ELEMENTS OF AUDITOR'S REPORT

The auditor's report includes the following basic elements, ordinarily in the following layout:

(a) *Title*: It may be appropriate to use the words "Auditor's report".

(b) *Addressee*: Ordinarily the auditor's report is addressed to the authority appointing the auditor.

(c) *Opening or introductory paragraph*: covers the following aspects:
- Identification of financial statements that have been audited
- Date and period covered by the financial statements;
- Management responsibility for preparation of financial statements;
- Auditor's responsibility for expression of opinion.

Illustration of opening paragraph is:

"We have audited the attached Balance Sheet of M/s ____________as at 31st March _________ and also the profit and loss account for the year ended on that date annexed thereto. These financial statements are the responsibility of the entity's management. Our responsibility is to express an opinion on these financial statements based on our audit".

(d) *Scope Paragraph*: covers the following aspects:
- Describing the scope of audit by stating that audit was conducted in accordance with auditing standards generally accepted in India.
- Requirement of auditing standards that auditor plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.
- Auditors believing that their audit provides a reasonable basis for their opinion.

Illustration of Scope paragraph is:

"We conducted our audit in accordance with the auditing standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion"

(e) *Opinion paragraph*: covers the following aspects:
- Auditor's opinion about true and fair view of financial statements.
- Reporting on various matters required by law.

Illustration of opinion paragraph is:

"In our opinion and to the best of our information and according to the explanations given to us, the financial statement gives a true and fair view in conformity with the accounting principles generally accepted in India:
- in the case of Balance Sheet, of the state of affairs of the M/s ______ as at 31st March ____.
- in the case of Profit and Loss Account of the profit/loss for the year ended on that date.

(f) *Date of the report*: date on which the auditor signs the report.

(g) *Place of signature*: location which is ordinarily the city where the audit report is signed.

(h) *Auditor's signature*: should be along with membership number.

Previous Years Questions

Q. No. 1: Enumerate the basic elements of Audit Report as enshrined in AAS – 28. [Nov. 04 (8 Marks)]

Q. No. 2: Bring out the significance of the following two illustrative paragraphs found in the statutory auditor's report in recent days.

(i) Opening Paragraph:

"We have audited the attached Balance Sheet of …….. as at 31st March, 2xxx and also the Profit and Loss Account for the year ended on that date annexed thereto. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements".

(ii) Scope Paragraph:

"We conducted our audit in accordance with the auditing standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material statement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial presentation. We believe that our audit provides a reasonable basis for our opinion."

[Nov. 04 (8 marks)]

UNQUALIFIED OPINION

An opinion is said to be unqualified when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements. The auditor gives a clean or unqualified report when he does not have any significant reservation in respect of matters contained in the financial statements.

An unqualified opinion indicates the following:

(a) the financial statements have been prepared using the generally accepted accounting principles, which have been consistently applied.

(b) The financial statements comply with relevant statutory requirements and regulations; and

(c) There is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to the statutory requirements , where applicable.

(d) Any change in the accounting policies or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements.

MODIFIED REPORTS

- When an auditor issues any report other than unqualified, his report is said to be MODIFIED.
- As per AAS – 28, "The auditor's Report on Financial Statements" an auditor's report is considered to be modified when it includes :
  - (a) matters that do not affect the auditor's opinion - with emphasis of matter
  - (b) matters that do affect the auditor's opinion –
    1. Qualified opinion;
    2. Disclaimer of opinion;
    3. Adverse opinion.

MODIFIED AUDIT REPORT WITH EMPHASIS OF MATTER:

The addition of an emphasis of matter paragraph does not affect the auditor's opinion. The paragraph would preferably be included preceding the opinion paragraph and would ordinarily refer to the fact that the auditor's opinion is not qualified in this respect.

The circumstances in which the modified report may be issued are:

- Where the going concern question is not resolved and adequate disclosures have been made in the financial statements.
- There is a significant uncertainty (other than going concern) the resolution of which depends upon future events and which may affect the financial statements.

However in Multiple uncertainties that are significant to the financial statements, auditor may consider it appropriate to express a disclaimer of opinion instead of adding an emphasis of matter paragraph.

Example: *"Without qualifying our opinion, we draw attention to Note ______ of Schedule _______ to the financial statements. The entity is the defendant in a lawsuit alleging infringement of certain patent rights and claiming royalties and punitive damages. The entity has filed a counter action, and preliminary hearings and discovery proceedings on both actions are in progress. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the financial statements."*

QUALIFIED AUDIT REPORTS

- A qualified audit report is one where an auditor gives an opinion on the truth and fairness of financial statements, subject to certain reservations. The auditor may have reservations about a particular item or items. In majority of cases, items which are subject matter of the qualification are not so material as to affect the truth and fairness of the whole of the accounts. Thus, where the issues involves though material do not substantially affect the view presented by the accounts, the audit report shall be qualified.
- The auditor must clearly express the nature of qualifications and should also give reasons for such qualifications.
- The qualification must be made in the report in such a manner so as not to leave any doubt in the mind of the user of financial statements.
- The auditor while qualifying his report must use the words 'subject to' for the qualification in the report along with reasons thereof and quantify the impact of qualifications, if quantification is not possible, the fact shall be stated. The auditor's reservation is generally stated as: "Subject to the above, we report that the Balance sheet shows a true and fair view."
- A qualified opinion should be expressed when the auditor concludes that –
  1. An unqualified opinion cannot be expressed ; or
  2. The effect of any disagreement with management is not so material and pervasive as to require and adverse opinion;
  3. The limitation on scope is not so material and pervasive as to require a disclaimer of opinion.

Circumstances in which qualified audit report is issued:

1. If the auditor is unable to obtain all the information and explanations which he considers necessary for the purpose of his audit.
2. If proper books of account have not been kept by the company in accordance with the law.
3. If the Balance Sheet and Profit & Loss Account are not in agreement with the books of account and returns.
4. If information as required by law in not furnished.
5. If the profit and loss account and the balance sheet do not comply with the Accounting standards referred u/s 211 (3C) of the Companies Act.
6. If there is contravention of the provisions of Companies Act having a bearing on the accounts and transactions of the company.

DISCLAIMER OF OPINION

- The auditor while performing his work may come across several instances where he fails to obtain sufficient information to warrant an expression of opinion, and, thus, is unable to form an opinion, he issues a disclaimer of opinion. Accordingly, the auditor may state that he is unable to express an opinion because he has not been able to obtain sufficient and appropriate audit evidence to form an opinion.
- The necessity of a disclaimer of opinion may arise due to many reasons such as the scope of examination is restricted or in certain circumstances the auditor may not have access to all the books of account for certain reasons, e.g., books are seized by excise authorities or destroyed in fire, etc. Another instance may be that an auditor is not permitted to verify inventory at location outside the city in which the company's office is located, it amounts to restriction on the scope of the duties of an auditor. In both the types of cases the auditor may state that he is unable to express an opinion because he has not been able to obtain sufficient audit evidences to form an opinion.
- It is but natural that the auditor must make all efforts to verify and substantiate the events. In case he is unable to obtain audit evidence even from alternative sources, then the auditor can only state that he is unable to form an opinion.

FORMAT OF AN QUALIFIED RERORT

Auditor's Report

The members of M/s X LTD.

1. We have audited the attached balance sheet of M/s X Ltd., as at 31st March, 2XXX and also the profit and loss account and the cash flow statement for the year ended on that date annexed thereto. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.
2. We conducted our audit in accordance with the auditing standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
3. As required by the Companies (Auditor's Report), Order, 2004 issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Companies Act, 1956, we enclose in the Annexure a statement on the matters specified in the paragraphs 4 and 5 of the said Order.
4. As stated in Note X of Schedule ______ to the financial statements, no depreciation has been provided for the period in the financial statements. This is contrary to Accounting Standard (AS) 6 on "Depreciation Accounting", issued by the Institute of Chartered Accountants of India and the accounting policy being followed by the entity according to which depreciation is provided on straight line basis. Had this accounting policy been followed, the provision for depreciation for the period would have been Rs.______. This short provisioning for depreciation has resulted into the profit for the year, fixed assets and reserves and surplus being overstated by Rs..........
5. Further to our comments in the Annexure referred to above, we report that:
   (i) We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purpose of our audit.
   (ii) In our opinion, proper books of account as required by law have been kept by the company so for as appears from our examination of those books (and proper returns adequate for the purposes of our audit have been received from the branches not visited by us). The Branch Auditor's Report(s) have been forwarded to us and have been appropriately dealt with.
   (iii) The Balance Sheet and Profit & Loss Account and Cash Flow Statement dealt with by this report are in agreement with the books of accounts (and with the audited returns from the branches).
   (iv) In our opinion, the Balance Sheet, Profit and Loss Account and Cash Flow Statement dealt with by this report comply with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956.
   (v) On the basis of written representations received from the directors, as on 31st March 2XXX and taken on record by the Board of Directors, we report that none of the directors is disqualified as on 31st March 2XXX from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Companies Act, 1956;
6. In our opinion and to the best of our information and according to the explanations given to us, subject to the effects on (on the financial statements of the matter referred to in the paragraph 4), the financial statements give the information required by the Companies Act, 1956, in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:
   a) in the case of the Balance Sheet of the state of affairs of the company as at 31st March 2XXX;
   b) in the case of the Profit and Loss account of the profit/loss for the year ended on that date; and
   c) in the case of the Cash Flow Statement of the Cash Flow for the year ended on that date.

Place of Signature
Date:

For XYZ and Co.
Chartered Accountants

Signature
(Name of the member signing the Audit Report)
Designation
M. NO.__________.

Previous Years questions on Various Types of Reports

Q. No. 6: Distinguish with suitable examples – between a case where an auditor is obliged to state in his report to the members of a company that the accounts do not show a true and fair view and a case where he states that he is unable to form an opinion as to whether or not the accounts give a true and fair view.
[Nov. 03 (8 Marks)]

Q. No. 7: As Chartered Accountant you are required to give your reports on various financial statements under Companies Act, 1956 which are as under:
(i) Report to the shareholders under Section 227;
(ii) Report to be set out in prospectus under Section 60 (3);
(iii) Report to be given to the Central Government as special auditor under Section 233 A,
(iv) Report to be given on voluntary winding up under Section 488 (1).
Explain the significance of each of these reports and your functional approach very briefly.
[May 04 (8 Marks)]

Answer: Auditor's report on the Companies Act, 1956 (the Act):

(i) ***Report to Shareholders U/s 227****: Under Section 227 of the Act auditor is required to make a report to the members on the followings:*
(a) on the accounts examined by him, and
(b) on every balance sheet and profit and loss account.
The significance of the report lies in the fact that it requires that the report shall state whether in his opinion and to the best of his information and according to the explanations given to him the said accounts give the information required by the Act in the manner so required and give a true and fair view.
The functional approach by the auditor for making a report u/s 227 of the Act, requires him to perform compliance and substantive audit procedures to verify the information contained in the financial statements.

(ii) Report to be set out in the prospectus u/s 60 (3): Section 60 (3) of the Act provides that a prospectus should be accompanied inter alia by the consent in writing of the person named there in as the auditor of the company or intended company, to act in that capacity. Part II of Schedule II to the Act prescribes the reports to be set out in a prospectus. There report contains particulars about profit and losses of the company for five preceding year, assets and liabilities, rates of dividend, etc.
The significance of the report lies in the fact that a prospectus is issued by a company when it seeks to raise funds from the public and gives detailed information about the company to enable prospective investors to take a well informed decision.
The functional approach on the part of auditor involves obtaining information from the management, particularly, in respect of estimation of current and future profits. He has to also ensure that all adjustments have been made properly.

(iii) ***Special Audit Report U/s 233A****: Under section 233A of the Act, the Central Government has a power to order a special audit of the accounts of a company for a specified period. An order to conduct special audit of the accounts of a company may be made where the Central Government is of the opinion that:*
(a) the affairs of the company are not being managed in accordance with sound business principles or prudent commercial practices; or
(b) the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or
(c) the financial position of the company is such as to endanger its solvency.
The main objective of such an audit is to provide a critical review of the company's working and state of affairs to the government. The special audit report should, as far as possible, include all the information required to be included in an audit report under section 227 of the Act. However, the central government may direct that the special audit report shall also include a statement on any other matter referred to the special auditor by the government.

(iv) ***Report on the accounts prepared on voluntarily winding up u/s 488 (1)***: *Section 488 (1) of the Act requires that where it is proposed to wind up a company voluntarily, its directors, or in case the company' has more than two directors, the majority of the directors, may, at a meeting of the Board, make a declaration verified by an affidavit, to the effect that they have made a full inquiry into the affairs of the company, and that, having done so, they have formed the opinion that the company has no debts, or that it will be able to pay its debts in full within such period not exceeding three years from the commencement of the winding up as may be specified in the declaration. Such declaration has to be accompanied by a copy of the report of the auditors of the company on the profit and loss account of the company for the period commencing from the date up to which the last such account was prepared and ending with the latest practicable date immediately before the making of the declaration and the balance sheet of the company made out as on the last mentioned date and also embodies a statement of the company's assets and liabilities as at the date.*

Q. No. 8: Draft audit report u/s 227(3)(f) of the Companies Act, 1956 on the following three situations in respect XYZ Ltd. as on 31.3.2009:

a. Where all directors have given written representations that they have not defaulted u/s 274(1)(g) of the Companies Act, 1956.

b. Where one of the directors, Mr. Flexible has failed to produce written representation that he has not defaulted u/s 274(1)(g) of the Companies Act, 1956.

c. Where on the basis of written representations received from the directors it is noticed that one of the directors, Mr. Rigid has defaulted in terms of Section 274(1)(g) of the Companies Act, 1956.

[Nov. 06 (2 + 3 + 3 Marks)]

Answer: (a) ***Where the directors have not defaulted*** :

"On the basis of the written representations received from the directors and taken on record by the Board of Directors, we report that none of the directors is disqualified as on 31 March, 2009 from being appointed as a directors in terms of Section 274(1)(g) of the Companies Act, 1956."

(b) ***Where one of the directors failed to produce written representation***.

"Mr. Flexible who is also a director of XYZ Ltd. has not produced any written representation to the company as to whether XYZ Ltd. as at 31.03.09 had not defaulted in terms of Section 274(1)(g) of the companies Act. In the absence of the representation we are unable to comment whether Mr. Flexible is disqualified from being appointed as director in terms of section 274(1)(g). As far as other directors are concerned on the basis of the written representation received from such directors and taken on record by the Board, we report that none of the remaining directors is disqualified as on 31.3.2009 from being appointed as a director in terms of Section 274(1) (g) of the Companies Act, 1956".

(c) ***Where a director is found to be disqualified***.

"On the basis of the written representation received from Mr. Rigid who is a director of XYZ Ltd. as on 31.3.2009 and taken on record by the board, we report that Mr. Rigid is disqualified from being appointed as a director in terms of Section 274(1) (g) of the Companies Act, 1956. As far as other directors are concerned, on the basis of written representations received and taken on record by the board we report that none of the remaining directors is disqualified as on 31.3.2009 from being appointed as director in terms of Section 274 (1) (g) of the Companies Act."

Certificates and Reports

- A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. Such certificates are often required by Government authorities in support of statements or other information prepared by an enterprise. Such certificates represents that the auditor has verified certain figures and is satisfied about their accuracy.
- An audit report, is a formal statement usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon. While issuing an audit report, auditor is responsible to ensure that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill.

Contents of Reports and Certificates for special purposes:

In some cases, contents of Reports and Certificates are specified by law and cannot be changed. However in other cases, reporting auditor is free to draft his report or certificate in a manner he likes. While drafting such report or certificate , the auditor should consider the following:

(a) Identification of specific elements, accounts or items covered by the report or certificate.

(b) Stating the manner in which the audit was conducted, e.g., by the application of generally accepted auditing practices, or any other specific tests.
(c) limitation on scope, if any, should be clearly mentioned.
(d) Fundamental Assumptions on which the special purpose statement is based should be clearly indicated.
(e) Information and explanations obtained during the course of work should be included.
(f) The title of the report or certificate should clearly indicate its nature.
(g) Extent to which reliance has been placed on the report of other auditor, who have carried out audit of general purpose financial statements.
(h) Where a report requires the interpretation of statute, the reporting auditor should clearly indicate the fact that he is merely expressing his opinion in the matter.
(i) An audit report or certificate should ordinarily be a self- contained document and should not confine itself to a mere reference to another report or certificate.
(j) Extent of responsibility assumed by the reporting auditor should be clearly indicated in report or certificate.

Previous Years Questions

Q. No. 9: Mention the difference between 'report' and 'certificate'. *[Nov. 02 (4 Marks)]*

or

Write short note on: Certificate for Special Purpose vs. Audit Report. *[Nov. 04 (4 Marks)]*

Q. No. 10: What are the contents of reports and certificates for special purposes. *[Nov. 04 (6 Marks)]*

COMPANIES (AUDITOR REPORT) ORDER, 2004

***Application of CARO, 2004*:** The Companies (Auditor's Report) Order, 2004 is applicable to all types of companies including a foreign company as defined u/s 591 of the Companies Act, 1956, but shall not apply to:

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;
(ii) an insurance company as defined in clause (21) of section 2 of the Companies Act, 1956;
(iii) a company licensed to operate under section 25 of the Companies Act, 1956; and
(iv) a private limited company :
  - with a paid up capital and reserves not more than Rs. 50 lakh; and
  - which does not have loan outstanding exceeding Rs. 25 from any bank or financial institution; &
  - does not have a **turnover** exceeding Rs. 5 Crore at any point of time during the financial year".

  Note: Part II of Schedule VI to Companies act, 1956, II defines the term "turnover" as the aggregate amount for which sales are affected by the company. "Sales affected" would include sale of goods as well as services rendered by the company.

MATTERS TO BE INCLUDED IN AUDITOR'S REPORT

The auditor's report on the account of a company to which this Order applies shall include a statement on the following matters, namely:

FIXED ASSETS [Paragraph 4 (i)]

(k) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;
(l) 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; and
(m) If a substantial part of fixed assets have been disposed off during the year, whether it has affected the going concern.

Previous Years Questions

Q. No. 14: Under CARO, 2003 how, as a statutory auditor would you comment on the following: Fixed assets comprising 1/3rd of the total assets have been disposed off during the year. *[Nov. 05 (4 Marks)]*

Answer: As per Paragraph 4 (i) (c) of CARO, 2004 an auditor is required to consider the appropriateness of the going concern assumption if substantial part of fixed assets has been disposed during the year. What constitutes substantial part of fixed assets is a subject of professional judgement and depends upon the facts and circumstances of the each case.

Accordingly, in the instant case, the auditor should satisfy himself as to whether disposal off of 1/3rd of fixed assets during the year had any effect on the going concern assumption on account of such sale of fixed assets. The Auditor is required to exercise his professional judgement to determine whether one third of total assets constitutes substantial part or not. Based upon the judgement arrived, auditor shall report whether substantial part of fixed assets have been disposed off or not during the year and whether it has affected the assumption of going concern or not.

INVENTORIES [Paragraph 4 (ii)]

(a) whether physical verification of inventory has been conducted at reasonable intervals by the management;

(b) are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported; and

(c) whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account.

LOANS AND ADVANVCES[Paragraph 4 (iii)]

(a) has the company granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and amount involved in the transactions;

(b) whether the rate of interest and other terms and conditions of loans given by the company, secured or unsecured, are prima facie prejudicial to the interest of the company;

(c) whether receipt of the principal amount and interest are also regular;

(d) if overdue amount is more than rupees one lakh, whether reasonable steps have been taken by the company for recovery of the principal and interest;

(e) has the company taken any loans, secured or unsecured from companies, firms or other parties covered in the register maintained under section 301 of the Act. If so, give the number of parties and the amount involved in the transactions;

(f) whether the rate of interest and other terms and conditions of loans taken by the company, secured or unsecured, are prima facie prejudicial to the interest of the company; and

whether payment of the principal amount and interest are also regular."

INTERNAL CONTROL[Paragraph 4 (iv)]

Is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services? Whether there is a continuing

Previous Years Questions

Q. No. 15: What are the reporting requirements for closing stock in the MAOCARO, 1988. *[Nov. 04 (6 Marks)]*

Answer: Refer Para 4(ii) of CARO 2004.

Q. No. 16: As the statutory auditor of B Ltd. to whom CARO, 2004 is applicable, how would you report in the following situations: Physical verification of only 50% (in value) of items of inventory has been conducted by the company. The balance 50% will be conducted in next year due to lack of time and resources. *[May 05 (4 Marks)]*

Answer: Para 4(ii) of CARO, 2004 requires the auditor to state in his report whether physical verification of inventory has been conducted at reasonable interval by the management and the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business.

In the given case, procedure of physical verification followed by management is not reasonable and hence the auditor should point out the inadequacies in physical verification procedures.

failure to correct major weaknesses in internal control system.

Previous Years Questions

Q. No. 17: Explain the propriety elements in the CARO 2004. *[Nov. 06 (8 Marks)]*

Answer: It will cover the Paragraphs 4 (iii , 4 (v), 4 (xviii)

CONTRACTS IN WHICH DIRECORS ARE INTERESTED [Paragraph 4 (v)]

(a) whether the particulars of contracts or arrangements referred to in section 301 of the Act have been entered in the register required to be maintained under that section; and

(b) whether transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time;";

PUBLIC DEPOSITS [Paragraph 4 (vi)]

- In case the company has accepted deposits from the public, whether the directives issued by the RBI and the provisions of sections 58A and 58AA or any other relevant provisions of the Act and the rules framed there under, where applicable, have been complied with. If not, the nature of contraventions should be stated;
- If an order has been passed by 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?

INTERNAL AUDIT [Paragraph 4(vii)]

In the case of listed companies and/or other companies having a paid up capital and reserves exceeding Rs.50 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding five crore rupees for a period of three consecutive financial years immediately preceding the financial year concerned, whether the company has an internal audit system commensurate with its size and nature of its business.

Factors to be considered to ensure adequacy of Internal Audit system:

(i) *Organisational status*: The level of the department within the company and the level to which the internal auditor reports. In general, the higher the level to which internal auditor reports, the greater will be his independence.

(ii) *Scope of function*: Ascertain the nature and depth of coverage of the assignment, which the internal auditor discharges for the company. In particular, attention should be paid to restrictions, if any, on the scope of activities.

(iii) *Technical competence*: Ascertain that internal audit work is performed by persons having adequate technical training and proficiency. This may be accomplished by reviewing the experience and professional qualifications of the persons undertaking the internal audit work.

(iv) *Due professional care*: Ascertain whether internal audit work appear to be properly planned, supervised, reviewed and documented. An example of the exercise of due professional care by the internal auditor is the existence of adequate audit manuals, audit programmes and working papers.

(v) *Follow up of recommendations*: Ascertain whether recommendations on improvements in the system of internal check and control contained in such reports, are implemented by the management, whether errors reported are corrected without delay or any remedial action taken.

Previous Years Questions

Q. No. 18: As the Statutory Auditor of a Manufacturing Company, what are the points you will consider to conclude "Whether the company has an Internal Audit system commensurate with the size of the company and its operations"? [Nov. 07 (8 Marks)]

COST RECORDS [Paragraph 4(viii)]

Where maintenance of cost records has been prescribed by the Central Government under clause (d) of sub-section (1) of section 209 of the Act, whether such accounts and records have been made and maintained.

STATUTORY DUES [Paragraph 4 (ix)]

(a) is the company **regular** in depositing **undisputed statutory dues** including Provident Fund, Investor Education and Protection Fund, ESI, Income-tax, Sales-tax, Wealth tax, Service tax, Custom Duty, Excise Duty, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

(b) in case dues of Income tax/ Sales tax /Wealth tax/ Service tax/ Custom duty/ Excise duty/ cess 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 Department shall not constitute the dispute).

Previous Years Questions

Q. No. 19: As a statutory auditor, how would you deal with eth following case: During the course of audit of ABC Ltd. it is noticed that out of Rs. 12 Lacs of provident fund contribution accounted in the books, only Rs. 2 Lacs has been remitted to the authorities during the year. On enquiry the Chief Accountant informed that due to financial problems they have not remitted but will remit the same as and when the position improves. [May 04 (4 Marks)]*

Answer: Non payment of provident fund of Rs. 10 Lacs needs to be disclosed by the auditor in his audit report as per requirement of paragraph 4(ix)(a) of CARO 2004.

Q. No. 20: As a Statutory Auditor, how would you deal with the following: PQR Ltd. has not deposited Provident Fund contribution of Rs. 10 lakhs with the authorities till the year-end. [May 08 (4 Marks)]

Answer: Non payment of provident fund of Rs. 10 Lacs needs to be disclosed by the auditor in his audit report as per requirement of paragraph 4(ix)(a) of CARO 2004.

ACCUMULATED LOSSES [Paragraph 4 (x)]

Whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year.

Previous Years Questions

Q. No. 21: As the statutory auditor of B Ltd. to whom CARO, 2004 is applicable, how would you report in the following situations? Accumulated losses of the company are 50.9% of its net worth and it is incurring continuous cash losses since last 2 years.

[May 05 (4 Marks)]

Answer: As per paragraph 4 (x) of CARO, 2004 auditor is required to report in respect of a company in existence for last five years the followings:

- *Whether accumulated losses at the end of the financial year are more than 50% of its net worth, &*
- *whether it has incurred cash losses in such financial year and in the immediately preceding financial year.*

In the present case, as both situations exists, hence the auditor is required to report the same in his report.

REPAYMENT OF DUES[Paragraph 4 (xi)]

Whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported;

RECORDS OF LOANS AND ADVANCES ON SECURITY OF PLEDGE OF SHARES, ETC. [Paragraph 4 (xii)]

Whether adequate documents and records are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities; If not, the deficiencies to be pointed out.

CHIT FUND[Paragraph 4 (xiii)]

Whether the provisions of any special statute applicable to chit fund have been duly complied with? In respect of nidhi/ mutual benefit fund/societies:

(a) whether the net-owned funds to deposit liability ratio is more than 1:20 as on the date of balance sheet;
(b) whether the company has complied with the prudential norms on income recognition and provisioning against sub-standard/doubtful/loss assets;
(c) whether the company has adequate procedures for appraisal of credit proposals/requests, assessment of credit needs and repayment capacity of the borrowers;
(d) whether the repayment schedule of various loans granted by the nidhi is based on the repayment capacity of the borrower;

OTHERS

- If the company is dealing or trading in shares, securities, debentures and other investments,
  (a) whether proper records have been maintained of the transactions and contracts, and
  (b) whether timely entries have been made therein; also
  (c) whether the shares, securities, debentures and other investments have been held by the company, in its own name except to the extent of the exemption, if any, granted under section 49 of the Act [Paragraph 4 (xiv)];
- whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company [Paragraph 4 (xv)];
- whether term loans were applied for the purpose for which the loans were obtained [Paragraph 4 (xvi)];
- whether the funds raised on short-term basis have been used for long term investment; If yes, the nature and amount is to be indicated [Paragraph 4 (xvii)];
- whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under section 301 of the Act and if so whether the price at which shares have been issued is prejudicial to the interest of the company [Paragraph 4 (xviii)];
- whether security or charge has been created in respect of debentures issued [Paragraph 4 (xix)]
- whether the management has disclosed on the end use of money raised by public issues and the same has been verified [Paragraph 4 (xx)];
- 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. [Paragraph 4 (xxi)]

Q. No. 25: As an auditor, how would you deal with the following: ABC Limited to whom CARO is applicable made a public issue of 7% debentures of Rs. 3 crores, redeemable after 5 years and used the proceeds of issue for payment of Sundry creditors and other Current liabilities to the tune of 3 crores. *[May 07 (4 Marks)*]*

Answer: As per Para 4 (xx) of CARO auditor is required to report whether the management has disclosed on the end use of money raised by public issues and the same has been verified. Hence the auditor is expected to verify and report whether the end use of moneys raised by way of public issue have been properly disclosed in the financial statements.

The auditor is required to ascertain the terms of issue of debentures so as to find the purpose for which debentures are issued. It the terms of issue of debentures is for liquidating sundry creditors and other current liabilities, it would be in order for the company to do so.

Auditor should verify that the amount of end use of money disclosed in the financial statements by the management is adequate and is not significantly different from the proposed and actual use. If either end use is not for the purpose for which a public issue is made or the disclosure is not adequate, the auditor should state the fact in his report.

Q. No. 26: As a Statutory Auditor, how would you deal with the following: LM Ltd. had obtained a Term Loan of Rs. 300 lakhs from a bank for the construction of a factory. Since there was a delay in the construction activities, the said funds were temporarily invested in short term deposits. *[May 08 (4 Marks)]*

Answer: Auditor is required to report the fact that the pending utilisation of term loan, the funds are temporarily invested in short term deposits, in his audit report as per requirement of paragraph 4 (xvi) of CARO 2004.

Previous Years Questions

Q. No. 22: As the statutory auditor of B Ltd. to whom CARO, 2004 is applicable, how would you report in the following situations: The company has stood guarantee to its sister concern, whose financial condition was not healthy for a sum of Rs. 20 lakhs borrowed from a bank.

[May 05 (4 Marks)]

Answer: As per paragraph 4 (xv) of CARO 2004, Auditor is required to report whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company.

In the present case, since financial condition of the company on behalf of whom guarantee is given is not healthy, the auditor may consider expressing an opinion that the terms and conditions on which the company has given guarantees for loans taken by the sister concern is prejudicial to the interests of the company.

Q. No. 23: Under CARO, 2004 how, as a statutory auditor would you comment on the following: A Term Loan was obtained from a bank for Rs.75 lakhs for acquiring R&D equipment, out of which Rs.12 lakhs was used to buy a car for use of the concerned director, who was overlooking the R&D activities.

[Nov. 05 (4 Marks)]

Answer: As per requirement of paragraph 4 (xvi) of CARO 2004, auditor is required to report the fact that out of the term loan obtained for R & D equipment, Rs. 12 Lacs was not utilized for the purpose of acquiring the R & D equipment.

Q. No. 24: As a statutory auditor, how would you report on the following under CARO:

(i) O Pvt. Ltd. Is a dealer in Shares and Securities.

(ii) ABC Pvt. Ltd. is an manufacturer of jewellery. A senior employee of the Company informed you that the Company does not properly disclose the purity of gold used on the jewellery.

[May 06 (4 + 4 Marks)]

Answer: (i) Refer Paragraph 4 (xiv)

(ii) If purity of gold is not properly disclosed, it amounts to defrauding the customers. However, the auditor is concerned with those fraudulent acts that cause a material misstatement in financial statements. So long as books of account are concerned, it does not affect the financial statements hence, it has no implication for the auditor except for the valuation of inventory. But this aspect is not required to be reported under CARO, 2004.

Thus, from the view point of reporting on frauds under CARO, 2004, there is no implication for misstatement in the financial statements. Hence, no reporting is necessary for improper disclosure of purity of gold on the jewelry.