried out the investigation and adequacy of the scope of work provided to them. (Refer paragraphs 96 to 100)

j) Details of other procedures carried out to evaluate the reasonableness of investigation/forensic audit/action taken by the Board or Audit Committee in respect of the matter reported. (Refer paragraphs 96 to 100)

k) Conclusions on whether or not the auditor was satisfied with the procedures carried out by the Board or the Audit Committee along with the basis and reasons therefor. (Refer paragraphs 98 to 104)

l) If the auditor is satisfied with the Board or the Audit Committee response that the suspected offence involving fraud does not exist, the details of additional procedures performed, supporting evidence and additional evidence received by the auditor in this regard. (Refer paragraphs 99 and 100)

m) Copy of the report submitted to the Central Government. The matters included in this report needs to be appropriately cross-referenced to the source documents. (Refer paragraphs 102, 104 and paragraph 109)

n) Management representations. (Refer paragraph 105)

o) Documentation on how the auditor evaluated the implications of the suspected offence involving fraud on other aspects of audit and on the financial statements—whether the impact is isolated occurrence or pervasive (Refer paragraphs 106 and 110).

p) If experts and specialists were involved in carrying out these procedures, then their work papers should also form part of the auditor’s work papers.

q) Any memo on consultations the auditor had during the course of carrying out the procedures with regard to fraud.

r) Evidence of a quality control review having been performed on the audit procedures carried out and the report submitted to the Board or Audit Committee and the Central Government. (Refer paragraph 108)

108. Whilst reporting under Section 143(12) is not a separate engagement from an audit of financial statements, it arises from such an audit, since reporting under Section 143(12) is consequent to any fraud noted in the course of performance of duties as auditor. Further, since the auditor is required to report to the Central Government in case of fraud against the company, and given the exceptional nature of circumstances, the auditor should ensure that the reporting under Section 143(12) is subject to quality control considering the provisions of SA 220 – “Quality Control for an Audit of Financial Statements”.

109. Whilst the Act or the Rules do not specify that the auditor should send a copy of the Form ADT–4 sent to the Central Government to the Board or the Audit Committee, the Act or the Rules do not prohibit the same. Accordingly, the auditor may send a copy of the Form ADT–4 and the documents annexed thereto to the Board or the Audit Committee for their information and records.

If a fraud has been noted and reported under Section 143(12), the auditor will have to evaluate the implications of the matter reported in the financial statements, on his audit opinion on the financial statements and on any other matter to be included in his report under Sections 143(1) to (3) including with regard to reporting on the adequacy and operating effectiveness of the internal financial controls. The following will need to be considered by the auditor in this regard:

- When the auditor has reason to believe that the management is involved in the fraud, how the auditor re-evaluated the risks of material misstatement due to fraud and reliability of the evidences previously obtained.
- When the auditor confirms that, or is unable to conclude whether the financial statements are materially misstated due to fraud, how the auditor evaluated the implications for the audit.

111. Consideration in Joint Audits

In case of joint audits, where a suspected offence involving fraud against the company by its officers or employees is identified/noted by one of the joint auditors, such joint auditor should communicate the same to the other joint auditor(s) to enable them to consider and evaluate if the same could exist in the areas/account balances audited by them and each of the joint auditor should individually comply with the requirements of this Guidance Note.

The reporting to those charged with governance and to the Central Government as required under Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015, may be carried out by the joint auditor who identified/noted the suspected fraud or by any or all of the joint auditors together.

When the reporting in Form ADT – 4 is carried out only by the joint auditor who identified/noted the suspected fraud, such joint auditor should provide a copy of the Form ADT – 4 to the other joint auditors.

112. Consideration of Disclosure of Frauds in the Board's Report

SA 720 – “The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements” requires the auditor to read the other information in documents that contain audited financial statements because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information.

Pursuant to the amendments to Section 143(12) of the Companies Act, 2013 read with Rule 13(3) and (4) of the Companies (Audit and Auditors) Rules, 2014 [as amended by the Companies (Audit and Auditors) Amendment Rules, 2015], the auditor is required to report a fraud involving less than Rupees One Crore only to the Audit Committee or the Board of Directors. Such frauds may have been appropriately dealt with in the audited financial statements of the company. However, as per the aforesaid Rules, the Board of Directors’ report is required to disclose the following information in respect of such frauds:
Since the Board’s report also includes audited financial statements, the auditor should read the disclosures relating to fraud in the Board’s report to determine if they are consistent with the matter reported by the auditor and dealt with in the audited financial statements. In case the auditor observes any material inconsistency in the disclosure in the Board’s report in this regard, the auditor should consider the requirements of SA 720 to determine the manner of dealing with the inconsistency observed.

SECTION V: APPENDICES

APPENDIX 1

(Refer paragraph 61)

Illustrative Matters for Engagement Team Discussion on Fraud

Discussion among the engagement team

A discussion among the engagement team members and a determination by the engagement partner of matters which are to be communicated to those team members not involved in the discussion should place particular emphasis on how and where the entity’s financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur.

The discussion should occur notwithstanding the engagement team members’ beliefs that management and those charged with governance are honest and have integrity.

Discussing the susceptibility of the entity’s financial statements to material misstatement due to fraud with the engagement team:

- Provides an opportunity for more experienced engagement team members to share their insights about how and where the financial statements may be susceptible to material misstatement due to fraud.
- Enables the auditor to consider an appropriate response to such susceptibility and to determine which members of the engagement team will conduct certain audit procedures.
- Permits the auditor to determine how the results of audit procedures will be shared among the engagement team and how to deal with any allegations of fraud that may come to the auditor’s attention.

The discussion may include such matters as:
III.968 Auditing Pronouncements

- An exchange of ideas among engagement team members about how and where they believe the entity’s financial statements may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.

- A consideration of circumstances that might be indicative of earnings management and the practices that might be followed by management to manage earnings that could lead to fraudulent financial reporting.

- A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalise committing fraud.

- A consideration of management’s involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.

- A consideration of any unusual or unexplained changes in behavior or lifestyle of management or employees which have come to the attention of the engagement team.

- An emphasis on the importance of maintaining a proper state of mind throughout the audit regarding the potential for material misstatement due to fraud.

- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.

- A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the audit procedures to be performed.

- A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity’s financial statement to material misstatement due to fraud and whether certain types of audit procedures are more effective than others.

- A consideration of any allegations of fraud that have come to the auditor’s attention.

- A consideration of the risk of management override of controls.

**Illustrative matters for consideration during engagement team discussions on fraud risk factors**

- What are the business risks that the entity is subject to?

- How might fraud, including fraudulent financial reporting, occur at the entity? How can it be concealed?
• Have there been any frauds that have been reported in the same industry as the entity? If so, is it possible that the fraud identified is applicable to the entity and should be considered?

• Where are the financial statements susceptible to material misstatement as a result of fraud or error?

• How could assets at the entity be misappropriated?

• Is there a high risk of management override of controls?

• What is the susceptibility of financial statements to material misstatement due to fraud or error that could result from the entity’s related party relationships and transactions?

• Are there circumstances that indicate earnings management and the practices that might be followed by management to manage earnings that could lead to fraudulent financial reporting?

• Are there known external or internal factors affecting the entity that may create an incentive or pressure for management and others to commit fraud, provide the opportunity for fraud to be perpetrated, indicate a culture or environment that enables management or others to rationalise committing fraud?

• Is the financial stability or profitability of the entity threatened by economic, industry, or other operating conditions?

• Does the nature of the entity’s operations provide opportunities to engage in fraudulent financial reporting?

• Does the entity have a complex or unstable organisational structure?

• Are there any unusual or unexplained changes in behavior or lifestyle of management and/or others?

• Have there been any actual frauds uncovered at the entity?

• If so, what was the circumstances surrounding the fraud and what was the outcome of the investigation?

• Did management and others take the appropriate actions to address the fraud?

• Have there been any allegations of fraud?

In addition to assessing the susceptibility to fraud, engagement teams may consider the following matters in addressing the fraud risk factors:

• What insights can be shared amongst engagement team members based on the knowledge of the entity?
• Does each engagement team member understand the potential for material misstatements related to each audit area they have been assigned to?
• What types of circumstances, if encountered, during the engagement could indicate a possibility of fraud?
• What type of procedures might be selected to respond to possible fraud?
• Are there certain types of procedures that are more effective than others?
• Is the engagement team aware of the importance of maintaining a proper state of mind throughout the audit regarding the potential for material misstatement due to fraud?
• How will the element of unpredictability be incorporated into the nature, timing and extent of the audit procedures to be performed?
• What happens if fraud is identified during the engagement?

APPENDIX 2

(Refer paragraphs 62 and 65)

Illustrative Checklist for Inquiries with Board/ Audit Committee, Management and Internal Auditor

Inquiries of Management and Others regarding the risk of fraud:
Document responses after each chart within the space provided.

Questions Regarding the Identification of Fraud Risks and Other Risks of Material Misstatement

The following questions are designed to identify fraud risks that are known to management. Questions may be directed to those individuals indicated:

<table>
<thead>
<tr>
<th>Questions</th>
<th>Board/Audit Committee</th>
<th>CEO</th>
<th>CFO</th>
<th>Internal Audit</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>What are your views regarding the risks of fraud?</td>
<td>*</td>
<td>*</td>
<td>*</td>
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<tr>
<td>Do you have knowledge of any actual or suspected fraud affecting the entity? If so, describe each instance including:</td>
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### Questions

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<th></th>
<th>Board/ Audit Committee</th>
<th>CEO</th>
<th>CFO</th>
<th>Internal Audit</th>
<th>Others</th>
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<tbody>
<tr>
<td>a.</td>
<td>The individual’s position within or relationship to the entity.</td>
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<td>b.</td>
<td>Identification of others involved or that may have been involved in the matter and their relationship to the entity or any of its employees.</td>
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<td>c.</td>
<td>The scheme used or possibly used to misstate the financial statement amounts and/or disclosures.</td>
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<tr>
<td>d.</td>
<td>Whether the misstatement or potential misstatement was detected in a timely manner by the internal controls, especially the antifraud programs and controls, established by management.</td>
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</table>
| e. | If the misstatement or potential misstatement was not detected in a timely manner, indicate whether it was because the programs and controls were:  
  i. Not in place  
  ii. Improperly designed  
  iii. Properly designed but not operating effectively. |     |     |                |        |
| f. | How management (or others, such as the Audit Committee) became aware of the scheme used or possibly used to misstate the financial statements. |     |     |                |        |
| g. | The actual or potential effect on the financial statement amounts and/or disclosures. |     |     |                |        |
| h. | The actions that management and/or those charged with governance (e.g., the Audit Committee) took in response to each instance described (e.g., investigation, restating the financial statements). If no action was taken, please explain the reasons for that decision. |     |     |                |        |
| i. | Any disciplinary actions that management and/or those charged with governance (e.g., the Audit Committee) took with respect to the individual(s) involved in the matters described. If there was no disciplinary action taken, please indicate such and explain why no action was considered necessary. |     |     |                |        |
| j. | How management plans to prevent, deter, and detect the risks relating to such schemes in the future. |     |     |                |        |

Provide copies of reports on suspected fraud received from the cost.
<table>
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<tr>
<th>Questions</th>
<th>Board/Audit Committee</th>
<th>CEO</th>
<th>CFO</th>
<th>Internal Audit</th>
<th>Others</th>
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</thead>
<tbody>
<tr>
<td>auditors, secretarial auditors and erstwhile statutory auditors in the last year in terms of Section 143(12) of the Companies Act, 2013 and the Rules thereunder, along with the responses of the company provided to such persons and copies of reporting on fraud to any other regulatory authority.</td>
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<tr>
<td>Are you aware of allegations of fraud or suspected fraud affecting the entity (e.g., received in communications from employees, former employees, analysts, regulators, short sellers, or other investors)? If so, describe each instance, addressing items (a) through (j) from the above question as applicable.</td>
<td>x</td>
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<tr>
<td>Is the entity in compliance with laws and regulations that may have a material effect on the financial statements?</td>
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<tr>
<td>Are you aware of tips or complaints regarding the entity's financial reporting (including those received through any internal whistleblower program, if such program exists) and, if so, what were your responses to such tips and complaints?</td>
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<tr>
<td>Have you reported to those charged with governance on how the entity's internal control serves to prevent and detect material misstatements due to fraud?</td>
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<td>Are you aware of instances of management override of controls and the nature and circumstances of such overrides?</td>
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<tr>
<td>[To the extent necessary, expand inquiries of the audit committee, or equivalent (or its chair), management, the internal audit function, and others within the entity who might reasonably be expected to have information that is important to the identification and assessment of risks of material misstatement]</td>
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<td>Other:</td>
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**Documentation**

**Questions Regarding Processes to Prevent or Mitigate Fraud Risks**
The following questions are designed to identify the processes, including absence thereof or weaknesses therein, to prevent or mitigate fraud risks. Questions may be directed to those individuals indicated:

<table>
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<tr>
<th>Questions</th>
<th>Board or the Audit Committee</th>
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<th>CFO</th>
<th>Internal Audit</th>
<th>Others</th>
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</thead>
<tbody>
<tr>
<td>Does management perform an assessment of the risk that the financial statements may be materially misstated due to fraud (e.g., processes used to identify, analyse, and manage fraud faced by the entity)? If so, describe such processes, including the nature, extent, and frequency of such assessments.</td>
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<tr>
<td>Describe your understanding about management's process for identifying, responding to, and monitoring the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist.</td>
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<tr>
<td>Has the entity established programs and controls to mitigate specific fraud risks the entity has identified, or that otherwise help to prevent, deter, and detect fraud? If so, describe such programs and controls, including how management monitors them.</td>
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<tr>
<td>Describe how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.</td>
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<tr>
<td>Has management communicated with those charged with governance (e.g., Audit Committee; others with equivalent authority and responsibility such as the Board of Directors, the board of trustees, or the owner-manager of the entity) regarding its processes for identifying and responding to the risks of fraud in the entity? Describe the frequency, nature, and extent of such communications.</td>
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<td>Has management communicated to employees its</td>
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### Questions

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<th>CFO</th>
<th>Internal Audit</th>
<th>Others</th>
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</thead>
<tbody>
<tr>
<td>views on business practices and ethical behavior? If so, how?</td>
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<td>Does the entity have a compliance-monitoring process? If so, describe the process.</td>
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<tr>
<td>Describe controls that the entity has established to address risks of fraud the entity has identified, or that otherwise help to prevent and detect fraud, including how management monitors those controls.</td>
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<tr>
<td>For entities with multiple locations, describe (a) the nature and extent of monitoring of operating locations or business segments, and (b) whether there are particular operating locations or business segments for which a risk of fraud may be more likely to exist.</td>
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<tr>
<td>Has the entity established policies and procedures regarding compliance with laws and regulations (including the prevention of non-compliance)? If so, describe those policies. If not, explain why. What do you do to check compliance with this policy?</td>
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<tr>
<td>Has the entity issued directives requiring periodic representations from management at appropriate levels of authority concerning compliance with laws and regulations? If not, why?</td>
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<tr>
<td>Has the entity obtained periodic representations from management at appropriate levels of authority concerning compliance with laws and regulations?</td>
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<tr>
<td>Has internal audit performed any procedures during the year to identify or detect fraud? If yes, has management satisfactorily responded to any findings resulting from those procedures performed? Note: Consider any significant risks identified when describing the role of those charged with governance (e.g., the Audit Committee) in addressing the risk that management may commit fraud through an override of existing controls.</td>
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<tr>
<td>Other:</td>
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Illustrative Fraud Risk Factors

(Refer Appendix I of SA 240)

The fraud risk factors identified in this Appendix are examples of such factors that may be faced by auditors in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor’s consideration, i.e., fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (a) incentives/pressures, (b) opportunities, and (c) attitudes/rationalizations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting.

Incentives/Pressures

Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by):

- High degree of competition or market saturation, accompanied by declining margins.
- High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates.
- Significant declines in customer demand and increasing business failures in either the industry or overall economy.
- Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.
III.976 Auditing Pronouncements

- Rapid growth or unusual profitability especially compared to that of other companies in the same industry.
- New accounting, statutory, or regulatory requirements.

Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:

- Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are unduly aggressive or unrealistic), including expectations created by management in, for example, overly optimistic press releases or annual report messages.
- Need to obtain additional debt or equity financing to stay competitive - including financing of major research and development or capital expenditures.
- Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.
- Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards.

Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity’s financial performance arising from the following:

- Significant financial interests in the entity.
- Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, or cash flow.
- Personal guarantees of debts of the entity.
- There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.

Opportunities

The nature of the industry or the entity’s operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

- Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.
• A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm’s-length transactions.

• Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.

• Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult “substance over form” questions.

• Significant operations located or conducted across international borders in jurisdictions where differing business environments and cultures exist.

• Use of business intermediaries for which there appears to be no clear business justification.

• Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.

The monitoring of management is not effective as a result of the following:

• Domination of management by a single person or small group (in a non-owner managed business) without compensating controls.

• Oversight by those charged with governance over the financial reporting process and internal control is not effective.

There is a complex or unstable organizational structure, as evidenced by the following:

• Difficulty in determining the organization or individuals that have controlling interest in the entity.

• Overly complex organizational structure involving unusual legal entities or managerial lines of authority.

• High turnover of senior management, legal counsel, or those charged with governance.

Internal control components are deficient as a result of the following:

• Inadequate monitoring of controls, including automated controls and controls over interim financial reporting (where external reporting is required).

• High turnover rates or employment of accounting, internal audit, or information technology staff that are not effective.

• Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

**Attitudes/Rationalizations**
• Communication, implementation, support, or enforcement of the entity’s values or ethical standards by management, or the communication of inappropriate values or ethical standards, that are not effective.

• Non-financial management’s excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.

• Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations.

• Excessive interest by management in maintaining or increasing the entity’s stock price or earnings trend.

• The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.

• Management failing to remedy known significant deficiencies in internal control on a timely basis.

• An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.

• Low morale among senior management.

• The owner-manager makes no distinction between personal and business transactions.

• Dispute between shareholders in a closely held entity.

• Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.

• The relationship between management and the current or predecessor auditor is strained, as exhibited by the following:
  – Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters.
  – Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor’s report.
  – Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance.
  – Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor’s work or the selection or continuance of personnel assigned to or consulted on the audit engagement.
Risk Factors Arising from Misstatements Arising from Misappropriation of Assets

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and other deficiencies in internal control may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

**Incentives/Pressures**

- Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.
- Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:
  - Known or anticipated future employee layoffs.
  - Recent or anticipated changes to employee compensation or benefit plans.
  - Promotions, compensation, or other rewards inconsistent with expectations.

**Opportunities**

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

- Large amounts of cash on hand or processed.
- Inventory items that are small in size, of high value, or in high demand.
- Easily convertible assets, such as bearer bonds, diamonds, or computer chips.
- Fixed assets which are small in size, marketable, or lacking observable identification of ownership.
- Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:
  - Inadequate segregation of duties or independent checks.
Inadequate oversight of senior management expenditures, such as travel and other reimbursements.

− Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.

− Inadequate job applicant screening of employees with access to assets.

− Inadequate record keeping with respect to assets.

− Inadequate system of authorization and approval of transactions (for example, in purchasing).

− Inadequate physical safeguards over cash, investments, inventory, or fixed assets.

− Lack of complete and timely reconciliations of assets.

− Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.

− Lack of mandatory vacations for employees performing key control functions.

− Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.

− Inadequate access controls over automated records, including controls over and review of computer systems event logs.

Attitudes/Rationalizations

• Disregard for the need for monitoring or reducing risks related to misappropriations of assets.

• Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.

• Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee.

• Changes in behavior or lifestyle that may indicate assets have been misappropriated.

• Tolerance of petty theft.
The Fraud Triangle – Risk factors

Additional Examples of Fraud Risk Factors for Consideration by Auditors (these are in addition to those stated in SA 240)

Probable areas where fraud may occur:

- Improper Disclosures.
- Expenses.
- Liabilities.
- Reserves.
- Bribery and kickbacks.
- Cash and bank balances.
- Inflating the purchase consideration for acquisition of business and thereby recording fictitious Goodwill.
- Investments.
- Asset misappropriation.
- Trade Receivable.
- Inventory.
- Revenue Recognition.

Adverse situations impacting the company:
III.982 Auditing Pronouncements

- Heavy rejections of stores, spares and equipment in a factory could be used as means for smuggling good stocks.
- Situation of disorderliness.
- Non-reconciliation of Bank Statements for a long period of time.
- Disaster situations like floods or fire whereby assets are deliberately pilfered.
- Sudden profits in otherwise loss making business not supported by any reasonable change in environment.
- Consistent losses in otherwise thriving industry.
- Situation of incomplete information like missing records.
- Absence of rotation of duties or prolonged exposure in the same area.
- Close nexus with vendors, clients or external parties whereby preference is given to one party over the other though the terms of trade may be unfavorable.
- Domination of management by a single person.

Favorable situations that could also be indicative of fraud:

- One way errors – Where the store keeper always show excessive inventory and has never reported shortages.
- Inefficient accountant suddenly turns very responsible and undertakes extraordinary work such as a reconciliation of long-outstanding/overdue receivable or payable balances, which bears fruits.
- An accountant/employee pays up from his own pocket to make up for the lapse.
- Employee does not take advances/cash float when he goes on outstation tours for company purposes.
- Extreme behavior of being very obedient or friendly or compliant.
- No significant over-dues/delinquencies not commensurate with industry norms.

Common situations in computerised environments where frauds are likely to take place:

- Migration from manual system to computerised system or migration from one application to a new one where migration is enforced on staff, the timeline for migration appears inadequate or parallel alternate records in the erstwhile system are not maintained.
- Implementing computerised system without staff orientation.
- Teething problems in implementation or customisation of computerised systems could be used as camouflaging or cloaking devices for frauds or hiding one's own inefficiencies.
- Frauds using excel spread sheets – cells with values hidden but included in totals; values directly input in cells which normally have formulas or values added in cells which have formulas, etc.
Discrepancies/unusual transactions in the accounting records, including:

- Transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy.
- Unsupported or unauthorised balances or transactions.
- Inter-company funding arrangements not in a transparent manner.
- Funding from unknown parties or at valuations that do not appear arm’s length.
- Ownership changes in a dormant company or significant business activity in an otherwise dormant company.
- Last-minute adjustments that significantly affect financial results.
- Evidence of employees’ access to systems and records inconsistent with that necessary to perform their authorised duties.
- Tips or complaints to the auditor about alleged fraud.

Conflicting or missing evidence, including:

- Missing documents.
- Documents that appear to have been altered.
- Unavailability of other than photocopied or electronically transmitted documents when documents in original form are expected to exist.
- Significant unexplained items on reconciliations.
- Unusual balance sheet changes or changes in trends or important financial statement ratios or relationships, for example, receivables growing faster than revenues.
- Inconsistent, vague, or implausible responses from management or employees arising from inquiries or analytical procedures.
- Unusual discrepancies between the entity’s records and confirmation replies.
- Large numbers of credit entries and other adjustments made to accounts receivable records.

Common fraud schemes in revenue recognition:

- Recording of fictitious revenues.
- Recognition of revenue when products or services are not delivered, delivery is incomplete, or delivered without customer acceptance.
- Recognition of revenue from sales transactions billed, but not shipped (“bill and hold”).
- Recognition of revenue from excessive shipments to resellers beyond actual demand (“channel stuffing”).
- Recognition of revenue from sales where collectability is not reasonably assured.
- Recognition of revenue from sales improperly financed by the selling entity.
III.984 Auditing Pronouncements

- Recognition of revenue for goods on consignment.
- Recognition of revenue when disputes or claims exist.
- Recognition by a lessor of revenue from an operating lease as a sale.
- Failure to establish appropriate provisions for sales discounts and other allowances.
- Failure to establish appropriate provisions for rights to refunds or exchange, cancellation or refusal rights, or liberal unconditional rights of return granted through undisclosed verbal or written agreement (“side agreements”).
- Recognizing inappropriate amount of revenue from swaps or barter arrangements.
- Improper recognition of revenue from long-term contacts (including those accounted for using percentage of completion).
- Recognition of revenue in the wrong period either by holding the books open after period-end or by closing the books prior to period-end.
- Recognition of revenue where there are contingencies associated with the transactions that have not yet been resolved.
- Recognition of revenue associated with undelivered elements of multiple-elements contracts (“bundled contracts”).

APPENDIX 4

(Refer paragraph 79)

Illustrative Possible Audit Procedures to Address the Assessed Risks of Material Misstatement due to Fraud

(Refer Appendix 2 of SA 240)

The following are examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from both fraudulent financial reporting and misappropriation of assets. Although these procedures cover a broad range of situations, they are only examples and, accordingly they may not be the most appropriate nor necessary in each circumstance. Also the order of the procedures provided is not intended to reflect their relative importance.

Consideration at the Assertion Level

Specific responses to the auditor’s assessment of the risks of material misstatement due to fraud will vary depending upon the types or combinations of fraud risk factors or conditions identified, and the classes of transactions, account balances, disclosures and assertions they may affect. The following are specific examples of responses:

- Visiting locations or performing certain tests on a surprise or unannounced basis. For example, observing inventory at locations where auditor attendance has not been previously announced or counting cash at a particular date on a surprise basis.
• Requesting that inventories be counted at the end of the reporting period or on a date closer to period end to minimize the risk of manipulation of balances in the period between the date of completion of the count and the end of the reporting period.

• Altering the audit approach in the current year. For example, contacting major customers and suppliers orally in addition to sending written confirmation, sending confirmation requests to a specific party within an organization, or seeking more or different information.

• Performing a detailed review of the entity’s quarter-end or year-end adjusting entries and investigating any that appear unusual as to nature or amount.

• For significant and unusual transactions, particularly those occurring at or near year-end, investigating the possibility of related parties and the sources of financial resources supporting the transactions.

• Performing substantive analytical procedures using disaggregated data. For example, comparing sales and cost of sales by location, line of business or month to expectations developed by the auditor.

• Conducting interviews of personnel involved in areas where a risk of material misstatement due to fraud has been identified, to obtain their insights about the risk and whether, or how, controls address the risk.

• When other independent auditors are auditing the financial statements of one or more subsidiaries, divisions or branches, discussing with them the extent of work necessary to be performed to address the assessed risk of material misstatement due to fraud resulting from transactions and activities among these components.

• If the work of an expert becomes particularly significant with respect to a financial statement item for which the assessed risk of misstatement due to fraud is high, performing additional procedures relating to some or all of the expert’s assumptions, methods or findings to determine that the findings are not unreasonable, or engaging another expert for that purpose.

• Performing audit procedures to analyse selected opening balance sheet accounts of previously audited financial statements to assess how certain issues involving accounting estimates and judgments, for example, an allowance for sales returns, were resolved with the benefit of hindsight.

• Performing procedures on account or other reconciliations prepared by the entity, including considering reconciliations performed at interim periods.

• Performing computer-assisted techniques, such as data mining to test for anomalies in a population.

• Testing the integrity of computer-produced records and transactions.

• Seeking additional audit evidence from sources outside of the entity being audited.

Specific Responses—Misstatement Resulting from Fraudulent Financial Reporting
Examples of responses to the auditor’s assessment of the risks of material misstatement due to fraudulent financial reporting are as follows:

**Revenue Recognition**

- Performing substantive analytical procedures relating to revenue using disaggregated data, for example, comparing revenue reported by month and by product line or business segment during the current reporting period with comparable prior periods. Computer-assisted audit techniques may be useful in identifying unusual or unexpected revenue relationships or transactions.
- Confirming with customers certain relevant contract terms and the absence of side agreements, because the appropriate accounting often is influenced by such terms or agreements and basis for rebates or the period to which they relate are often poorly documented. For example, acceptance criteria, delivery and payment terms, the absence of future or continuing vendor obligations, the right to return the product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances.
- Inquiring of the entity’s sales and marketing personnel or in-house legal counsel regarding sales or shipments near the end of the period and their knowledge of any unusual terms or conditions associated with these transactions.
- Being physically present at one or more locations at period end to observe goods being shipped or being readied for shipment (or returns awaiting processing) and performing other appropriate sales and inventory cut-off procedures.
- For those situations for which revenue transactions are electronically initiated, processed, and recorded, testing controls to determine whether they provide assurance that recorded revenue transactions occurred and are properly recorded.

**Inventory Quantities**

- Examining the entity’s inventory records to identify locations or items that require specific attention during or after the physical inventory count.
- Observing inventory counts at certain locations on an unannounced basis or conducting inventory counts at all locations on the same date.
- Conducting inventory counts at or near the end of the reporting period to minimize the risk of inappropriate manipulation during the period between the count and the end of the reporting period.
- Performing additional procedures during the observation of the count, for example, more rigorously examining the contents of boxed items, the manner in which the goods are stacked (for example, hollow squares) or labelled, and the quality (that is, purity, grade, or concentration) of liquid substances such as perfumes or specialty chemicals. Using the work of an expert may be helpful in this regard.
• Comparing the quantities for the current period with prior periods by class or category of inventory, location or other criteria, or comparison of quantities counted with perpetual records.

• Using computer-assisted audit techniques to further test the compilation of the physical inventory counts - for example, sorting by tag number to test tag controls or by item serial number to test the possibility of item omission or duplication.

Management Estimates

• Using an expert to develop an independent estimate for comparison to management’s estimate.

• Extending inquiries to individuals outside of management and the accounting department to corroborate management’s ability and intent to carry out plans that are relevant to developing the estimate.

Specific Responses - Misstatements Due to Misappropriation of Assets

Differing circumstances would necessarily dictate different responses. Ordinarily, the audit response to an assessed risk of material misstatement due to fraud relating to misappropriation of assets will be directed toward certain account balances and classes of transactions. Although some of the audit responses noted in the two categories above may apply in such circumstances, the scope of the work is to be linked to the specific information about the misappropriation risk that has been identified.

Examples of responses to the auditor’s assessment of the risk of material misstatements due to misappropriation of assets are as follows:

• Counting cash or securities at or near year-end.

• Confirming directly with customers the account activity (including credit memo and sales return activity as well as dates payments were made) for the period under audit.

• Analysing recoveries of written-off accounts.

• Analysing inventory shortages by location or product type.

• Comparing key inventory ratios to industry norm.

• Reviewing supporting documentation for reductions to the perpetual inventory records.

• Performing a computerized match of the vendor list with a list of employees to identify matches of addresses or phone numbers.

• Performing a computerized search of payroll records to identify duplicate addresses, employee identification or taxing authority numbers or bank accounts.

• Reviewing personnel files for those that contain little or no evidence of activity, for example, lack of performance evaluations.
III.988 Auditing Pronouncements

- Analysing sales discounts and returns for unusual patterns or trends.
- Confirming specific terms of contracts with third parties.
- Obtaining evidence that contracts are being carried out in accordance with their terms.
- Reviewing the propriety of large and unusual expenses.
- Reviewing the authorization and carrying value of senior management and related party loans.
- Reviewing the level and propriety of expense reports submitted by senior management.

Possible other audit procedures for consideration by auditors

A. Illustrative Q & A for Evaluating the Fraud Risk Assessment process of the company

Fraud Risk Assessment

1. Does the company have formal and regularly scheduled procedures to perform fraud risk assessments?
2. Are appropriate personnel involved in the fraud risk assessments?
3. Are fraud risk assessments performed at all appropriate levels of the organization (such as the entity level, significant locations or business units, significant account balance or major process level)?
4. Does the fraud risk assessment include consideration of internal and external risk factors (including pressures or incentives, rationalizations or attitudes, and opportunities)?
5. Does the fraud risk assessment include the identification and evaluation of past occurrences and allegations of fraud within the entity and industry? Does it include the evaluations of unusual financial trends or relationships identified from analytical procedures or techniques?
6. Does the fraud risk assessment consider the risk of management's override of controls?
7. Does management consider the type, likelihood, significance, and pervasiveness of identified fraud risks?
8. Are fraud risk assessments updated periodically to include considerations of changes in operations, new information systems, acquisitions, changes in job roles and responsibilities, employees in new positions, results from self-assessments of controls, monitoring activities, internal audit findings, new or evolving industry trends, and revisions to identified fraud risks within the organization?
9. Does management assess the design and operating effectiveness of the fraud risk assessments?
10. Does management adequately document its assessments and conclusions regarding the design and operating effectiveness of the fraud risk assessments?
11. Is the fraud risk assessment designed and operating effectively?

**Control Environment**

1. Does the company maintain a proper tone at the top? Did management assess the tone of the organisation to determine if the culture encourages ethical behaviour, consultation, and open communication? (This assessment can be made through inquiries and interviews, or by internal audit review.)

2. Do the audit committee and the Board of Directors have sufficient oversight of management's anti-fraud programs and controls?

3. Does the internal audit function have sufficient involvement in anti-fraud programs and controls, including monitoring of the effectiveness of anti-fraud programs and controls, given the size and complexity of the organization? Does the internal audit function reports directly to the audit committee?

4. Does the company have a published code of ethics/conduct (with provisions related to conflicts of interest, related-party transactions, illegal acts, and fraud) made available to all personnel and does management require employees to confirm that they accept and agree to follow it? Does the frequency of exceptions undermine the code’s effectiveness? Does the code comply with all applicable rules and regulations?

5. Does the company have an ethics/whistle blower hotline with adequate procedures to handle anonymous complaints (received from inside and outside the company), and to accept confidential submission of concerns about questionable accounting, internal accounting control, or auditing matters? Are tips and whistle blower complaints investigated and resolved in a timely manner?

6. Does the company have formal hiring and promotion policies, including background checks for those employees with influence over financial reporting or involved in the preparation of the financial statements?

7. Does the company have formal and effective training for employees and new hires on issues of fraud, ethics, and the code of ethics/conduct?

8. Does the company respond in a timely and appropriate manner to significant control deficiencies, allegations or concerns of fraud, and violations of the code of ethics/conduct?

9. Does management assess the design and operating effectiveness of the control environment?

10. Does management adequately document its assessments and conclusions regarding the design and operating effectiveness of the control environment?
11. Is the control environment designed and operating effectively?

**Anti-fraud Control Activities**

1. Does the company adequately map or link identified fraud risks to control activities designed to mitigate the fraud risks?

2. Does management design and implement preventative and detective controls (preventative controls are designed to stop fraud from occurring and detective controls are designed to identify the fraud if it occurs)?

3. Does the company have controls that restrain the misappropriation of company assets that could result in a material misstatement of the financial statements?

4. Does the company have controls that address the risk of management’s override of controls (including controls over journal entries and adjustments, estimates, and unusual or non-routine transactions)?

5. Does the company consider security controls (including IT controls and limited access to accounting systems), and consider the adequacy of fraud detection and monitoring activities utilizing information systems?

6. Does management assess the design and operating effectiveness of anti-fraud control activities?

7. Does management adequately document its assessments and conclusions regarding the design and operating effectiveness of anti-fraud control activities?

8. Are anti-fraud control activities designed and operating effectively?

**Information & Communication**

1. Is information on ethics and management’s commitment to anti-fraud programs and controls effectively communicated throughout the organisation to all employees?

2. Does management have procedures to disseminate and collect information regarding anti-fraud programs and controls, fraud risks, allegations of fraud, and concerns of improper accounting to and from all levels of the organization and external parties (where appropriate)?

3. Does management assess the design and operating effectiveness of information and communication?

4. Does management adequately document its assessments and conclusions regarding the design and operating effectiveness of information and communication?
5. Are procedures and activities for communicating information regarding anti-fraud programs and controls designed and operating effectively?

**Monitoring Activities**

1. Are internal audit and others actively involved in monitoring and assessing anti-fraud programs and controls?

2. Is the internal audit activity adequate for the size and operations of the organization?

3. Are findings and weaknesses identified during monitoring activities incorporated back into the fraud risk assessment, the design of the control environment and anti-fraud control activities?

4. Does the audit committee have oversight of monitoring activities?

5. Does management assess the design and operating effectiveness of monitoring activities?

6. Does management adequately document its assessments and conclusions regarding the design and operating effectiveness of the monitoring activities?

7. Are monitoring and assessment activities designed and operating effectively?

**B. Additional examples of audit procedures to address fraud risk factors**

**Incorporate “element of surprise” in the audit procedures and timeliness**

- Existence of assets is generally confirmed through physical verification. To re-verify the existence of assets at a later date to ensure that they were not borrowed or temporarily created.

- Compliance tests of internal controls, disbursement of wages, procedures for obtaining quotations for sale and disposal of scrap, material weighments, etc. can be verified repeatedly. Such procedures may reveal inconsistencies, if any.

- Element of unpredictability/surprise should be incorporated in physically verifying stocks with third parties.

- Rotate the components between audit team members to overcome familiarity threat with regard to audit procedures.

- Visiting locations or performing certain tests on a surprise or unannounced basis.

**Apply test of reasonableness and test of absurdity**
Existence of vendor/customer website for all huge value bills and payments. Also check the date on which the website was hosted. A recently uploaded webpage is also suspicious.

Two or more employees arriving and departing at the same time consistently.

Are stocks ordered irrespective of large existing balances.

Whether value of property acquired is within the acceptable range of prevailing market value.

Check for inconsistent facts while reading the contracts and agreements.

**Search for mutually exclusive events**

- Production quantity cannot be greater than machine capacity; sales cannot be quantitatively greater than opening stocks plus purchases/production.
- Production cannot be possible in periods of strike, downtime etc.
- Fuel for diesel cars cannot be supported by petrol bills or *vice versa*.
- Stocks cannot be physically greater than the volumetric capacity of storage place.
- An employee who has left cannot approve any transactions after the date of departure or before the date of appointment.
- Yield and rejection ratio for identical machines in different locations should theoretically be the same.
- Sales returns and warranty claims for the same products across different sales locations should be more or less consistent. If they are grossly inconsistent, analyse reasons.

**Possible Other Audit Procedures – Cash and Bank**

<table>
<thead>
<tr>
<th>Risks</th>
<th>Audit Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cheque signing mandate given to more number of persons which is not commensurate with the nature, size of the business. This may increase the risk of collusion between cheque signing authorities in remote locations</td>
<td>Review the cheque signing mandate for both crossed and bearer cheque. Evaluate whether the authority levels set are strong and is commensurate with the nature and size of the business.</td>
</tr>
</tbody>
</table>
Possibilities of cheques being forged and payment vouchers being approved by unauthorised persons

<table>
<thead>
<tr>
<th>Tests</th>
<th>Purpose</th>
<th>Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obtain specimen signatures of all authorised signatories and share it with the engagement team members during the planning stage.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Snowballing of bank charges and forex gains/losses

<table>
<thead>
<tr>
<th>Tests</th>
<th>Purpose</th>
<th>Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Check all cash contras and inter-back transfers – Ensure that cash withdrawals as per the bank statement is reflected as cash withdrawal in the bank book as well on the same date.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Duplicates in cheque numbers could indicate double accounting of expense or payment.

<table>
<thead>
<tr>
<th>Tests</th>
<th>Purpose</th>
<th>Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>The “IF” function in Excel along with its derivative usage with “And/or” can be useful for detecting gaps, finding duplicates and locating multiple records.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Gaps in cheque numbers may indicate that some cheques have been deliberately kept aside for some other motives which certainly is a concern

<table>
<thead>
<tr>
<th>Tests</th>
<th>Purpose</th>
<th>Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>The “IF” function in Excel along with its derivative usage with “And/or” can be useful for detecting gaps, finding duplicates and locating multiple records.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Cash withdrawals or other transactions as per bank statement accounted differently in the bank book

<table>
<thead>
<tr>
<th>Tests</th>
<th>Purpose</th>
<th>Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obtain a list of bank accounts held and ascertain the purpose for which each bank account is used. On a sample basis, select one month each for each of the bank accounts, obtain bank statements directly from the bank and re-perform bank reconciliation statements.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
III.994 Auditing Pronouncements

| Physical voucher consistency test in a series | • Helps identify replacement or insertion of a new voucher.  
• Can be applied for cash and bank payments, supplier invoices from the same supplier, purchase vouchers, journal vouchers etc. | a) Is the paper relatively new or has it yellowed less in comparison with other vouchers around the same date.  
b) Are the routine ticks missing.  
c) Is the paid stamp missing. |
| Specimen signatures comparison test | Helps to identify simple forgeries or fictitious transactions. | To obtain specimen signatures of all signatories and keep them for comparison during vouching. |
| Chronological test of supporting vouchers | Helps in identifying fraudulent/fictitious bills when huge bunches of supporting vouchers are attached to a single voucher. | Check if the supporting vouchers are dated subsequent to the payment voucher date or the date relates to earlier periods? |
| Chronological test of approvals | Helps to identify if any vouchers were approved by the resigned/newly joined employee after the resignation date or before the joining date. | If any of the authorised signatories had resigned or newly joined during the year, along with the specimen signatures also obtain their date of resignation or joining. |

Possible Other Audit Procedures – Management Override of Controls

• Performing a detailed review of the entity’s quarter-end or year-end adjusting entries and verifying any that appear unusual as to nature or amount.

• For significant and unusual transactions, particularly those occurring at or near year-end, verifying the possibility of related parties and the sources of financial resources supporting the transactions.

• Use of statistical tool for sample selection.

• Reviewing large and unusual expenses.

• Reviewing the authorisation and carrying value of senior management and related party loans.
• Reviewing the level and propriety of expense reports submitted by senior management.

**Possible Other Audit Procedures – Revenue Recognition**

• Comparing revenue reported by month/product line/remote locations during the current reporting period with comparable prior periods.

• Computer-assisted audit techniques may be useful in identifying unusual or unexpected revenue relationships or transactions.

• Inquiring of the entity's sales and marketing personnel or in-house legal counsel to corroborate information relating to sales returns, discounts, shipments near the end of the period etc.

• Being physically present at one or more locations at period end to observe goods being shipped or being readied for shipment

• Risk of understating/not accounting scrap sales.

**Possible Other Audit Procedures – Inventory**

• Examining the entity's inventory records to identify locations or items that require specific attention during or after the physical inventory count.

• Observing inventory counts at certain locations on an unannounced basis or conducting inventory counts at all locations on the same date.

• Analysing inventory shortages by location or product type.

• Performing additional procedures during the observation of the count, for example:
  − more rigorously examining the contents of boxed items,
  − the manner in which the goods are stacked (for example, hollow squares) or labeled,
  − the quality (that is, purity, grade, or concentration) of liquid substances such as oil or specialty chemicals.
  − take the help of technical experts to weigh/measure inventory.

**Possible Other Audit Procedures – Vendor and Customer**

• Check for duplicate vendor IDs, contact number, bank account number.

• Obtaining back dated cheques from customers and credit to customer based on instrument date and not the deposit date to reduce the outstanding debtors and also to reduce the penal interest.
Unidentified credit balances have possibility of being misused by way of wrong credits to suppliers, customers, accomplices and could also facilitate teeming and lading of collections.

- Analysing recoveries of written-off accounts.
- Receivables growing faster than revenues.

**Possible Other Audit Procedures – Employees**

- Reviewing personnel files for those that contain little or no evidence of activity, for example, lack of performance evaluations.

**Appendix 5**

(Refer paragraph 87)

**Illustrative Format for Reporting to Board or the Audit Committee on Fraud**

(As required by Rule 13(2)(a) and Rule 13(3) of the Companies (Audit and Auditors) Rules, 2014 [as amended by the Companies (Audit and Auditors) Amendment Rules, 2015]

Date:

Subject: Report under Sub-section (12) of Section 143 of the Companies Act, 2013 on suspected offence involving fraud being committed or having been committed against the company by its officers or employees.

<table>
<thead>
<tr>
<th>S.No</th>
<th>Particulars</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>1(a)</td>
<td>Name of the Company</td>
<td>4</td>
</tr>
<tr>
<td>1(b)</td>
<td>CIN</td>
<td></td>
</tr>
<tr>
<td>1(c)</td>
<td>Address of the Registered Office</td>
<td></td>
</tr>
<tr>
<td>2(a)</td>
<td>Name of the auditor or auditor’s Firm</td>
<td>5</td>
</tr>
<tr>
<td>2(b)</td>
<td>Membership number</td>
<td></td>
</tr>
<tr>
<td>2(c)</td>
<td>Address</td>
<td></td>
</tr>
</tbody>
</table>

4 Where the suspected offence relates to any component (subsidiary, associate, joint venture) forming part of the consolidated financial statements, to include and specify accordingly.

5 Where the period of offence dates back to an earlier time period, where the current auditor was different, to indicate the name of the predecessor auditor.
<table>
<thead>
<tr>
<th>S.No</th>
<th>Particulars</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>Date of the annual general meeting when the auditor was appointed or reappointed</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>SRN and date of filing</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Address of the office or location where the suspected offence is believed to have been or is being committed</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Full details of the suspected offence involving fraud (attach documents in support)(^6) (Refer Note 1)</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Particulars of the officers or employees who are suspected to be involved in the commission of the offence, if any:</td>
<td></td>
</tr>
<tr>
<td>7(a)</td>
<td>Name (s)</td>
<td></td>
</tr>
<tr>
<td>7(b)</td>
<td>Designation</td>
<td></td>
</tr>
<tr>
<td>7(c)</td>
<td>If Director, his DIN</td>
<td></td>
</tr>
<tr>
<td>7(d)</td>
<td>PAN</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Basis on which fraud is suspected(^7)</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Period during which the suspected fraud has occurred</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Date of sending report to the Board or Audit Committee as per rule 13(2)(a)</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Estimated amount involved in the suspected fraud (Refer Note 2)</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Any other relevant information</td>
<td></td>
</tr>
</tbody>
</table>

Notes:

1. The details of suspected offence involving fraud are those that have arisen during the course of performance of duties by the auditor and hence the auditors do not offer any assurance on completeness of the said matter or any other matter that may not be knowledgeable to the auditor.

\(^6\) Supports would relate to the convincing evidence that supported the suspicion of the auditor.

\(^7\) With respect to the suspected fraud, briefly state procedures performed, the audit evidence obtained and the conclusions on evaluation of the audit evidence.
2. The estimated amount indicated in Point No. 11 in the table above is based on the available information and evidence relating to the suspected fraud that supports the suspicion of the auditor. It is expected that based on this reporting by the auditors, Those Charged with Governance would initiate an investigation/forensic audit and provide complete details to the auditor to enable him to report to the Central Government and also to assess the impact of the same on the financial statements.

APPENDIX 6
(Refer paragraphs 3 and 103)

Form No. ADT-4
REPORT TO THE CENTRAL GOVERNMENT
(See rule 13(2)(f) of the Companies (Audit and Auditors) Rules, 2014) [as amended by the Companies (Audit and Auditors) Amendment Rules, 2015]

Date:

**Subject:** Report under sub-section (12) of section 143 of the Companies Act, 2013 on suspected offence involving fraud being committed or having been committed

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
</table>
| 1) | (a) Name of the Company  
(b) CIN:  
(c) Address of the Registered Office:  |
| 2) | (a) Name of the auditor or auditor’s Firm  
(b) Membership Number  
(c) Address  |
| 3) | Date of the annual general meeting when the Auditor was appointed or reappointed  |
| 4) | SRN and date of filing  |
| 5) | Address of the office or location where the suspected offence is believed to have been or is being committed  |
| 6) | Full details of the suspected offence involving fraud (attach documents in support)  |
| 7) | Particulars of the officers or employees who are suspected to be involved in the |
commission of the offence, if any:

a) Name(s) :

b) Designation

c) If Director, his DIN

d) PAN

8) Basis on which fraud is suspected:

9) Period during which the suspected fraud has occurred

10) Date of sending report to the Board or Audit committee as per rule 13(2)(a)

11) Date of reply received from Board or Audit committee, if any and if so received, attach copy thereof and give gist of the reply

12) Whether the auditor is satisfied with the reply of the Board or Audit committee.
    Yes _____ No _____.

13) Estimated amount involved in the suspected fraud;

14) Details of steps, if any, taken by the company in this regard; (Furnish full details with references)

15) Any other relevant information.

VERIFICATION

I, .........., Proprietor/Partner of ............... Chartered Accountants do hereby declare that the information furnished above is true, correct and complete in all respects including the attachments to this form.

(Name, Signature and Seal of the Auditor)

Attachments:
1. Optional attachments

APPENDIX 7

(Refer paragraph 105)

Illustrative Management Representation Letter

(for the reply of the Board or the Audit Committee on fraud reported by the auditor under Rule 13(2)(b) and (d) and Rule 13(3) and (4) of Companies (Audit and Auditors)
Messrs. Name of the Audit Firm
Chartered Accountants

Dear Sirs,

This representation letter is provided in connection with our reply dated ___ to you pursuant to your letter dated ____ on fraud suspected by you and reported to us under Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015.

We understand that the fraud reported by you is as follows:

(Details of fraud reported by the Auditors)

We acknowledge that because of the inherent limitations of an audit, together with the inherent limitations of internal controls, there is an unavoidable risk that material misstatements due to fraud or error may occur and not be detected, even though the audit is properly planned and performed by the auditor in accordance with the Standards on Auditing and that the matter reported by you in your letter dated ____ is not exhaustive or complete list of frauds against the Company that may exist.

We acknowledge our responsibility for the prevention and detection of fraud. Our responsibility also includes informing you about any fraud detected and remedied by the management, any incidence of fraud reported through the vigil mechanism or through any other internal or external sources. We acknowledge that we are also responsible to take appropriate action when a fraud is detected or reported though any of the sources.

In particular we confirm that we are responsible for the following:

a) Designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of the financial statements which are free from material misstatements, whether due to fraud or error.

b) To set up a vigil mechanism for reporting suspected fraud and administer the mechanism effectively.

c) Take appropriate action to detect the fraud and wrongful gain or loss, if any, incurred on account of the fraud.

d) Take appropriate action against the fraudsters.
Part-III: Guidance Notes  III.1001

e) Address the control weaknesses which were the root cause for fraud and strengthen the internal control system.

We confirm the following representations in respect of fraud noted and reported during the year/period, other than for the matters reported by you:

1. There have been no communications from regulatory agencies concerning non-compliance with or deficiencies in financial reporting practices [except for (insert appropriate description)].

2. We have disclosed to you all changes/deficiencies in the design or operation of internal controls over financial reporting identified as part of our assessment, including separately disclosing to you all such deficiencies that we believe to be significant deficiencies or material weaknesses in internal controls over financial reporting.

3. We acknowledge our responsibilities for the implementation and operation of accounting and internal control systems that are designed to prevent and detect fraud and error. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

4. We are not aware of any/We have disclosed to you all significant facts relating to any frauds or suspected frauds known that may have involved (i) Management; (ii) Employees who have significant roles in accounting and internal control; or (iii) Others.

5. To the best of our knowledge and belief, the Company has not made any improper payments or payments which are illegal or against public policy.

6. The Company has complied with all aspects of contractual agreements which could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of regulatory authorities that could have a material effect on the financial statements in the event of non-compliance.

7. We have no plans or intentions which may materially affect the carrying value or classification of assets and liabilities reflected in the financial statements.

8. We have made available to you all books of account, supporting documentation and minutes of all meetings of the shareholders and the Board of Directors and Committees of the Board and all other details with regard to action taken by the management to evaluate the fraud reported by you.

9. We have acted in good faith and in the best interests of the Company regarding the action taken by the management to evaluate the fraud reported by you.
We have not withheld from you any relevant information that we are aware of and would have an implication on the process of your responsibilities to report fraud under the statute.

The conclusions reached by us are based on the rationale of facts and data that were identified during the investigation/other action taken by us to evaluate the fraud reported by you.

We believe that appropriate action has been taken against employees/officers involved in the fraud and we confirm that appropriate controls have been put in place to ensure that such incidences are avoided in the future.

With effect from 1st April 2014, the provisions of the Companies Act, 2013 (‘the Act’) have become applicable to the Company. We understand that Section 143(12) of the said Act read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014, as amended by the Companies (Audit and Auditors) Amendment Rules, 2015 requires the auditors to report on fraud to the Board or the Audit Committee prior to reporting the same to the Central Government. We are aware that the Board or the Audit Committee is required to consider the report of the auditor and respond on the matter reported within 45 days of the date of the report of the auditor.

Insofar as the matter reported by you in your letter dated ___ and our reply thereto dated ____, we confirm the following:

1. We have carried out an investigation into the matter reported by you towards which ____ an independent agency/the Company’s internal auditor/Senior Management of the Company were engaged to investigate the matter.

2. Status of the investigation commissioned by the Board or the Audit Committee.

I. Investigation complete and Board or the Audit Committee concurs with the auditor on the suspected fraud

1. We concur with your assessment of suspected fraud based on the following: (State details and the reasons for occurrence).

2. The persons allegedly involved in the matter are: (list names and designations, DIN (if a Director is involved) and PAN of the person.

3. Based on the investigation carried out, we confirm that the period to which the fraud relates is ____.

4. The estimate of amounts involved in the fraud as determined by the investigation is Rs. ______.

5. We have initiated the following steps with immediate effect to mitigate the recurrence of such fraud. (State steps taken to mitigate such risk in future).
6. We have initiated the following actions on the persons involved in the fraud (List action taken on the concerned persons.) [or] Pending closure of the internal hearings of the Committee of Ethics of the Company, no action has been taken on the persons involved.

II. Investigation complete and Board or the Audit Committee does not concur with the auditor on the suspected fraud

1. State reasons for not concurring with the auditor’s assessment of suspected fraud with persuasive evidence supporting the Board or the Audit Committee conclusion.

2. We believe that the investigation commissioned by us was independent, comprehensive, objective, unbiased and did not involve any scope limitations. Specifically, the investigation focused on the following areas that are impacted by the suspected fraud reported by you: (list areas)

3. We confirm that no fraud has been or is being committed against the Company by its officers or employees as reported by you.

III. Investigation is in progress

1. As on date of this letter, the investigation commissioned by the Board or the Audit Committee is in progress.

2. Management to state items in I.3 to I.8 to the extent applicable.

We acknowledge that your report on suspected fraud under Section 143(12) of the Act is made in good faith to comply with the requirements of the law and, therefore, cannot be considered as breach of maintenance of client confidentiality requirements or be subject to any suit, prosecution or other legal proceeding since it is done in pursuance of the Act or of any rules or orders made thereunder.

Yours faithfully,

Chairman of the Audit Committee/Board