

## Compliance under Companies Act 2013 vis-a-vis CARO 2020 and related Audit procedures



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This article primarily intended to highlight the Compliance requirement of CA 2013 ("CA 2013") with respect to CARO 2020 and the related audit procedures to be carried out during the course of Audit.

Lets discuss on some of the important Clauses as below:

### 1. Clause iv: Compliance with section 185 & 186 of CA 2013

#### Provisions as per CA 2013:

Section 185 of CA 2013 deals with prohibitions, relaxations & exemptions on the part of companies towards lending of loans, providing security & guarantees to the directors of such a company or any other person in whom the directors are interested.

Section 185 states that,

- A company cannot advance loans to its directors, relatives or partners or firm in which a director is a relative or a partner. Any security or guarantee with connection to such loans can also not be provided to them.
- However, loans, guarantees or security can be given to the person in whom the director of the company is interested provided a resolution is passed in the general meeting.

Only the persons & entities mentioned in section 185(2) are considered as persons in whom the director of the company is interested. Hence, the company is required to check if the persons to whom they want to grant loans comes under the list of persons mentioned in section 185(3) of CA 2013.

Further, Section 186 of the CA 2013 provides for the loans & investments that can be made by a company. It states that a company cannot make investments through more than two layers of investment companies.

It also states that a company cannot directly or indirectly:

- Give loan to any person or body person,
- Give any security or provide a guarantee in connection with a loan to any other person or body corporate, & acquire by way of purchase, subscription or otherwise, the securities of any other body corporate exceeding 60% of its paid-up share capital, free reserves & securities premium account or 100% of its free reserves & securities premium account, whichever is more.

**Provisions as per CARO 2020 - Clause iv:**

According to CARO 2020, clause (iv), the Auditor needs to report, if the company has given any loan to directors or any other person in whom the director is interested, or made any investments, whether the company has complied with the provisions governing such loans, investments & guarantees.

**Audit Procedures**

- a. Scrutiny of Financial Statements for identifying whether company has granted any loans or advances to the Directors.
- b. Where company has granted loans or advances, inquire with management, scrutiny of agreement for identifying the purpose of loan or advances.
- c. Obtaining copy of special resolution wherever required as per the requirement of Section 185 of CA 2013.
- d. Check whether the Rate of Interest at which the loan is granted is equivalent to the Rate of Interest on GOI security of closest tenure.
- e. In case of loans, investment or guarantee covered U/s 186 of the CA 2013, obtaining Board resolution, passed by a unanimous vote, special resolution (in case limits are exceeded) & approval of Bank/PFI in case of term loan taken from them (in case limits exceeded or default made by company).

**2. Clause v: Deposits****Provisions as per CA 2013:**

Provisions U/s 73 to 76 of the CA 2013 & the Companies Acceptance of Deposits Rules, 2014 shall apply to all companies except:

- Banking Companies
- NBFCs registered with RBI
- Notified companies, by central Government after consultation with RBI

A Company can accept the deposits from members as well as from public in accordance to section 73 to 76 of CA 2013. However only eligible companies are permitted to accept deposit from the public, in addition to their members.

**Maximum Amount of Deposits:**

An eligible company is permitted to accept or renew deposits as under:

- **From its members:**

The amount of such deposit together with outstanding deposits from the members as on the date of acceptance or renewal can be maximum 10% of the aggregate of its paid-up share capital, free reserves & securities premium account.

- **From persons other than its members:**

The amount of such deposit together with outstanding deposits (excluding deposits from

members) as on the date of acceptance or renewal can be maximum 25% of the aggregate of its paid-up share capital, free reserves & securities premium account.

- **Eligible Government Company:**

Such company is permitted to accept or renew any deposit together with the amount of other outstanding deposits as on the date of acceptance or renewal maximum up to 35% of the aggregate of its paid-up share capital, free reserves & securities premium account.

**Provisions as per CARO 2020 - Clause v:**

According to CARO 2020, clause (v), the Auditor needs to report in case the company has accepted deposits or deemed deposits,

- Whether the company has followed the directives of the RBI
- Compliance with the provisions prescribed for accepting deposits U/s 73 to 76 of CA 2013.
- The nature of contraventions, if the above provisions are not followed.
- Compliance with any order passed by any court or tribunal.
- Reporting of any non-compliance with the provisions of CA 2013.

**Audit Procedures**

- a. Checking whether company is eligible for accepting deposits as per the criteria specified U/s 73 of the CA 2013.
- b. Obtaining copy of resolution passed by the members at the General meeting (wherever required).
- c. Checking whether deposits accepted are within the limits specified U/s 73 of the CA 2013.
- d. Checking compliance of company with the payment of interest & repayment of deposit as & when due & in case of default, disclosure of the same.
- e. Where the depositors have filed an appeal to the Tribunal, obtaining copy of the order & checking whether order of tribunal has been complied with.
- f. Checking balance in deposit repayment reserve account, whether 20% of the maturing amount of deposits kept in the scheduled bank account.

**3. Clause vi: Cost Records**

**Provisions as per CA 2013:**

Section 148 of the CA 2013 contains provisions relating to the cost records to be maintained & cost audit applicability under the Companies Act.

The maintenance of Cost record are mandatory if the following conditions are satisfied –

1. The company is engaged in manufacturing goods or provision of services which are listed in Table A or Table B as below:

- a) Table A specified goods/ services –
    - i. Overall annual total turnover of the company from all the products/ services is INR 50 crores or more; &
    - ii. Aggregate turnover from the individual product/ services for which cost records are required to be maintained is INR 25 crores or more.
  - b) Table B specified goods/ services –
    - iii. Overall total turnover of all the products/ services should be INR 100 crores or more; &
    - iv. Aggregate turnover from the individual product/ service for which cost records are required to be maintained is INR 35 crores or more.
2. Total aggregate turnover of the company from all its production or service is more than INR 35 crore in the preceding financial year.

#### **Provisions as per CARO 2020 - Clause vi:**

If company satisfies the conditions & is required to maintain the cost records, the Auditor shall report whether the cost records have been maintained during the year & non-compliance, if any under clause (vi) of CARO 2020,

#### **Audit Procedures**

- a. Checking turnover of the company from the signed Financial Statements of previous year to check whether company is required to maintain cost records.
- b. If yes, whether cost records are maintained in FORM CRA-1.
- c. Checking whether company is required to get its cost records audited as per section 148 of CA 2013.
- d. Obtaining copy of Cost Auditors report for identifying any adverse remarks in their report.

#### **4. Clause xi: Fraud Reporting**

##### **Provisions as per CA 2013:**

Section 143(12) of the CA 2013 provides that if an auditor of a company, in the course of the performance of his duties as auditor, has reasons to believe that an offence involving fraud is being or has been committed against the company by officers or any employee of the company, he shall report the matter to the Central Government immediately within such time & in such manner as may be prescribed in the CA 2013.

The auditor will have to report any fraud by the company or any fraud on the company with the nature of fraud & amount involved. Any report under subsection (12) of section 143 of Companies Act has been filed by the auditors in Form ADT – 4 as prescribed under rule 13 of Companies (Audits & Auditors) Rules, 2014 with the Central Government has to be reported by the auditor.

##### **Provisions as per CARO 2020 - Clause xi:**

The auditor should report under clause (xi) of CARO 2020, whether there has been any fraud done on the company. If any such fraud has been noticed or reported any time of the year. If yes, nature & amount

involved have to be reported. Whether the auditors of the company have filed a report in Form ADT-4 with the Central Government as prescribed under the Companies (Audit & Auditors) Rules, 2014. In case of receipt of whistle-blower complaints, whether the complaints have been considered by the auditor.

Reporting the whistle-blower complaints is an additional responsibility for auditors which was not there in CARO 2016.

### **Audit Procedures**

- a. Obtaining reports of Internal auditor, cost auditor, secretarial auditor, or report by any other institute for identifying any instance of fraud on the company or by the company, reported therein.
- b. In case of any fraud identified by the auditor, checking the requirements of section 143(12) of the companies for the reporting of the fraud to the Central Govt.
- c. Obtaining reasons & clarification from the Board/ Audit committee regarding the nature, amount & parties involved.
- d. Checking whether the same is disclosed in the Board Report.
- e. Where the company is required to establish vigil mechanism, checking management's action on the whistleblower complaints received.

### **5. Clause xiii: Related Party Transactions**

#### **Provisions as per CA 2013:**

Section 188 of CA 2013 is about related party transactions & the same is applicable to both Private & Public limited company. A Company shall disclose all related parties & related party transactions, in their Financial Statements, whether the same is at arms-length price or not. The party need not be a related party at the ended of the year or during the whole year, it can be a related party any given point of the financial year.

Important pointers to be noted in a related party transaction

- If the transaction is in the ordinary course of business & done on an arm's length basis it shall not require the approval of the board of directors or the company.
- No member shall vote in the special resolution if such member is a related party.
- Details of every contract entered into shall find a reference in the board's report along with justification about the same.
- Ratification of the transaction may be done by the Board or the shareholders within three months. If the same is not done, then the contract is voidable at the option of the board.
- If the contract is with anyone related to the director or is authorized by any other director, the directors concerned shall make good to the company for losses if any caused by the company.

#### **Provisions as per CARO 2020 - Clause xiii:**

Auditor shall report under clause (xiii) of CARO 2020, whether all transactions with related parties are in compliance with section 188 of CA 2013 where applicable & whether the details have been disclosed in the Financial Statements, etc., as required by the applicable Accounting Standards.

**Audit Procedures**

- a. Checking signed Financial Statements of previous year for requirement of establishing audit committee.
- b. Where audit committee is established, whether requisite no. of directors & composition is present.
- c. Scrutiny of Financial Statements for identifying transactions with Related Parties. Inquiry of management of its method of identifying related party transactions.
- d. Checking audit committee minutes for approval of audit committee for entering into transaction with the related parties.
- e. Obtaining copy of board resolutions passed.
- f. Where the transaction carried out exceeds the threshold limit specified U/s 188 of the CA 2013, checking whether approval of members via a resolution is taken & obtaining a copy thereof.
- g. Comparing transaction entered with such related parties, vis-a-vis transaction carried out with other parties to check whether the same is at Arm's length price. In case there are no transaction entered with other parties, alternate procedures needs to be performed.

**6. Clause xv: Transaction with Directors****Provisions as per CA 2013:**

Section 192 of CA 2013 states restriction on entering in a non-cash transactions involving the directors or their relatives.

A company shall not enter in to any arrangement by which director of the company or its holding company or any person connected with him can acquire assets for consideration other than cash from the company & vice versa without the approval of the Company in General meeting.

Where the director or connected person is a director of its holding company, the resolution from holding company will also be required.

**Provisions as per CARO 2020 - Clause xv:**

Auditor shall report under clause (xv) of CARO 2020, whether the company has entered into any non-cash transactions with directors or persons connected with him & if so, whether the provisions of section 192 of CA 2013 have been complied with.

**Audit Procedures**

- a. Obtaining copy of resolution passed for entering into non-cash transaction with the directors by the company as specified U/s 192 of the CA 2013.
- b. In case such transaction involves transfer, purchase, or sale etc. of assets, obtaining report of registered valuer & checking whether the same value is mentioned in the notice of approval.

