



Company Law - Statutory Audit

CARO and IFC

Seminar on Audit of SME
WIRC of ICAI

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AGENDA

- Regulatory framework
- CARO – Audit Approach
- IFC Framework – Audit Approach
- Risk assessment
- Materiality planning
- Test of controls
- Audit Approach

REGULATORY FRAMEWORK

Requirements under Companies Act, 2013

- Section 134 (2) – Financial statement, Board’s report, ect.

The Auditors’ Report shall be attached to every financial statement.

- 139 – Appointment of auditors

Subject to the provisions of this Chapter, every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as may be prescribed.

Companies (Audit & Auditors) Rules, 2014

REGULATORY FRAMEWORK – SPECIFIC ENQUIRIES


- 143(1) – Specific enquiries
 - whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
 - whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
 - where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
 - whether loans and advances made by the company have been shown as deposits;
 - whether personal expenses have been charged to revenue account;
 - where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

REGULATORY
FRAMEWORK –
REPORT ON
MATTERS AS PER
ORDER

143(11) r w Companies (Auditor's Report) Order, 2016

- The Central Government may, in consultation with the National Financial Reporting Authority, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.
- Applicable to all the Companies except specifically exempted from the application of the Order
- The Order is also applicable to the audits of branch(es) of a company – S143(8) read with Rule 12 of the Companies (Audit and Auditors) Rules, 2014
- CARO 2016 is not applicable to audit of Consolidated Financial Statements

APPLICABILITY – COMPANIES NOT COVERED BY THE ORDER

- 
- Banking Company – defined in clause (c) of section 5 of the Banking Regulation Act, 1949
 - An insurance company as defined under the Insurance Act, 1938
 - Companies licensed to operate under section 8 of the Companies Act, 2013 including companies licensed to operate under section 25 of the Companies Act, 1956
 - One person Company as defined under section 2(62) and Small Company as defined under section 2(85) of the Companies Act, 2013
 - Private limited company [S.2(68)] satisfying all the conditions mentioned in the Order collectively

It may also be noted that in case a company is covered under the definition of small company, it will remain exempted from the applicability of the Order even if it falls under any of the criteria specified for private company.

APPLICABILITY

Conditions for private limited company in order to be exempt from the applicability of the Order

CARO 2016

Paid up capital
& Reserves -
100 lakhs

Loan From Banks
& Financial
Institution -
Rs.100 lakhs

Total turnover -
Rs.1000 lakhs

AS AT THE
BALANCE
SHEET DATE

Paid-up Capital [S2(64)]

- Equity share Capital (including bonus shares)
- Including amounts on forfeited shares & excluding unpaid call
- Preference share Capital
- Share application money received should not be considered as part of the paid-up capital**

Reserves and Surplus

- Capital Reserve **including revaluation reserves**
- Revenue reserve after netting off of debit balance

APPLICABILITY

Conditions for private limited company in order to be exempt from the applicability of the Order

CARO 2016

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100 lakhs

Loan From Banks
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AS AT THE
BALANCE
SHEET DATE

Borrowings **at any point of time during the financial year**

- Fund based credit facilities
- Non-fund based credit facilities to the extent such facilities that have devolved and converted into fund based
- Outstanding dues in respect of credit cards to be considered
- Interest accrued and not due not to be considered

Total Revenue

- Total revenue would include other income
- Total revenue would also include revenue from discontinuing operations

COMPANIES (AUDITOR'S REPORT)

ORDER, 2016

AUDIT APPROACH



AUDIT APPROACH

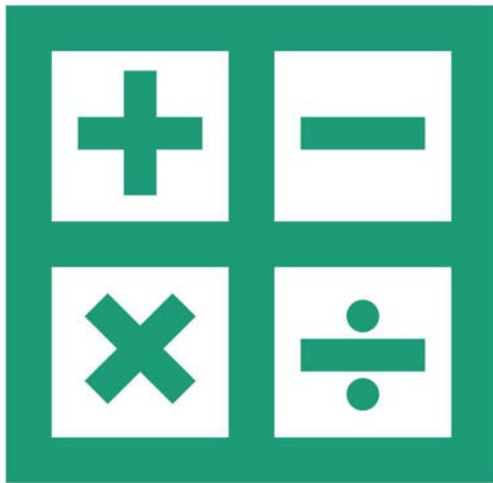
Audit objective not changed: Reporting under the Order is supplemental to the audit of financial statements and not to be construed as a separate reporting engagement

S. 143(9) – Every auditor shall comply with the auditing standards

Audit Documentation – SA 230

- submit to the company, a questionnaire on all important matters covered by the Order
- make specific inquiries in writing on all important matters not covered by the questionnaire
- insist that replies of the company are furnished in writing and are signed by a person those charged with governance
- where the explanations are not separately recorded, maintain a record of the discussions with the management





MATERIALITY PLANNING

Materiality in Planning and Performing an Audit – SA 320

- reasonable assurance by obtaining audit evidences to reduce audit risk to an acceptable low level
- audit risk and materiality should be considered for determining the nature, timing and extent of audit procedure
- expresses opinion in good faith and after exercise of reasonable care and judgement

CARO – Paragraph 3(i)

FIXED ASSETS

UNDERSTANDING THE REQUIREMENT OF CLAUSE

Maintenance of Records

Physical verification report – Material discrepancies

Immovable Properties as defined under General Clauses Act, 1897

- include land, benefits to arise out of land, and
- include things attached to earth, or permanently fastened to anything attached to earth
 - does not include TDRs(Transfer Development Rights), Plant and Machinery embedded in land

Title Deeds

- legal deed or document constituting evidence of a right, especially to the legal ownership of the immovable property

CARO – Paragraph 3(i)

FIXED ASSETS

CHALLENGES

- Legal and technical ability to validate title deeds
- Verification of title deeds pledged with lenders
- Information about area not appropriately captured in the Fixed Asset Register
- Exceptions noted in title deeds and dealing with them in the CARO report and its consequent impact on the financials
- Name of the entity has changed in the past
- Conversion of LLP to company / Merger of the entity – Title deeds in the process of being registered
- Immovable assets to include items in Capital Work in Progress too
- Disputed title deeds
- Title deeds in different languages

CARO – Paragraph 3(ii)

INVENTORIES

UNDERSTANDING THE REQUIREMENT OF CLAUSE

Reasonable intervals of physical verification by the management and material discrepancies

- It depend on the nature of inventories, their location and the feasibility of conducting a physical verification
- Normally, wherever practicable, all the items of inventories should be verified by the management of the company at least once in a year
- The Company may determine the frequency of verification by 'A-B-C' classification of inventories, i.e. 'A' category items being verified more frequently than 'B' category and the latter more frequently than 'C' category items.

CARO – Paragraph 3(iii)

COMPLIANCE WITH THE PROVISIONS OF S189

UNDERSTANDING THE REQUIREMENT OF CLAUSE

Parties covered under section 189 of the Act

- a) Companies, body corporate, firm or association of individuals in which the directors are interested
- b) Body corporate in which director(s) hold $> 2\%$ shareholding or of which the director is a promoter, manager or CEO
- c) Firm or other entity in which the director is a partner, owner or member
- d) Related parties covered under section 188 i.e. related parties as defined under section 2(76)

CARO – Paragraph 3(iii)

UNDERSTANDING THE REQUIREMENT OF CLAUSE

Coverage

- a) Whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest
 - the clause uses the term “grant” which would ordinarily be understood to mean loans granted/given during the year, however, it may be appropriate to include such loans also that were renewed during the year
 - Auditors' inquiry under S.143(1)(a) of the Companies Act
- b) Whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular; and
- c) If the amount is overdue, state the total amount overdue for more than 90 days, and whether reasonable steps have been taken by the company for recovery of the principal and interest.

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

CARO – Paragraph 3(iii)

UNDERSTANDING THE REQUIREMENT OF CLAUSE

Audit Procedure and reporting

- Obtain a list of companies, firms, limited liability partnerships or other parties covered in the register maintained under section 189 of the Act from the management
- Examine all loans (secured or unsecured) granted by the company to identify those loans granted to companies, firms, limited liability partnerships or other parties covered in the register maintained under section 189 of the Act
 - If a party is covered by section 188 or section 184, even if the loan given to these parties are **not entered** in the Register specified under section 189 of the Act, reporting must be made under Clause (iii) of CARO 2016.
- All loans to such parties whether given in cash or in kind needs to be considered including loans square off during the year to be considered for reporting
- Special attention needs to be given to interest free loans granted for which repayment terms/ schedule is not specified

CARO – Paragraph 3(iii)

UNDERSTANDING THE REQUIREMENT OF CLAUSE

Audit Procedure and reporting

- In case of waiver of principal amount and/ or interest on the loans given by the Company, the same need to be assessed and concluded for reporting as to why such waiver is not prejudicial to the interest of the Company.
- If there is no agreement/ arrangement or agreement/ arrangement does not contain the schedule of repayment of principal and payment of interest, the auditor shall report that there is no stipulation of schedule of repayment of principal & payment of interest and accordingly unable to make specific comment on the regularity of repayment of principal & payment of interest
- In case where repayment of principal or interest is not regular then the auditor may report the fact and may give no. of cases and remarks, if any
- Reasonable steps for recovery may not always be legal
- The auditor should ask the management to give in writing, the steps which have been taken and arrive at his opinion only after consideration of the management's representations and other relevant evidence.

CARO – Paragraph 3(iv)

COMPLIANCE WITH THE PROVISIONS OF S185 & 186

UNDERSTANDING THE REQUIREMENT OF CLAUSE

SECTION 185

.....no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person.....

Indirect loan is not defined in section 185 Indirect is interpreted in case of Dr. Freddie Ardeshir Mehta v. UOI to mean a loan to a director through the agency of one or more intermediaries

EXEMPTIONS:

- Loan to MD/WTD as a part of conditions of service / approved by the special resolution
- Loan given in the ordinary course of its business and having interest not less than bank rate declared by RBI
- Subject to the condition that the loan is used by the subsidiary for its principal business activity
 - Loan given by holding company to wholly owned subsidiary company
 - Guarantee or security provide by H Co. for loan taken by wholly owned subsidiary company
 - Guarantee or security provide by H Co. for loan taken from banks or FIS by subsidiary company

CARO – Paragraph 3(iv)

“to any other person in whom the director is interested”

Such Director = Director of the Company or Director of the Holding Company

Director

Other person in whom director is interested

Director of the Company or his partner or his relative

Any body corporate BOD/MD or manager is acting on the advice of company's BOD or any of its director

Director of the HCo or his partner or his relative

Firms in which such director or his relative is a partner

Any body corporate where such director(s) control or exercise >25% of the total voting power in the general meeting

Private company in which such director is a director or member

CARO – Paragraph 3(iv)

UNDERSTANDING THE REQUIREMENT OF CLAUSE

Audit Procedure and reporting

- Obtain from the management the details of the directors or any other person in whom the director is interested. Verify details of the persons covered under this clause from MBP-1 and from the Register maintained u/s 189
- Further examine the details to find out whether any of the transaction is attracting the provisions of section 185
- In case of transactions that are covered under the exceptions as provided under section 185, the auditor should obtain the necessary evidence in support of such exception

The auditor should report the nature of non-compliance, the maximum amount outstanding during the year and the amount outstanding as at the balance sheet date in respect of

- (i) the Directors; and
- (ii) persons in whom directors are interested (specify the relationship with the Director concerned).

CARO – Paragraph 3(iv)

UNDERSTANDING THE REQUIREMENT OF CLAUSE

SECTION 186

- Corresponds to section 372A of Companies Act, 1956
- This section governs activities of giving loans, and guarantee or providing and security in connection with a loan, by a company to any person or other body corporate and acquiring securities of any other body corporate by a company
- Prescribes ceiling limit of sixty per cent of paid-up share capital, free reserves and securities premium account or one hundred per cent of its free reserves and securities premium account, whichever is more for obtaining requisite prior approvals
- The section also prohibits a company from making investments through more than two layers of investment companies
- Exemptions to specified Investment and Infrastructure companies

CARO – Paragraph 3(iv)

UNDERSTANDING THE REQUIREMENT OF CLAUSE

Audit Procedure and reporting

- Obtain the details of, loans given, guarantee given or security provided in connection with a loan and securities acquired of any other body corporate by way of subscription, purchase or otherwise, made during the year as well as the outstanding balances as at the beginning of the year
- Verify ceiling related compliances i.e. 60% or 100% as the case may be
- Verify any investments made through more than two layers of investment companies
- In case subsisting term loan from public financial institution verify prior approval obtained
- Check if the company is in default in the repayment of any deposits/ interest, then the company is not allowed to give any loan or guarantee or any security or an acquisition till such default is subsisting
- Verify rate of interest should not be lower than the prevailing yield of government security closest to the tenor of the loan granted
- Check whether the company has maintained a register (as per MBP-2)
- However the restriction with regard to the investment through more than two layers of investment companies would be applicable for such companies also. The auditor may ensure compliance accordingly.

CARO – Paragraph 3(5)

PUBLIC DEPOSITS

UNDERSTANDING THE REQUIREMENT OF CLAUSE

- S.73 – Acceptance of Deposits from Public – Section 58A of the Companies Act, 1956
- S.74 – Repayment of Deposits
- S.75 – Damages for fraud
- S.76 – Acceptance of deposits from public by certain companies – for Public companies having prescribed net worth or turnover
- To be read with The Companies (Acceptance of Deposits) Rules 2014
- Report on compliance with the order, if any, passed by the Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any other Tribunal

CARO – Paragraph 3(6)

MAINTENANCE OF COST RECORDS

UNDERSTANDING THE REQUIREMENT OF CLAUSE

- Companies (Cost Records and Audit Rules) 2014 has been notified
- Applicable to specified companies with turnover > Rs. 35 crores
- Cost records means details relating to utilisation of materials, labour and other items of cost applicable to production of goods or provision of services
- Detailed examination is not required, only a general review is required

Where the auditor finds that the records have not been written or are not prima facie complete, it will be necessary for the auditor to make a suitable comment in his report.

CARO – Paragraph 3(vii)

REPORTING OF UNDISPUTED / DISPUTED STATUTORY DUES

UNDERSTANDING THE REQUIREMENT OF CLAUSE

COVERAGE

“Regularity” – The scope of auditor’s inquiry is restricted to only those statutory dues, which the company is required to deposit regularly to an authority.

- The auditor is not required to ascertain whether the company is regular in depositing amounts, which may be levied by an appropriate authority from time to time upon occurrence or non-occurrence of certain events and therefore are not required to be paid regularly
- Any sum, which is to be regularly payable under a statute (whether Central, State or Local or Foreign) applicable to the company, should be considered as a “statutory due” for the purpose of this clause

“Disputed” – Where there is a positive evidence or action on the part of the company to show that it has not accepted the demand for payment of tax or duty, e.g., where it has gone into appeal. For this purpose, where an application for rectification of mistake (e.g., under section 154 of the Income Tax Act, 1961) has been made by the company, the amount should be regarded as disputed.

CARO – Paragraph 3(vii)

UNDERSTANDING THE REQUIREMENT OF CLAUSE

- Penalties / Interest levied under respective laws are covered
- Show cause notices / demand set aside
- Demand stayed
- Appeal preferred by the department

Concept of materiality – which is fundamental to the entire auditing process – should be borne in mind while reporting on this clause as in case of other clauses of the Order

Audit Procedure and reporting

- Enquiry with the management on applicability of various status and procedure implemented for its compliance in assessing the completeness
- In case test performed by the auditor recognise that that there could be a situation that a statutory due might have become payable but has not been captured by the accounting and internal control systems – Perform procedures to mitigate risk arising from such a situation
- Reporting of amount paid under protest
- Disputed due of Income tax, Sales Tax, VAT, Service tax, GST, Excise and Custom duty are to be considered
- Summarise the cases stage-wise under each broad head, e.g., sales tax, income-tax, duty of customs, duty of excise, and give the particulars

CARO – Paragraph 3(viii)

REPORTING OF REPAYMENT OF DUES TO FIs, BANK, GOVERNMENT, DEBENTURE HOLDERS

UNDERSTANDING THE REQUIREMENT OF CLAUSE

- All defaults existing at the balance sheet date irrespective of when those defaults have occurred to be considered
- Government includes central, state governments, union territory and its departments. Government companies, PSU, board, authorities, corporation and foreign governments are excluded
- In case of dispute with respect to repayment schedule, existing terms and conditions is to be considered for reporting
- Reschedulement/Restructuring Proposal – Submission of application does not mean no default has happened
- Default of dues to government added
- Lender wise default has to be reported
- For loans from banks/FIs/Government only principal amount has to be considered. For debenture holders both principal and interest outstanding has to be considered

CARO – Paragraph 3(ix)

REPORTING OF END USE OF FUND RAISED BY IPO/FPO/TL

UNDERSTANDING THE REQUIREMENT OF CLAUSE

- Money's raised from issue of all kinds of securities has to be considered
- Since the Order is silent, term loans raised from persons other than bank / FIs is also to be considered
- End use should be verified from the offer documents or from the loan agreement
- Not necessary to establish a one-to-one relationship for reporting under this clause
- Term loan taken at the end of FY – Term loans which although were taken in the previous accounting period but have been actually utilised during the current accounting period should be Considered for reporting
- Temporary investment pending utilisation – Report that the funds were temporarily used for the purpose other than for which they were raised but were ultimately utilised for the stated end-use

CARO – Paragraph 3(x)

FRAUD REPORTING

Fraud by others on the Company has been omitted and only frauds on the company by the officers/employees and fraud by the company is to be reported

UNDERSTANDING THE REQUIREMENT OF CLAUSE

COVERAGE

- This clause is restricted to frauds ‘noticed or reported’ during the year
 - management of the company should have the knowledge about the frauds by the company or on the company by its Officer and employees that have occurred during the period covered by the auditor’s report
 - irrespective of the auditor’s comments under this clause, the auditor is also required to comply with the requirements of Standard on Auditing (SA) 240, “The Auditor’s Responsibility Relating to Fraud in an Audit of Financial Statements”.
- Auditor should refer to the ‘Revised Guidance Note on Reporting on Fraud under Section 143(12) of the Companies Act, 2013’ and ensure that reporting under CARO, 2016 is reconciled with the reporting that they make to the Central Government / the Company
- Rs.1 crore threshold determined for reporting on frauds to the Central Government under S.143(12) may not determine what is material from a CARO standpoint.
- This clause applies to all frauds regardless of whether it has been identified by auditors.

CARO – Paragraph 3(x)

FRAUD REPORTING

WRITTEN REPRESENTATIONS

The auditor should obtain written representations from management that:

- it acknowledges its responsibility for the implementation and operation of accounting and internal control systems that are designed to prevent and detect fraud and error;
- it believes the effects of those uncorrected misstatements in financial statements, aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such items should be included in or attached to the written representation;
- it has
 - disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity; and
 - it has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

CARO – Paragraph 3(xi)

MANAGERIAL REMUNERATION

Whether Managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with schedule V to the Companies Act? If not, state the amount involved and steps taken by the Company for securing refund of the same

UNDERSTANDING THE REQUIREMENT OF CLAUSE

- Applicable to public companies
- “Remuneration” would not include:
 - Sitting fees paid to directors in accordance with the provisions of the Companies Act
 - Remuneration payable to directors for services rendered by him of a professional nature
- Overall limits under section 197 read with schedule V
- “Amount involved” and steps taken by the company for securing refund

Reporting pursuant
to the requirements
of 197(16)

REPORTING

- Payment made to Whole time Director / Managing Director / Manager
- Amount paid/ provided in excess of the limits prescribed
- Amount due for recovery as at Balance Sheet date
- Steps taken to secure the recovery of the amount and Remarks, if any

CARO – Paragraph 3(xii)

NIDHI COMPANY

Whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

UNDERSTANDING THE REQUIREMENT OF CLAUSE

- Nidhi Company is formed for the mutual benefits of its members
- Deposits are taken and lending are done only to the members
- Deposits includes FD, recurring deposits and saving deposits accepted from its members
- “Net-owned fund” as per last balance sheet:
 - Paid up capital
 - (+) Free reserves / (-) Accumulated losses
 - (-) Intangible assets
 - (-) Proceeds from issue of preference shares
- 10% is to be calculated on the deposits outstanding at the close of business on the last working day of the second preceding month

REPORTING

- Shortfall in the required ratio – NOF to Deposit & unencumbered deposit

CARO – Paragraph 3(xiii)

RELATED PARTY TRANSACTIONS AND ITS DISCLOSURES

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

UNDERSTANDING THE REQUIREMENT OF CLAUSE

SECTION 177 – AUDIT COMMITTEE

- Requirement of Audit Committee
 - All listed company
 - Public company – Paid up capital > Rs. 10 crores, OR Turnover > Rs. 100 crores OR outstanding loans/borrowings/ deposits > Rs. 50 crores
 - Approval and subsequent modification of transactions with related parties
 - All transactions with related parties are covered

CARO – Paragraph 3(xiii)

RELATED PARTY TRANSACTIONS AND ITS DISCLOSURES

UNDERSTANDING THE REQUIREMENT OF CLAUSE

SECTION 188 – RELATED PARTY TRANSACTIONS

- applicable to all classes of companies (including private companies)
- envisages the approval of Board of Directors and/or the approval of the shareholders (by way of resolution passed in the general meeting of the company)
 - not required for transactions entered into between a holding company and its wholly owned subsidiary
 - not required in respect of related party transactions entered into by the company in its ordinary course of business and on an arm's length basis
- arm's length transaction
 - transaction between two related parties that is conducted as if they were unrelated i.e. a transaction conducted on such terms and conditions as between a willing buyer and a willing seller who are unrelated and are acting independently of each other and pursuing their own best interest

CARO – Paragraph 3(xiii)

RELATED PARTY TRANSACTIONS AND ITS DISCLOSURES

UNDERSTANDING THE REQUIREMENT OF CLAUSE

- Ordinary course of business – ordinary course of business will cover the usual transactions, customs and practices of a business

Standard on Auditing (SA) 550 Related Parties has listed certain examples of transactions outside the entity's normal course of business

- Complex equity transactions, such as corporate restructurings or acquisitions
- Transactions with offshore entities in jurisdictions with weak corporate laws
- The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged
- Sales transactions with unusually large discounts or returns
- Transactions with circular arrangements, for example, sales with a commitment to repurchase
- Transactions under contracts whose terms are changed before expiry

CARO – Paragraph 3(xiii)

RELATED PARTY TRANSACTIONS AND ITS DISCLOSURES

UNDERSTANDING THE REQUIREMENT OF CLAUSE

SECTION 188 – RELATED PARTY TRANSACTIONS

Specific transactions covered and special resolution limits	
transaction for goods, materials or services directly or through appointment of agent	> 10% of turnover or rupees 100 crores whichever is lower
selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agent	> 10% of net-worth or rupees 100 crores whichever is lower
leasing of property of any kind directly or through appointment of agent	> 10% of turnover or rupees 100 crores whichever is lower
availing or rendering of any services directly or through appointment of agent	> 10% of turnover or rupees 50 crores whichever is lower
related party's appointment to any office or place of profit on the company, its subsidiary company or associate company	> Rs. 2.50 lacs
underwriting the subscription of any securities or derivatives thereof of the company	> 1% of net-worth

ACCOUNTING STANDARD (AS 18)

Related party disclosures as required AS 18 are disclosed in the financial statements

CARO – Paragraph 3(xiv)

PREFERENTIAL ALLOTMENT OR PRIVATE PLACEMENT OF SHARES

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;

UNDERSTANDING THE REQUIREMENT OF CLAUSE

- 'Private placement' and 'preferential Allotment'

- Securities covered

- Temporary parking of funds

CARO – Paragraph 3(15)

NON CASH TRANSACTIONS

Whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with;

UNDERSTANDING THE REQUIREMENT OF CLAUSE

- Auditor to report on whether the company has entered into any non-cash transactions with the directors or any persons connected with such director/s and
- Auditor to report whether the provisions of section 192 of the Act have been complied with

Person connected with the director

- any director of the lending company, or of a company which is its holding company or any partner or relative of any such director
- any firm in which any such director or relative is a partner
- any private company of which any such director is a director or member
- anybody corporate at a general meeting of which not less than twenty five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together
- anybody corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.”

CARO – Paragraph 3(16)

REGISTRATION WITH RBI

Whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained

UNDERSTANDING THE REQUIREMENT OF CLAUSE

- Registration is required when financing activity is a principal activity

- 50-50 test

- Net-owned fund

INTERNAL FINANCIAL CONTROLS
OVER FINANCIAL REPORTING

AUDIT APPROACH



REGULATORY FRAMEWORK – IFC REPORTING

Section 143(3)(i) applicable to Statutory Auditors while reporting

- The auditor's report should also state whether the company has adequate IFC system in place and the operating effectiveness of such controls

Section 134 (5) applicable to Board of Directors' report

- The Directors' Responsibility Statement referred to in clause (c) of subsection (3) shall state that:
- The directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Section 177 – Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include evaluation of internal financial controls and risk management systems.

OVERVIEW
IFC PROCESS



IFC PROCESS

Control Policies and Procedures

- Define controls, policy and procedures
- Develop delegation of Authority
- Review of policies and procedures

Safeguarding of Assets

- Assess Adequacy of protection and use of Assets
- Carry out periodic Physical Verification of Assets

Prevention and Detection of Fraud and Errors

- Implement Anti-Fraud Program
- Carry out fraud Risk Assessment

Accuracy and Completeness of Accounting Records

- Perform an assessment of:
- Entity level controls, Process Level Control, IT Control, Fraud Control

Timely preparation of Reliable Financial Information

- Develop accounting Policy manual
- Develop a robust financial close process with inbuilt control for oversight and monitoring

AUDIT APPROACH – TEST OF CONTROLS PROCESS

Importance of controls

- The auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement.

Testing design effectiveness

- Auditor should test the design effectiveness of controls by determining the company's controls objectives that can effectively prevent or detect errors or fraud that could result in material misstatements in the financial statements.
- Walkthroughs that include these procedures ordinarily are sufficient to evaluate design effectiveness.

Testing operative effectiveness

- Test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively

COMPONENTS OF IFC FRAMEWORK

- Control Environment (Install Entity Level Controls)
- Risk Assessment (Prepare Risk Control Matrix)
- Control Activities (Frame policies and procedures)
- Information system and Communication (IT Controls)
- Monitoring (Testing of controls)



RISK ASSESSMENT

- Entity objectives to enable the identification and assessment of related risks
- Identifies and analyses risk related to the objectives
- Considers the potential for fraud
- Identifies and analyses significant changes that would impact the internal control system

IMPORTANT ASPECTS OF IFC-FR FRAMEWORK

- Establishing a governance framework for implementation,
- managing and monitoring internal controls
- Involvement of Board and audit committee from the beginning
- Formalization of processes, standard operating procedures, workflows and authority matrix
- Segregation of duties and access controls, automation of controls through ERP
- Redeployment of work routines to enable audit trails, evidencing the reviews etc.
- Maker – Checker control or the 4-eye principle
- Regular Systems or IT audit to ensure effectiveness of controls

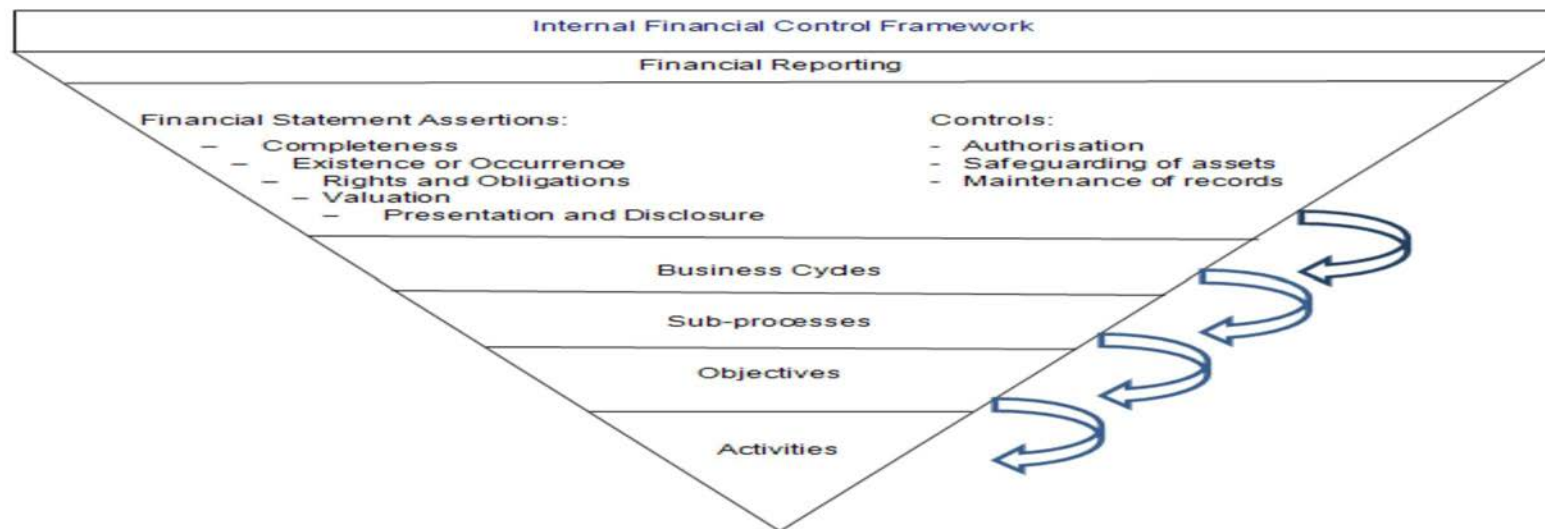


AUDIT OF ICFR INVOLVES

A Top Down Begins at the financial statement level and with the auditor's understanding of the overall risks to internal financial controls over financial reporting.

The auditor then focuses on entity-level controls and works down to significant accounts and disclosures and their relevant assertions.

The auditor then verifies his or her understanding of the risks in the company's processes and selects for testing those controls.



(For illustrative list refer ICAI Guidance Note)

AUDIT APPROACH

- Audit engagement letter
- Understand the business model
- Understand various policies and procedures
- Identify various risks associated at entity level and process level
- Identify significant account balances from the Trail balance / Financial statements (drill down / Top down approach)
- Identify significant disclosure items in the Financial statements
- Identify Significant class of Transactions [SCOT] and its flows (obtain process narrative in respect of those transactions)



AUDIT APPROACH

- Conduct the Walkthrough
- Test the design of the controls (review process narratives)
- Test the controls (based on samples selected)
- Identify the risks associated & controls which address the risk of material misstatement
- Check whether any significant deficiency in control exist?
- Document the results of control testing
- Discuss the findings with the management/ communicate significant deficiencies
- Obtain Management Representation letter
- Report



QUESTIONS





Thank you