PRACTICAL ASPECTS OF
FINANCIAL STATEMENTS
&
AUDIT REPORTS
(Including CARO & IFC)

THE COMPANIES ACT, 2013

LUNAWAT & CO.
Chartered Accountants
1st September 2016, Chandigarh

CA. PRAMOD JAIN
FCA, FCS, FCMA, LL.B, MIMA, DISA
THE PROCESS

Lunawat & Co.

Financial Statements

Auditors Report

Directors Report
Financial Statements
Financial Year – 31\textsuperscript{st} March

Cash Flow for all except:
- OPC
- SC
- DC

FS to be in Schedule III

Amended w.e.f. 4.9.15 to include MSMED details under Trade Payable
**BASICS – CURRENT VS. NON-CURRENT**

- **Current Asset** - satisfies any of following criteria;
  - In the company’s normal operating cycle it is;
    - Intended for sale; or
    - Intended to be consumed; or
    - Expected to be realized.
  - Held primarily for the purpose of being traded; or
  - Expected to be realized within 12 months after reporting date; or
  - Cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least 12 months after reporting date.
Current liability if it satisfies any of the following criteria; if it is:

- Expected to be settled in the company’s normal operating cycle; or
- Held primarily for the purpose of being traded; or
- Due to be settled within 12 months after reporting date; or
- The company does not have an unconditional right to defer settlement of liability for at least 12 months after reporting date. Terms of a liability that could, at option of counterparty, result in its settlement by issue of equity do not affect its classification.
GENERAL

- Balance Sheet Title – ‘as at’ or ‘as on’ 31st March
- PL Title - Statement of Profit & Loss / I & E
- Rounding off based on turnover.
  - < Rs. 100 Crores - To the nearest hundreds, thousands, lakhs or millions or decimal thereof
  - Rs. 100 Crores or more - To the nearest lakhs or millions or crores or decimal thereof
- Comparative figures required to be disclosed for the last reporting period
GENERAL

- Linking of notes with B/S & PL
- Name, DIN, designation & address of signatories to any document uploaded / filed with ROC
- B/s & PL on letterhead of Auditors
- Date of signing
- Payment to shareholders for 2(22)(e)
SHARE CAPITAL & RESERVES

- Authorized / Paid up Capital – Check with Master Data
- Reconciliation of no of shares outstanding at beginning and at end of reporting period.
- Rights, preference & restrictions attaching to each class of shares etc.
- Is conversion of loans into shares in event of default in repayment – Non-cash?
- Share Premium A/c??
BORROWINGS

- Long Term vs. Short Term
  + Directors??
  + CC Limits?? Demand Loans??

- Secured / unsecured – nature of security to be stated & guaranteed by directors to be shown separately.

- Term of repayment of term loans to be given
  + Period of maturity with respect to B/S date
  + Number of installments due; Amt of installments due
  + Applicable rate of interest

- Period & amount of default in payment of principal & interest as on B/S date
The amount shall be classified as:

- Current maturities of long term debts
- Current maturities of finance lease obligations
- Interest accrued but not due on borrowings
- Interest accrued and due on borrowings
- Income received in advance
- Unpaid dividends
- Share Application money due for refund and interest accrued thereon (including advances for allotment of share Capital)
- Unpaid matured deposit and interest thereon
- Unpaid matured debentures and interest thereon
- Other payables
Others payable may include:

- Statutory obligations like, ESI, PF, VAT, CST, etc.
- Liability for purchase of fixed assets
- Contractually reimbursable expenses
- Interest accrued on trade payables
- Expenses Payable.
- TDS Payable
- Trade / Security Deposit
- Mark-to-market loss on forward and option contracts
- Retention Monies
- Accrued salaries and benefits
Fixed Asset on the face of the Balance Sheet has to be classified as follows:

- Tangible Assets
- Intangible Assets
- Software
- Capital work-in-progress
- Intangible assets under development

Capital advances to be grouped as Capital Work-in-Progress or loans and advances? Long term or short term?
INVENTORIES

Classification into:
+ Raw Materials
+ Work-in-progress
+ Finished goods
+ Stock-in-trade (trading goods)
+ Stores and spares
+ Loose tools
+ Others (specifying nature)

Finished goods should include all goods except acquired for trading purposes

Goods-In-transit - disclose under relevant sub-head

Mode of valuation to be stated
REVENUE FROM OPERATIONS

▪ For companies other than finance company:
  + Sale of Products
  + Sale of Services
  + Other Operating Revenues
  ▶ Less: Excise Duty

▪ For Finance company:
  + Interest
  + Other Financial services

▪ As per AS 9 presentation for excise duty - on face of PL
OTHER INCOME

- To be classified as:
  - Interest income (other than for finance company)
  - Dividend
  - Dividend from subsidiary company
  - Net gain / loss on sale of investments
  - Other non-operating income

- Interest, dividend, etc. to be disclosed separately for Current as well as Non Current Investments
EXPENSES

Disclosure on face of the PL:
- Cost of material consumed
- Purchase of stock-in-trade
- Changes in inventories of finished goods
  Work-in-progress and stock in trade
- Employee benefit expenses
- Finance cost
- Depreciation and amortization expenses
- Other expenses.
FINANCE COST

- Interest expense
  - Interest on borrowings, debentures, bonds, etc.
  - Finance charges on finance lease are in nature of interest

- Other borrowing costs
  - Commitment charges
  - Loan processing charges
  - Guarantee charges
  - Loan facilitation charges
  - Discounts/ premium on borrowings
  - Other ancillary costs

- Applicable net loss on foreign currency transactions to the extent they are regarded as adjust to interest cost

- Interest on Tax???
OTHER EXPENSES

✖ All other expenses will be grouped here. Following to be disclosed separately:
  ✔ Consumption of stores and spares
  ✔ Power and fuel
  ✔ Rent
  ✔ Repairs to buildings
  ✔ Repairs to machinery
  ✔ Insurance
  ✔ Rates and taxes, excluding taxes on income
  ✔ Miscellaneous expenses

✖ Any expenditure which exceeds 1% of revenue from operations or Rs.1 L whichever is higher - separate
Notes to the Accounts
Entities that are to follow AS

Corporate

Companies (Accounting Standards) Rules, 2006

Ind AS

ICDS

Non-Corporate

AS issued by ICAI

ICDS
AS DISCLOSURES IN NOTES

- SMC / Non-SMC
- AS 1
- FS to be prepared in compliance of AS
- FS has to be AS compliant:
  - FS to disclose deviation from AS
  - Reason for deviation
  - Financial effect arising of deviation
<table>
<thead>
<tr>
<th>AS No.</th>
<th>Short Title</th>
<th>Corporate</th>
<th>Non-Corporate Entities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td>Non-SMC</td>
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<td>Cash Flow</td>
<td>Y</td>
<td>N (C)</td>
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<td>4</td>
<td>Events after Balance Sheet date</td>
<td>Y</td>
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<tr>
<td>5</td>
<td>Prior Period Items &amp; Policies</td>
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<td>6</td>
<td>Depreciation</td>
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<td>7</td>
<td>Construction</td>
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<td>9</td>
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<td>Borrowing Cost</td>
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<td>17</td>
<td>Segment</td>
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<td>19</td>
<td>Leases</td>
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<td>20</td>
<td>Earning Per Share</td>
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<td>21</td>
<td>Consolidation</td>
<td>Y (listed)</td>
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<td>Deferred Taxes</td>
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<td>23</td>
<td>Consolidated Statements</td>
<td>Y (listed)</td>
<td>N (C)</td>
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<td>24</td>
<td>Discontinuing Operation</td>
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<td>25</td>
<td>Interim Reporting</td>
<td>Y (listed)</td>
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<td>26</td>
<td>Intangible Assets</td>
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<tr>
<td>27</td>
<td>Interest in Joint Ventures</td>
<td>Y (listed)</td>
<td>N (C)</td>
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<td>28</td>
<td>Impairment</td>
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<td>Partly</td>
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<td>29</td>
<td>Contingency</td>
<td>Y</td>
<td>Partly</td>
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<tr>
<td>30-32</td>
<td>Financial Instruments</td>
<td>N***</td>
<td>N***</td>
</tr>
</tbody>
</table>
IMPORTANT NOTES

- Contingent Liabilities / Commitments (to the extent not provided for)
- Broad Heads – RM, Income, Purchases
- Value of imports made during the year on CIF basis:-
  - Raw Materials
  - Components (intermediaries & components) & Spare Parts (for capital equipment)
  - Capital Goods
IMPORTANT NOTES

- Expn. in foreign currency (accrual basis) on:
  - Royalty
  - Know-how
  - Professional & consultation fee
  - Interest
  - Others

- Dividend if paid in FC (cash Basis):
  - Total amount remitted during the year in FC
  - Total no. of non-resident shareholders
  - No. of shares held by them on which dividend due
  - Year to which dividend relates
Foreign Exchange Earnings (Accrual basis):

+ Export of goods (calculated on F.O.B. basis)
+ Royalty, know how, professional and consultation fees
+ Interest and dividends
+ Other income (indicating the nature thereof)
OTHER DISCLOSURES IN NOTES

❖ To disclose in FS full particulars of:
  + Loan given;
  + Investment made;
  + Guarantee given; or
  + Security Provided.
  + Purpose for which loan or guarantee or security is proposed to be utilised by recipient of loan or guarantee or security [186(4)]

❖ Contribution during yr to National Defence Fund

❖ Amount contributed to Political Party and name of party [182(3)]
OTHER DISCLOSURES IN NOTES

- Public Companies:
  + Money received from director

- Private companies
  + Money received from director
  + Money received from relative of director
RELATED PARTY

Accounting Standards
- AS 18

Companies Act
- S. 2(76)

Income Tax
- 40A(2)(b)

S. 184
S. 188

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Audit

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AUDITING STANDARDS

- Auditor to comply with auditing standards
- NFRA to notify auditing standards. Till NFRA does – as by ICAI
- Total 38 SAs

<table>
<thead>
<tr>
<th>SA. No.</th>
<th>Sub-division</th>
<th>No.</th>
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<tbody>
<tr>
<td>100-199</td>
<td>Introductory Matters</td>
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<td>200-299</td>
<td>General Principles &amp; Responsibilities</td>
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<tr>
<td>300-499</td>
<td>Risk Assessment and Response to Assessed Risks</td>
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<td>500-599</td>
<td>Audit Evidence</td>
<td>11</td>
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<tr>
<td>600-699</td>
<td>Using Work of Others</td>
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<td>700-799</td>
<td>Audit Conclusions and Reporting</td>
<td>6</td>
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<tr>
<td>800-899</td>
<td>Specialized Areas</td>
<td>3</td>
</tr>
</tbody>
</table>
Audit Reports

Companies Act
- CARO
- Non-CARO

Other Acts
- Tax Audit
- LLP
- Society

Form 3CA
Form 3CB
Inquiry u/s 143(1) – 6 points

To be reported when comments required

Report to also include:

Matters specified u/s 143(3) - 9 points

Matters specified in Rules - 3 points

Any order made u/s 143(3) for specified Companies in consultation with NFRA – CARO 2016 – 16 points
CARO 2016
CARO 2016 – APPLICABILITY

- Applicable to all including Foreign Co. for a/cing period after 1.4.15 except:
  + Banking Co. / Insurance Co.
  + Section 8 Co.
  + OPC
  + Small Co.
  + Not applicable on CFS
  + Branch auditor also covered, if applicable to co.
P. Co not being sub. or holding of Pub. Co. whose:

- Paid up Capital & Reserves < 1 Cr as at B/s date; and
  - Bonus, Pref. shares to be included
  - Share Application money !!
  - All reserves to be included including revaluation reserve
P. Co not being sub. or holding of Pub. Co. whose:

- Outstanding Loans - Bank or FIs < 1 Cr during FY; and
  - All borrowings included – non fund based – to extent devolved, invoked guarantees & devolved LCs
  - TL – interest accrued & due only to be considered
  - CC – balance on any day as per books
  - OD against FD included
  - Outstanding due of Credit card also included
  - Foreign banks covered - FIs include NBFC
Pvt. Co not being sub. or holding of Pub. Co. whose:

- Total Revenue (including from discontinuing operations) < 10 crores as per Financial Statements as per Schedule III
- Other income included
1(a) - Proper records - full particulars, quantitative details and situation of FA.

- FAR in electronic form if 2 conditions satisfied:
  - Controls & security measures in Co. are such that once finalised, FAR cannot be altered without proper authorization & audit trail.
  - FAR can be retrieved in a legible form.

- In case above conditions not satisfied, to obtain a duly authenticated print-out of FAR. In case auditor decides to rely on electronically FAR - to maintain adequate documentation evidencing evaluation of controls that seek to ensure completeness, accuracy & security of register.
**1(b) - Physical verification – material discrepancy**

**1(c) - Whether title deeds of immovable properties are held in the name of the company. If not, provide details thereof**

- TDR / Plt & Mach imbedded in land not imm. Prop.
- In case of conversion
- In case of mortgage – banks
- Online if available
- Details – no. of cases, leasehold/freehold, gross/net block, remarks
2(a)(b)(c) merged into 2 - Whether physical verification of inventory has been conducted at reasonable intervals by the management & whether any material discrepancies were noticed and if so, how they have been dealt with in books of a/c

3 - Whether company has granted any loans, secured or unsecured to cos, firms, LLP or other parties covered is registered maintained u/s 189.[MBP-4] – 184(2)/188
3 – MBP 4 - If so,

(a) Whether terms & conditions of grant of such loans are not prejudicial to company’s interest;
   - CY only, terms s. 186(7), ability to lend, borrower standing

(b) Whether the schedule of repayment of principal & interest is stipulated & whether repayments & interest are regular.
   - Opening + CY, squared up loans covered – no. of cases

(c) If overdue amount for more than 90 days, whether reasonable steps taken by Co. for recovery of the principal & interest
   - Opening + CY – no. of cases, principal amt overdue, intt overdue. steps taken
CARO 2016 - CLAUSES

- 4 – Internal control on purchase etc not required

- 4 - In respect of loans, investments and guarantees, whether provisions of Section 185 and 186 have been complied with. If not, provide details thereof.
  + 185 Details – maximum amount and closing Bal.
  + 186 – more than 2 layers, exceeding limits, rate of interest, other defaults

5 – Deposits – no change 73-76
CARO 2016 - CLAUSES

◆ 6 – Cost Records – no change

◆ 7 – Statutory Dues – Wealth tax (c) IEPF
  + Statutory due arises out of a statute, rather than on an independent contractual or legal relationship
  + Advance tax, TDS, Custom duty... if intt – irregular.
  + Instalments granted by authority, penalty/intt covered
  + Irregularity vs. due more than 6 months
  + Mere show cause – not disputed, S. 154 – disputed
  + If no appeal filed – undisputed dues
  + Disclose disputed amounts even if provision made or amount deposited under protest
CARO 2016 - CLAUSES

× 8 – Accum. /cash losses– not required

× 8 – Earlier 9 – Default to Bank, FIs, Govt. & debenture holders - (in case of banks, Govt. and FIs, lender wise details to be provided).
   + Default – non payment of dues, FIs include NBFCs
   + Period of default and amount lender wise
   + All defaults existing on B/S date – even earlier years
   + Debentures – lender-wise detail not required
   + Govt. does not include – Foreign govt., Govt. Co, PSU, Boards, Corporations
CARO 2016 - CLAUSES

9 - New - Whether moneys raised by way of IPO/FPO (including debt instruments) & term loans were applied for purposes for which those are raised. If not, details together with delays / default & subsequent rectification.

- Default - amount involved, nature of default, delay in utilization
- Co. to disclose end use of IPO/FPO in notes & auditor to verify – see SEBI (Listing Obl. & Dis. Req.) Reg.
- Temporary investment (FDR) to be reported
- Term Loans from Private Parties
- If against property, FDR, etc – no specific purpose
CARO 2016 – CHANGES

- 10 - Whether any fraud by Co. or any fraud on Co. by its officers/employees has been noticed or reported during the year; If yes, nature and amount involved be indicated
  - Only to report ‘noticed or reported’ frauds. 143(12) frauds to CG/AC. Reported frauds u/s 143(12) to be reported not suspected frauds
  - Management fraud vs. Employee fraud
  - Fraudulent Financial Reporting vs. Misappropriation of assets
11 – New - Whether managerial remuneration has been paid / provided in accordance with the requisite approvals mandated by the provisions of s. 197 r.w. schedule V? If not, state the amount involved & steps taken for securing refund of the same.

+ Only Public Cos
+ Exclusion – sitting fee, for professional services
+ Entitled persons, limits, procedure and approval
+ Reporting – payment to MD, WTD, MD, Manager, Excess amount paid/ provided, Due for recovery & steps taken
12 – Nidhi Co.

13 – **New** - Whether all transactions with related parties are in compliance with S. 177 and 188 and details have been disclosed in FS etc as required by applicable AS.

- To see s. 177 & 188 and AS 18
- S. 188 applicable to all companies other than on arm’s length transactions entered into in ordinary course of business
- May test on TP mechanism per IT Act
13 – SA 550 Related Parties - transactions not in normal course of business (Eg):

- Complex equity transactions, such as corporate restructurings or acquisitions
- Transactions with offshore entities in jurisdictions with weak corporate laws
- Leasing of premises or rendering of management services by entity to another party if no consideration is exchanged
- Sales transactions with unusually large discounts or returns
- Transactions with circular arrangements, for example, sales with a commitment to repurchase
- Transactions under contracts whose terms are changed before expiry.
14 - **New** - Whether Co. has made preferential allotment / PP of shares or fully or partly convertible deb. during yr. Whether S. 42 complied & amount raised used for purposes for which funds were raised.

- If not, details of amount involved and nature of non-compliance.
15 – New - Whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether provisions of S. 192 complied with

- Persons connected - 185(1) Expl. – check MBP 1
- Loan, guarantee, etc – MBP 2; Contracts – MBP 4
- FAR, BOD Meetings, EGM, AGM
- Merger under court schemes – Not non-cash
- Acquisition of asset in one year, settlement of liability in another year – Not non-cash
16 – **New** - Whether Co is required to be registered u/s 45-IA of RBI and if so whether the registration has been obtained

+ Understanding business, if principal business is Financing activity
+ 50-50 Test - Financial Assets > 50% of total assets and income from Financial assets > 50% of Gross Income
+ If required and registration not obtained reasons to be stated
INTERNAL FINANCIAL CONTROLS
LESS COMPLEX

- Concentration of ownership & management in a small number of individuals;
- Straightforward or uncomplicated transactions;
- Simple record-keeping/centralized accounting;
- Few lines of business & few products within business lines;
- Few internal controls;
- Few levels of management with responsibility for a broad range of controls;
- Few personnel, many having a wide range of duties;
- Use of less complex IT systems;
- Extensive involvement by owners & senior management in the day-to-day activities of the business.
ICFR REPORTING

- Take Engagement Letter
- Perform procedures
- Take Representation Letter
- Issue Separate / Combined Report
  - Unmodified
  - Modified
    - Qualified
    - Adverse
    - Disclaimer
| Due to adequacy (and therefore operating effectiveness) | • The Company did not have an appropriate internal control system for customer acceptance, credit evaluation and establishing customer credit limits for sales, which could potentially result in the Company recognising revenue without establishing reasonable certainty of ultimate collection  
• ..except for the effects/possible effects of the material weakness/es described above on the achievement of the objectives of the control criteria, the Company has maintained, in all material respects, adequate internal financial controls over financial reporting as on..  
• ...these material weakness/es do not affect our opinion on the standalone financial statements of the Company |

Lunawat & Co.
Due to adequacy (and therefore operating effectiveness)

- The Company did not have an appropriate internal control system for customer acceptance, credit evaluation and ......
- The Company did not have an appropriate internal control system for inventory with regard to receipts, issue for production and physical verification. Further, the internal control system for identification and allocation of overheads to inventory was also not adequate. These could potentially result in material misstatements in the Company’s trade payables, consumption, inventory and expense account balances.
- ...the Company has not maintained adequate internal financial controls over financial reporting
- ...these material weakness/es do not affect our opinion on the financial statements of the Company
**ICFR REPORTING - QUALIFIED**

<table>
<thead>
<tr>
<th>Qualified - Due to operating effectiveness</th>
<th>Unmodified – On Adequacy</th>
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</thead>
<tbody>
<tr>
<td>• The Company’s internal financial controls over customer acceptance, credit evaluation and establishing customer credit limits for sales, were not operating effectively which could potentially result in the Company recognising revenue without establishing reasonable certainty of ultimate collection</td>
<td></td>
</tr>
<tr>
<td>• ..except for the effects/possible effects of the material weakness/es described above on the achievement of the objectives of the control criteria, the Company’s internal financial controls over financial reporting were operating effectively as on..</td>
<td></td>
</tr>
<tr>
<td>• ...these material weakness/es do not affect our opinion on the standalone financial statements of the Company</td>
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</table>
Lunawat & Co.

**ICFR REPORTING - ADVERSE**

<p>| Due to operating effectiveness | The Company’s internal financial controls over customer acceptance, credit evaluation and establishing customer credit limits for sales, were not operating effectively which could potentially result in the Company .... |
| Unmodified – On Adequacy | The Company’s internal control system for inventory with regard to receipts, issue for production and physical verification were not operating effectively. Further, the internal control system for identification and allocation of overheads to inventory was also not operating effectively. These could potentially result .... |
| | ...Company’s internal financial controls over financial reporting were not operating effectively |
| | ...these material weakness/es do not affect our opinion on the financial statements of Company |</p>
<table>
<thead>
<tr>
<th>Due to - Essential components of internal controls not adequately considered in the internal financial controls established by the company</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>• The Company did not have an appropriate internal financial control system over financial reporting since the internal controls adopted by the Company did not adequately consider risk assessment, which is one of the essential components of internal control, with regard to the potential for fraud when performing risk assessment</td>
<td></td>
</tr>
<tr>
<td>• ...the Company has not maintained adequate and effective internal financial controls over financial reporting as on..</td>
<td></td>
</tr>
<tr>
<td>• ...these material weaknesses do not affect our opinion on the financial statements of the Company</td>
<td></td>
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</tbody>
</table>
| Resulting in modified opinion of standalone financial statements | • The Company **did not have appropriate internal controls for reconciliation of physically inventory with the inventory records, which has resulted in misstatement of inventory values in the books of account.**  
• because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, the Company **has not maintained adequate and effective internal financial controls over financial reporting as of.**  
• **...these material weakness/es has affected our opinion on the standalone financial statements of the Company and we have issued a qualified (adverse / disclaimer of) opinion on the standalone financial statements.** |
### ICFR Reporting - Disclaimer

<table>
<thead>
<tr>
<th>Due to - Framework for internal financial control over financial reporting not established but does not impact the audit opinion on financial statements</th>
</tr>
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<tbody>
<tr>
<td>• the Company has not established its internal financial control over financial reporting on criteria based on or considering the essential components of internal control stated in the Guidance Note on Audit of IFCoFR issued by the ICAI. Because of this reason, we are unable to obtain sufficient appropriate audit evidence to provide a basis for our opinion whether the Company had adequate internal financial controls over financial reporting and whether such internal financial controls were operating effectively as at...</td>
</tr>
<tr>
<td>• ...the disclaimer does not affect our opinion on the financial statements of the Company</td>
</tr>
<tr>
<td>Due to - Auditor unable to obtain sufficient appropriate audit evidence on internal financial controls over financial reporting but does not impact audit opinion on the financial statements</td>
</tr>
<tr>
<td>---</td>
</tr>
</tbody>
</table>
| • The system of internal financial controls over financial reporting with regard to **one of the significant branches of the Company at _____ were not made available to us to enable us to determine if the Company has established adequate internal financial control over financial reporting at the aforesaid branch and whether such internal financial controls were operating effectively as at...**  
• **...the disclaimer does not affect our opinion on the financial statements of the Company** |
Due to Auditor unable to obtain sufficient appropriate audit evidence on internal financial controls over financial reporting and impacting audit opinion on the financial statements:

- The system of internal financial controls over financial reporting with regard to the Company were not made available to us to enable us to determine if the Company has established adequate internal financial control over financial reporting and whether such internal financial controls were operating effectively as at...

- ... the disclaimer has affected our opinion on the financial statements of the standalone Company and we have issued a qualified (/ adverse / disclaimer of) opinion on the financial statements.
THE ONLY WAY