

Non-Compliances Observed with Respect to Requirements Prescribed under CARO, 2016



Financial Statements are the paramount source in hands of the stakeholders to understand the financial well-being of an enterprise. The users are highly reliant on the information depicted in the financial statements and, therefore, the preparers ought to ensure that the information presented in the financial statement is correct, reliable and in adherence to the regulatory requirements. Financial Reporting Review Board (hereinafter referred as FRRB or Board) reviews the General Purpose Financial Statements (GPFS) of enterprises with a view to identify the non-compliances with Accounting and Auditing Standards, CARO, Companies Act, and other statutory requirements applicable in preparation and presentation of the financial statements. The non-compliances observed by the Board are compiled from time to time and published under the name of “Study on Compliance with Financial Reporting Requirement”. Till date three volumes of the aforesaid publication have been released by the Board. This article deals with the non-compliances, observed by the Board, with requirements prescribed under Companies (Auditor’s Report) Order, 2016. {Also referred hereunder as ‘CARO, 2016’, ‘CARO’ or ‘Order’}

Clause 3(i)(a) In many of the cases it was observed that auditors have reported under clause 3(i)(a) in following manner:

- “The Company has maintained **reasonable records** showing full particulars, including quantitative details and situation of fixed assets.”
- “The Company has **generally** maintained proper records showing full particulars including quantitative details and situation of fixed assets.”

Observation: In the first case it was noted by the Board that auditor has reported on maintenance of ‘reasonable

records’ instead of ‘proper records.’ It was viewed that the use of words such as ‘reasonable records’ gives the impression of impromptu reporting by the auditor and does not clearly indicate whether proper records have been maintained by the company or not.

Similarly, in second case it was viewed that usage of term ‘generally maintained’ gives the impression that there might be the instances where proper records of fixed assets have not been maintained by the company for some of the asset classes. If such being the case, auditor is obligated to report the deficiencies in record maintenance.

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Accordingly, it was viewed in above cases that reporting done by the auditor is not strictly in line with the requirements of clause 3(i)(a) of CARO, 2016.

Paragraph 3(i)(b): In many of the cases it was observed that auditors have reported under clause 3(i)(b) in following manner:

- “**As explained to us**, fixed assets are physically verified by the management at reasonable intervals in a phased manner in accordance with a programme of physical verification. **We are informed** that no material discrepancies were noticed on such verification.”
- “The management, at the end of the year, has physically verified the fixed assets and **we have been informed** that no material discrepancies were noticed.”
- “Physical verification of the fixed assets is covered under a scheme of verification over a period of three years. **No serious discrepancy was noticed** on such verification during the period.”

Observation: It was viewed that use of the words ‘we are/ have been informed’ or ‘as informed ...’ or ‘as explained to us’ or ‘as certified to us’ indicates that auditor has not carried out adequate audit procedure to satisfy himself regarding the reasonableness of verification procedure of fixed assets as well as in determination of materiality of the discrepancies observed in the management’s verification of fixed assets. It gives the impression that auditor has solely relied on the assertions made by the management. It may be noted that sub-paragraphs (c), (e) and (f) of paragraph 35 of Guidance Note on CARO, 2016 cast the duty on auditor to examine reasonableness of the method of verification of fixed assets, reasonableness of intervals of the verification and whether the material discrepancies were noticed on such verification. Accordingly, the reporting under this clause should be done in a manner which clearly indicates that auditor has exercised his judgment and not solely relied on the managements assertions.

Paragraph 3(i)(c): In some of the cases it was noted that although auditor has commented on requirements of paragraph 3(i)(a) and 3(i)(b) however, he **did not comment on title deeds of immovable properties** as required under paragraph 3(i)(c) of the Order, at all. In some cases, it was observed that although auditors has reported that in case of certain immovable **properties title deeds were not held in the name of the company, however, omitted to give details of such properties.**

Observation: It was viewed that, in the cases discussed above, incomplete reporting has been done by the auditor as it does not comply with the requirements of clause 3(i)(c) of the Order.

Paragraph 3(ii) In some of the cases it was noted that auditors have reported under clause 3(ii) of CARO in following manner:

- “Inventories have been physically verified by the management. According to the information & explanations given to us, no discrepancies were noticed on physical verification of inventories.”
- “**As explained to us**, the inventories of the company at all its locations (except stock lying with third parties and stock-in-transit) have been physically verified by the management at reasonable intervals and no discrepancies were found.

Observation: In first case, it was observed that although auditor has reported that physical verification has been done by the management, however, he **omitted to report whether such verification of inventories was done at reasonable intervals** or not. It was viewed that paragraph 37(d) of Guidance Note on CARO, 2016 casts the duty upon the auditor to satisfy himself that physical verification of inventories has been conducted at reasonable intervals.

In second case, it was viewed that the comment of auditor gives an impression that stock lying with third parties and stock-in-transit are **material items and therefore adequate audit procedure need to be followed for such stock also. Further, use of term ‘as explained to us’ indicates that the auditor has simply relied on the explanation of the management** rather than using his own judgment, backed by the adequate audit procedures, in forming opinion about no discrepancies being observed in the physical verification of inventories.

Paragraph 3(iii): In some of the cases it was noted that auditors have reported under clause 3(iii) of CARO in following manner:

- “According to the information and explanation provided to us and as per the records examined by us, as at 31st March, 20xx, company has granted interest free unsecured loans amounting Rs. xxx to two of the parties covered in the register maintained under section 189 of Companies Act, 2013. Maximum balance outstanding during the year amounted to ₹ xxx. In our opinion, other

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terms and conditions of such loan are prima facie not prejudicial to the interest of the company.”

- “To the best of our knowledge and as per our verification of the books and records, the company has neither provided any guarantee nor granted any loan to **companies, firms and other parties** covered under section 189 of the Companies Act 2013.”

Observation: In first case it was viewed that although auditor has reported that interest free loan has been provided to two of the parties covered under section 189 of Companies Act, 2013 as well as the terms and conditions of such loans as required under clause 3(iii) (a) of CARO, 2016. However, **auditor omitted to comment on the requirements of sub-clause (b), and (c) of clause 3(iii) of CARO, 2016 regarding schedule of repayment of principal and overdue amount, if any, for more than ninety days** as well as steps regarding recovery of such overdue amount, respectively.

In second case it was viewed although, auditor has reported on loan given or guarantees provided to companies, firms and other parties covered under section 189, however, he **did not include ‘Limited Liability Partnership’ in his comment.**

Paragraph 3(iv): Following non-compliances under clause 3(iv), were observed from some of the Auditor’s Reports:

- Auditor commented on investments, guarantees and security however **he omitted to cover loans** while reporting under clause 3(iv).
- Auditor reported that requirements of Section 186 has been complied with however it was noted from the Notes to Accounts that company had provided interest free loans to its holding company, which is a non-compliance of Section 186(7).

Observation:

- It was viewed that clause 3(iv) specifically requires auditor to comment on compliance of Section 185 and 186 in respect of loans given, investments made, guarantees given and security provided. Non-reporting on any of the item would be a non-compliance of clause 3(iv).
- In second case it was viewed that auditor’s reporting was contradictory to the facts presented in the Financial Statement which is not correct.

Paragraph 3(v): Following was observed from one of

the reporting under clause 3(v) of CARO, 2016:

“The Company has not accepted deposits from the public, under the directives issued by the Reserve Bank of India and the provisions of the Section 73 to 76 of the Act and the rules framed thereunder. However, **temporary loans have been taken from employee welfare trust without adequate records.**”

Observation: It was noted that under the given clause, the auditor has also reported about inadequate records for temporary loans taken from employee welfare trust. The context due to which such fact was included in the aforesaid clause was not clear. **It was viewed that in case those temporary loans fall within purview of Section 73 to 76 of Companies Act, it should have been reported clearly. However, if those loans fall outside the purview of this clause and auditor still wants to draw attention of reader to such facts then it should have been reported as ‘Emphasis of Matter’ as per SA 706.**

Paragraph 3(vii)(a): Following was observed from one of the reporting under clause 3(vii)(a) of CARO, 2016:

“Undisputed statutory dues including provident fund, income-tax, service-tax, and ESIC have been generally deposited in many cases with the appropriate authorities except that there have been delays in payment of service-tax in few cases.”

Observation: It was noted that although auditor has commented on regular deposit of income-tax, service-tax and ESIC, however, he **omitted from commenting on duty of customs, duty of excise and other statutory dues.** It was further noted that **in case of delay in deposit of service-tax, auditor has not reported the fact in the manner as required under paragraph 42(q) of Guidance Note on CARO, 2016 issued by AASB of ICAI.**

Paragraph 3(vii)(b): Following was observed from one of the reporting under clause 3(vii)(b) of CARO, 2016:

“According to the information and explanations given to us, no disputed amount payable in respect of income tax, wealth tax, sales tax, custom duty, excise duty and cess were in arrears, as at 31st March, 20XX **for a period of more than six months from the date on which they are payable.**”

Observation: It was viewed that auditor has commented only on those disputed statutory dues which are in arrears for a period of more than six months. It was viewed that paragraph 3(vii)(b) of

the **Order requires the auditor to report on all disputed statutory dues irrespective of the period of their arrears**, unlike in the case of reporting for undisputed statutory dues.

Paragraph 3(viii) In many of the cases it was noted that although auditors **omitted to include one or more of the lenders in their comments** while reporting under this clause. In some cases, it was also found that although auditors have reported that **there had been defaults in repayment of certain loans however, further details about such defaults have not been reported** as required under this clause.

Observation: It was noted that non-inclusion of any of the lending entities while commenting on default in repayment of loans/ borrowings under this clause is an incomplete reporting, auditor shall comment on all the loans/ borrowings taken from banks, financial institutions and Government as well as dues to debenture holders. It was further noted that if auditor observes that there have been default in repayments of loans/borrowings/ dues, he should report the details of such default in the manner prescribed under paragraph 44(l) of Guidance Note on CARO.

Paragraph 3(ix): In many cases it was observed that auditors, while reporting under clause 3(ix) have commented only on money raised by way of initial public offer/ further public offer (IPO/FPO) and **skipped to include term loans in their comments**. In some cases, it was, also, noted that, though, the auditor **has reported that there have been defaults in utilisation of said money on the purpose they were raised for, however, further details of such defaults were not disclosed** as required under this clause.

Observation: It was noted that clause 3(ix) of the Order specifically requires the auditor to comment on utilisation of the monies raised through IPO/FPO as well as through term loans. Omitting any source of fund in the comment will tantamount to incomplete reporting. Further, if auditor is of the opinion that there have been defaults in use of the money for the intended purpose, he shall report the details in the manner specified under paragraph 45(s) of Guidance Note on CARO, 2016.

Paragraph 3(x): In some of the cases it was noted that auditors have reported under clause 3(x) of CARO in following manner:

- “According to the information and explanations

given to us, no fraud on company by its officers or employees has been noticed or reported **during the course of audit**.

- “In our opinion and according to the information and explanations given to us, no fraud on company by its employees or officers has been noticed during the year, that causes the financial statements to **be materially misstated**.”

Observation: In first case it was noted that reporting under clause 3(x) is not correct as it indicates that auditor has restricted the scope of the comment under the paragraph to the frauds noticed during the course of his audit which is as required by Section 143 (12) of the Companies Act, whereas clause under 3(x) of CARO requires reporting on any fraud noticed by the company during the year.

In second case it was viewed that auditor has given a conditional statement that if fraud have occurred, they do not materially misstate the financial statement. However, the clause requires that if fraud has occurred, auditor should report the nature and amount involved. Accordingly, it was viewed that reporting done by the auditor is not in line with the requirements of clause 3(x) of CARO, 2016.

Paragraph 3(xiii): In one of the case auditor had **reported that company has not entered into related party transaction during the year**, and therefore, requirements of clause 3(xiii) are not applicable. However, **notes to the account disclosed related party transactions**.

Observation: It was viewed that reporting done by auditor under clause 3(xiii) is not correct as there have been transactions with related parties and auditor has not carried out adequate procedure to satisfy himself regarding compliance of Section 177 and 188 of Companies Act, 2013 w.r.t. such transactions. It was, further, viewed that if auditor, after adequate audit procedures, comes across any non-compliance of Section 177 and 188 it should be reported in the manner prescribed under clause 49(o) of Guidance Note on CARO, 2016. It was viewed that information reported in the financial statements i.e., Balance Sheet, Statement of Profit & Loss, Cash Flow Statement and notes to accounts should corroborate with the report of auditor be it Statutory audit report, reporting under CARO or on Internal Financial Controls. ■