Guidance Note on Audit of Accounts of Non-Corporate Entities (Bank Borrowers)*

Contents

Paragraph(s)

Introduction 1.1-1.4
Reserve Bank of India Circular 2.1-2.7
Books of Account and Records 3.1-3.2
Formats of Financial Statements 4.1-4.3
Auditor 5.1-5.6
Audit Procedure 6.1-6.12
Audit Report 7.1-7.3
Special Audit Report 8.1
Non-Corporate Entities and Credit Facility 9.1-9.3
Financial Statements 10.1-10.9
Profit and Loss Account 11.1-11.16
Depreciation 12.1
Taxation 13.1-13.3
Balance Sheet 14.1-14.9
Funds Flow Statement 15.1-15.2
Reporting Requirements 16.1-16.9
Special Audit 17.1-17.10
Appendices

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Introduction

1.1 Companies, public sector corporations, cooperative societies and public trusts (hereinafter referred to as the corporate entities) are required by law to maintain books of accounts and records get them audited and submit their audited financial statements to regulating agencies and others. Over a period of years, the utility of accounting discipline has been recognised by the users of financial statements who place great reliance on audited statements.

1.2 The need for extending this discipline to non-corporate entities has been felt for quite some time. Most of the business enterprises in the non-corporate sector depend on public finance. The Government has, therefore, started laying emphasis on maintenance of proper books of accounts and records and audit thereof by an independent agency in the non-corporate sector.

1.3 It is in this context that the Government has issued a notification on 31st May, 1984 that all active members of recognised Stock Exchanges should maintain accounts and records as specified in Rule 15 of the Securities Contracts (Regulation) Rules 1957, and get these accounts audited by chartered accountants. This provision applies in respect of the accounting year commencing on or after 1st April, 1984. The form of the audit report has also been prescribed and the same is to be filed by the stock broker with the Stock Exchanges and the Government within the specified time limit. The objective behind this requirement is to safeguard the interest of small investors and to ensure that the stock brokers remain within the financial and accounting discipline.

1.4 Similarly, the Finance Act, 1984, has inserted Section 44AB in the Income Tax Act and has provided for audit of all assessees having business turnover exceeding Rs. 40 lakhs and professional gross receipts exceeding Rs. 10 lakhs. This requirement is effective from the previous year relevant to assessment year 1985-86. This provision is intended to ensure that the books of accounts and other records are properly maintained and faithfully reflect the true income of the tax payer. The form of audit report prescribed by the Central Board of Direct Taxes (CBDT) requires the auditor to express his opinion in the case of a non-corporate assessee about the true and fair view of the state of affairs of the assessee. The auditor is also required to give certain particulars in a separate annexure to enable the tax authorities to speedily dispose of the assessments on the basis of the information provided in the report.

Reserve Bank of India Circular

2.1 The Reserve Bank of India (RBI) had issued a circular on 22nd December, 1977 advising all scheduled banks to consider the feasibility of implementing the suggestion that annual accounts of all industrial and other borrowers enjoying aggregate credit limits of Rs. 10 lakhs and above for working capital from the banking system be audited by chartered accountants. The above proposal was examined by the Indian Banks' Association (IBA) with a view to consider whether uniform formats of financial statements and audit report could be recommended for the purpose of the above audit requirements. The IBA in consultation with the Institute of Chartered Accountants of India (ICAI) prepared the formats of financial statements for trading and manufacturing entities, funds flow statements, auditor's report and special audit report for consideration of RBI.

2.2 The above proposal has since been considered by RBI. In this context, it was noted by RBI that the Finance Act, 1984 provided for audit of the accounts of all assessees carrying on business having turnover exceeding Rs. 40 lakhs and of professionals with gross receipts exceeding Rs. 10 lakhs by chartered accountants. The forms of audit reports for the above purpose have also been prescribed by CBDT. As this statutory requirement would cover all non-corporate borrowers enjoying working capital limits of Rs. 10 lakhs and above from the banking system, the RBI has advised all scheduled banks, vide its circular dated 12th April, 1985 that the banks should ensure that such non-corporate borrowers get their accounts audited by chartered accountants.

2.3 For the above purpose 'working capital' will include all funds based loans given by banks to non-corporate entity to meet working capital requirements. In other words, it will include the following loans:

(a) Packing credit facilities;

(b) Cash credit facilities;

(c) Loans-secured or unsecured;

(d) Overdraft-secured or unsecured;

(e) Loans against Book Debts/L.M. Pledge;

(f) Bill discounting facility; and

(g) Any other credit facility (other than term loans, guarantees, letter of credit etc.).

2.4 This requirement will apply in respect of the accounting year of the non-corporate entity commencing on or after 1.4.1984. It will be necessary for the non-corporate entity enjoying such credit facility to submit the audited statements and audit report to the concerned bank as early as possible but in any case not later than 6 months from the close of the accounting year.

2.5 The financial statements will have to be prepared in the formats which have been approved by RBI. Two separate formats have been approved for this purpose. The first format relates to non-corporate entities engaged in trading activities and the second format relates to non-corporate entities engaged in manufacturing activities.

2.6 Similar circular is expected to be issued in respect of non- corporate entities enjoying credit facilities from urban, rural and other co-operative banks. This Guidance Note will apply to audit of accounts of such entities also after such circular is issued.

2.7 The formats of financial statements have been so designed that they will provide adequate information about the financial health of the borrowing entities and will assist the bank in their appraisal of the credit needs of such entities. The form of Audit Report is so devised that a non-corporate entity which is required to get the accounts audited under tax audit provisions of Section 44AB of the Income-tax Act (where sales, turnover or gross receipts exceed Rs. 40 lakhs in business or Rs. 10 lakhs in profession) will be able to get its accounts audited under the requirements of the RBI circular at a reasonable cost. In other words, there will be no duplication in audit effort and the auditor will be able to conduct the audit concurrently keeping in view the requirements of Tax Audit and RBI Circular. It may be noted that in the Guidance Note on Tax Audit Under Section 44AB of the Income-tax, Act issued by the institute, it is suggested that in the case of a non-corporate entity, the auditor should get the financial statements prepared in the same formats as recommended by RBI in the above circular. This will ensure that the financial statements of a non-corporate entity will be prepared in the same form for purposes of tax audit as well as audit of borrowers from banks and it will be possible to bring uniformity in the preparation and presentation of the financial statements.

Books of Account and Records

3.1 The primary responsibility for maintenance of books of accounts and records is that of the non-corporate entity. Since there is no legislation prescribing the books of account to be maintained by a non- corporate entity, it will be necessary for a chartered accountant to advise his clients in the non-corporate sector about the form and contents of the books and records to be maintained. Attention of the member is drawn to the publication of the Institute entitled 'Monograph on Compulsory Maintenance of Accounts'. The monograph provides guidance regarding maintenance of proper books of accounts by an entity.

3.2 It is suggested that a non-corporate entity should maintain a cash book/bank book, sales/purchase journals or registers and ledgers. Besides, it should also maintain quantitative details of principal items of stores, raw materials and finished goods. It is also necessary to maintain proper evidence in the form of bills, vouchers, receipts etc., to support entries in the above books.

Formats of Financial Statements

4.1 Two separate sets of format of Balance Sheet and Profit and Loss Account have been approved. Format applicable to a trading entity is given in **Appendix I** and the format applicable to a manufacturing entity is given in **Appendix II**. Besides, the entity is also required to prepare a Funds Flow Statement given in **Appendix III**.

4.2 In the formats of financial statements, emphasis is given on the following matters:-

(a) Uniformity in presentation;

(b) Computation of cost of goods sold in the case of a trading entity;

(c) Computation of cost of production in the case of a manufacturing entity;

(d) Any item of expenditure which forms a significant proportion, say 5% or more of the total sales (5% or more of cost of production in the case of a manufacturing entity) or has special significance otherwise, should be shown separately under appropriate heads;

(e) Withdrawals made by partners or proprietors by way of remuneration or otherwise;

(f) Investment made or loans given to partnership firms or associate concerns where the proprietor or partners or their relatives are interested directly or indirectly to ascertain whether the funds have been diverted for non-business purposes.

(g) Overdue statutory liabilities;

(h) Accumulated losses (i.e., cash losses and depreciation); and

(i) Method of valuation of stock

4.3 The Funds Flow statement for the period summarises the changes in the financial position, including the sources from which funds were obtained by the entity and the specific uses to which such funds were applied.

Auditor

5.1 The audit is to be conducted by a chartered accountant (or a firm of chartered accountants). The non-corporate entity is free to choose any practising chartered accountant to conduct this audit. Similarly, such entity will be free to change the auditor. In the event of any such change, it is necessary for the incoming auditor to communicate with the outgoing auditor before accepting the assignment, as required by the Chartered Accountants Act. He should also ensure that he does not resort to under-cutting while accepting any such assignment.

5.2 The appointment of the auditor for the purpose of this audit can be made by a partner or the proprietor or by any other person authorised by the non-corporate entity. It is possible for the non-corporate entity to have two or more chartered accountants as joint auditors for carrying out this audit, in which case the audit report will have to be signed by the joint auditors.

5.3 The auditor should obtain from the entity a letter of appointment before accepting the audit. It is suggested that the letter should state that the auditor has been appointed for the purpose of conducting the audit as required by the lending bank. It should also state the name and address of the previous auditor, if any. Besides, it should clarify that the auditor shall have the power to call for the books of accounts, information, documents and explanations and he shall have access to all books and records. A specimen of letter of appointment is given in **Appendix VI** as an example. It should be varied according to individual requirements and circumstances.

5.4 It should be noted that as per the decision of the Council (Code of Conduct under clause (4) of Part I of Second Schedule), a chartered accountant who is in employment of a concern or in any other concern under the same management cannot be appointed as auditor of that concern. Therefore, an employee of an entity or of a concern under the same management cannot audit the accounts of the entity. It may also be noted that under the Second Schedule to the Chartered Accountants Act, if a member gives an audit report in the case of a concern in which he and/or his relatives have substantial interest, it will be necessary for him to disclose his interest in the audit report.

5.5 The auditor is required to submit his report to the person appointing him i.e., the non corporate entity and not to the bank directly. However, with the consent of the non-corporate entity, he can submit the report to the lending bank.

5.6 The auditor signing the report (in his individual capacity or partner of the audit firm) should state his name in the report and should also give his membership number below his name.

Audit Procedure

6.1 The auditor should study the constitution of the non-corporate entity which may be evidenced by a deed of partnership, a deed of association or a deed of trust. It will be necessary for him to ensure that the accounts are drawn up in conformity with the above documents / agreements and the terms thereof are complied with. The minutes and other records relating to decisions taken by the owners or trustees of the entity should also be studied. If there are any material violations of the terms of the above documents and records, he should take them into consideration during the course of audit and make an appropriate report.

6.2 The auditor should carry out the audit of non-corporate entities in the same way as he conducts the audit of all corporate entities. However, there are certain special features pertaining to the audit of non-corporate borrowers from banks which are discussed in the Guidance Note.

6.3 This Guidance Note is supplementary to the existing publications of the Institute and the members are advised to follow them where applicable. Particular attention is invited to the following publications of the Institute:

(i) Guidance Note on Terms Used in Financial Statements. This Note shall be of relevance since the terms used in the preparation and presentation of the financial statements have the same meaning as explained in this Note;

(ii) Statement on Auditing Practices;[1]

(iii) A Guide to Company Audit;

(iv) Statement on Manufacturing and Other Companies (Auditors' Report) Order, 1975;[**]

(v) Statement on Qualification in Auditor's Report;[2]

(vi) Statements on Standard Auditing Practices; and [***]

(vii) Accounting Standards.

6.4 The auditor is required to express his opinion as to whether the financial statements give a true and fair view of the state of affairs of the entity. In giving this report, the auditor will have to use his professional skill and expertise and apply such audit tests as the circumstances of the case may require. Considering the contents of the audit report, he will have to conduct the audit by applying the same principles which are applicable for an audit in the corporate sector. He can apply the technique of test audit depending on the type of internal control procedures followed by the entity. If he finds that there is no internal control, it would not be advisable for him to conduct the audit by applying test checks. The auditor will also have to keep in mind the concept of materiality depending upon the circumstances of each case. He would be well advised to refer to the "Statement on Auditing Practices" while determining the extent of test check and materiality in each particular case.

6.5 Section 227 of the Companies Act gives certain powers to the auditors to call for the books of accounts, information, documents, explanations, etc. and to have access to all books and records. In the case of audit of a non-corporate entity, it will be in the interest of the entity to furnish all the information and explanations and produce books of accounts and records required by the auditor. If, however, the entity, refuses to produce any particular record or to give any specific information or explanation, the auditor will be required to report the same and qualify his report.

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[1] Withdrawn in March, 2005.

[**] Refer the Statement on the Companies (Auditor's Report) Order, 2003 (Revised 2005).

[2] The Council, at 269th meeting, held from July 18 to 20, 2007, decided to withdraw the "Statement on Qualification in Auditor's Report" except paragraphs 2.1 to 2.30 dealing with reporting under section 227 (1A) of the Companies Act, 1956 and to rename the Statement as "Statement on Reporting under section 227(1A) of the Companies Act, 1956".

[***] Now known as the Engagement Standards.

6.6 Where the non-corporate entity covered under the audit requirements is also covered by the audit requirements under Section 44AB of the Income Tax Act, the auditor should frame his audit programme in such a manner that the requirements of audit under the Income-tax Act are also covered and the audit is conducted concurrently without any duplication of work.

6.7 If a non-corporate entity has branches and separate accounts are maintained at the branches, the entity can request the auditor to visit these branches for auditing the accounts. In the alternative, the entity can appoint any chartered accountant as auditor for any of the branches. The branch auditor in such a case, will have to give an audit report in the same form to the management or to the auditor appointed for audit of the head office accounts. The auditor appointed for the head office can rely on the audited accounts and the report of branch auditors subject to such checks and verifications he may choose to make and shall submit his report on the consolidated financial statements of the head office and branch accounts. The auditor appointed for the head office, while making his consolidated report on the head office and branch accounts should make a comment in his audit report as under:--

> "I/We have taken into consideration the audit report and the audited statements of accounts received from the auditors of the branches not audited by me/us".

6.8 The RBI circular does not provide for any exemption from audit of a branch of a non-corporate entity. If, however, the accounts of a particular branch are not audited, the auditor should suitably qualify his report and also state the reasons why the branch accounts are not audited.

6.9 The procedure for appointment of branch auditors will be the same as explained in para 5 above.

6.10 In order that the auditor may be in a position to explain any question which may arise later, it is necessary that he should keep detailed notes about the evidence on which he has relied upon while conducting the audit and also maintain all his working papers properly. Such working papers should include his notes on the following, amongst other matters:

(a) What books and records were examined and by whom;

(b) Brief note on the system of internal control and procedure followed in the entity;

(c) The extent to which test checks were applied in the course of audit;

(d) What explanations and information were given to him during the course of the audit and by whom; and

(e) What decisions on the various points were taken.

6.11 It may be noted that when any question relating to audit conducted by an auditor arises, he is answerable to the Council of the Institute under the Chartered Accountants Act. In all matters concerning the audit, the Institute's disciplinary jurisdiction will prevail.

6.12 The following Standards on Auditing (SAs) issued by the Institute are given in **Appendices VII and VIII**@.

(i) Basic Principles Governing an Audit: SA 200 (**Appendix VII**)

(ii) Objective and Scope of the Audit of Financial Statements: SA 200A (**Appendix VIII**)

Audit Report

7.1 The form of audit report is given in **Appendix IV**. The first part of the report is on the same lines as applicable for audit of accounts of non-corporate assessees under section 44AB of Income Tax Act (Form 3CB). In the second part, instead of giving the statement of particulars (Form 3CD) the auditor has to give a statement in respect of various matters stated in para 2 of the report. It will be noticed that this statement is on the same lines as the audit report to be given under section 227 (4A) of Companies Act.

7.2 Where any of the matters stated in the report is answered in the negative, the report shall state the reasons therefor. If the qualifications materially affect the true and fair view of the financial statements, the auditor should state all qualifications in the audit report itself so that the same becomes a comprehensive report and the user of the audited ·financial statements can realise the impact of such qualifications. The auditor should follow the guidance given by the Institute in the matter of qualifications in the audit report in the "Statement on Qualifications in Audit Reports". Chapter 3 of this Statement is reproduced in **Appendix IX**@@.

@ Not reproduced. Members may refer to the Handbook of Auditing Pronouncements-2010 Edition.

@@ Appendix IX not published. Members may refer to the Statement on Qualifications in Auditor's Report, published in the Handbook of Auditing Pronouncements-I: Compendium of Statements and Standards (2007 edition). The Council, at 269th meeting, held from July 18 to 20, 2007, decided to withdraw the "Statement on Qualification in Auditor's Report" except paragraphs 2.1 to 2.30 dealing with reporting under section 227 (1A) of the Companies Act, 1956 and to rename the Statement as "Statement on Reporting under section 227(1A) of the Companies Act, 1956".

7.3 As the audit report is to be submitted by the non-corporate entity to the lending bank, the auditor should keep in mind his obligation to this specific user. In order that the report may assist the lending bank, it is recommended that the following additional information is given in the statement accompanying the auditor's report:

(a) non-fulfillment of any of the terms and conditions on which the loan was sanctioned, if it has a bearing on the financial statements;

(b) diversion of borrowed funds to use other than those for which they were sanctioned.

Special Audit Report

8.1 A separate format of a special audit report is also prescribed by the Reserve Bank of India (See **Appendix V**). The lending bank may, in special cases, require the non-corporate entity to obtain special audit report from the auditor. In any such case, the auditor will have to give his report in the specified format.

Non-Corporate Entities and Credit Facility

9.1 Non-corporate entities which are required to get their accounts audited under RBI circular will include partnership firms, proprietary concerns, association of persons and private trusts which are engaged in trading or manufacturing activities.

9.2 The RBI circular provides that audit should be conducted in the case a non-corporate entity enjoying credit facilities of Rs. 10 lakhs and above from any scheduled bank. The above credit facilities relate to fund based loans given to the non-corporate entity to meet its working capital requirements. In particular this will include the following credit facilities:

(i) Packing credit facilities;

(ii) Cash credit facilities;

(iii) Loans-secured or unsecured;

(iv) Overdraft-secured or unsecured;

(v) Loans against-Book Debts/L.M. Pledge;

(vi) Bill discounting facilities; and

(vii) Any other credit facilities (other than term loans, guarantees, letter of credit etc.).

9.3 It may be noted that the requirement for audit is with reference to the credit facilities enjoyed by the entity. Thus, even if the actual borrowing during the year or as at the close of the year is less than Rs. 10 lakhs, the entity would be covered under this requirement if the total credit facility enjoyed by it is Rs. 10 lakhs or more.

Financial Statements

10.1 The purpose of preparation and presentation of financial statements in the applicable formats is to assist the lending bank to know whether proper books of accounts are maintained. This will also ensure evaluation of:

(i) Financial health of the entity; and

(ii) Movement of funds, in particular, the application of the borrowed funds.

10.2 While separate formats of financial statements for trading entities and manufacturing entities have been suggested, no formats have been designed for other types of entities, such as investment entities, service entities, etc. It is suggested that for these entities, financial statements should be prepared in the form as close as possible to the form applicable to trading entities. In respect of entities engaged in processing of goods, the financial statements should be prepared in the form as close as possible to the form applicable to manufacturing entities.

10.3 In case an entity undertakes multiple activities, it is necessary to determine the relative significance of each activity. For instance, an entity which is predominantly engaged in manufacturing activity, may also purchase a relatively small quantity of finished goods in the open market for direct sale to its customers. In such a case, it should prepare its accounts in the formats applicable for manufacturing entities. However, it is suggested that the financial statements should be so prepared as to highlight the important aspects of each major activity.

10.4 The proforma of the Profit and Loss Account is in the vertical form, whereas that of the balance sheet is in the horizontal form. The entities can, at their option, present both, the Balance Sheet and the Profit and Loss Account, in the same form-either vertical or horizontal provided the information as required in the formats is given.

10.5 The information required to be given under any item or sub-item of the financial statements, if it cannot be conveniently given on the face of the financial statements, may be given by way of separate schedules or through notes annexed to and forming part of such financial statements.

10.6. The figures relating to the previous year should be given in a manner so as to enable meaningful comparison. If the accounts of such previous year are not audited, the fact should be indicated by way of a note. The auditor should also report this fact in his audit report.

10.7 The primary responsibility of maintenance of proper books of account and preparation of the financial statements lies with the management of the entity. The accounts should clearly disclose the results of the working of the entity for the year, every material feature, transactions of an exceptional and recurring nature and also transactions pertaining to earlier years, if material. Further, the accounts should be prepared in conformity with the generally accepted accounting principles followed consistently. Any deviation, if material either from the accepted principles or from the accounting policy followed in the previous year, should be clearly brought out in the notes.

10.8 In the preparation of financial statements, the overall consideration should be that they give a true and fair view of the working of the entity. Moreover, these statements should also assist the lending bank in its evaluation of the loan proposals and in ensuring financial discipline in the matter of repayment schedule of loans.

10.9 It should be noted that the terms used in the formats of financial statements given in **Appendices I & II** have the same meaning as in Schedule VI to the Companies Act 1956, unless otherwise stated.

Profit and Loss Account

11.1 The purpose of any Profit and Loss Account is to disclose clearly the result of working of the entity during the period covered by it. The formats of Profit and Loss Account for trading as well as manufacturing entities are identical in many respects and hence separate discussion is not called for except in respect of special items.

11.2 The Profit and Loss Account should be so made out as to disclose every material feature, including transactions of non-recurring and exceptional nature. Adjustments in respect of prior period items, if material, should be separately disclosed.

11.3 In the case of a trading entity, the "cost of goods sold" is to be separately shown. In the case of a manufacturing entity "cost of production" is to be shown separately. In arriving at the cost of goods sold the figures of opening stock, purchases (less returns) and closing stock have to be separately shown. The amount of direct expenses incurred for the goods dealt in have also to be separately shown. Such direct expenses would include freight, transport, insurance, etc.

11.4 The cost of production is required to be separately worked out in the case of a manufacturing entity. This would imply that overheads relating to the manufacturing process will have to be segregated and shown under the manufacturing expenses. The auditor should examine whether factory overheads have been properly charged to the cost of production.

11.5 It is necessary to disclose the consumption of the raw materials. Members are advised to refer to the 'Statement on the Amendments to Part II of Schedule VI to the Companies Act, 1956', for a detailed discussion on what constitutes 'raw materials consumed'.

11.6 Certain entities follow the practice of writing off the stores/spares to the Profit and Loss Account in the year of purchase, whether or not they are consumed. This fact should be brought out in the notes to the financial statements. The auditor should evaluate the effect of this practice and if the effect is material, he should qualify his report. The auditor should also examine whether adequate provision has been made in respect of slow moving and damaged stores and spares and in respect of discrepancies noticed on physical verification. The amount of such provision or write off should be separately disclosed. The auditor should also check the valuation of stores and spare parts to ensure that it is in accordance with the normally accepted accounting principles and that a consistent basis of valuation is being followed.

11.7 Salaries and wages paid to the proprietor or to the partners should be disclosed separately.

11.8 The various manufacturing expenses should be listed out under the head 'Other Manufacturing Expenses' in a manner that all significant items are separately disclosed.

11.9 Inventories often form a significant proportion of the assets of a non-corporate entity. The duties of the auditor as regards inventories are explained in the 'Statement on Auditing Practices'. However, the auditor should obtain a certificate regarding the existence, title and value of the stocks held by the entity as at the end of the year and also at the time of submission of stock statement to the bank. While It is the duty of the management to take the physical verification, the auditor should review the procedure and observe the physical verification at the year end or at periodical intervals. He should also look into the discrepancies between the book records and the physical quantities. The auditor should particularly examine the method of valuation of stock and whether the method is as per the normally accepted accounting principles. If there is any change in the basis of valuation of stock, the auditor should report the change and its effect. **Appendix X** reproduces Chapter 5 of Statement on Auditing Practices relating to 'Inventories'.

11.10 The figure of gross profit (or loss) is to be indicated separately. This is arrived at by deducting from net sales, any increase/decrease in finished goods, the cost of goods sold/cost of production.

11.11 Various expenses under the heads "Sales and Administrative Expenses" should be disclosed under appropriate heads.

11.12 The item 'Interest and other over heads' includes interest and financial expenses such as commitment charges, bank charges, bill discount charges, etc. If the amounts are material, interest may be bifurcated for the purpose of disclosure as below:

(i) Interest to partners/proprietor;

(ii) Interest on secured loans;

(iii) Interest on unsecured loans; and

(iv) Interest on other loans.

11.13 Separate disclosure should be made in case interest paid on funds borrowed for the purpose of acquisition of a fixed asset is capitalised. The auditor should qualify his audit report if such capitalisation has been resorted to with regard to interest accruing after the commencement of production.

11.14 Various items of income and expenses should be separately disclosed under the heading 'Other Income or Other Expenses'. In case an item is significant, it should be disclosed separately,

11.15 In case of a trading entity, any item of expenditure which is significant, say 5% or more of "total sales", should be separately shown under the appropriate heads, In the case of a manufacturing entity, the item of expenditure should be separately shown if it is 5% or more of the "Cost of production". Further, if the item has special significance otherwise, it should be separately shown. Such items of expenditure should be classified under the heads (i) Salary (ii) Commission (ii) Perquisites (iv) Travelling etc.

11.16 Any allocation out of profit (e.g., transfer to investment allowance reserve) should be separately shown. Final allocation of net profits to partners/members of the entity should be verified with reference to the terms of deed of partnership or other documents concerning the constitution of the entity.

Depreciation

12.1 Depreciation on fixed assets is to be separately shown. Since there is no specific provision for calculation of depreciation in any law governing non-corporate entities, it is suggested that depreciation should be calculated on written down value method (WDV) or straight line method (SLM) as provided in section 205 of the Companies Act, 1956. The method once adopted should be consistently followed. If there is a change in the method of providing depreciation, the effect of such change should be brought out in the financial statements and audit report for the year in which such change is made. In some non corporate entities, there may not be any proper system of providing depreciation in earlier years. In such cases, the book value on the first day of the year in which the above audit requirement has become applicable, be considered as the original cost of the assets and the rate of depreciation applicable under WDV method or SLM should be applied to the above assumed original cost. If, in any year, the depreciation provided is less than the amount required to be provided under WDV/SLM which is adopted by the entity, the shortfall/arrears of depreciation should be shown by way of a note in the balance sheet.

Taxation

13.1 In the case of non-corporate entities, the provision for taxation will relate to the tax liability of the entity engaged in trading or manufacturing activity. Therefore, it will be necessary to consider the status of the entity under the Income-tax Act. If the entity is a registered firm (RF), the tax liability in respect of RF tax should be provided in the accounts. If the status is URF, AOP or trust, the tax liability should be provided on that basis.

13.2 In the case of an individual who is the proprietor of the entity, it is possible that he may be having other income (e.g., income from house property, dividends, and other sources) which is not credited in the books relating to the business entity which is being audited. In such a case, it would be necessary to find out the total tax liability of the individual in respect of his total income from all sources and provision for proportionate tax relatable to the business income from trading/manufacturing entity should be made in the accounts under audit. In such a case, a specific note should be given that the tax liability has been provided in the financial statements on a proportionate basis.

13.3 For working out the tax liability in any year reference should be made to past tax records for ascertaining disallowance of expenses etc. The liability should be estimated by taking into consideration the provisions of the Income-tax Act applicable to the relevant year.

Balance Sheet

14.1 Where the original cost of fixed assets is not available, the book value of the fixed assets on the first day of the financial year under audit can be taken as the original cost of the fixed assets. However, a clarificatory note should be given on the balance sheet explaining the position. Similarly, where it is not possible or practicable to determine the details of the revaluation of assets undertaken in the previous five years, a note should be given. The auditor may make a qualification on this ground only if he finds that it affects the true and fair view of the financial position.

14.2 In the non-corporate sector, it may be a common practice to treat certain capital expenditure as revenue and *vice versa*. Material violation of the fundamental principle of segregation between capital and revenue expenditure would be required to be brought out by the auditor by way of a qualification in the auditor's report.

14.3 The questions relating to accounting of fixed assets and valuation and verification thereof assume importance when the non-corporate entity has invested significant funds for acquiring and installation of fixed assets. Chapter 3 of Statement on Auditing Practices dealing with 'Fixed Assets' is reproduced in **Appendix XI**. Guidance Note on Audit of Fixed Assets is given in **Appendix XII**.

14.4 Investments in concerns wherein proprietor/partners or their relatives are interested, are to be shown separately under the head "Investments". Similarly, loans to proprietors/partners or associated concerns have to be shown separately under the head "Loans". Similar information is also required to be given in respect of receivables, and loans and borrowings. The terms "relative" and "associated concern" have not been defined. As regards the term "relative", it will have to be given the same meaning as defined for the purpose of Schedule VI to the Companies Act. In other words, this term will have the same meaning as defined in Section 6 of the Companies Act 1956. As regards, the term "associated concern", there is no definition in the Companies Act. It is, therefore, suggested that if the proprietor or partner of the entity has a substantial interest in any other concern (a corporate or non-corporate entity), such concern should be treated as an associated concern. For this purpose, the proprietor or partner shall be considered as having a substantial interest in a concern if (a) the proprietor, partners or their relatives beneficially own in aggregate 20% or more of the voting power at any time during the year in a company or (b) the proprietor, partners or their relatives are entitled in the aggregate, at any time during the year, to 20%, or more of the profits of such concern.

14.5 It may be noted that in respect of loans given by the non- corporate entity, the amounts due within one year of the date of the balance sheet have to be shown separately. Similarly, instalments of deferred receivables due within one year have to be shown separately. On the liability side, under the head 'loans and borrowings', the amounts due for repayment within one year of the balance sheet date have to be shown separately. The current liabilities, which are due to payment beyond one year from the date of the balance sheet have also to be shown separately.

14.6 Chapter 7 of Statement on Auditing Practices dealing with 'Debtors, Loans and Advances, is reproduced in **Appendix XIII**. Chapter 9 of the above Statement dealing with' Liabilities is reproduced in **Appendix XIV**.

14.7 The accumulated losses have to be shown in the Balance Sheet and they should be bifurcated into (a) cash losses; and (b) accumulated depreciation. In the case of a partnership firm, the losses will have to be divided among the partners and, therefore, the question of disclosing the figure of accumulated losses will not arise.

14.8 Capital Reserves, if any, have to be separately shown in the Balance Sheet. In the case of a non-corporate entity, an item of Capital Reserve will appear in the Balance Sheet if such a reserve is created on revaluation of assets. It is open to a non-corporate entity to credit the surplus on revaluation of assets to capital reserve account or credit the same to the capital accounts of the partners or proprietor. Whatever treatment is given in the accounts on revaluation of assets, the same should be disclosed in the financial statements.

14.9 If the entity is a partnership firm, it is necessary to state by way of a note (i) whether, the firm is registered with the Registrar of Firms, (ii) registration number, (iii) date of registration, and (iv) the State in which it is registered.

Funds Flow Statement

15.1 The Funds Flow Statement summarises, for the period covered by it, changes in the financial position, including the sources from which funds were obtained by the entity and the specific uses to which such funds were applied. A Funds Flow Statement may also be called 'Statement of Changes in Financial Position' or 'Statement of Sources and Application of Funds'.

15.2 The following are some of the general considerations to be borne in mind while preparing or auditing the Funds Flow Statement:

(i) This statement is not prescribed by law for corporate entities, though a number of companies now a days voluntarily publish this statement as part of the annual accounts. There are no prescribed rules and hence the general rules for preparation of this statement should be followed.

(ii) The most important of such rules is that the statement should bring out the significant factors which have led to the change in the funds position of the entity.

(iii) A statement should be prepared for the period covered by the Profit and Loss Account and for the corresponding previous period. It should be noted that the auditor should not certify the future projection of the entity.

(iv) The prescribed form is not exhaustive in its contents, and hence, the necessary information not covered by any of the items listed may be disclosed under any appropriate heading.

(v) Attention is invited to the Accounting Standard 3 on 'Changes in Financial Statements' from which guidance may be obtained.@@@

(vi) Attention is also invited to the part dealing with 'Reporting Requirements' where the duties of the Auditor in respect of the funds flow statements are outlined.

@@@ The AS 3 is now known as Cash Flow Statements.

Reporting Requirements[$]

16.1 The auditor has to make a report on the accounts examined by him, and on every Balance Sheet, Profit and Loss Account and Funds Flow Statement and on every other document annexed to the Balance Sheet or Profit and Loss Account and Funds Flow Statement (herein referred to as financial statements). The audit report shall state, whether in his opinion and to the best of his information and according to the explanations given to him, the said Balance Sheet, Profit and Loss Account and Funds Flow Statement give a true and fair view:

(i) In the case of the Balance Sheet, of the state of affairs of the entity as at the Balance Sheet date;

and

(ii) in the case of the Profit and Loss Account, of the profit or loss of the entity for the accounting period;

and

(iii) in the case of the Funds Flow Statement, the movement of funds during the accounting period.

16.2 The auditor's report shall also state:

(a) Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of his audit.

(b) Whether, in his opinion, proper books of account have been kept by the head office and branches of the entity so far an appears from his examination of those books.

(c) Whether the Company's Balance Sheet and Profit and Loss Account and Funds Flow Statement dealt with by the report are in agreement with the books of account at head office and branches.

16.3 Where any of the matters referred to above is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer. Where in the auditor's report, the answer to any of the questions referred to in the Statement annexed to the financial statements is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified answer, as the case may be. Where the

[$] Refer to SA 700(Revised), "Forming an Opinion and Reporting on Financial Statements".

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 a question.

16.4 The audit report is in two parts. The first part of the report is in the conventional form and is on the same lines as Form 3CB prescribed for Tax Audit purposes. The second part is in the form of a statement to be annexed to the main audit report. There are 17 clauses in the statement in the second part. These clauses are identical to the matters covered in the audit report under Section 227(4A)[$$] of the Companies Act. These requirements can be summarised as under:

(i) Whether the entity is maintaining proper records about fixed assets and whether such records show the particulars about the situation of the assets. It is also necessary to state as to whether the management have physically verified the fixed assets during the year and whether the discrepancies noticed on such verification have been properly dealt with in the books of accounts. In the event of revaluation of fixed assets the basis of revaluation should be indicated. Paragraphs 22 and 23 of the Statement on MAOCARO[$$$] deal with the requirements relating to maintenance of records, and verification of fixed assets. These are reproduced in **Appendix XV**.

(ii) It is also necessary that the management should carry out physical verification of finished goods, raw materials, stores and spare parts at reasonable intervals. The auditor has to report whether the discrepancies on such verification as compared to book records have been properly dealt with in the books of accounts. The auditor should also specify whether the valuation of stocks is fair and proper in accordance with the normally accepted accounting principles and that there is no deviation from the method followed in the earlier years. If there is any material effect because of the change in the method of valuation, the same should be quantified reported by the auditor. Para 24 of the statement on MAOCARO dealing with aspects of inventory valuation and verification is reproduced in **Appendix XVI**.

(iii) If the entity has taken any loan (secured or unsecured) from firms,

[$$] The Department of Company Affairs has notified the Companies (Auditor's Report) Order, 2003 in June 2003 in terms of the powers given to it under section 227(4A) of the Companies Act, 1956.
[$$$] Refer the Statement on the Companies (Auditor's Report) Order, 2003 (Revised 2005).

companies or other parties, it will be necessary for the auditor to state whether the rate of interest and the terms and conditions of such loans are *prima facie* prejudicial to the interest of the entity. This requirement will apply only in respect of loans from partners, proprietors or their relatives and from firms, companies or other parties who fall within the category of associated concerns.

(iv) If the entity has given loans or advances which are in the nature of loans, it will be necessary for the auditor to report as to whether such loans are being repaid as stipulated and whether the interest is being regularly recovered. It is also necessary to report as to whether reasonable steps are being taken by the entity for recovery of the principal and interest.

(v) The auditor has to report on the adequacy of internal control procedure, depending upon the size of the entity and nature of business. This requirement applies to internal control procedures relating to purchases of stores, raw materials, components, plant and machinery, equipments and other assets. Para 27 of the Statement on MAOCARO dealing with the topic of internal control is reproduced in **Appendix XVII**.

(vi) If the entity has made purchase of stores, raw materials or components from associated concerns or from other parties in which the partners/proprietors are interested, it will be necessary for the auditor to report as to whether the prices paid for such items are reasonable as compared to the prices of the similar items supplied by other parties if such purchases exceed Rs. 10,000/- in value for each type of items.

(vii) It is also necessary to report whether unserviceable or damaged stores and raw materials are determined and provision for loans have been made in the accounts.

(viii) The entity is also required to maintain reasonable records for the sale and disposal of realisable by-products and scrap. If such records are not maintained, it will be necessary for the auditor to report.

(ix) In the case of an entity whose capital at the commencement of the financial year exceeds Rs. 25 lakhs, it is necessary for such entity to have an internal audit system commensurate with its size and nature of its business. The auditor has to report as to whether such an internal audit system exists in the case of such an entity. Para 32 of the Statement on MAOCARO dealing with internal audit system is reproduced in **Appendix XVIII**.

(x) The auditor has also to report as to whether the entity is depositing provident fund dues with the appropriate authorities. If there are any arrears of provident fund dues he has to indicate the same in his audit report.

16.5 In the case of an entity engaged in rendering services, besides the report on the above items (to the extent applicable), the auditor has also to report as to whether the entity has a reasonable system of recording receipts, issues and consumption of materials and stores commensurate with its size and nature of its business. Such system should provide for a reasonable allocation of the material and man hours consumed for the relative jobs. Further, the auditor should ensure that there is reasonable system of authorisation at proper levels with necessary control on the issue of stores and allocation of stores and labour to jobs, and there should also be a proper system of internal control depending on the size of the entity and the nature of its business.

16.6 In the case of a trading entity the auditor has to report on the items (to the extent applicable) mentioned in para 16.4 above and he has also to state as to whether damaged goods have been determined and that adequate provision has been made in respect of loss, if the value of the damaged goods was significant.

16.7 In the case of an entity which is engaged in the business of finance, investment, chit fund, *nidhi* or mutual benefit society the auditor will have to report on the items (to the extent applicable) stated in para 16.4 above and also state as to whether adequate documents and records are maintained in respect of loans and advances granted on the basis of security by way of pledge of shares, debentures and similar other securities. He has also to mention in his report as to whether the provisions of the special statute applicable to such an entity have been duly complied with. If the entity is dealing or trading in shares, securities, debentures and other investments, the auditor should report as to whether proper records have been maintained in respect of the transactions and contracts in such business and whether timely entries have been made in such records. It is also necessary to report as to whether such shares, securities, etc., are held by the entity in its own name.

16.8 In the Statement on MAOCARO, there is a detailed discussion in respect of each of the above items and therefore these items are not separately discussed in this Guidance Note. Members are requested to refer to detailed discussion in the above Statement issued by the Institute. Members should follow the guidelines given in the above Statement while conducting the audit under RBI Circular and also give the report on the basis of the above guidelines. Paragraphs 22, 23, 24, 27 and 32 of the above Statement have been given in the **Appendices XV to XVIII** for ready reference.

16.9 It may be noted that in the above audit report, the auditor has to give his opinion that the fund flow statement giving the movement of funds during the relevant year gives a true and fair view. This requirement is new. Such a requirement does not exist in the case of a corporate entity although a number of companies voluntarily publish this statement as part of their annual accounts. Since this requirement is new the auditor should take care that the funds flow statement (i.e., statement of changes in the financial position) is properly prepared and the figures given in this statement have been properly verified. Since figures of the previous year have to be stated in this statement, the auditor should qualify his report if the accounts of the previous year are not audited and figures are given in the statement on the basis of unaudited accounts. The auditor should also note that he is not required to certify future projections of the entity in this statement.

Special Audit

17.1 A lending bank may, in special cases, require the non-corporate entity to obtain a special audit report from the auditor. Such a report can be called by a lending bank if it finds that it is necessary to have more information about the working of the entity. In such a case, the report will have to be given by the auditor on a quarterly basis.

17.2 The special audit report which is to be given on a quarterly basis in the specified form (**Appendix V**) is in addition to the normal audit report which is to be given by the auditor on an yearly basis.

17.3 In the quarterly special audit report, the auditor will have to give information relating to the operating data for each quarter. This information will have to be classified in the following manner:

(i) Actual production;

(ii) Actual production as a percentage of rated capacity;

(iii) Sales;

(iv) Cost of goods sold/cost of production;

(v) Gross margin;

(vi) Interest on bank borrowing; and

(vii) Interest to others.

It is not necessary to work out the actual fixed cost for this purpose.

17.4. The age-wise classification of raw materials and finished goods is to be given. For this purpose age-wise classification is to be made in the following manner in respect of raw materials and finished goods separately:

(i) Inventory for more than one year;

(ii) Between 6 months and one year;

(iii) Between three months and 6 months; and

(iv) Below 3 months.

Similar information about the work-in-progress, i.e., the number of days production which remains in progress should also be given.

17.5 The basis of valuation of raw material and finished goods should be given. For this purpose the following information is to be given:

(i) The manner of determination of cost (i.e., components of cost).

(ii) The method of valuing stock i.e., FIFO, LIFO etc.

It is also necessary to state if there is any discrepancy between the quantity and value of the stock as furnished to the bank and as appearing in the books. The reasons for such discrepancy should be given in the audit report.

17.6 Age-wise classification of bills receivable and other receivables with reference to the bills due from domestic parties and bills in respect of exports should be given. The age-wise classification is to be done on the same basis as the classification for raw materials and finished goods as stated in para 17.4 above.

17.7 The information in respect of the following items is also to be given:

(i) Balances at the end of each month of the quarter for major categories of stock, receivables and bills receivables;

(ii) Tax assessments and payments made during the quarter;

(iii) Actual disbursement of capital expenditure during the quarter;

(iv) Outstanding contracts on capital account at the end of the quarter giving the details about the names of parties and amounts outstanding;

(v) The contingent liability which may or may not materialise during the financial year succeeding the relevant quarter;

(vi) Investments made during that quarter and the income from such investments including profit on sale of investments;

(vii) Loans given during the quarter;

(viii) Loans raised during the quarter from banks and from others. Separate figures to be given;

(ix) Overdue statutory liability at the end of the quarter;

(x) Amounts due but not paid at the end of the quarter in respect of (a) loans from banks (b) public deposit and (c) other loans; and

(xi) Figures of cash losses during the last 2 years to be stated on the basis of the annual accounts. If such accounts were not audited this fact should be stated.

17.8 Purchases and sales transactions of the entity exceeding Re. 10,000/- per annum from companies, partnership firms or other entities in the same group should be in the normal course of business and the same should be at prices which are reasonable as compared to the prices of similar items in the market. If the auditor finds that such transactions have not been entered into in the normal course of business or at prices which are unfavourable to the entity it will be necessary for him to give details of such transactions.

17.9 The funds obtained from the lending banks have to be utilised for the purpose for which they are given by the banks. If the auditor finds that these funds have been diverted for the purposes other than those for which they were given by the bank, he will have to give the details of the diversion for such other purposes.

17.10 In order that the lending bank may be able to ascertain the correct financial position and financial health of the entity it is necessary for the auditor to give information about the following ratios:

(a) Current ratio

(b) Acid test ratio

(c) Raw materials- turnover ratio

(d) Finished goods-turnover ratio

(e) Receivables-turnover ratio

(f) Return on investment

(g) Interest cover ratio

(h) Net margin ratio

(i) Capital turnover ratio

(j) Debt equity ratio

(k) Operating Cash Flow

Appendix I

Form of Balance Sheet (For Non-Corporate Trading Entities)

Name of Entity/Entities
Balance Sheet as at

Figures for Previous Year	Capital and Liabilities	Figures for Current Year	Figures for Previous Year	Properties and Assets	Figures for Current Year
	I. CAPITAL (In case of partnership, these particulars to be given separately for each partner and if possible, the fixed capital accounts may be segregated from the current accounts) as at the beginning of the year. Add/Deduct, Net Profit/Net Loss during the year. Interest on capital Drawings Any other items (give details)			**I. FIXED ASSETS** 1. Under each head the original cost the additions thereto, the deductions there from during the year and the total depreciation written off or provided upto the end of the year to be stated. 2. Where the assets have been revalued, the revalued figures to be shown. Each balance sheet for the first five years subsequent to the date of revaluation to state the amount of revaluation. 3. Distinguishing as far as possible between expenditure upon: a) Goodwill b) Land c) Buildings d) Leaseholds e) Railway sidings f) Plant and Machinery g) Furniture and Fittings h) Development of property i) Patents, trademarks and designs j) Livestock k) Vehicles etc. 1. Cost 2. Less : Depreciation	
	II. RESERVES (Give details under each head)			**II. ADVANCES AND DEPOSITS ON CAPITAL ACCOUNT**	

1. Capital reserves (if any)

2. Other Reserves (including retained profits to the extent not already added to the capital, give details)

3. Sinking Funds (if any)

III. LOANS AND BORROWINGS

I. Interest accrued and due on each category to be shown separately.

2. In case of secured loans the nature of security to be specified.

3. Amounts due for repayments within one year from the balance sheet date to be shown separately.

4. Loan from partners, relatives of the proprietors or partners to be shown separately

a. Loans from financial institutions.

b. Loans and borrowings from banks (Specify the name of the bank, the relevant amount and the nature of the borrowing, e.g., cash credit term-loans, overdraft, packing credit etc., (separately)

c. Fixed deposits (from public and others)

d. Others (Give details)

IV. CURRENT LIABILITIES AND PROVISIONS

(Amounts due for payment beyond one year from the date of the balance sheet to be shown separately).

A. CURRENT LIABILITIES

1. Sundry creditors for goods supplied.

2. Sundry creditors (Others)

3. Advances/ Progress Payments from customers/ deposits from dealers-selling agents, etc.

4. Interest and other charges

III. INVESTMENTS

(Attach details of investment showing in each case nature of investment and mode of valuation, e.g., cost or market value)

1. Investment in shares, debentures or bonds

(Note: Investments in concerns wherein proprietor, partner or their relatives are interested to be shown separately)

2. Immovable properties.

3. Investments in the capital of partnership firms

4. Other investments.

IV. LOANS

1. The nature, security (if any) and amount of each type of loan to be specified.

2. Amounts due within one year to be shown separately.

3. Loans to proprietors, partners or associated concern (to be shown separately)

4. Loans considered bad or doubtful to be separately stated.

Less: Provision for bad and doubtful loans.

accrued but not due for payment.

5. Bills payable.

6. Statutory liabilities (Overdue amounts to be shown separately)

7. Other current liabilities and provisions (Major items to be shown separately)

B. PROVISIONS

1. For taxation
   Less: Advance tax paid
2. For Provident Fund
3. For Contingencies
4. Other provisions

A foot note to the Balance Sheet may be added to show separately:

1. Claims against the entity not acknowledged as debts.
2. Uncalled liability on shares partly paid
3. Estimated amount of contracts remaining to be executed to capital account and not provided for.
4. Contingent liability for bills discounted.
5. Other moneys for which the entity is contingently liable (give details)
6. Aggregate amount of arrears of depreciation if any.

Notes on Balance Sheet

(i) In case of partnership firms, state whether it is registered with the Registrar of Firms, registration number, date of registration and the state in which it is registered.

(ii) Unless otherwise indicated the terms used herein have the same meaning as they have in Schedule-V1 to the Companies Act, 1956.

V. CURRENT ASSETS
A. INVENTORIES

(The mode of valuation to be

shown separately)

1. Stock in Trade

2. Supplies and sundries. (If the trading organisation is also involved in any processing activity/ies other categories of inventories e.g. raw material. and work-in-progress, should be separately disclosed.

B. RECEIVABLES

1. Debts due and outstanding for a period exceeding six months (to be shown separately.)

2. Instalments of deferred receivables due within one year to be shown separately.

3. Debts considered bad or doubtful to be shown separately.

4. Amount due from proprietors, partners or associated concerns (to be shown separately)

i) On account of sales on deferred payment basis.

ii) On account of exports

iii) Others

iv) Total receivables

v) Less: Provision for bad and doubtful debts.

C. BILLS OF EXCHANGE

(Same information to be given as for 'Receivables')

D. ADVANCES ON CURRENT ACCOUNT

(Same information to be given as for loans).

1. Advances to suppliers of raw-material and stores/ spares/ consumables;

2. Advance payment of taxes (in excess of tax payable)

3. Pre-paid expenses.

4. Others.

E. CASH AND BANK BALANCES

	1. Fixed deposit account 2. Current and savings account 3. Cash in hand **VI. MISCELLANEOUS EXPENDITURE** To the extent not written off or adjusted (specify the nature and amount of each item). **VII. ACCUMULATED LOSSES, if any** i) before depreciation. ii) depreciation.
TOTAL RUPEES	**TOTAL RUPEES**

Proforma of Profit and Loss Account for a Trading Entity

Name of the entity

Profit & Loss Account for the year ending ....

		Last Year Rs.	**This Year Rs.**
1.	Sales (Net of Sales tax) (Income from services may be shown separately)		
2.	Cost of Goods sold		
	(a) Opening Stock Add: Purchases (Less returns) Less: Closing Stock		
	(b) Other direct Expenses (if any)		
3.	Gross Profit (1-2)		
4.	Sales and administrative expenses		
5.	Other income/expenses* Net (±)		
6.	Interest		
7.	Profit before depreciation and tax [(item 3 minus item (4+5+6)]		
8.	Depreciation		
9.	Taxation (for example for registered firms)**		
10.	Profit after depreciation & taxation item minus item (8+9)		

*** Note:** Any item of expenditure which forms a significant proportion, say 5% or more of the total sales or has special significance otherwise should be shown separately under appropriate heads for example (i) salary (ii) commission (iii) perquisites and money value thereof.

** Registered firms are subject to tax, before the profit is apportioned amongst partners.

Appendix II

Form of Balance Sheet (For Non-Corporate Manufacturing Entities)

Name of Entity
Balance Sheet as at

Figures for Previous Year	Capital and Liabilities	Figures for Current Year	Figures for Previous Year	Properties and Assets	Figures for Current Year
	I. CAPITAL (In case of partnership, these particulars to be given separately for each partner and if possible the fixed capital accounts may be segregated from the current accounts) As at the beginning of the year.			**I. FIXED ASSETS**	
	Add/Deduct net profit/net loss during the year			1. Under each head the original cost, the additions thereto, the deductions therefrom during the year and the total depreciation written off or provided up to the end of the year to be stated.	
	Interest on capital			2. Where the assets have been revalued, the revalued figures to be shown. Each balance sheet for the first five years subsequent to the date of revaluation to state the amount of revaluation.	
	Drawings			3. Distinguishing as far as possible between expenditure upon	
	Any other item (give details)			a) Goodwill	
				b) Land	
				c) Buildings	
				d) Leaseholds	
				e) Railway sidings	
				f) Plant and machinery	
				g) Furniture and fittings	
				h) Development of property	
				i) Patents, trademarks and designs	
				j) Livestock	
				k) Vehicle etc.	

II. RESERVES (Give details under each head)

1. Capital reserves (if any)

2. Other Reserves (including retained profits to the extent not already added to the capital, give details)

3. Sinking funds (if any)

III. LOANS AND BORROWINGS

1. Interest accrued and due on each category to be shown separately)

2. In case of secured loans the nature of security to be specified.

3. Amounts due for repayments within one year from the balance sheet date to be shown separately.

4. Loan from partners relatives of the proprietors or partners to be shown separately.

i) Loans from Financial Institutions.

ii) Loans and borrowings from banks (specify the name of the bank the relevant amount and the nature of borrowing e.g. Cash credit, term-loans, overdraft, packing credit etc. separately)

iii) Fixed deposits (from public and others)

iv) Others (give details)

IV. CURRENT LIABILITIES AND PROVISIONS

(Amounts due for payment beyond one year from the date of the balance sheet to be shown separately)

A. CURRENT LIABILITIES

a) Sundry creditors for goods supplied

b) Sundry creditors (Others)

1. Cost

2. Less: Depreciation

II. ADVANCES AND DEPOSITS ON CAPITAL ACCOUNT

III. INVESTMENTS (attach details of investment showing in each case nature of investment and mode of valuation e.g. cost or market value).

1. Investment in shares, debentures or bonds (Investments in concerns wherein proprietor/partner or their relatives are interested to be shown separately)

2. Immovable properties

3. Investments in the capital of partnership firms

4. Other investments.

IV. LOANS

1. Nature of security (if any) and amounts of each type of loan to be specified.

2. Amount due within one year to be shown separately.

3. Loans to proprietors, partners or associated concerns to be shown separately.

c) Advances/ progress payments from customers/deposits from dealers selling agents etc.

d) Interest and other charges accrued not due for payment.

e) Bills payable.

f) Statutory liabilities (Overdue amounts to be shown separately)

g) Other current liabilities & provisions (major items, to be shown separately)

B. PROVISIONS

1. For taxation less advance tax paid
2. For Provident Fund
3. For Contingencies
4. Other Provisions.

A Footnote to the balance sheet may be added to show separately:

1. Claims against the entity not acknowledged as debts.
2. Uncalled liability on shares partly paid.
3. Estimated amount of contracts remaining to be executed to capital account and not provided for.
4. Contingent liability for bills discounted.
5. Other moneys for which the entity is contingently liable (give details)
6. Aggregate amount of arrears of depreciation, if any.

NOTES ON BALANCE SHEET

1. In case of partnership firms state whether it is registered with registrar of firms, registration number, date of registration and the state in which it is registered.
2. Unless otherwise indicated the terms used herein have the same meaning as they have in Schedule VI to the Companies Act, 1956.

4. Loans considered bad or doubtful to be shown separately.

Less: Provision for bad and doubtful Loans.

V. CURRENT ASSETS

A. INVENTORIES (The mode of valuation to be shown separately)

1. Raw materials (including stores and other items used in the process of manufacture)
2. Work in progress.
3. Finished goods
4. Consumable stores and spare parts.
5. Loose Tools.
6. Others.

B. RECEIVABLES

1. Debts due and outstanding for a period exceeding six months to be shown separately.
2. Instalments of deferred receivables due within one year to be shown separately.
3. Debts considered bad or doubtful to be shown separately.
4. Amount due from proprietors, partners or associated concerns to be shown separately.

1. On account of sales on deferred payment basis.
2. On account of exports.
3. Others
4. Total receivables
5. Less: Provision for bad and doubtful debts.

C. BILLS OF EXCHANGE

(Same information to be given as for receivables)

D. ADVANCES ON CURRENT ACCOUNT

(Same information to be given as for (Loans))

1. Advances to suppliers of merchandise supplies and sundries etc. and

	stores/spares/consumables.
	2. Advance payment of taxes (in excess of tax payable)
	3. Prepaid expenses.
	4. Others.
	E. CASH AND BANK BALANCES
	1. Fixed deposit account
	2. Current and savings account
	3. Cash in hand
	VI. MISCELLANEOUS EXPENDITURE
	To the extent not written off or adjusted. (Specify the nature and amount of each item)
	VII. ACCUMULATED LOSSES: if any
	1. Before depreciation
	2. Depreciation.
TOTAL	**TOTAL**

Proforma of Profit and Loss Account of a Non-Corporate Manufacturing Entity

Name of the entity ....

Profit & Loss Account for the year ending .... (000's omitted)

		Previous year (actuals)	**Current Year**
1.	Sales (Income from services may be shown separately)		
2.	Less: Excise duty		
3.	Net Sales (Item No.1 minus Item 2)		
	Add/Deduct/Increase/Decrease in Finished Goods		
	Closing stock		
	Less: Opening Stock		
4.	Cost of Production		
(a)	Raw materials consumption		
	(i) Opening stock Add: Purchases Less: Closing stock		

(b)	Stores and spare consumption	
(c)	Salaries and wages	
(d)	Other manufacturing expenses, excluding depreciation	
		Sub-total
	Add: Opening stocks-in-process	
	Deduct: Closing stocks-in-process	
	Cost of Production	
5.	Gross profit/loss (item 3 minus item 4)	
6.	Sales and administration expenses	
7.	Interest and other overheads	
8.	Other income/expenses net (+)	
9.	Profit/Loss before depreciation & tax (Item 5 minus item) (6+7+8)	
10.	Depreciation	
11.	Profit after depreciation	
12.	Taxation	
13.	Profit after tax.	

Notes:

1. Any item of expenditure which forms a significant proportion, say 5% or more, of the total cost of production or has special significance otherwise should be shown separately under appropriate heads for example (i) salary (ii) commission (iii) perquisites and money value thereof.

2. If audited accounts for the previous year are not available, the fact should be stated.

Appendix III

FORM OF FUNDS FLOW STATEMENT FOR NON-CORPORATE BORROWERS

NAME OF THE ENTITY ……..

FUNDS FLOW STATEMENT FOR THE YEAR ENDING ………

(000'S omitted)

PARTICULARS		Current Year	Previous Year
SOURCES			
Profit before tax	....		....
Add: Depreciation	....		....
Add: Interest on capitals of partners/ proprietors	....		....
Add: Salaries, Commission etc. Paid/payable to partners/ proprietors	....		....
Gross funds generated	....		....
	....		....
Less : Taxes/ paid payable on the profits of the firm (relating to the year)	....		....
		....	....
(applicable only to partnership firms)			
Less : Withdrawals (including personal taxes paid /payable on income of the partners/proprietor out of the income of the entity) by the Partners/proprietors			
Less: Salaries, commission etc. paid to partners/ proprietors			
A. SUB-TOTAL		**.................**	**................**
Increase in capital (only the fresh capital introduced – by the partners/ proprietor during the year)		....	....
Increases in term loans/ deferred payment liabilities		....	....
Increase in fixed deposits		....	....
Increase in loans from partners, Increase in loans from relatives, friends etc.		....	....
Decrease in fixed assets		....	....

Decrease in investments in other partnerships/ business	....	....
Decrease in advances and deposits on capital account	....	....
B. SUB-TOTAL	**................**	**................**
Increase in short-term bank borrowings	....	....
Increase in other current liabilities	....	....
Decrease in inventory	....	....
Decrease in receivables	....	....
Decrease in loans to partners/ proprietors/ associated concerns etc.	....	....
Decrease in other loans	....	....
Decrease in bills of exchange	....	....
Decrease in advances on current Account	....	....
Decrease in cash and bank balances	....	....
C. SUB-TOTAL	....	....
TOTAL FUNDS AVAILABLE (A + B + C)	**................**	**................**
USES		
Decrease in term loans/ deferred payments liabilities	....	....
Decrease in fixed deposits	....	....
Increase in fixed assets	....	....
Increase in investments of other partnerships/business etc.	....	....
Increase in advances and deposits on capital account	....	....
D. SUB-TOTAL	....	....
Decrease in short-term bank borrowings	....	....
Decrease in other current liabilities	....	....
Increase in inventory	....	....
Increase in receivables	....	....
Increase in loans to partners/proprietors/ associated concerns etc.	....	....
Increase in other loans.	....	....
Increase in bills of exchange	....	....
Increase in advances on current account	....	....
Increase in cash and bank balances	....	....
E. SUB-TOTAL	....	....

Loss (See Note – 3)	....	....
Less : Depreciation:		
Less: interest on capitals of partners/proprietors	....	....
Less: Salaries, commissions etc. paid/payable to partners/proprietors	....	....
Balance i.e. Gross funds lost (-) or Gross funds generated (+)	....	....
Add: Taxes paid/payable on the profits of a registered firm (relating to the year) (applicable only to partnership firms)	....	....
Add: Withdrawals (including personal taxes paid/payable on incomes of the partner/proprietors	....	....
Add: Salaries, commissions etc. paid to partners/proprietors	....	....
F. SUB TOTAL	....	....
	========	========
TOTAL FUNDS USED (D + E + F)	....	....
	========	========
SUMMARY		
Long term sources	....	....
Less: Long term uses	....	....
Changes in Net working capital (±)	....	....
Short term sources	....	....
Less: Short term uses	....	....
	---------------	---------------
	....	....
	---------------	---------------

NOTES:

1. The valuation of current assets or current liabilities and recording of income and expenses in these forms should be on the same basis as adopted for the Balance Sheet submitted to the Bank and should be applied on a consistent basis.
2. Under the items increase/ decrease in term loan/deferred payments liabilities, together with the names of the concerned lending/guaranteeing institutions should be indicated separately.
3. Figures should be filled in here only when the total effect is net funds lost. In case of loss, if loss, taxes, withdrawals etc., are more than compensated by depreciation, interest on capital, etc., the amount of loss should be shown under 'Sources' against the item 'Profit before tax' with a negative figure.

Appendix IV

Audit Report for Non-Corporate Borrowers

1. I/We have examined the Balance Sheet of …………………………………………………… as at ………….. and the Profit and Loss Account and the funds flow statement for the year ended on that date which are in agreement with the books of account maintained at the head office at …………………………………………………………………………………………… …… and branches at ………………………………………………………………..

(i) I/We have obtained all the information and explanation which to the best of my/our knowledge and belief were necessary for the purpose of my/our audit.

(ii) In my/our opinion, proper books of account have been kept by the head office and the branches of the entity so far as appears from my/our examination of such books, subject to the comment given below: -

(iii) In my/our opinion and to the best of my/our information and according to the explanations given to me/us, the said accounts and the funds flow statement give a true and fair view:

(a) in the case of the balance sheet of the state of affairs of the entity as at ….

and

(b) in the case of the Profit and Loss Account of the profit or loss of the entity for the account year ending on ….

(c) In so far as it relates to the funds flow statement of the movement of funds during the year ending on that date.

2. The auditor's report on the accounts of the entities shall be accompanied by a statement in respect of the following matters, *viz*.

A. In the case of a manufacturing, mining or processing entity:

(i) Whether the entity is maintaining proper records to show full particulars, including quantitative details and situation of fixed assets, whether these fixed assets have been physically verified by the management and if any serious discrepancies were noticed on such verification, whether the same have been properly dealt with in the books of account.

(ii) In a case where the fixed assets have been revalued during the year the basis of revaluation should be indicated.

(iii) Has physical verification been conducted by the management at reasonable periods in respect of finished goods stores, spare parts and raw materials, and if any significant discrepancies have been noticed on such verification as compared to book records, whether or not the same have been properly dealt with in the books of account; whether the auditor is satisfied that the valuation of these stocks is fair and proper in accordance with the normally accepted accounting principles and is on the same basis as in the earlier years; if there is any deviation in the basis of valuation, the effect of such deviation, if material, is to be reported.

(iv) If the entity has taken any loan whether secured or unsecured from firms, companies or other parties, whether the rate of interest and the terms and conditions of such loans are *prima-facie* prejudicial to the interest of the entity.

(v) Whether the parties to whom the loans or advances in the nature of loans have been given by the entity are repaying the principal amounts as stipulated and are also regular in payment of the interest and if not, whether reasonable steps have been taken by the entity for recovery of the principal and interest;

(vi) Is there an adequate internal control procedure commensurate with the size of the entity and the nature of its business, for the purchase of stores, raw materials including components, plant and machinery, equipment and other assets.

(vii) Wherein stores, raw materials or components exceeding Rs. 10,000/- in value for each types thereof are purchased during the year from the associate firms or other parties in which the partners proprietors are/is interested, whether the prices paid for such items are reasonable as compared to the prices of similar items supplied by other parties.

(viii) Whether any unserviceable or damaged stores and raw-materials are determined and whether provision for the loss, if any, has been made in the accounts.

(ix) Is the entity maintaining reasonable records for the sale and disposal of realisable by products and scraps where applicable and significant.

(x) In relation to entities the capital of which at the commencement of the financial year concerned exceeds Rs. 25 lakhs, whether the entity has an internal audit system commensurate with its size and nature of its business.

(xi) Is the entity regular in depositing provident fund dues with the appropriate authorities and if not, the extent of arrears of provident fund dues shall be indicated by the auditor.

B. In the case of a service entity:

(i) All the matters specified in clause (A) to the extent to which they are applicable.

(ii) Whether the entity has a reasonable system of recording receipts, issues and consumption of materials and stores commensurate with its size and nature of its business and whether such system provides for a reasonable allocation of the materials and man hours consumed to the relative jobs.

(iii) Whether there is a reasonable system of authorisation at proper levels with necessary control on the issue of stores and allocation of stores and labour to jobs and whether there is any system of internal control commensurate with the size of the entity and the nature of its business.

C. In the case of a Trading Entity:

(i) All the matters specified in Clause (A) to the extent to which they are applicable,

(ii) Have damaged goods been determined and if the value of such goods is significant, has provision been made for the loss.

D. In the case of finance, investment, chit fund, *nidhi* or mutual benefit entity –

(i) All the matters specified in Clause (A) to the extent to which they are applicable,

(ii) Whether adequate document and records are maintained in a case where the entity has granted loans and advances on the basis of security by way of pledge of shares, debentures and other similar securities,

(iii) Whether the provisions of any special statute applicable to chit fund, *nidhi* or mutual benefit society have been duly complied with,

(iv) If the entity is dealing or trading in shares, securities debentures and other investments, whether proper records have been maintained of the transactions and contracts and whether timely entries have been made therein; also whether the shares, securities, debentures and other investments have been held by the entity in its own name.

NOTE:

In the above statement, the answer to any of the questions referred to as in 2 above is unfavourable or qualified, the auditor's shall also state the reasons for such unfavourable or qualified answer, as the case may be. Where the auditor is unable to express any opinion in answer to a particular question, he shall indicate such fact together with the reasons why it is not possible for him to give an answer to such question.

Appendix V

Special Audit Report

In the case of accounts perceived by the Bankers as important for regular and active monitoring, the following audit report may be given.

I/We have examined the information given below relating to quarter ending at ………..

In my/our opinion and to the best of my/our information and according to the explanations given to me/us.

1. The important operating data for the quarter is as below:-

Actual Production	....
Actual Production as a percentage of rated capacity.	....
Sales	....
Cost of goods sold	....
Gross Margin	....
Interest on bank borrowings	....
Interest on others	....

(Actual fixed costs need not be worked out)

2. The age wise classification of raw materials inventory and finished goods as at ……. is as below :

	Raw Materials	Finished goods
(a) Above one year	....	....
(b) Between six months and one year	....	....
(c) Between three months and six months	....	....
(d) Below three months	....	....

3. The work in process of Rs…………..as at ……………..represents ……days production.

4. The raw materials are valued at ………. The stock-in-trade is valued at ……… (give detailed basis for valuation including the manner of determination of cost e.g. first in first out etc). Accordingly, the value of raw materials and the finished goods is as below:

   The said valuation of stock is fair and proper in accordance with the normal accepted accounting principles, and is on the same basis as in the earlier quarter.

   The discrepancies (if any) between the value given here and that shown in the stock statements to the bank and the reasons thereof are given below:

5. The age-wise classification of total bill receivables and receivables outstanding as at………is as below:

	Domestic	Exports
(a) Above one year	....	....
(b) Between six months and one year	....	....
(c) Between three months and six months	....	....
(d) Below three months.	....	....

6. The month and balances of the stocks, bills receivables and receivables are as below. (Give the balances as at the end of each month in the quarter for major categories of a stocks, receivables and bills receivable.
7. The assessments and payments made during the quarter were as below:
8. Actual disbursements for capital expenditure during the quarter were as below:
9. Outstanding contracts on capital account as on ……………are as below:-

Name of the Party	Amount (Rs.)
1.	....
2.	....
3.	....

10. Contingent liabilities which may or may not materialise, as on ……….during the financial year, immediately succeeding the quarter in relation to which this information pertains.
11. (i) Investments made during the quarter were as below:
    (ii) Income from investments including profit on sale thereof was as below:
12. Loans given by the entity during the quarter were as below:
13. Details of loans raised during the quarter are as below: and
    (a) from banks (give details)
    (b) from others
14. The purchase and sale transactions of the entity exceeding Rs. 10,000/- per annum from/to the companies, partnership firms or other entities in the same group appear to be in the normal course of business and the transacted prices of such items are/are not reasonable as compared to the prices of similar items in the market (if not give details).
15. The funds from the bank have been utilised for the purpose for which they were lent. Details of the funds diverted for purposes other than for those for which they were lent are given below:
16. The overdue statutory liabilities as at the end of the quarter are as below: (give details)
17. As per the annual accounts the cash losses during the last two years are as below:
    (State whether the accounts were audited or not)
18. At the end of the quarter, the following were amounts due but not paid:
    (a) Loans from Banks
    (b) Other Loans
    (c) Public Deposits
19. We give below some important ratios of the entity as per the last audited accounts:

(a) Current Ratio = $\dfrac{\text{Assets realisable within a year}}{\text{Liabilities due to be paid within a year}}$

(b) Acid Test Ratio	= $\dfrac{\text{Cash + Bank balance + marketable Securities + debtors due within two months}}{\text{Liabilities due to be paid within next six months}}$
(c) Raw materials turnover ratio	= $\dfrac{\text{Raw materials consumed during the year}}{\text{Average raw materials stock}}$
(d) Finished goods turnover ratio	= $\dfrac{\text{Sales during the year}}{\text{Average finished goods in stock}}$
(e) Receivables turnover ratio	= $\dfrac{\text{Credit sales during the year}}{\text{average receivables}}$
(f) Return on investment	= $\dfrac{\text{Earnings before interest and tax}}{\text{Net capital employed}}$
(g) Interest over ratio	= $\dfrac{\text{Earnings before interest and tax}}{\text{Interest charge payable}}$
(h) Net margin ratio	= $\dfrac{\text{Earnings before interest and tax}}{\text{Sales}}$
(i) Capital turnover ratio	= $\dfrac{\text{Sales}}{\text{Net capital employed}}$
(j) Debt equity ratio	= $\dfrac{\text{Liabilities to outsiders}}{\text{Capital Reserves – Miscellaneous expenditure}}$

(k) Operating cash flow (Debit plus depreciation)/Sales (Net of excise)

Appendix VI

Example of Letter of Appointment

A & Bros.,
……… Lane,
New Delhi. Date:

M/s. X.Y. & Co.,
Chartered Accountants
New Delhi.

Dear Sir,

We are happy to inform you that you have been appointed as auditors of our Firm/our Branch at .... for the purpose of audit of accounts for the year ending......………for submitting our audited accounts and report to............. Bank as per the requirement of the Reserve Bank of India. You will be paid a total remuneration of Rs. __________ including / excluding your travelling and other incidental expenses for conducting the audit and submitting the audit reports to us as per the requirements of the bank.

I may inform yon that the audit of accounts for the last year i.e., year ending ....……………………………. for this purpose was conducted by M/s. N. & M. & Co., Chartered Accountants of.............. New Delhi -1.[#]

Please acknowledge this letter in token of your acceptance and intimate the date you intend to commence the audit work. Needless to say, you shall get full co-operation from us for conducting the audit and you shall have access to all our books of accounts and records. You can call for any information or explanation which you may need for the purpose of your audit. We hereby authorise you to file a copy of the audited accounts and audit report with the above bank.

Yours faithfully,

( )

Partner

[#] In case there was no previous auditor, the letter may confirm this fact.

Appendix X

Inventories

(Chapter 5 of the Statement on Auditing Practices)

The section on audit of inventories has been withdrawn upon the issuance of the Guidance Note on Audit of Inventories by the Auditing Practices Committee of the Council of the Institute of Chartered Accountants of India in August, 1994.

Appendix XI

Fixed Assets

(Chapter 3 of the Statement on Auditing Practices)

The section on audit of fixed assets has been withdrawn upon the issuance of the Guidance Note on Audit of Fixed Assets by the Auditing Practices Committee of the Council of the Institute of Chartered Accountants of India in April, 1985.

Appendix XII

Guidance Note on Audit of Fixed Assets

Refer to the Guidance Note on Audit of Fixed Assets published in the Handbook of Auditing Pronouncements - 2010 Edition.

Appendix XIII

Debtors, Loans and Advances

(Chapter 7 of the Statement on Auditing Practices)

The section on audit of debtors, loans and advances has been withdrawn upon the issuance of the Guidance Note on Audit of Debtors, Loans and Advances issued by the Auditing Practices Committee of the Council of the Institute of Chartered Accountants of India in June, 1994. The Guidance Note has been published elsewhere in this Compendium.

Appendix XIV

Liabilities

(Chapter 9 of the Statement on Auditing Practices)

The section on audit of liabilities has been withdrawn upon the issuance of the Guidance Note on Audit of Liabilities issued by the Auditing Practices Committee of the Council of the Institute of Chartered Accountants of India in December, 1995. The Guidance Note has been published elsewhere in this Compendium.

Appendix XV

Maintenance of Fixed Assets Register

[Statement on the Manufacturing and Other Companies (Auditor's Report) Order 1975]

Refer to Paragraphs 44 and Paragraphs 45 of the Statement on the Companies (Auditor's Report) Order, 2003##.

Appendix XVI

Verification and Valuation of Inventories

[Statement on the Manufacturing and Other Companies (Auditor's Report) Order 1975 (Para 24)]

Refer to Paragraphs 47 to Paragraphs 49 of the Statement on the Companies (Auditor's Report) Order, 2003.

Appendix XVII

Internal Control

[Statement on the Manufacturing and Other Companies (Auditor's Report) Order 1975 (Para 27)]

Refer to Paragraphs 54 of the Statement on the Companies (Auditor's Report) Order, 2003.

Appendix XVIII

Internal Audit

[Statement on the Manufacturing and Other Companies (Auditor's Report) Order 1975 (Para 28)]

Refer to Paragraphs 58 of the Statement on the Companies (Auditor's Report) Order, 2003.

The Statement on Companies (Auditor's Report) Order, 2003 has been published in Handbook of Auditing Pronouncements-2015 edition, Volume I.B: Compendium of Statements.