

Commonly found Non-compliances in Financial Statements of Companies – Auditor’s Report and CARO, 2016

Observations related to Auditor’s Report

1. **Case:** In the financial statements of a company, the relevant abstract of Independent Auditor’s report read as under:

“Independent Auditors Report

.....

Opinion

In our opinion and to the best of our information and according to the explanations given to us, the standalone Ind AS financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of **the state of affairs of the Company as at March 31, 20XX, its profit and its cash flows** for the year ended on that date.”

Observation: It was noted that paragraph 27 read with Illustrative format of Independent Auditor’s given in Implementation Guide on Auditor’s reports under Ind AS for transition phase, provides as follows:-

“Paragraph 27

With regard to the opening balance sheet and the financial statements for the corresponding period (“Comparative Ind AS Financial Statements”), the following considerations would inter alia apply while reporting:

In addition to the notes required by Ind AS, the notes to such financial statements should describe that as part of conversion to Ind AS, the company has prepared the Comparative Ind AS financial statements to establish the financial position (balance sheet), income **(including results of operations and Other Comprehensive Income)** and cash flows of the company necessary to provide the comparative financial information expected to be included in the company's first complete set of Ind AS financial statements as at the company's Ind AS reporting date. The note should also state that these financial statements do not themselves include comparative financial information for the prior period;”

(Emphasis added)

“Annexure I - Illustrative Format of Independent Auditor’s Report on the First Standalone Ind AS Financial Statements of a Company under the Companies Act, 2013 and the Rules Thereunder

Opinion

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid standalone Ind AS financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India including the Ind AS, of the state of affairs (financial position) of the Company as at 31st March, 2017, and its profit/loss (financial performance including **other comprehensive income**), its cash flows and the **changes in equity** for the year ended on that date.

(Emphasis added)

It was noted from the Auditor’s Report that the auditor has not included ‘other comprehensive income’ and ‘changes in equity’ in the opinion paragraph while giving his opinion on financial position and financial performance of the company, as required by paragraph 27 read with format of independent auditor’s report given under Implementation Guide.

Accordingly, it was viewed that auditor has not complied with the requirements of paragraph 27 read with Illustrative Format of Independent Auditor’s Report given in Implementation Guide on Auditor’s Reports under Indian Accounting Standards for Transition Phase.

2. **Case:** In the financial statements of a company, the relevant abstract of paragraph (ii) of Annexure A to the Independent Auditor’s Report (CARO Reporting) and Annexure B to the Independent Auditor’s Report read as under:

“Annexure – A to the Independent Auditor’s Report

ii. In our opinion and according to the information and explanations given to us, there is no inventory. Hence, the provision of clause 3(ii) is not applicable.”

“Annexure – B to the Independent Auditor’s Report

Specific areas examined during the course of audit of Annual Accounts of XYZ Limited for the year ended 31st March 20XX, in terms of the directions/sub-directions issued to us:

S. No.	Particulars	Management Reply	Statutory Auditor Reply
	Whether proper records are maintained for inventories lying with third parties and assets received as gift/ grants	The Company has maintained adequate records in respect of the company’s inventories lying with third parties. In all cases, the	Based on the information and representations provided by the Management to us and based on the verification procedures performed by

	from the Government or other authorities.	confirmation from such parties have been obtained on year end basis. No assets were received as gift from Government or other Authorities.	us, we agree to the Management's response."
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Observation: It was noted that section 143(5) of Companies Act,2013,provides as follows:-

“In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Government, or partly by the Central Government and partly by one or more State Government, the Comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 and direct such auditor the manner in which the accounts of the company are required to be audited and"] thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.”

It was noted from the Auditor's Report that while reporting on the directions issued by the Comptroller and Auditor General of India (C&AG of India) under Sec. 143(5) of Companies Act, 2013, auditor has also included the reply given by the management. It was viewed that the said section specifically requires auditor to report on matter specified in the directions of C&AGI and not the management to reply on comments of the auditor. Accordingly, it was viewed that management's reply should not have been included by the auditor in his comments under section 143(5).

Accordingly, it was viewed that auditor's reply to the directions given by C&AGI is not in line with the section 143(5).

3. **Case:** In the financial statements of a company , the relevant abstract of the note on 'Balance Confirmation' reads as under :

“Note No. xyz. Party Balances and Confirmations

Balances of recoverable shown under Assets and Other Payables shown under Liabilities include balances subject to confirmation/ reconciliation and consequential adjustments if any. However, reconciliations are carried out on ongoing basis.”

Observation: It was noted that paragraph 7,8 & 9 of SA 505: External Confirmation , provides as follows :

“7. When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

- (a) Determining the information to be confirmed or requested;(Ref: Para.A1)
- (b) Selecting the appropriate confirming party; (Ref: Para.A2)
- (c) Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and (Ref: Para.A3-A6)
- (d) Sending the requests, including follow-up requests when applicable, to the confirming party. (Ref: Para. A7)”

“8. If management refuses to allow the auditor to send a confirmation request, the auditor shall:

- (a) Inquire as to management’s reasons for the refusal and seek audit evidence as to their validity and reasonableness; (Ref: Para. A8)
- (b) Evaluate the implications of management’s refusal on the auditor’s assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing, and extent of other audit procedures; and (Ref: Para.A9)
- (c) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence. (Ref: Para.A10)”

“9. If the auditor concludes that management’s refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260. The auditor also shall determine the implications for the audit and the auditor’s opinion in accordance with SA 705.”

It was noted from the Note ‘xyz’ that certain balances of ‘receivable’ and ‘payables’ were subject to confirmation from the parties. It was viewed that if the amount of these ‘receivables’ and ‘payables’ is not material, then such note was not required to be given in the financial statements. However, if the amount is material, then it is the responsibility of the auditor to qualify his report and quantify its effect as required by SA 705.

Further, it was viewed that as per paragraphs 7, 8 and 9 of SA 505, External Confirmation, the auditor shall maintain control over external confirmation requests, and in case management refuses the auditor to send a confirmation request, the auditor shall, inter alia, perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

Accordingly, it was viewed that the auditor should have exercised appropriate procedure to satisfy himself regarding external confirmation and if he is not in agreement with the confirmation received, then auditor shall modify the report in accordance with aforesaid paragraph of SA 505, otherwise such notes should not be given in the financial statements

as these might create confusions in the mind of readers of the financial statements that balance confirmations have not been done and auditor has not carried out appropriate procedures in accordance with SA 505 with regard to the same.

Observations related to CARO, 2016

4. **Case:** In the financial statements of a company, the relevant abstract of paragraph (viii) of Annexure A to the Independent Auditor's Report (reporting under CARO, 2016) reads as under:

"In our opinion and according to the information and explanations given to us, the Company has not defaulted in the repayment of dues to financial institutions, banks, and debenture holders."

Observation: It was noted that paragraph 3(viii) of the Companies (Auditor's Report) order, 2016 requires the auditor to report as per the following:

Paragraph 3 (viii)

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

It was noted that in paragraph (viii) of Annexure A to the Auditor's Report, the auditor reported that the company had not defaulted in repayment of dues to FIs, banks. However, it was noted from the financial statements that the company had not borrowed any fund from Banks, Financial Statements (FIs) & Government and the only borrowing of the company was in the form of debentures issued to the holding company.

Accordingly, it was viewed that the reporting done by the auditor that no default has been made by the company in repayment of dues to FIs, banks is not correct.

5. **Case:** In the financial statements of a company, the relevant abstract of paragraph (xiii) of Annexure A to the Independent Auditor's Report (reporting under CARO, 2016) reads as under:

"In our opinion and according to the information and explanation given to us, the related party transactions are in compliance with section 177 and 188."

Observation: It was noted that paragraph 3(xiii) of the Companies (Auditor's Report) order, 2016 requires the auditor to report as per the following:

Paragraph 3 (xiii)

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

It was noted from the paragraph (xiii) of Annexure A to the Independent Auditor’s Report that auditor has stated that transactions with related parties are in compliance with the section 177 and 188 of the Companies Act, 2013. However, he has not reported as to whether these transactions with the related parties were disclosed in the financial statement in compliance with the applicable accounting standards i.e., Ind AS 24.

Accordingly, it was viewed that the requirements of paragraph 3 (xiii) of CARO, 2016 have not been complied with by the auditor.

6. **Case:** In the financial statements of a company, the relevant abstract of paragraph (vii)(a) of Annexure A to the Independent Auditor’s Report(reporting under CARO, 2016) reads as under:

“According to the information and explanations given to us the company is generally regular in depositing undisputed statutory dues with appropriate authorities and there were no arrears as at 31st March, 20XX for the period more than six months from the date they became payable.”

Observation: It was noted that paragraph 3(vii)(a) of the Companies (Auditor’s Report) order, 2016 requires the auditor to report as per the following:

Paragraph 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.”

It was noted from the paragraph (vii) (a) of Annexure A to the Independent Auditor’s Report that while reporting on the regularity in payment of various undisputed statutory dues, the auditor has merely mentioned ‘statutory dues’ and has not specified in his comments the dues in respect of provident fund, employees’ state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess etc. as required in aforesaid paragraph of CARO, 2016.

Accordingly, it was viewed that the auditor’s comment under paragraph vii (a) of CARO Report is not in line with paragraph 3(vii)(a) of CARO, 2016.