

# **INTRICACIES IN CARO 2016**

**CA Shrinivas Y. Joshi**

# CARO 2016 - APPLICABILITY

## Issue 1

Whether CARO 2016 applies to the agent of a Foreign Company?

Ans :

Applies to Foreign Companies [Sec.2(42)] i.e. companies incorporated outside India but have place of business in India either by itself or through Agent or through electronic mode and conducts business activity in India in any other manner.

# CARO 2016 - APPLICABILITY

## Issue 2

Whether Auditing Standards apply to reporting under CARO 2016

Ans :

Sec.143(9) requires auditor to comply with Auditing Standards specified u/s 143(10). Hence, audit procedure for reporting on the order need to be within the framework of the principles enunciated in SA.

# CARO 2016 - APPLICABILITY

## Issue 3

If a small company has a borrowing more than Rs.1 Crore from a Bank, whether CARO 2016 is applicable.

## Ans :

Companies covered under definition of small company will remain exempt even if it falls under any of the criteria specified for Private Limited Company

# CARO 2016 - APPLICABILITY

## Issue 4

Whether borrowings to include non-fund based facilities

Ans :

No. Borrowings from banks or financial institutions whether short-term or long-term in the form of Term Loan, Demand Loans, Export Credits, C/C, OD, Bills Purchased or Discounted, Interest Accrued on loans are the borrowings. Guarantees if invoked and LCs if devolved are to be included in the borrowings.

# CARO 2016 - APPLICABILITY

## Issue 5

Whether CARO 2016 is applicable to Section 25 Companies registered under 1956 Act.

## Ans :

The specific exemption is given to companies licensed u/s 8. In view of the provisions of Sec.465 of the Act, the exemptions would also extend to companies licensed to operate u/s 25 of the Companies Act, 1956

# CARO 2016 - APPLICABILITY

## Issue 6

Whether Capital Reserves and Revaluation Reserves are part of Capital and Reserves upto Rs.1 Crore for application of CARO 2016.

Ans :

As per Schedule III of the Companies Act, 2013, 'Reserves & Surplus' include capital reserve and revaluation reserve. Both should be taken into consideration while computing the limit of Rs.1 Crore.

# CARO 2016 - APPLICABILITY

## Issue 7

Whether CARO 2016 is applicable to Companies having positive revaluation reserve but negative free-reserve, where net amount including capital is more than 1 Crore.

Ans :

Yes.



# CARO 2016 - APPLICABILITY

## Issue 8

Bank has not debited interest accrued and due as account is NPA for the past 5 years with balance of loan Rs.80 lakhs as on 31<sup>st</sup> March 2012 with agreed rate of interest as 15% p.a.

## Ans :

Incase of term loans, interest accrued and due is considered as a borrowing whereas interest accrued but not due is not considered as a borrowing. Is interest on NPA A/c due?

# CARO 2016 - APPLICABILITY

## Issue 9

Sanctioned limit Rs.100 lakhs, balance in CC Rs.99.95 lakhs, Credit Cards held by Directors with balance Rs.0.25 lakhs

Ans :

Outstanding dues in respect of credit cards would also be considered while calculating the limit of Rs.1 Crore.

# CARO 2016 - APPLICABILITY

## Issue 10

Temporary Overdraft Rs.20 lakhs for 3 months of December quarter. CC sanctioned and balance Rs.85 lakhs.

Ans : Yes.

The order shall not apply to -

A Private Limited Company .....which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year ....

# CARO 2016 - APPLICABILITY

## Issue 11

Turnover Rs.9.5 Crores. Sale of Assets from discontinuing operations Rs.1 Crore.

Ans :

Order applicable if the revenue from discontinuing operations is more than Rs. 50 lakhs out of sale consideration of Rs.1 Crore.

# CARO 2016 - APPLICABILITY

## Issue 12

What is turnover – whether Excise Duty, Sales Tax, Insurance, Transport charges to be included

Ans :

Turnover to be construed in commercial sense and not necessarily in legal sense.

Turnover to be construed in accordance with method of accounting regularly employed by the Company.

# CARO 2016 - APPLICABILITY

## Issue 13

Turnover for the year Rs.10.10 crores – Credit notes Rs.0.20 crore

## Ans :

Turnover will be equal to total revenue disclosed in Schedule III which will be net of credit notes issued during the year. Hence CARO will not be applicable.

# CARO 2016 - APPLICABILITY

## Issue 14

Defunct Private Limited Company which is a subsidiary of a Public Limited Company

Ans :

(2) The order shall apply to every company including a foreign company..... except –

(v) A Private Limited Company not being a subsidiary or holding company of a public Company....

# CARO 2016 - APPLICABILITY

## Issue 15

Closely held Private Company which is a holding company of a Public Company

Ans :

(2)The order shall apply to every company including a foreign company..... except –

(v) A Private Limited Company not being a subsidiary or holding company of a public Company....



# CARO 2016 - RECORDS

## Issue 16

### Improper records for part of the Financial Year

#### Ans :

Maintenance of the records is not an end by itself but is a necessary condition for the auditor to satisfy himself regarding the authenticity of the transactions on which he is reporting.

Order should be judged with reference to the whole accounting year and not merely with reference to the position existing at the balance et date or the date at which he makes his report.

# CARO 2016 – ASSET REGISTER

## Issue 17

### Preparation of Fixed Assets Register at the time of Audit

Ans :

Order should be judged with reference to the whole accounting year and not merely with reference to the position existing at the balance sheet date or the date at which he makes his report.

However, in deciding whether or not to make an unfavourable comment, the auditor should consider what detrimental effect, if any, has been caused by the failure to comply with the requirements of the Order for any part of the year.

# CARO 2016 –TRANSACTION REPORTING

## Issue 18

Whether individual transaction on non-compliance to be reported

Ans :

It is not necessary that the auditor should refer individually to each of the transactions throughout the year where there has not been compliance with the requirements of the Order unless the non-compliance is so significant as to merit individual attention.

# CARO 2016 – Guarantee for Director

## Issue 19

Whether Guarantee given for loan taken by director need to be reported

Ans :

CARO 2003 Clause xv – Whether company has given any guarantee for loans taken by others .....the terms and conditions whereof are prejudicial to the interest of the company – Omitted

Clause 3(iv) of CARO 2016 – In respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with.

# CARO 2016 – Records in Electronic Format

## Issue 20

What are the precautions required to be taken for Fixed Asset Register kept in Excel format.

Ans :

In case the auditor decides to rely on electronically maintained fixed assets register, he should maintain adequate documentation evidencing the evaluation of controls that seek to ensure the completeness, accuracy and security of the register.

# CARO 2016 – Title Deeds

## Issue 21

Whether auditor is responsible if title deeds held by the company are found to be fake.

Ans :

The management is responsible for legal determination of the validity of title deeds, the auditor may refer SA 250 “Consideration of Laws and Regulations in an audit of Financial Statements” to the extent considered relevant and obtain sufficient and appropriate audit evidence.

# CARO 2016 – Disputes of Title

## Issue 22

The registration of property is not done in the name of the company due to court dispute but shown as fixed assets by the Company.

### Ans :

- a) Have detailed discussion with Management
- b) Consider communication with Legal Counsel in accordance with SA-501 “Audit Evidence – Specific considerations for selected items.”
- c) Disclose dispute in report if material

# CARO 2016 – Assets not in the name of Company

## Issue 23

Vehicles registered in the name of the directors but loan repayment done by Company by showing them as its assets.

Ans :

**Sec.187 of the Companies Act, 2013 –**

**(1) All investments made or held by a company in any property, security or other asset shall be made and held by it in its own name**



# CARO 2016 – No Stock Records

## Issue 24

No stock records kept by the Company and valuation of stock is based on physical verification of inventory.

## Ans :

When closing inventory is established only on the basis of year end physical verification and day to day records are not maintained, consumption in units need to be correlated to the production or the consumption should be established with reasonable accuracy.

# CARO 2016 – Renewal of Loans

## Issue 25

Whether loans given 3 years back renewed on the same terms during the year need to be scrutinized for being prejudicial to the company's interest.

Ans :

Clause 3(iii)(a) uses the term “grant” which would ordinarily be understood to mean loans granted/given during the year, however, it may be appropriate to include such loans also that were renewed during the year.

Clause 3(iii)(b) and 3(iii)(c) cover the loans granted during the year and also all loans having opening balances

# CARO 2016 – Loan in Kind

## Issue 26

Loans given of stock which is returned in kind, whether the terms prejudicial to be considered.

Ans :

Clause 3(iii) Grant of loans – there is no stipulation regarding the loan being given in cash or in kind. In the absence of such stipulation, the auditor is required to disclose the requisite information as specified in sub-clauses (a),(b) and (c) in respect of all kinds of loans whether given in cash or kind the parties covered in Sec. 189.

# CARO 2016 – Prejudicial Actions

## Issue 27

Loss making company lending to directors whether prejudicial

## Issue 28

Loan without interest given to loss making subsidiary, whether prejudicial

**Ans :** In determining whether the terms of the loans are prejudicial, the other factors connected with the loan, including its ability to lend, terms of its borrowings, borrower's financial standing, credit rating, if available, the nature of the security, rate of interest and so on.

# CARO 2016 – Necessity of Legal Steps

## Issue 29

Not filing case in court when borrower is not responding whether prejudicial to the interest of the company

Ans :

Reasonable steps for recovery depend upon facts and circumstances of each case, including the amounts involved , degree of delay in recovery, issue of reminders or sending of legal notice, even though no legal action is taken. Management's explanation is required in writing

# CARO 2016 – Indirect Loans

## Issue 30

Loan given to the relative of the director by the agent of the company and adjusted in transactions with company - whether violative of Sec.185

Ans :

Sec.185 prohibits advances of any loan to directors, etc. directly or indirectly. What is an indirect loan is not defined in sec.185 or elsewhere in the Act. Indirect is interpreted in case of Dr.Fredie Ardeshir Mehta v. Union of India [1991] 70 Comp. Cas. 210 (Bom.) to mean a loan to a director through the agency of one or more intermediaries.

# CARO 2016 – Deposit from Employees

## Issue 31

Whether deposits from an Employee of Rs.10 lakhs is covered u/s 73

Ans :

Companies (Acceptance of Deposits) Rules, 2014 – Rule 2(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 deposits.

# CARO 2016 – Undisputed Statutory Dues

## Issue 32

Is non-payment of electricity bill an undisputed statutory dues.

Ans :

Obligation to pay a statutory due is created or arises out of a statute, rather than being based on an independent contractual or legal relationship.

Any sum payable to an electricity company as electricity bill would not constitute a statutory due despite the fact that such a company has been established under a statute.



# CARO 2016 – Default in payment of dues

## Issue 33

Will non-payment of Advance Tax constitute default in payment of statutory dues.

Ans :

Yes. Unless company has an income after the last date on which Advance Tax was payable.

Any genuine error in calculation or difference in legal interpretation resulting into short / non payment of Advance Tax will not be a default.

# CARO 2016 – Unsustainable Dispute

## Issue 34

Whether dispute of a demand that is unsustainable in the opinion of the auditor, is an undisputed dues.

Ans :

It is not necessary for the auditor to examine the sustainability or otherwise of the claim of the company regarding disputed amounts.

# CARO 2016 – Instalments of dues

## Issue 35

In case of installment payments of statutory dues –  
What is to be reported as undisputed dues - original demand or non-payment of any instalment.

Ans :

When tax becomes payable as at the date of expiry of stay granted by the authorities or the date on which the default of the installments occurs, the amount so defaulted be reported.

# CARO 2016 – Computation of Dues

## Issue 36

How the amount of undisputed/disputed dues to be computed for reporting.

Ans :

Penalty and/or interest levied under the respective laws would be covered within the term “amounts payable”. The report should be restricted to the actual arrears and should not include the amounts which have not fallen due for payment to appropriate authority and have not been recognized as o/s dues in balance sheet.

# CARO 2016 – Minor Disputes

## Issue 37

Whether non-payment of Service Tax of Rs.1000/- due to dispute to be reported.

Ans :

Clause 3(vii)(b) requires that in case of disputed statutory dues, the amounts involved should be stated along with the forum where the dispute is pending. Therefore, even minor amounts would be required to be reported under this clause.

# CARO 2016 – Stayed Demand

## Issue 38

Whether stayed demand is a disputed dues.

Ans :

Yes. These should be disclosed along with a disclosure of the fact of stay. Stay has been granted does not mean that the authority granting the stay has held that the amount in question is not a valid demand against the company.

# CARO 2016 – Provision of Demand

## Issue 39

When disputed demand is fully provided, whether it needs reporting.

Ans :

A plain reading of the clause suggests that the amounts to be reported under clause 3(vii)(b) of the Order are those which have not been deposited on account of any dispute, irrespective of the treatment of such disputed amounts in accounts.

# CARO 2016 – Non Payment of Disputed Dues

## Issue 40

Amount paid under protest or guarantee issued for keeping the demand in abeyance – whether non-payment of disputed dues

## Ans :

It is also possible that an amount disputed has been deposited and on consideration of the likely outcome of the dispute, has been shown as a recoverable. Though such an amount is not contemplated for reporting under the clause, since it has been deposited, the fact of such deposit having been made under protest should be brought out by the auditor in his report under this clause.



# CARO 2016 – Rectification of defaults

## Issue 41

Defaults in repayment of loans during the year rectified on the balance sheet date. Whether to be reported

Ans :

The auditor should report the period and amount of all defaults existing at the balance sheet date irrespective of when those defaults have occurred.

# CARO 2016 – General Purpose Term Loans

## Issue 42

How to report Term loan taken for general purpose with bullet repayment.

Ans :

The auditor should clearly mention the fact that in absence of any stipulation regarding the utilisation of loans from the lender, he is unable to comment as to whether the term loans have been applied for the purposes for which they were obtained.

For general purpose loans auditor should verify whether company has utilise the money for its objects.

# CARO 2016 – Non Cash Transactions

## Issue 43

Assets purchased from director entered by way of journal entry and amount not settled by the year end, whether a non-cash transaction.

Ans :

**No. If the liability created is settled in the following year.**

# CARO 2016 - NBFC

## Issue 44

What is an NBFC.

Ans :

NBFC is a company engaged in the business of loans and advances, acquisition of securities and business of leasing , hire-purchase, Insurance, and Chit-Fund. But not having principal business of agricultural activity, Industrial activity, Trading, provision of services and construction/dealing in immovable property.

# CARO 2016 - NBFC

## Issue 44

What is an NBFC.

Ans : Contd...

“Financial activity as principal business is when a company’s financial assets constitute more than 50 percent of the total assets and income from financial assets constitute more than 50 percent of the gross income. A company which fulfils both these criteria will be registered as NBFC by RBI.

Only companies predominantly engaged in financial activity get registered with RBI and are regulated and supervised by it.

# CARO 2016 – Explanations received

## Issue 45

Whether management's explanations for an unfavorable opinion or qualified answers need to be included in the audit report.

## Ans :

Normally no unless such inclusion is necessary for –

- i. To make the comment more meaningful and complete
- ii. To explain the fact why in spite of an unfavourable comment, the true and fair view of the financial statements is not vitiated.

# CARO 2016 – Unrecorded Liability

## Issue 46

Taxes not deducted or liability not recorded in books whether to be reported.

## Ans :

Yes. Under respective clauses for non-payment of disputed or undisputed statutory liability.

# CARO 2016 – Selective Reporting

## Issue 47

When several clauses are not applicable whether Auditor can skip them and report only on applicable clauses.

Ans :

Sec.143(1) requires auditor to make certain specific enquiries but is not required to report unless he has any special comments to make on the said matters.

Order on CARO 2016 requires a statement on each of the matters specified therein.



# CARO 2016 – Approach and Documentation

## Issue 48

### Approach to audit and documentation for CARO 2016

#### Ans :

- i. Does not replaced an audit by investigation
- ii. Need close interaction with management and advanced planning regarding manner of examination and collection of necessary information.

# CARO 2016 – Approach and Documentation

## Issue 48

### Approach to audit and documentation for CARO 2016

Ans : Contd..

iii. Preserving working papers to evidence opinion expressed – which is based on examination of documents, giving due cognizance to information and explanation received and evidencing completeness of information and its accuracy through reasonable tests.

# CARO 2016 – Reporting Fraud

## Issue 49

What is the difference in reporting on Fraud under paragraph 3(x) of CARO 2016 against Sec.143(12) of Companies Act, 2013

Ans :

U/s 143(12) auditor should find fraud in the course of performance of his duties as auditor i.e. he has to report only if he is the first person to identify or note the fraud.

Fraud already reported/ identified/ detected by management/whistle blower/vigil mechanism need to be reported under paragraph 3(x) of CARO 2016

# CARO 2016 – Reporting Fraud

## Issue 49

What is the difference in reporting on Fraud under paragraph 3(x) of CARO 2016 against Sec.143(12) of Companies Act, 2013

Ans : Contd....

Reporting u/s 143(12) when there is reason to believe that fraud exists and sufficient information and convincing evidence is available thereof.

All frauds noticed or reported during the year will have to be mentioned under paragraph 3(x) without going into the abovementioned facts.

In both cases – Concept of materiality will have to be followed

The background of the slide is a solid green color with a faint, stylized pattern of overlapping leaves. The leaves are rendered in various shades of green, creating a sense of depth and texture. The central text is prominently displayed in a bright yellow color with a white outline, making it stand out against the green background.

**THANK YOU.**