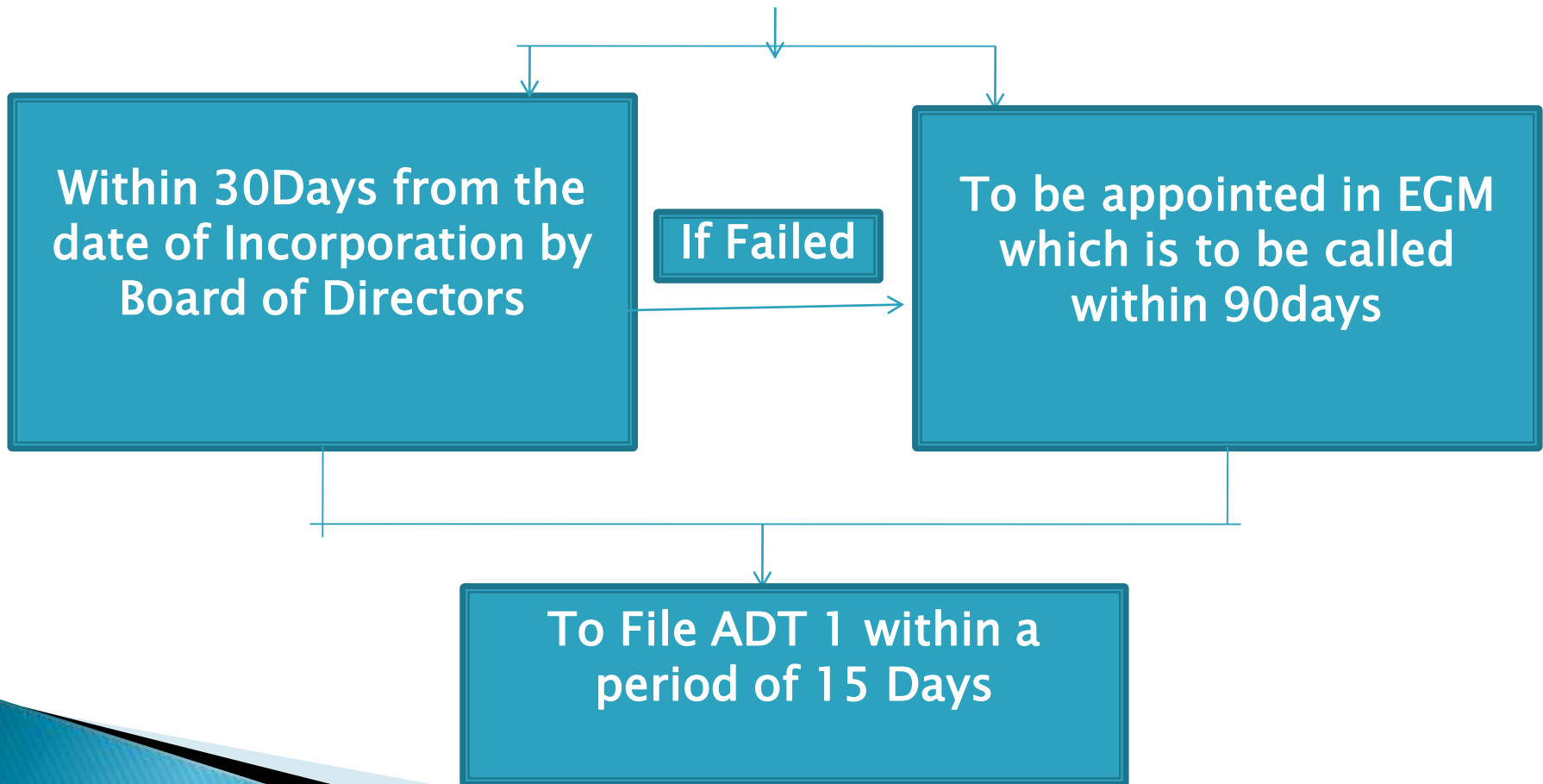


PRACTICAL ISSUES IN AUDIT OF PRIVATE LIMITED COMPANIES

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APPOINTMENT AS AUDITORS

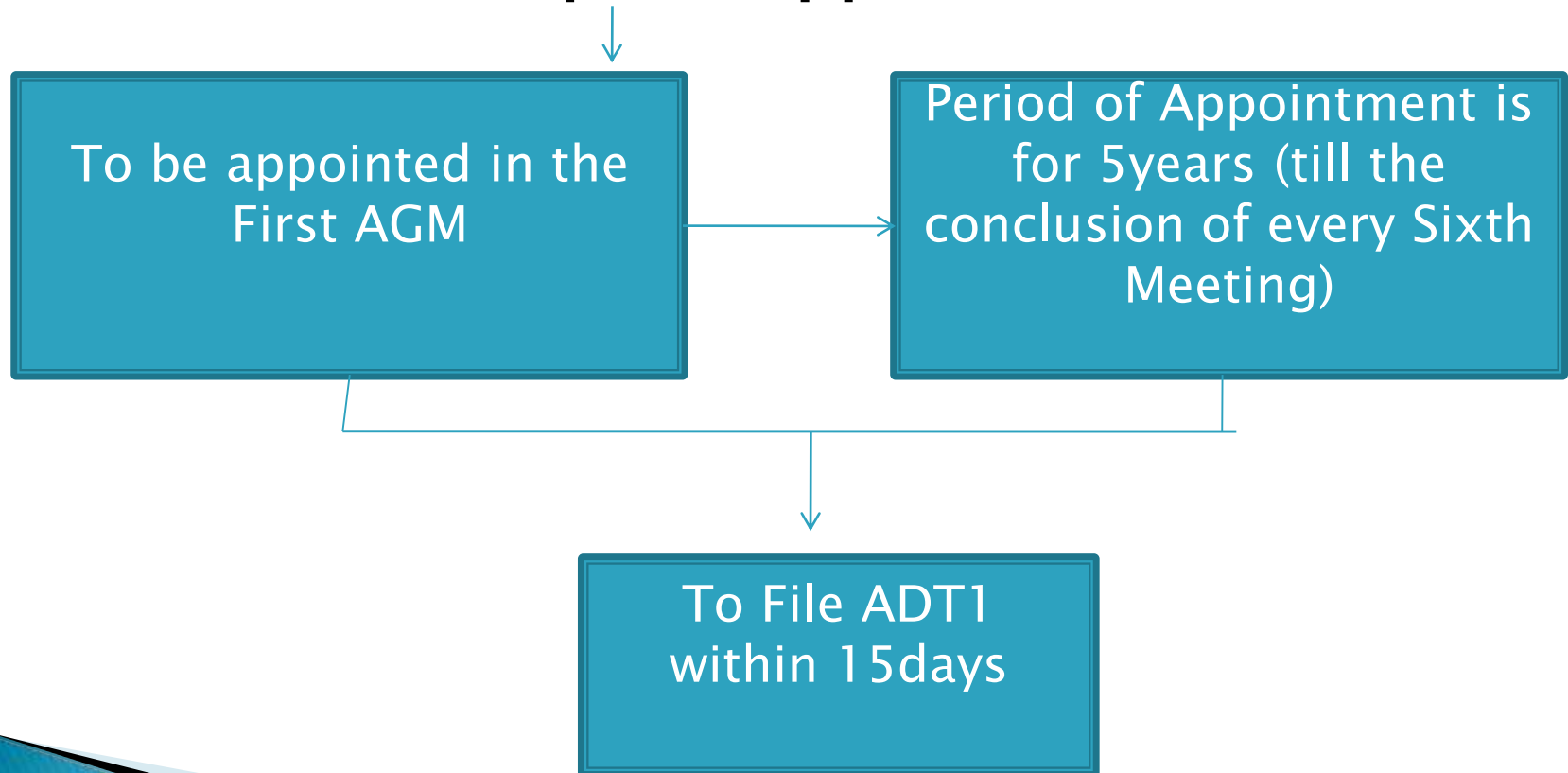
First Auditor [First Appointment]



Issues:

How to regularize, if it is not done before any specified Dates?

Subsequent Appointment



Issues:

Failure to reappoint.

Appointment for casual Vacancy

In case of Death

By the Board of Directors
within 30Days

In Case of Registration

Appointed at EGM to be
convened within 3 Months
of the recommendation of
the Board.

Note:

1. In case of Resignation, auditor should file ADT3 within a period of 30 Days from the date of Resignation.
2. In case of non-compliance, the resigning auditor has to pay
 - a) Penalty of Rs.50,000/- or an amount equal to the remuneration of auditor

b) In case of continuous failure, a further penalty of Rs.500/- each day after the first during which the failure continues, subject to a maximum of Rs.2Lakhs.

Issues in Resignation:

1. Stating genuine / Bonafide reason
2. Communicating to the management of the company
3. Incoming auditor should get NOC

Issues in Resignation:

4. The Resigning auditor should share with the incoming auditor the resignation letter and the reasons for resignation.
5. It is important to note that CARO 2020 has introduced a new reporting requirement related to resignation of Statutory Auditors.

REMOVAL OF AUDITORS:

1. Only by way of a special resolution of the company
2. Previous approval of the Central Government is required in the prescribed manner.
3. The Concerned auditor is required to be given a reasonable opportunity of being heard

Important post – Appointment formalities

- ▶ Documentation of KYC [Know your Client(Requirement of code of ethics)]
- ▶ Engagement Letter issued by firm/auditor counter signed by client(Requirement of SA 210)
- ▶ Independence confidentiality declaration by all firm members (requirement of SQC1)

Rotation of Auditors:

1. Rotation is applicable for
 - (I) All Listed Companies;
 - (II) All Unlisted Public companies having paid up share capital of Rupees Ten Crore or more
 - (III) All Private Limited companies having paid up share capital of Rupees Fifty Crore or more;

IV) All companies having paid up share capital of below threshold limit mentioned in point(i) and (ii) above , but having public borrowings from Financial Institutions, Banks or Public Deposits of Rupees Fifty Crores or more

2. It is not applicable to One person company or Small company

3. Period of Rotation is

- ▶ **Individuals** – Cannot be appointed as an auditor for a term of more than 5 years
- ▶ **Firms** – Cannot be appointed as an auditors for more than two terms of 5 years each.

ISSUES:

By oversight existing auditor will continue

Verification of Opening Balances:

ISSUES:

1. Inventory opening balance.
2. Wrong grouping of Sundry debtors and creditors.
3. Considering Predecessor auditor opinion .
4. Balances which materially affect the current's year's financial statements
5. Reporting of modified opinion (or) Qualified opinion (or) Disclaimer of Opinion

Audit of Share Capital:

ISSUES:

1. Increase in Authorised capital
(Alteration of MOA/ AOA– Adequate fee and stamp duty payable)
2. **Issues of Fresh shares**
 - a) Section 62(1)(a)– To be complied with
 - b) Valuation to be taken care
 - c) In case of Private placement Section 42 is to be complied with

3. Right shares Vs Private placement:

Private placement comes under Rule 13 of Companies (Share Capital and Debentures) Rule 2014. Rule 13(2)(d)(iv) requires registered value report for share issue price.

4. Form SH7 and PAS3 to be obtained and verified

5. Form FC– GPR (Foreign currency – Gross provisional return)

6. The premium on issue of shares is to be treated as capital receipt and credited to securities premium account.
7. Such Share premium amount is to be applied only for the purpose prescribed in section 52(2)

Shares Issued at Discount:

As per section 53 of the companies act, 2013 a company shall not issue shares at a discount except as provided in section 54 for issue of sweat equity shares

Buy Back of shares:

1. Auditor should verify the compliance of section 68 to 70.
2. Sources for buyback:
 - ▶ Free reserve
 - ▶ Securities premium account
 - ▶ Proceeds of fresh issue of any shares



Buy Back of shares:

3. Authorisation for Quantum of buyback:

(a) Up to 10% of paid up capital and free reserves by the Board of Directors.

(b) Up to 25% of the paid up capital and free reserves by a Special resolution at a General meeting.



AUDIT OF BORROWINGS:-

1. Classification to be given importance

(a) On the basis of Security < Secured

< Unsecured

(i) Secured – By Company's Properties only

(ii) Unsecured – All others

(b) On the basis of tenure of repayment

(i) Long Term – Repayable after 12 months.

(ii) Short Term – Repayable within 12 months

Including current maturity of
Long Term Debt.

AUDIT OF BORROWINGS:-

- c) Disclosure about Security.
- d) Guarantee given by Directors.
- 2. Loan Sanction Letter to be carefully scrutinised.
- 3. Balance confirmation to be obtained.
- 4. Registration of charges to be verified with Register of charge (Form CHG7) Due importance to be given to satisfaction of charges.

AUDIT OF BORROWINGS:-

5. In case of ECB, FEMA guidelines to be seen. Auditor should verify the transaction of Foreign Currency borrowings by verifying the exchange rates used. Further the auditor should ensure that any resulting gain or loss has been dealt with according to AS 11.

6. CARO Reporting – Purpose of the loan and its utilisation – Short Term Vs Long Term.

7. Issues in Disclosures.

(a) Security Details

(b) Particulars about Default

8. Directors' Loan – Filing of DPT3.

9. Loan from shareholders Section 73(2)(a) to (e)

Maximum Limit:

- ▶ A private company may accept from its members monies not exceeding One hundred percent of aggregate of the paid up share capital, free reserves and securities premium account.

Exemption from Maximum Limit:

The maximum limit in respect of deposits to be accepted from members shall not apply to following classes of private companies, namely:-

(i) A private company which is a start - up, for ten years from the date of its incorporation;

(ii) A private company which fulfils all of the following conditions, namely:-

Exemption from Maximum Limit:

(a) Which is not an associate or a subsidiary company of any other company;

(b) The borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or Fifty crore rupees, Whichever is less and

(c) Such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under section 73.

However company has to file DPT 3 in respect of deposits.

Audit of Trade Payables

1. MSME Creditors

(a) KYC Process

(b) Status of Vendor

(c) Verification of Vendor Invoice on Sample basis.

2. Provision for Interest payable to MSME Creditors.

Audit of Trade Payables

1. Statutory Dues Payables
2. Accrued Interest payable on Loans
3. Creditors for Fixed Assets
4. Employees Benefit Payable
5. Advances from customers.



Issues in classification of Current & Non-Current

1. Normal operating cycle
2. Ageing for Non-Payment does not affect classification as current
3. In each balance sheet date reassessment is to be made.

Audit of Provisions and Contingent Liability

1. Excess Provision – Creating Hidden Reserves
 - (a) Excess O/S Expenses
 - (b) Actual income as unrecorded income
 - (c) Excess Depreciation
2. Provision for Gratuity
 - (a) All employees have been employed for less than 5 years.
 - (b) No actual Valuation has been done.

3. In case of Contingent Liability, Collecting Evidence is a challenging task.
4. Minutes to be seen. Even legal and professional expenses to be studied.
5. (a) Arrears of dividend on Cumulative Preference Shares.
(b) Guarantees given by the company on behalf of other companies.
(c) Export Commitments under various schemes.

6. Provision Vs Contingent Liability

AS 29 summarises the recognition and disclosure criteria as under:

There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation.

There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.

There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.

6. Provision Vs Contingent Liability

AS 29 summarises the recognition and disclosure criteria as under:

A provision is recognised	No provision is recognised	No provision is recognised
Disclosures are required for the provision	Disclosures are required for the contingent liability	No disclosure is required.

Audit of Property, Plant & Equipment

1. Land – Ownership
2. Building – Consolidated Purchase
3. Machinery
4. Equipment
5. Vehicles
6. Useful Life
7. Depreciation Methods
8. Capital WIP – Ageing
9. Capital Vs Revenue
10. Deletion of line items which are not in use
11. Scrap Sales to be studied

Audit of Intangible Assets

1. AS 26 to be complied with
2. Computer Software, Patents, Copyrights, Goodwill, Brands, Trade Marks, License & Franchise.
3. Normally, the useful life is 10 years or less. In case of amortisation over 10 years, sufficient reasoning is to be established.

Audit of Investments

1. Current Vs Non Current Investments (AS 13 Vs Schedule III)
2. System 186 (1), 186 (2), 186 (3), 186 (5), 186 (8) are to be carefully noted.
3. Reporting under CARO
 - ▶ Clause 3 (iii), Clause 3 (iii) (b), clauses 3(iv) to be carefully reported.

Audit of Inventories

1. Compliance of AS 2
2. Spare Parts, Servicing Equipment and standby Equipment are PPF as per AS 10.
3. Valuation – Lower of Cost and net realisable Value.
4. Stock with third parties, Goods in Transit.
5. NRV to be ascertained correctly.
6. Improper allocation of production overheads.
7. Stock in process

Audit of Inventories

8. Out turn Statement

9. Physical Verification of Inventory – Audit Evidence – Floor to Sheet and Sheet to Floor.

(a) On the date of Balance Sheet.

(b) On any Subsequent Date (Roll back Reconciliation)

10. Valuation Certificate by Cost Accountant.

Audit of Trade Receivables

- ▶ Actual Estimate
- ▶ No longer collectable
- ▶ PBD is understated
- ▶ Invoice at the year end and delivery after the year end.
- ▶ Channel Stuffing
- ▶ Receivables from Related Parties.
- ▶ Foreign Currency Receivable AS 11 compliance.
- ▶ Ageing Schedule.
- ▶ Factoring / Discounting Agreement.
- ▶ Credit balances in Customers account.

Audit of Loans & Advances & Other Assets

1. Section 185 & 186 to be studied carefully.
2. (a) U/s 185 Special Resolution in General Meeting.
(b) Utilisation by Borrowing entity.
3. U/s. 186 – Not exceeding 60% of Share Capital + Free Reserve + Share premium or 100% of Free Reserves + Share Premium, whichever is more.
4. Disclosure of Advance Income Tax & Provision for Tax.
5. Incorrect input tax credit.

Audit of Related Party Transactions

1. Identification of Related Party relationships and transactions are not always easy.
2. Study Section 2(76) of the Companies Act 2013 to understand the definition of Related Party.
3. Ordinary Course of Business Vs Outside Normal Course of Business.
4. Paragraph 21,23 and 26 are to kept in mind.

Assessment of Subsequent Events

1. Adjusting Events
2. Non Adjusting Events.

Assessment of Going Concern

1. Para 6 of SA570 is to be studied
2. Indicators which signals the company's ability to continue as a Going Concern are to be identified.

Assessment of Going Concern

3. Auditor's Conclusion and Reporting.

There are two scenarios

(i) Material uncertainty Exists but Going Concern Assumption is Appropriate.

(ii) Going Concern Assumption is Inappropriate.

Operating Income Vs Other Income

Operating Income

- ▶ Sales
- ▶ Scrap Sales & Miscellaneous Sales.

Other Income

- (a) Interest Income
- (b) Gain on conversion of Foreign Exchange
- (c) Insurance Claim
- (d) Duty Draw Back Receipts and other similar Receipts
- (e) Profit on Sale of Assets
- (f) Credit Balances No longer required.

Disclosing Other Expenses & Other Income

Separate disclosure is to be made for income or expenditure which exceeds 1% of the Revenue from operation or Rs. 10,00,000/- whichever is higher.

Other Expenses



Payment to Auditors

1. Classification of Total Payments

- (i) Audit Fee
- (ii) For Taxation Matters
- (iii) For Company Law Matters
- (iv) For Other Services
- (V) For Reimbursement of Expenses

2. Other Services – Prohibition under Section 144.

3. Component of Total Fee. The fees received for any other service should not exceed 50% of the Audit Fee. ICAI – Code of Ethics.

Other Information under “Notes on Accounts”

- (a) Imports in CIF Basis.
- (b) Expenditure in Foreign Currency
- (c) Earnings in Foreign Exchange.

Other Regulatory Disclosures

1. Title Deeds Verification
2. Investment Property
3. Utilisation of Borrowings
4. Monthly Stock Statements & QIS submitted to Bank.
 - ▶ “There were no material discrepancies between the books of accounts and the monthly statements submitted to the Bank in respect of the Borrowings”.

Other Regulatory Disclosures

5. Charges/satisfaction of charges to be registered with ROC.
6. Computation of Financial Ratios.
7. Transactions with Companies Struck of u/s 248 of the Companies Act 2013 or Section 560 of the Companies Act 1956.
8. Rounding off.

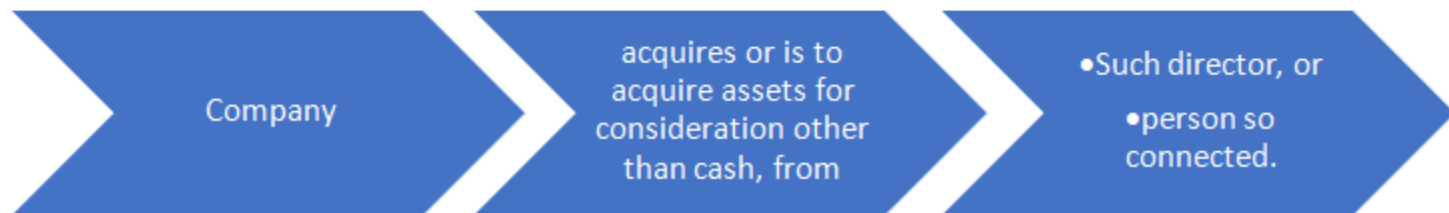
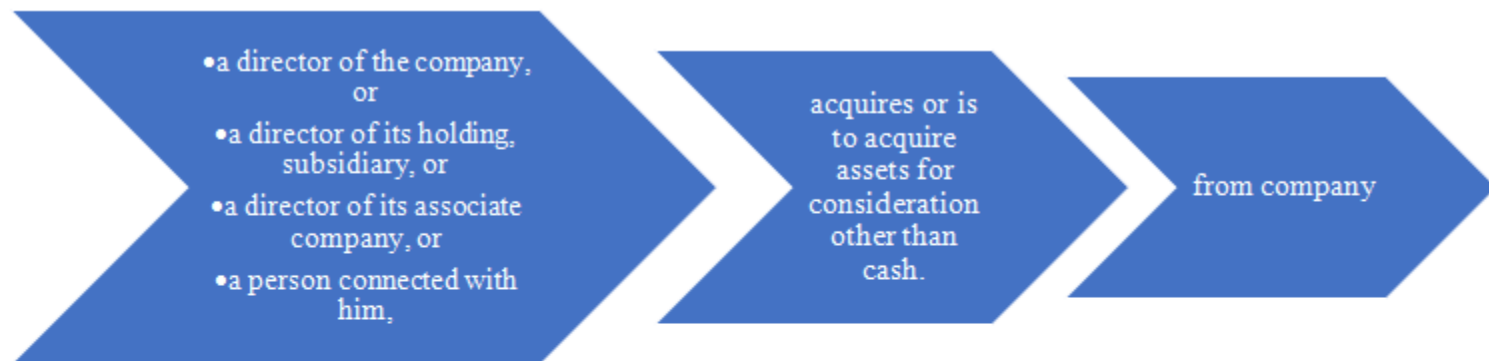
Issues in CARO

1. Fixed Assets Register – a) Tangible b) Intangible.
2. Title Deeds in the name of the company.
3. Loan to Directors – Section 185 & 186
4. Maintenance of Cost Records, Applicability of Cost Audit.
5. Application of Loan Funds.
6. Resignation of Auditor – ADT 4



Non – Cash Transactions u/s 192

- ▶ Restriction on Non–Cash transactions involving Directors.
- ▶ Prior approval of the company in General Meeting



Disclosure for CSR

- a) Amount to be spent
- b) Amount actually spent
- c) Brief particulars about on – going project
- d) Parking of Balance Amount in Separate Bank Account.



“Thank You”

