# CHALLENGES AND PRECAUTION IN PREPARATION OF STATUTORY AUDIT REPORT WHILE DEALING WITH LOANS/BORROWINGS UNDER COMPANIES ACT 2013 AND UNDER CARO 2020

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The audit of liabilities is primarily directed at ensuring that all known liabilities have been properly accounted for since material omission or misstatement of liabilities vitiates the true and fair view of the financial statements.

One may adopt the following checklist for Audit of Loans & Borrowings:

**1.** Whether the following aspects of internal control relating to loans and borrowings properly reviewed?

**a)** the borrowing powers and limits;

**b)** persons authorized and competent to borrow;

**c)** terms of borrowings;

**d)** procedure for ensuring compliance with relevant legal requirements/internal regulations

**e)** Any variations in the terms of loans and borrowings are truly approved/ratified in writing by the competent authority

**f)** Security offered against loans and borrowings is properly recorded and periodically reviewed

**g)** The records and documents are kept in proper custody and reviewed periodically

**h)** The system brings out all cases of non-compliance with terms and conditions including amounts of principal and/or interest that have become overdue

**i)** Confirmation of balances is obtained at periodic intervals and the discrepancies, if any, are duly investigated and reconciled

**j)** There is a proper procedure for year-end valuation of loans and borrowings, especially for those designated in foreign currencies

**2.** Whether the loans obtained within the borrowing powers of the entity?

Section 179 provides power to the Board of Directors to exercise all such powers, and to do all such acts and things, as the Company is authorized to exercise and do and also gives prescribed powers which any general meeting of the Company cannot invalidated the prior act of the Board.

Whereas Section 180 provides restrictions on the Powers of the Board and the transactions given in this Section are only valid with the consent of the company by a special resolution. Form MGT – 14 has to be filed with the ROC.

In case of private Company this section shall not apply.

However, the special resolution passed by the Company in the General meeting shall specify the total amount up to which monies may be borrowed by the Board of Directors.

**3**. Review of operations:

Any transaction susceptible of fraud to be directly reported to the RBI by auditors

Auditor to scrutinize bank statements, account transfers, cheque returns, withdrawals/deposits of cash, turnover in account, transfers to sister concerns (diversion of funds) etc.

Auditor should compare movement of stock and book debts month-on-month with turnover in account. Compare it with audited/unaudited accounts. Book Debt statement should be certified by a CA on quarterly basis.

## Borrowings under CARO 2020

### Introduction:

The Central Government, in exercise of the powers conferred, under sub-section (11) of section 143 of the Companies Act, 2013 (Act), issued the Companies (Auditor's Report) Order, 2020, (CARO 2020/Order) vide Order number S.O. 849(E) dated 25th February 2020 and was subsequently amended vide number S.O. 1219 (E) dated 24th March 2020, and was again amended vide number S.O. 4588 (E) dated 17th December 2020 to be finally applicable from 1st April 2021)

CARO 2020 has included additional reporting requirements after consultations with the National Financial Reporting Authority (NFRA). NFRA is an independent regulatory body constituted under section 132 of the Companies Act, 2013, for regulating the audit and accounting profession in India. The aim of CARO 2020 is to enhance the overall quality of reporting by the company auditors

### Clauses dealing with Borrowings

**Clause 3(ix)(a)**

*Whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, certain details to be reported.[Paragraph 3(ix)(a)]*

Minor addition made "or in the payment of interest thereon"

Borrowings do not include public deposits as the reporting on public deposits is covered by clause 3(v) of the Order. Even preference share capital should not be considered as borrowings

The format prescribed by this clause also requires reporting on default in repayment of loans or other borrowings taken from the Government and / or interest thereon. The term "Government" means the Central Government, a State Government and its departments and a Union Territory and its departments but does not include Government Company Public Sector Undertaking, Boards, Authority, Corporation and Foreign Government.

The auditor should obtain the confirmation of the concerned lender as to the status of the loan account including the overdue position as at the balance sheet date.

Cases where the company might have submitted application for reschedulement/restructuring proposals to the lenders, which may be in different stages of processing. Submission of application for reschedulement/restructuring does not mean that no default has occurred. Accordingly, in such situations also the auditor should report the period of default and the amount of default. Where reschedulement of loan has been approved subsequent to the balance sheet date, the auditor should report the defaults during the year. However, he may mention this fact in the remarks column.

*Where the company has adequate balance in its current account on the due date of repayment of loan or payment of interest, but such date is either a public holiday or a bank holiday.*

If debited next day the auditor should not consider the same as default.

The auditor may come across a situation where there may be disputes between the company and the lender on certain issues relating to repayments. In such situations, the auditor should consider the prevailing terms and conditions only. However, he may give a brief nature of the dispute while reporting under this clause.

*What if loans/borrowings and/ or interest are repayable on demand and no repayment terms have been specified in the agreement.*

Obtain a management representation letter confirming that such loans/ borrowings and/ or interest have not been demanded for repayment. The auditor should mention the same in the audit report.

*Whether the company is a declared wilful defaulter by any bank or financial institution or other lender; [Paragraph 3(ix)(b)] New Clause.*

The term 'lender' appearing in the RBI Circular covers all banks/financial institutions to which any amount is due, provided it is arising on account of any banking transaction, including off balance sheet transactions such as derivatives, guarantee and letter of credit.

The auditor is required to report whether the company has been declared as a wilful defaulter by any bank or financial institution or any other lender – restricted to the relevant financial year under audit till the date of audit report. Government or government authorities by virtue of their powers, may be in a position to declare any borrower as a wilful defaulter. Refer to Master Circular of RBI dated July1, 2014 as updated from time to time.

1. Unit has defaulted in meeting its payment / repayment obligations to the lender even when it has the capacity to Honour the said obligations.

2. The unit has defaulted in meeting its payment / repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes

3 The unit has defaulted in meeting its payment / repayment obligations to the lender and has siphoned off the funds

4. The unit has defaulted in meeting its payment / repayment obligations to the lender and has also disposed off or removed the movable or immovable property given by him or it for the purpose of securing a term loan without the knowledge of the bank/lender.

**Clause 3(ix)(c) New Clause**

*Whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported; [Paragraph 3(ix)(c)]*

This clause is applicable to "term loan" -have a fixed or pre-determined repayment schedule. In the common parlance period beyond 36 months are usually known as term loans.

Cash credit, overdraft and call money accounts/deposits are therefore not covered by the expression "Term Loans".

**Clause 3 (ix)(d)**

*Whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated; [Paragraph 3(ix)(d)]*

Investing money from overdraft facilities in long-term investments in shares of subsidiaries/associates/joint ventures or investing money raised from public deposits due for repayment in three years in a project whose pay-back period is ten years. Ideal management of funds borrowed – short term or short term usage and long term borrowing for long term usage If funds raised for short term is used for long term it is not a prudent policy.

It is clarified that current maturities of long-term loans which are included as current liabilities as per Schedule III to the Act, are to be treated as long term sources of funds for the purpose of reporting under this clause

Long term applications of funds include investment in property, plant & equipment, intangible assets, long-term investments in shares, debentures and other securities and other assets of similar nature, repayment of long-term loans and advances or redemption of long-term debt or securities, etc. Application of funds which is not long-term may be categorized as short-term application.

If Loan Term Investment is < Long Term Fund it is an indication that short-term funds have been used to finance the long-term assets of the company Current Ration less than 1 is also an indication that short term funds have been used to finance long-term assets of the company.

The reporting under this clause may be as follows: According to the information and explanations given to us, and the procedures performed by us, and on an overall examination of the financial statements of the company, we report that no funds raised on short-term basis have been used for long-term purposes by the company. An example of unfavourable reporting under this clause is as follows: According to the information and explanations given to us, and the procedures performed by us, and on an overall examination of the financial statements of the company, we report that the company has used funds raised on short-term basis aggregating to Rs. X crores for long-term purposes.

**Clause 3(ix)(e)] New Clause**

*Whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case; [Paragraph 3(ix)(e)]*

Funds will include both long term and short-term funds Reporting under this clause would normally be required when the company has taken any funds from any entity or any person and has also granted loans or advances in the nature of loans to its subsidiaries, associate companies or joint ventures or has made further investments in such subsidiaries, joint ventures, or associate companies.

The auditor needs to consider new loans or advances given during the year, meeting the obligations of subsidiaries, joint ventures, or associate companies during the year and new investments (equity or debt investment) made during the year for the purpose of reporting under this clause. Therefore, if there are no such transactions during the year, the auditor may conclude that the company has not taken any funds from any such entities.

The Act or the Order does not define the word "obligation".- in normal parlance, obligation means a debt security (such as a mortgage or corporate bond) or a commitment to pay a particular sum of money. Obligation of subsidiary, joint venture or associate would mean the amounts that such subsidiaries, joint venture or associate companies are required to pay themselves either to their vendors, lenders, employees, or statutory authorities. When a company pays these amounts on behalf of its subsidiaries, joint ventures or associate companies, the amount so paid is generally treated as an asset either as loan, advance, or other current/ non-current assets in the financial statements of the company.

It is possible that the financial statements of subsidiaries, joint ventures, and associates are audited by another auditor. In such cases, the principal auditor may consider seeking specific information from the auditors of the components in accordance with the guidance given in SA 600, "Using the Work of Another Auditor" and Guidance Note on Audit of Consolidated Financial Statements to enable him to report under this clause.

**Clause 3(ix)(f)**

*Whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised; [Paragraph 3(ix)(f)]*

If yes, give details of such loans; and Report if the company has defaulted in repayment of such loans raised. –Yes or No – nothing else

As the defaults are in any case required to be reported under clause 3(ix)(a) for all lenders. All loans taken during the year even if these have been repaid during the year. Further, reporting is required only in case of loans taken during the year, Loans taken in earlier years and outstanding as at the balance sheet date need not be reported. Default will include both repayment of principal and payment of interest. Covers cases where the securities have been evoked.

Verify the form CHG 1 and CHG 4 lodged with the ROC \ MCA while creating and releasing the charge.

The reporting under this clause may be as follows: According to the information and explanations given to us and procedures performed by us, we report that the company has not raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies.

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