Accounting and Auditing Considerations for FY 2022-2023

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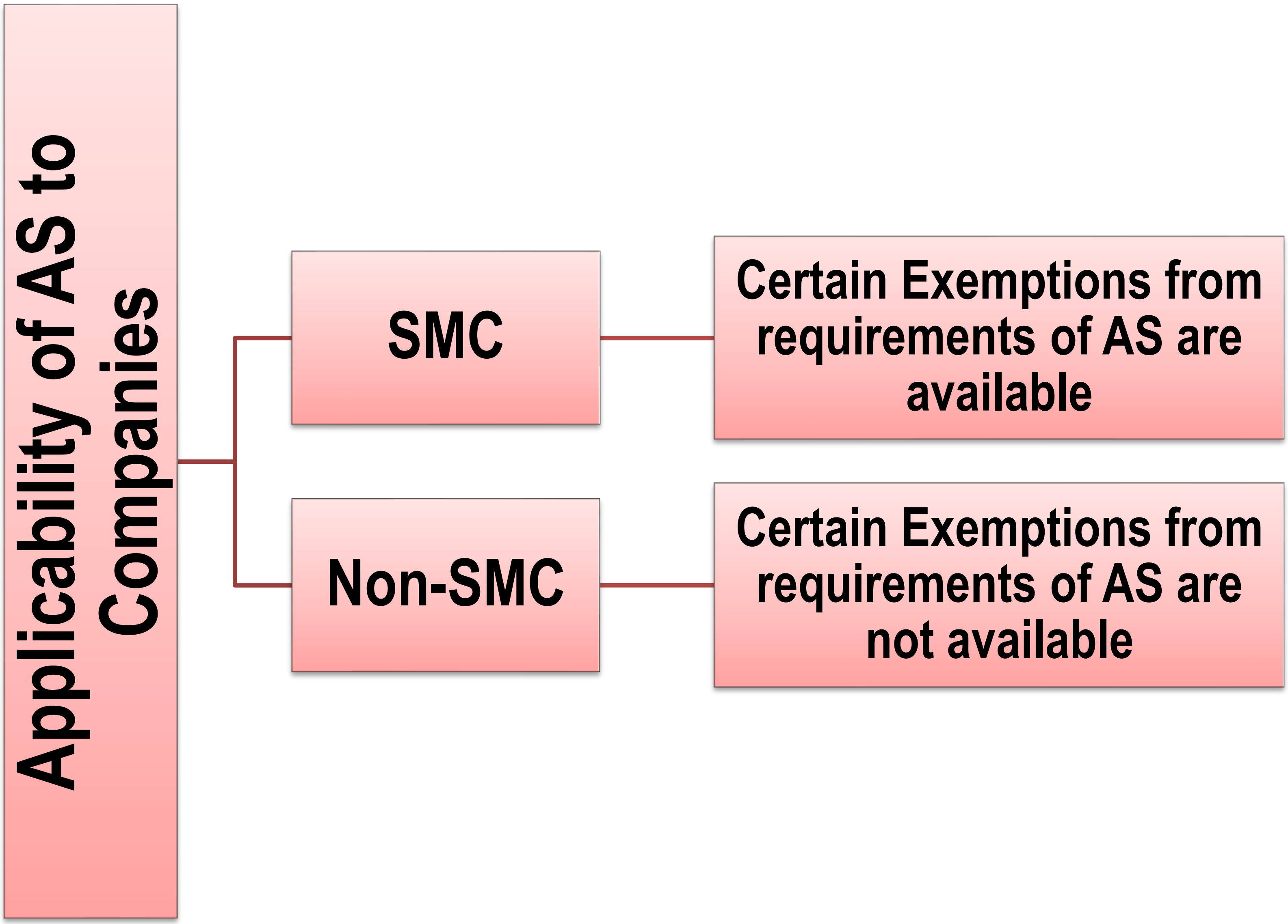
Legal Requirements under the Companies Act, 2013

The **financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards** notified under section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III – Section 129(1)

Auditor to report whether, in his opinion, **the financial statements comply with the accounting standards** – Section 143(3)(e)

Companies (Accounting Standards) Rules, 2021

- **Total AS Notified** = AS 1 to AS 29
- **Omitted** = AS 6, AS 8, AS 10
- **Introduced** = AS 10 (Revised) = AS 6 (Old) + AS 10 (Old) + Some new principles


Applicability of AS to Companies
SMC
Non-SMC
Certain Exemptions from requirements of AS are available
Certain Exemptions from requirements of AS are not available

Small and Medium Size Company (SMC)

- **Listing:** whose equity or debt securities are **not** listed or are not in the process of listing on any stock exchange, whether in India or outside India;

- **Financial Sector:** which is **not** a bank, financial institution (u/s 2(39)) or an insurance company;

- **Turnover:** whose turnover (excluding other income) $\leq$ Rs. 250 [50] crore in the immediately preceding accounting year;

- **Borrowings:** which have borrowings (including public deposits) $\leq$ Rs. 50 [10] crore at any time during the immediately preceding accounting year; and

- **Holding-Subsi.:** which is **not** a holding or subsidiary company of a company which is not a SMC

as at the end of the relevant accounting period – Rule 2(1)(e) of Companies (AS) Rules, 2021 [2006] applicable w.e.f. 1.4.2021 [till 31.3.2021]

Caution

- **Periodical validity of exemptions:** An existing company, which was previously not a SMC and subsequently becomes an SMC, shall not be qualified for exemption or relaxation in respect of Accounting Standards available to an SMC **until the company remains an SMC for two consecutive accounting periods**.
- **Comparatives:** The corresponding period of the previous accounting period **need not be revised** merely by reason of its having ceased to be an SMC. The fact that the company was an SMC in the previous period and it had availed of the exemptions or relaxations available to SMCs shall be disclosed in the notes to the financial statements.
- **Availing Exemptions on Selective basis:** If an SMC opts not to avail of the exemptions or relaxations available to an SMC in respect of ***any but not all*** of the Accounting Standards, it shall **disclose the standard(s)** in respect of which it has availed the exemption or relaxation

Exemptions to SMCs under various AS

Disclosure if Exemptions are availed

- ***"The Company is a Small and Medium Sized Company (SMC) as defined in the Companies (Accounting Standards) Rules, 2021 notified under the Companies Act, 2013. Accordingly, the Company has complied with the Accounting Standards as applicable to a Small and Medium Sized Company."***

AS	Exemptions
AS 3: Cash Flow Statement	Whole AS
AS 17: Segment Reporting	Whole AS
AS 29: Provisions, Contingent Liabilities and Contingent Assets	Exemption from following disclosures: • Movement in balances for each class of provisions; • brief description of the nature of the obligation, indication of the uncertainties, and expected reimbursement
AS 20: Earning Per Share	Exemption from disclosure of diluted earnings per share (both including and excluding extraordinary items)

AS	Exemptions
AS 19: Leases	**For both lessor and lessee – for both finance lease and operating lease, as the case may be:** There is no need to disclose: • maturity analysis of minimum lease payments; • general description of the significant leasing arrangements

AS	Exemptions
AS 15: Employee Benefits	• No need to recognise and measure expected cost of short-term accumulating compensated absences in respect of which employees are not entitled to cash payment for unused entitlement on leaving; • No need to discount contributions that fall due more than 12 months after the balance sheet date. • **Caution: For Small and Medium sized Companies (SMC), Detailed Disclosure are exempted, though provision is required as per "Actuarial Valuation PUCM Method".**
AS 28: Impairment of Assets	• Impairment Loss = Recoverable Amount (-) Carrying Amount • Recoverable Amount = higher of asset's NSP or VIU • VIU (general) = PV of estimated future cash flows from the continuing use of an asset and from its disposal at the end of its useful life • VIU (SMC) = PV of such estimated future cash flows or reasonable estimate thereof

Case Studies on Accounting Policies

Question 1

- **Accounting Policy – whether correct?**
- *"Subsequent expenditure related to an item of PPE is added to its carrying value only if it increases the future benefits from the existing asset beyond its previously assessed standard of performance"*

- Under AS 10 (Revised), there is no criterion that capitalisation of subsequent expenditure should be done only if there is increase of future benefits from the existing asset beyond previously assessed standard of performance.

Question 2

- **Accounting Presentation – whether correct?**
- *A company presented PPE and Capital Work in Progress as separate line items on face of its balance sheet. Although there was movement in balances in current year and previous year, no disclosure in the capital work in progress was made.*

- No disclosure of movement of capital work in progress was made in the financial statements. Capital work in progress is also part of PPE and therefore should have been disclosed as per AS 10 (Revised)
- Often companies miss out presenting the movement of capital work in progress balances in the PPE schedule. This movement/ reconciliation would be required to be presented.

Question 3

- **Accounting Policy – whether correct?**
- *"Borrowing costs directly attributed to the acquisition of* ***fixed assets*** *are capitalised as a part of the cost of asset up to the date is* ***put to use****. Other Borrowing costs are charged to the statement of profit and loss account in the year in which they are incurred."*

- The policy states that the borrowing cost directly attributable to the acquisition of ***fixed assets*** are capitalised. The word should have been ***qualifying assets*** rather than fixed asset.
- Also, the borrowing costs were capitalised which were incurred upto the date of asse is ***put to use***. The point until which the capitalisation should be carried out until the date of the asset is ***ready for its use***.

Question 4

A Ltd. is engaged in the business of manufacturing of parts of laptops. It imports raw materials for manufacturing of parts and exports almost all units it produces. For the purpose of recording the import and export transactions in the reporting currency the company uses a prefixed exchange rate. A Ltd. fixes exchange rate as on first day of the financial year.

Now, the question arises whether foreign currency transactions can be recognised at prefixed exchange rate?

- As per Para 9 of Accounting Standard 11, "*The Effects of Changes in Foreign Exchange Rates*", "A foreign currency transaction should be recorded, on initial recognition in the reporting currency, **by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency** at the date of the transaction".

- Therefore, A Ltd. should record the import and export transactions at the rate prevailing on the date of transaction. It can't use any prefixed rate.

Question 5: Cash and Cash Equivalents

- **Deposits with original maturity of three months or less** only should be classified as **cash equivalents ~ AS 3**;
- Under **AS 3 –** Bank balances held as **margin money or security against borrowings** are neither in the nature of demand deposits, nor readily available for use by the company, and accordingly, **do not meet the aforesaid definition of cash equivalents**;
- Under **Schedule III – Cash and Cash Equivalents** also comprise of:

  "Balances with banks held as margin money or security against borrowings, guarantees, etc. and bank deposits with more than 12 months maturity."

Cash and Cash Equivalents

- **Question:** How to deal with this apparent conflict between the requirements of the Schedule III and the AS with respect to which items should form part of Cash and cash equivalents
- **Answer:**
  1) AS would prevail over the Schedule III;
  2) Company to make necessary modifications in the F.S.;
  3) Accordingly, the conflict should be resolved by **changing the caption "Cash and Cash Equivalents"** to **"Cash and Bank Balances,"** which may have **two sub-headings:**
     a) "Cash and Cash Equivalents" and
     b) "Other Bank Balances."
  4) The former should include only the items that constitute Cash and cash equivalents defined in accordance with AS 3 (and not the Schedule III), while the remaining line-items may be included under the latter heading

Question 6: Earning Per Share

Para 15 of Accounting Standard 20, "Earnings Per Share", requires that ***BEPS should be calculated by dividing net profit for the period attributable to the equity shareholders by weighted average number of equity shares outstanding during the period***.

From the above Para 15 of AS 20, an entity should use weighted average number of equity shares outstanding during the period. It can't use number of equity shares outstanding either at the beginning or at the end of the year, ***except when there is no increase/ decrease in equity share capital during the period***.

Referring to above, in the instant case Company Z has not computed BEPS correctly.

- RST Limited
- 1st April, 2021 – Equity Shares – 10,000 shares
- 1st Oct, 2021 – fresh issue – 1,000 shares (additionally issued)
- 31st March, 2022 – outstanding equity shares – 11,000 shares
- PAT = Rs. 1,10,000
- BEPS = 1,10,000/ 11,000 = Rs. 10 = is it correct ? = no
- Weighted Avg. Number of Equity Shares = [(10,000 (x) 12/12) + (1,000 (x) 6/12)] = ’10,500’ number of shares
- BEPS = 1,10,000/ ’10,500’ = Rs. 10.48 = this is correct position as per AS 20

Question 7: Interest u/s 234B and 234C

Short payment of advance tax installments invites levy of interest under sections 234B and 234C of the Income Tax Act. The company has following questions in regard to the classification of interest levied u/s 234B and 234C of the Income Tax Act:

Should the company classify interest u/s 234B and 234C as tax expense in the financial statements

Is such interest an 'extraordinary item' in accordance with AS 5

Question 8: Forex Gain

As per **Para 13 of AS 11** provides that exchange differences arising on settlement of monetary items or on subsequent recognition of monetary items at the end of the accounting period should be recognised as income or expense.

Thus, A Ltd. is correct in treatment of exchange gains other than exchange gains on sales transactions. **Exchange gains on sales transactions should not be included in sales revenue, it should be included in other income**

Question 9: Cash Flow Statement

In the cash flow statement an entity has categorised its cash flows during a particular period into four categories, which are, Cash flow from Operating Activities, Cash flow From Investing Activities, Cash Flow from Financing Activities and Cash flow from Other Activities.

Whether the entity has categorised its cash flows correctly as per AS 3, Cash Flow Statements?

Particulars	Amount (Rs.)	Amount (Rs.)
Net Profit before Tax	1,000	
Non-cash items and working capital adjustments	(100)	
Cash from Operating Activities (A)		900
Cash from Investment Activities (B)		500
Cash from Financing Activities (C)		(200)
Net increase in cash and cash equivalents [(A) + (B) + (C)]		**1,200**
Cash and cash equivalents at beginning of period (D)		**1,800**
Cash and cash equivalents at end of period (E)		**3,100**
Changes during year on account of (D) and (E)		**1,300**

Particulars	Amount (Rs.)	Amount (Rs.)
Net Profit before Tax	1,000	
Non-cash items and working capital adjustments	(100)	
Cash from Operating Activities		900
Cash from Investment Activities		500
Cash from Financing Activities		(200)
Cash from Other Activities		**100**
Net increase in cash and cash equivalents		**1,300**
Cash and cash equivalents at beginning of period		**1,800**
Cash and cash equivalents at end of period		**3,100**

Question 10: Related Party Disclosures

As per Para 23 of AS 18, "Related Party Transactions“, if there have been transactions with related parties, during the existence of a related party relationship, ***the entity should disclose a description of the relationship between the parties***.

In the instant case, C Ltd. has disclosed description of relationship only in case of transactions with KMP and their relatives, but has not disclosed the type of relationship in case of transactions with other related parties.

Therefore, related party transactions in this case have not been properly disclosed.

Question 11: Govt. Grants related to revenue and clubbing with sales

A company (say Company X) is engaged in the business of manufacturing and selling of tea. During the previous financial year it had received subsidy on fertilisers from the government. While preparing financial statements for previous year, X has clubbed the amount of subsidy with revenue of that year.

Is accounting treatment of governmental subsidy correct?

- As per Para 15 of AS 12, "*Accounting for Government Grants*", Government grants related to revenue should be recognised on a systematic basis in the profit and loss statement over the periods necessary to match them with the related costs which they are intended to compensate. **Such grants should either be shown separately under 'other income'** or deducted in reporting the related expense.
- Therefore, the company X should disclose the subsidy on fertilisers as other income or should net off the amount of subsidy from the expenditure incurred on purchase of fertilisers.

Common areas in Companies Act generally overlooked by Statutory Auditors

Carry forward of profits

Extract of one of the Clause from AOA

- *(i) The **Board may, before recommending any dividend, set aside out of the profits of the company such sums as it thinks fit as a reserve or reserves which shall, at the discretion of the Board**, be applicable for any purpose to which the profits of the company may be properly applied, including provision for meeting contingencies or for equalising dividends; and pending such application, may, at the like discretion, either be employed in the business of the company or be invested in such investments (other than shares of the company) as the Board may, from time to time, thinks fit.*
- *(ii) **The Board may also carry forward any profits which it may consider necessary not to divide, without setting them aside as a reserve**.*

Areas not to be overlooked

- Check and document the relevant minutes of the Board Meeting to corroborate whether any dividends are recommended or not
- If not then check whether notes to account mention the fact the BOD has decided to carry forward the profits to the next year

Newly Incorporated Company

Case Study

- RST (P) Limited was incorporated on 28th December, 2022
- The subscribers undertook to bring in Rs. 5,00,000 towards the subscription money in terms of Section 10A of the Companies Act, 2013
- The amount was not received as at 31st March, 2023
- How should this be reflected in the financial statements of RST (P) Limited for the FY 2022-2023

Applicability of CARO vis-à-vis Small Company

Applicability

- **Not Applicable to Private Company**, if:
    i. Its not a subsidiary or holding of a Public Co.; **AND**
    ii. (Paid up Capital + Reserves & Surplus) <= Rs. 1 crore as on Balance Sheet Date; **AND**
    iii. Total Borrowings from Banks/ F.I. <= Rs. 1 crore at any point of time during the financial year; **AND**
    iv. Total Revenue (including revenue from discontinuing operations) under Schedule III <= Rs. 10 crores during the financial year as per the financial statements

Applicability

- **Not Applicable to Small Company [Sec. 2(85)]:** a Company having:
  a) Paid up share capital ≤ 50 lakhs; ***and***
  b) Turnover as per preceding year P & L ≤ 2 cr.

  Following do not qualify as a Small Company:
  a) Public company;
  b) Holding or a subsidiary company;
  c) Section 8 Company;
  d) Co. or body corporate governed by any special Act

  Note 1: Rule 2(1)(t) as inserted by the Companies (Specification of Definitions Details) Amendment Rule, 2021, **w.e.f. 1-4-2021**:
  a) Paid up share capital ≤ 2 cr.; ***and***
  b) Turnover as per preceding year P & L ≤ 20 cr.

  Note 2: Rule 2(1)(t) as amended by the Companies (Specification of Definitions Details) Amendment Rule, 2022, **w.e.f. 15-9-2022**:
  a) Paid up share capital ≤ 4 cr.; ***and***
  b) Turnover as per preceding year P & L ≤ 40 cr.

Particulars for XYZ (P) Limited	2022-2023	2021-2022	2020-2021	2019-2020
Paid-up Capital	48 Lakhs	48 Lakhs	48 Lakhs	48 Lakhs
Reserves and Surplus	3 Lakh	3 Lakh	1.5 Lakh	1 Lakh
Total	51 Lakhs	51 Lakhs	49.5 Lakhs	49 Lakhs
Borrowings from Banks/ F.I.	3 Cr.	3 Cr.	2 Cr.	1.2 Cr.
Total Revenue/ Turnover	35 Cr.	30 Cr.	22 Cr.	6 Cr.
CARO Applicable ?				
Reason				

Particulars for XYZ (P) Limited	2022-2023	2021-2022	2020-2021	2019-2020
Paid-up Capital	48 Lakhs	48 Lakhs	48 Lakhs	48 Lakhs
Reserves and Surplus	3 Lakh	3 Lakh	1.5 Lakh	1 Lakh
Total	51 Lakhs	51 Lakhs	49.5 Lakhs	49 Lakhs
Borrowings from Banks/ F.I.	3 Cr.	3 Cr.	2 Cr.	1.2 Cr.
Total Revenue/ Turnover	35 Cr.	30 Cr.	22 Cr.	6 Cr.
CARO Applicable ?	No	Yes	Yes	Yes
Reason	Small Company	Borrowings > Rs. 1 Cr.; or T.O. > Rs. 10 Cr.	Borrowings > Rs. 1 Cr.	Borrowings > Rs. 1 Cr.

Rule of Interpretation:
Expressio unius est exclusio alterius

ICoFR vis-à-vis Small Company

Applicability

- The auditor's report shall also state whether the company has **adequate internal financial controls with reference to financial statements** in place and the operating effectiveness of such controls [Section 143(3)(i)]
- **Non-applicability:** In case of private companies, section 143(3)(i) shall not apply to:
  - one person company; or
  - small company; or
  - **private company** which has:
    a) turnover < Rs. 50 crores as per latest audited financial statement; **and**
    b) aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the FY < Rs. 25 crores — Notification No. GSR 464(E), dated 5-6-2015, as amended by, Notification No. GSR No. 583(E), dated 13-6-2017.

CSR

Companies (Corporate Social Responsibility Policy) Amendment Rules, 2022

- Constitution of a **CSR Committee** by a company having any amount in its unspent CSR account;
- New class of **entities exempt under Section 10(23C)** which may be approved by the Principal Commissioner or Commissioner, have been included through the MCA amendment as implementation agencies;
- Change in the limits of **expenses incurred towards impact assessment** that can be considered as CSR spend = should not exceed 2% of the total CSR expenditure for that financial year or Rs. 50 lakh, whichever is higher;
- Revisions in the **format for the annual report** on CSR activities

Companies (Accounts) Fourth Amendment Rules, 2022

Effective from 5th August, 2022

- The books of account and other relevant books and papers maintained in electronic mode shall remain accessible in India, ***at all times***, so as to be usable for subsequent reference [Rule 3(1)];
- The back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a ***daily basis*** [Rule 3(5) proviso]
- ***Where the service provider is located outside India, the name and address of the person in control of the books of account and other books and papers in India*** [Rule 3(6)(e)]

GST ITC

What does Companies Act say

- Auditor need to inquire whether **transactions of the company which are represented merely by book entries** are prejudicial to the interests of the company – Section 143(1)(b);
- The purpose of book entries is to correctly record transactions which have, in fact, taken place. **If a book entry is passed which is not in accordance with the facts of the transaction, or is contrary thereto, this should be set right or reported upon by the auditor**. Again, if book entries are passed purporting to record "transactions" which have, in fact, not taken place, similar considerations would apply – ICAI Guidance

Areas not to be overlooked

- There may be situations in case of Goods and Services tax, where the **vendor has not shown the amount of Goods and services tax** paid to him in his statement/return but the company has appropriate justifications for considering those payments made as input tax credit in the books of account and consequently adjusted the same in the books of account against its Goods and services tax liability;
- Section 143(1)(b) is intended to cover transactions of the company for which the only evidence, or the principal evidence, is the entry regarding the transactions in the books of account. In such cases, the **auditor should inquire whether such transactions have in fact taken place** and, if so, whether they are prejudicial to the interests of the company – ICAI Guidance

Subscription Money

What does Companies Act say

- In case of company having share capital, after obtaining certificate of incorporation but before commencement of business, company is required to **submit declaration in Form INC-20A that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him** on the date of making of such declaration - section 10A of Companies Act, 2013 inserted vide the Companies (Amendment) Act, 2019 w.r.e.f. 2-11-2018;
- **“Paid up Share Capital”** or “share Capital Paid-up” means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and **also includes any amount credited as paid-up in respect of shares of the company**, but does not include any other amount received in respect of such shares, by whatever name called – Section 2(64)
- Situation may occur when **subscribers to the MOA fail to pay subscription money** as agreed by them in MOA.

Areas not to be overlooked

- Company has to **issue share certificate within a period of 2 months of incorporation** of the company irrespective of the fact that subscription money is received or not – Section 56.
- Further, paid up share capital means ‘any amount credit as paid up.’ In this situation, **company can credit the subscription money not received as paid up** in the Balance Sheet of the company, which is still receivable.
- If the Company fails to file Form INC 20A within 180 days from the date of Incorporation, the **RoC may initiate action for removal of the name of the Company -** Section 10A(3) & 248(1)(d) ~ **Going Concern Matter (SA 570)**
- **Calls can be made** only by a resolution by Board of Directors at meeting - section 179(3)(a). Subject to AOA the **company can collect interest if call money is paid late**
- In case of where **subscription money not received** has been credited as paid-up then as per **Schedule III the amount due from the subscriber should be appropriately disclosed in the balance sheet**.

Related Parties

Audit Requirements

AS 18	CARO
Related party transaction: a transfer of resources or obligations between related parties, regardless of ***whether or not a price is charged***.	**Para 3(xiii):** • Whether all transactions with the related parties are in compliance with sections 177 and 188 of the Companies Act, 2013 where applicable • Whether the details of the transactions have been disclosed in the Financial Statements etc. as required by the applicable accounting standards

What does Companies Act say

- A company can enter into **specified related party transaction only with approval of Board** - Section 188(1);
- Nothing in this sub-section shall apply to any transactions entered into by the company in its **ordinary course of business which are on an arm's length basis** - 4th Proviso
- **Specified related party transactions:**
  - sale, purchase or supply of any goods or materials
  - selling or otherwise disposing of, or buying, property of any kind
  - leasing of property of any kind
  - availing or rendering of any services
  - appointment of any agent for purchase or sale of goods, materials, services or property
  - such related party's appointment to any office or place of profit
  - underwriting the subscription of any securities or derivatives

What does AS 18 say

- There is a general presumption that transactions reflected in F.S. are consummated on an arm's length basis between independent parties. However **transactions between related parties may not be effected at the same terms and conditions as between unrelated parties**. Sometimes, no price is charged in related party transactions, e.g. free provision of management services and the extension of free credit on a debt – Para 16.
- **Examples of related party transactions – Para 24:**
  - purchases or sales of goods (finished or unfinished)
  - purchases or sales of fixed assets
  - rendering or receiving of services
  - agency arrangements
  - leasing or hire purchase arrangements
  - transfer of research and development
  - **finance (including loans/ equity contributions in cash/ kind)**
  - **guarantees and collaterals**

Areas not to be overlooked

- **Assess** whether a related party transaction is in **ordinary course of business**
- **Evaluate** management's representations that related party transactions are at **arm's length** by testing whether prices charged are at arm's length;
- Be careful about the **transactions which are in scope** of AS 18 but not in scope of Section 188

Share Application Money

What does Companies Act say

- A company making **shall allot its securities within 60 days** from the date of receipt of the application money.
- If the company is not able to allot the securities within that period, it shall **repay the application money to the subscribers within 15 days** from the date of completion of 60 days.
- If the company fails to repay the application money within the aforesaid period, it shall be liable to **repay that money with interest @12% p.a.** from the expiry of 60^{th} day – Section 42(7).
- If the securities for which application money or advance for such securities was received **cannot be allotted within 60 days from the date of receipt of the application money** and such application money is not refunded to the subscribers within 15 days from the date of completion of 60 days, **such amount shall be treated as a deposit** – Rule 2(1)(c)(vii) of Companies (Acceptance of Deposits) Rules, 2014

What does CARO say

Para 3(v)	Para 3(xiv)
in case, the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the **provisions of sections 73 to 76 or any other relevant provisions of the Companies Act, 2013 and the rules framed thereunder**, where applicable, **have been complied with?** If not, the nature of such contraventions be stated	whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to **whether the requirement of section 42 of the Companies Act, 2013 have been complied with** and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance

Areas not to be overlooked - Question

RST (P) Limited Equity and Liabilities (Extract)	As at 31.3.2023 (in Lakhs)	As at 31.3.2022 (in Lakhs)
Share application money pending allotment (money was received through Banking channels on 15th January, 2022)	100	100

Disqualification of Directors – Section 164(2)

Any Co. (***other than Govt. Co.***)

Made defaults in

Filing of annual F.S. **or** **annual returns** for 3 continuous F.Y.

Or

Repayment of **Deposits/ Interest** thereon/ **Debentures/ Interest** thereon/ **Dividend**

$\geq$ 1 year from due date

Then directors of such company

Cannot be appointed or re-appointed as director of such company or any other company for next 5 years

Audit
Trail

Comparative read through

Proviso to Rule 3(1) w.e.f. 1st April, 2023	Rule 11(g) w.e.f. 1st April, 2022
for the financial year commencing on or after the 1st day of April, 2023	in respect of financial years commencing on or after the 1st April, 2022
every company which uses accounting software for maintaining its **books of account**, shall use only such accounting software	has used such accounting software for maintaining its **books of account**
which has a feature of recording audit trail of each and every transaction, creating an edit log	which has a feature of recording audit trail (edit log) facility and the same has been **operated throughout the year** for all transactions recorded in the software and
of each change made in books of account along with the date when such changes were made and	?
ensuring that the audit trail cannot be disabled	the audit trail feature has not been tampered with and
?	the audit trail has been preserved by the company as per the statutory requirements for record retention

- **Rule 11(g) for FY 2022-2023**
- **Case 1 ~ company client is voluntary using audit trail compliant software since long**
- On the basis of information and explanation given to us, we report that the company is using audit trail compliant software which operated throughout the year and the audit trail was not tampered. However, we further report that the mandatory usage of audit trail compliant software by the company is applicable w.e.f. 1st April, 2023 only
- **Case 2 ~ company is yet to use such audit trail compliant software**
- Since the mandatory usage of audit trail compliant software by the company is applicable w.e.f. 1st April, 2023 only, we as auditors are of the opinion that reporting under Rule 11(g) of the Company (Audit and Auditors) Rules, 2014 is not tenable for the FY 2022-2023

Auditing Standards w.r.t. Audit Reports

Legal and Professional Requirements

Auditor shall comply with the auditing standards – Section 143(9);

Second Schedule of the Chartered Accountants Act, 1949 states that a member in practice guilty of professional misconduct, if he:

Authority Attached to Standards on Auditing and General Clarifications

- Standards issued by AASB under the Authority of the Council of ICAI;
- Statements on Auditing are issued with a view to securing compliance by professional accountants on matters which, in the opinion of the Council, are critical for the proper discharge of their functions. Statements are, therefore, mandatory;
- It is the **duty of the professional accountants** to ensure that the Standards/Statements/General Clarifications are followed in the engagements undertaken by them – Para 11 of ***"Preface to Standards on Quality Control, Auditing, Review, Other Assurance and Related Services effective from April 1, 2008"***

Certain Matters w.r.t. Audit Report to be looked into by the Auditors

Auditor has signed the Auditor's report prior to the date when the Financial Statements were signed and authenticated by the director of the company.

SA-700 (Para-26) Since the Auditor's responsibility is to report on the Financial Statements as prepared and presented by the management, the auditor should not date the report earlier than that the date on which the Financial Statements are signed or approved by management.

Auditor has mentioned his membership number with prefix "F" in Auditor's Report.

SA-700 (Para- 28) Neither Institute allots Membership Number to its members with any prefix like "F" or "A" nor SA-700 permits the use of such prefixes with the membership number in the Auditor's Report.

Abstract of Auditor's Report:
"For XYZ & Associates
Chartered Accountants
(ABC)
Partner
Membership No. 00000"

It may be noted that footnote 26 given with reference to Paragraph A36 of SA 700 (Revised), Forming an Opinion and Reporting on Financial Statements, inter alia, provides that in addition to the other requirements relating to signature on the audit report, as prescribed under the relevant Standard on Auditing, <u>the registration number of the firm as allotted by ICAI should be stated in the audit reports signed by them.</u>

In opinion and to the best of our information and according to the explanation given to us, the said accounts together with the notes thereon give the information required by the Banking Regulations Act, 1949 as well as Companies Act, 2013, in the manner so required for the banking companies and give a true and fair view in conformity with the accounting principals generally accepted in India:

In the case of the Profit and Loss Account <u>of the profit/ loss for</u> the year ended on that date;"

It was noted from the Auditors' Report that the auditor has expressed opinion 'profit/loss'. It was further noted that in the Opinion Paragraph of Appendix to SA 700, 'Forming an opinion and Reporting on Financial Statements', the phrase 'profit/loss' has been used while expressing the opinion. It was viewed that in appendix, such phrase has been used to indicate the situations when the given format may be used. However, in practice the enterprise earns either the profit or incurs loss, therefore, <u>the auditor should express his opinion either on profit or loss, as case may be. A reader may get confused on reading 'profit/ loss' which should be avoided.</u>

The Auditor has given his report within the paragraphs stated in SA 700 but without using the headings for respective paragraphs.

It was noted that Standard on Auditing (SA) 700 (Revised), Forming an Opinion and Reporting on Financial Statements is applicable from the periods beginning on or after April 1, 2018. Further, as per the illustrative format of Auditor's Reports on Financial Statements an auditor is required to present the audit report duly divided under different headings viz. 'Opinion', 'Management's and TCWG responsibility for the financial statements', 'Auditor's Responsibility', 'Report on other legal and regulatory requirements.

It was noted that the given financial statements pertain to financial year 2018-19, however, the heading of different paragraphs defining separate elements of report have not been given as prescribed under SA 700

“**<u>AUDITORS’ REPORT</u>**

The Bank of ....

....

Report on the Financial Statements

Management’s Responsibility

....

Report on Other Legal and Regulatory Requirements

..........”

It was noted that Paragraph 21 of SA 700, Forming an Opinion and Reporting on Financial Statements, reads as follows:

“21. <u>The auditor’s report shall have a title that clearly indicates that it is the report of an independent auditor.”</u>

It was noted that auditor has given report without stating <u>whether it is an independent report</u> or otherwise as per the requirements of SA 700.

Abstract of Signature in Auditor's Report given in the Annual Report:

"For and on behalf of"
XYZ & Associates

It was noted that auditor's report as well as report on CARO has been signed on behalf of the firm. It was viewed that the report should be signed by the auditor in his personal name. Where the firm is appointed as the auditor, <u>the report is signed in personal name of the auditor.</u>

Accordingly, the signatures of Auditor were considered to be not in accordance with the requirements of under SA 700.

Paragraph (1) of auditor's report reads as under:
"We have audited the attached Balance Sheet of XYZ Limited as at March 31, 2012 and the **related** Profit and Loss Account and the Cash Flow Statement for the year ended on that date all of which we have signed under reference to this report. 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 (emphasis added)."

It was noted from the auditor's report that the auditor has referred to Statement of profit and loss as "related Profit and Loss Account". It was viewed that there is no such term either in the Companies Act or other related regulations.

Hence, it was viewed that usage of such terms should be avoided.

Opening paragraphs of the Auditor's Report states "examined the attached Balance Sheet…"

Term 'examined' signifies wider function than the actual responsibility of the auditor. Auditor should have used the word 'audited' rather than using the word 'examined' to reflect his correct responsibility.

In the Auditor's Report, no reference was made to the Cash Flow Statement in opening paragraph and opinion paragraph.

SA-700 (Para-9) The Auditor's Report should identify the Cash Flow Statement as a part of Financial Statements and further, also express an opinion on the Cash Flow Statement audited.

Although the Auditors have Qualified their report with regards to non-compliance of certain Accounting Standards, they have omitted to report the qualification of the possible effect either individually or in aggregate.

With regards to SA-700, it is viewed that, while expressing opinions other than unqualified, the auditor should report the reasons for such opinion and should also report the quantitative impact of such on the financial statements of each, individually as well as their aggregate. Where it is not practicable to quantify the same, auditor must quantify the same based on estimates provided by the management.

"We have audited the attached Balance Sheet of X Ltd. as at 31st March, xxxx and Profit & Loss Account for the year ended on that date annexed thereto. The Financial Statements are the responsibility of the company's management".

Para 33 and 37 of SA-700 (R) requires the auditor to state the responsibility of management towards the Financial Statement along with their own responsibility to express an opinion on the Financial Statements based on Audit. This needs to be reported under two separate headings namely:

1. Responsibilities of Management and TCWG; and

2. Auditor's Responsibilities for the Audit of the Financial Statements

An unqualified opinion given referring to the following comment: "In our opinion, the Balance Sheet, the Profit & Loss Account, the Cash Flow Statement dealt with by this report comply with the Accounting Standards referred to in section 133 of the Companies Act, 2013".

From the Annual Report of the Company, there were many non-compliance of Accounting Standards, but still the auditors have given a Clean Report.

Auditor often omit to state whether the statements prepared are in conformity with the Financial Reporting Framework and statutory requirements relevant to the company.

SA-700 requires that the Opinion Para of the Auditor's Report should clearly indicate the FRF used to prepare the F/S and state the auditor's opinion as to whether the F/S gives true & fair view in accordance with FRF and, where appropriate, whether the F/S comply with the Statutory Requirements – see illustration in next slide.

- **Qualified Opinion**
- We have audited the standalone financial statements of ABC Company Limited ("the Company"), which comprise the balance sheet as at March 31, 20XX, and the statement of Profit and Loss, and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at (location of branches)).
- In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements ~~*give the information required by the Companies Act 2013 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 31st, 20XX and its profits and its cash flows for the year ended on that date.

The Auditor has expressed opinion on the Balance Sheet, Profit & Loss Account as well as on the accounts of the Company ‘subject to a note ‘x’ of notes to account’ stating a change in the Accounting Policy of Depreciation method.

‘subject to’ is improper although the company has made sufficient disclosure of change in Accounting Policy. Further, since the auditor is not in agreement with the management for change in Depreciation method, in that case, ‘subject matter of qualification’ is ambiguous and basis of opinion should be provided properly with financial impact to the extent practicable

When the auditor expresses a qualified opinion, it would not be appropriate to use phrase such as "subject to" in the Opinion section as these are not sufficiently clear or forceful – Para A20 of SA 705(R)

Membership no. of auditor was mentioned in Audit Report, but not in CARO, Balance Sheet, Statement of Profit & Loss.

SA-700 (Para-28) The partner/proprietor signing the audit report should compulsorily mention the Membership No. assigned by ICAI and also the Firm Registration No. to be mentioned.

Report was not addressed to anyone.

SA-700 (Para-8) The auditor's report should be appropriately addressed as required by the circumstances of engagement and applicable Laws & Regulations. Ordinarily, the auditor's report is addressed to the authority, appointing the auditor (Under the Companies Act 2013, audit report on CFS will be addressed to members, earlier it was addressed to Board of Directors.)

Matters to be looked into for CARO

The management has conducted physical verification of the fixed assets during the year and "we are informed that discrepancies noticed were not material".

The use of words "We are informed that", prima facie creates an impression that no documentary evidence was available to substantiate the verification and that the auditor has wholly relied on management's representation. However, the auditor's duty is to express his opinion and not just disclose the information given by the management, hence not as per CARO. [It may start with According to information and explanation given to us….]

"All assets are not verified but there is a regular programme of verification. The same is reasonable. <u>Management has explained that no material discrepancies were noticed".</u>

CARO requires <u>that auditor should use his judgment</u> to determine that discrepancy is material or not. Duty has been casted on auditor to express his opinion. In the given case, auditor has relied on the management's explanation and has not used his judgment.

"Programme of physical verification is reasonable, though all the assets are not verified. Management is in process of identifying discrepancies, if any, on such verification".

Comments are not as per requirement. It indicates lapse of the policy that physical verification of even those assets which were taken for verification is not complete. <u>Inappropriate conclusion is made by auditor that company is having regular programme for verification.</u>

The company has maintained proper records of inventory. No material discrepancies were noticed on physical verification of inventory except as recorded by excise department as per note...

CARO requires the auditor to comment on whether the discrepancies noticed have been adequately dealt with. Here, the auditor has only reported on discrepancies by referring to the note but he has omitted to comment on whether those discrepancies were properly dealt with in the Books of Accounts.

(a) The parties to whom loans have been given by the company are repaying the principal amounts as stipulated and interest thereon wherever applicable.

(b) In case of overdue amounts exceeding 1 Lakh reasonable steps have been taken by the company for recovery of principal amount & interest thereon and necessary provisions have been made wherever such amounts appear to be doubtful of recovery.

It is observed that the stated comments are providing contradictory information. If the parties are regular in repaying the principal as well as the interest then the question of overdue amounts does not arise.

It has been noticed that the auditor has reported only in context of ‘undisputed’ statutory dues and is silent on ‘disputed’ statutory dues.

As per clause (vii)(b) of CARO, the auditor is required to report on specified statutory dues that have not been deposited on account of any dispute. In case there are no dues which have not been deposited on amount of dispute then the auditor shall explicitly report it, rather being silent on it.

The company is regular in depositing undisputed statutory dues including provident fund, investor education and protection fund, employee state insurance, income tax, sales tax, wealth tax, custom duty, excise duty, cess and other statutory dues with the appropriate authorities. <u>Late deposit, if any, has been attached in Form 3CD.</u>

It is noted that whereas CARO requires ‘disclosure of amount’ which are in arrears for the period of more than 6 months, the auditor has simply reported the means, i.e. Form 3CD where such information is available. It was further viewed that Form 3CD is a part of Tax Audit Report and hence the requisite information for neither available in CARO report or in the F/S attached. Accordingly, the auditor has not complied with the reporting requirement.

Question

- RST Limited
- Gratuity is payable under Payment of Gratuity Act and Bonus is payable under Payment of Bonus Act
- The company has delayed in making such payments
- The Company has also delayed in transferring amounts to IEPF
- Whether such delay in payments of gratuity, bonus and IEPF is reportable under Para 3(vii) of CARO

- **Caution:**
- IEPF deposit delays are not reportable under CARO. They are reportable as per Rule 11 of Audit Rules on the face of audit report

- **Question:** Whether the following reporting made in CARO is correct?

  "According to the information and explanations given to us, no fraud on or by the company has been noticed or reported during the course of our audit";

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Statutory Audit – a Ready Reckoner (with illustrative formats, letters, paras)

Qualifications and Other Comments in Audit Report (with illustrative paras)

Audit Trail (with illustrative reporting paras)

CARO, 2020 (with Commentary, Checklists and Specimen Reporting)

Standards on Auditing – a Ready Reckoner

Company Balance Sheet and Profit & Loss Account (with Schedule III commentary and formats)

Tax Audit (with illustrative paras and common mistakes)

Internal Auditing (with illustrative programmes)

IFRS I Corporate Laws I Due Diligence I Forensic Audits

Thank you

Kamal Garg & Associates