CARO, 2015 Notes

CA IPCC & CA Final

FOR NOVEMBER 2015

SIDDHARTH AGARWAL, SSEI

NEW Companies (Auditor's Report) Order, 2015

Applicability of the Order

In exercise of the powers conferred by Section 143(11) of the Companies Act, 2013 and in supersession of the Companies (Auditor's Report) Order, 20O3, the Central Government, after consultation with the Institute of Chartered Accountants of India, hereby makes Companies (Auditor's Report) Order, 20l5.
Every report made by the auditor under section 143 of the Companies Act, on the accounts of every company examined by him to which this Order applies for the financial year commencing on or after 1st April, 2014, shall contain the matters specified in paragraphs 3 and 4.

Companies Covered by the Order

lt shall apply to every company including a foreign company as defined in Section 2(42) of the Companies Act, 2O13.

The Order is also applicable to the audits of branches of a company since a branch auditor has the same duties in respect of audit as the company's auditor. It is, therefore, necessary that the report submitted by the branch auditor contains a statement on all the matters specified in the Order to enable the company's auditor to consider the same while complying with the provisions of the Order.

Companies not Covered by the Order

The Order provides that it shall not apply to:
(1) **Banking company** as defined in Section 5(c) of the Banking Regulation Act, 1949;
(2) **Insurance company** as defined under the Insurance Act,1938;
(3) **Not for Profit Company** licensed to operate **under section 8** of the Companies Act 2013;
(4) **One Person Company** as defined in Section 2(62) of the Companies Act 2013;
(5) **Small company** as defined in Section 2(85) of the Companies Act 2013;
(6) **Private limited company** with a paid up capital and reserves not more than ₹ 50 lacs and which does not have loan outstanding exceeding ₹ 25 lacs from any bank or financial institution and does not have a turnover exceeding ₹ 5 crores at any point of time during the financial year.

The Order exempts from its application a private limited company which fulfils <u>**ALL**</u> the following conditions:
(Cumulative Conditions)
(i) Its paid-up capital and reserves are ≤ ₹ 50 lacs;
(ii) Its outstanding loan are ≤ ₹ 25 lacs from any bank or financial institution; and
(iii) Its turnover is ≤ ₹ 5 crores at any point of time during the financial year.

Matters to Be Included In the Auditor's Report

(Contained in Para 3)

<u>The new CARO contains 12 clauses only which are very similar to the erstwhile CARO.</u>

Clause No.	Details of the clause
1. Fixed Assets	(a) Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets. (b) 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.
2. Inventory	(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. (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.
3. Loan to Related Parties	Whether the company has granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 189 of the Companies Act. If so, (a) Whether receipt of the principal amount and interest are also regular; and (b) If overdue amount is more than ₹ 1 lac, whether reasonable steps have been taken by the company for recovery of the principal and interest.
4. Internal Control	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 failure to correct major weaknesses in internal control system.
5. Deposits	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 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 Company Law Board or 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?
6. Cost Accounting Records	Where maintenance of cost records has been specified by the Central Government under Section 148 (1) of the Companies Act, whether such accounts and records have been made and maintained.
7. Statutory Dues	(a) Is the company regular in depositing undisputed statutory dues including Provident Fund, Employees' State Insurance, Income-Tax, Sales-Tax, Wealth Tax,

Clause No.	Details of the clause
	Service Tax, Duty of Customs, Duty of Excise, Value Added Tax, 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 6 months from the date they became payable, shall be indicated by the auditor. (b) In case dues of Income Tax or Sales Tax or Wealth Tax or Service Tax or Duty of Customs or Duty of Excise or Value Added Tax or Cess have not been deposited on account of any dispute, then the amount involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not constitute a dispute). (c) Whether the amount required to be transferred to Investor Education and Protection Fund in accordance with the relevant provisions of the Companies Act, 1956 (Section 205C of the OLD Act) and rules made thereunder has been transferred to such fund within time.
8. Potentially Sick Company	Whether in case of a company which has been registered for a period not less than 5 years, its accumulated losses at the end of the financial year are not less than 50% of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year.
9. Default in Repayment	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.
10. Guarantee Given	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.
11. Borrowings End Use	Whether term loans were applied for the purpose for which the loans were obtained.
12. Fraud	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.

Reasons to be stated for unfavorable or qualified answers (Contained in Para 4)

(1) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavorable or qualified, the auditor's report shall also state the reasons for such unfavorable or qualified answer, as the case may be.

(2) Where the auditor is unable to express any opinion in answer to a particular question, his report shall indicate such fact together with the reasons why it is not possible for him to give an answer to such question.

Paid-up Capital and Reserves

Paid-Up Share Capital = Equity Share Capital + Preference Share Capital.

Reserves = All Capital Reserves + All Revenue Reserves + Revaluation Reserve – P & L (Dr) Balance

The debit balance of the profit and loss account, if any, should be reduced from the figure of revenue reserves only.

Therefore, if the company does not have revenue reserves, debit balance of profit and loss account cannot be reduced from the figures of paid-up capital, capital reserves and revaluation reserves. For example, if the company has ₹ 40 lakhs of paid up share capital, ₹ 5 lakhs as Revaluation Reserve, ₹ 6 lakhs in Capital Reserve and ₹ 6 lakhs as debit balance in the Profit and Loss Account, the amount of ₹ 6 lakhs standing to the debit of Proft and Loss Account cannot be deducted from the figures of ₹ 11 lakhs, being the total of the Revaluation Reserve and the Capital Reserve.

While calculating the paid-up capital, amount of calls unpaid should be deducted from and the amount originally paid-up on forfeited shares should be added to the figure of paid-up capital. Share application money received should not be considered as part of the paid-up capital.

However, miscellaneous expenditure to the extent not written off should not be deducted from the figure of reserves for the purpose of computing the above limit.

Loan Outstanding

(a) Loans from banks or financial institutions are normally in the form of term loans whether long term or short term, demand loans, export credits, working capital limits, cash credits, overdraft facilities, bills purchased or discounted. Outstanding balances of such loans should be considered as loan outstanding for the purpose of computing the limit of ` 25 lakhs.

(b) Non-fund based credit facilities, to the extent such facilities have devolved and have been converted into fund-based credit facilities, should also be considered as outstanding loan.

(c) Example: The figures of outstanding loan would also include the amount of bank guarantees issued by the company where such guarantee(s) has (have) been invoked and encashed or where, say, a Letter of Credit has devolved on the company.

(d) In case of term loans, interest accrued and due is considered as a loan whereas interest accrued but not due is not considered as a loan.

(e) It is clarified that since the words used by the Order are 'any bank or financial institution', the limit of "exceeding 25 lakh `" would apply in aggregate to all loans and not with reference to each bank or financial institution. For example, if a private limited company has 3 outstanding loans of ` nine lakhs each from two banks and a financial institution, the Order would be applicable to such a private limited company.

(f) Another important point to note with respect to loans outstanding is that even in case where the company had taken a loan from a bank in excess of ` 25 lacs but the yearend balance of the same is NIL, the company would be covered by the Order notwithstanding that it fulfills all other conditions for exemption from the Order.

Turnover

It may be noted that the "sales effected" would include sale of goods as well as services rendered by the company. For ascertaining the limit of ₹ 5 crores:

(1) Sales tax collected or excise duty collected should **not** be taken into account if they are credited separately to sales tax account or excise duty account;

(2) Sales returns should be deducted from the figure of turnover even if the returns are from the sales made in the earlier years. As a corollary, any sales returns etc., in respect of the sales made during the year under report, if received after the end of that year, would not be deductible from the figure of turnover of such year; and

(3) The income received by way of rent or dividend/interest would **not** form part of "turnover". In cases where the principal business of the company is letting out of property of the company or it is an investment company, the rent or dividend/interest, respectively, would constitute "turnover".

What is the definition of Small Company under the Companies Act, 2013?

Sec 2(85) of the Companies Act, 2013 defines a small company. As present, It is a private company whose paid-up share capital does not exceed ₹ 50 lacs and turnover as per its last profit and loss account does not exceed ₹ 2 crores

Provided that nothing aforesaid shall apply to (A) a holding company or a subsidiary company; (B) a company registered under section 8; or (C) a company or body corporate governed by any special Act;

Will CARO be applicable to a small company which has a loan outstanding exceeding 25 lacs from any bank or financial institution?

Small Companies are generally exempted from the applicability of CARO, 2015. As an accepted view, it shall not attract the applicability of CARO, so long as it remains a small company as defined under Section 2(85) of the Companies Act, 2013, even though

Can the applicability of CARO 2015 be illustrated through some examples?

Sr. No.	Example	Whether it is SMALL Company?	Whether the Trilogy limit of 50lac, 25lac and 5crore within limit?	Applicability
1	Public company (irrespective of size of its paid up capital, reserves & turnover)	Not Applicable	Not Applicable	CARO applicable.
2	Private company having paid up capital of ₹ 25 lacs, Reserves of ₹ 50 lacs and Turnover of ₹ 1 Crores	Yes it is a Small Company	No, PUSC + Reserves is 75 lacs which is more than limit of 50 lacs.	CARO not applicable because it is a Small company
3	Private company having paid up capital of Rs 51 lacs with no Reserves and Turnover	Not a small company	No, PUSC + Reserves is 51 lacs which is more than limit of 50 lacs.	Yes CARO applicable
4	Private Company (a subsidiary of public company) having paid up capital of Rs 25 lacs with no Reserves and Turnover	Deemed to be a Public Company. Is not a Small Company too.	Not applicable	Yes CARO applicable
5	Private Company having Paid up Capital of Rs 25 lacs with Reserves of Rs 1 Crores and Turnover of Rs 2 Crores	Yes it is a Small Company	No, PUSC + Reserves is 1.25 crores which is more than limit of 50 lacs.	CARO not applicable because it is a Small company
6	Private Company having Paid up Capital of Rs 25 lacs with Reserves of Rs 26 lacs and Turnover of Rs 3 Crores	Not a small company	No, PUSC + Reserves is 51 lacs which is more than limit of 50 lacs.	Yes CARO applicable

Sr. No.	Example	Whether it is SMALL Company?	Whether the Trilogy limit of 50lac, 25lac and 5crore within limit?	Applicability
7	Private Company which is a holding company having paid up capital of Rs 25 lacs, Reserves of Rs 26 lacs and turnover of not more than Rs 2 crores	Not a Small Company u/s 2(85)	No, PUSC + Reserves is 51 lacs which is more than limit of 50 lacs.	Yes CARO applicable
8	Private Company which is a subsidiary company having paid up capital & reserves of Rs 20 lacs each and turnover of Rs 50 lacs, outstanding loan of Rs 24 lacs from a bank	Not a Small Company u/s 2(85)	Yes, all limits within Threshold.	CARO not applicable because it is not a Small company and all the limits are within the threshold