

Manufacturing and Other Companies (Auditor's Report) Order, 1988

Notification No. G. S. R. 909(E), dated 7th September, 1988.

In exercise of the powers conferred by sub-section (4A) of section 227 of the Companies Act, 1956 (1 of 1956), read with the Notification of the Government of India in the Department of Company Affairs, No. G. S. R. 443(E), dated 18th October, 1972, as amended from time to time and in supersession of order No. G.S.R. 553(E), dated 7th November, 1975, except as regards things done or omitted to be done before such supersession, and after consultation with the Institute of Chartered Accountants of India (constituted under the Chartered Accountants Act, 1949 (38 of 1949)), in regard to class of companies to which this order applies and other ancillary matters, the Company Law Board hereby makes the following order, namely :-

1. Short title, application and commencement.-

- (1) This order may be called the Manufacturing and other Companies (Auditor's Report) Order, 1988.
- (2) (a) It shall apply to every company including a foreign company as defined in section 591 of the Companies Act, 1956 (1 of 1956), which is engaged or proposes to be engaged in one or more of the following activities, namely :-
 - (i) manufacturing, mining or processing ;
 - (ii) supplying and rendering services ;
 - (iii) trading ; and
 - (iv) the business of financing investment, chit fund, nidhi or mutual benefits societies.
- (b) It shall not apply to,-
 - (i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949) ;
 - (ii) an insurance company as defined in section 2(21) of the Companies Act, 1956 (1 of 1956) ; and
 - (iii) a company licensed to operate under section 25 of the Companies Act, 1956 (1 of 1956).
- (3) It shall come into force on the 1st day of November, 1988.

2. Definitions. - In this Order :

- (a) "chit fund", "nidhi" or "mutual benefit" company means a company engaged in the business of managing, conducting or supervising as a foreman or agent of

any transaction or arrangement by which it enters into an agreement with a number of subscribers that every one of them shall subscribe a certain sum of instalments for a definite period and that each subscriber, in his turn, as determined by lot or by auction or by tender or in such other manner as may be provided for in the agreement, shall be entitled to a prize amount, and includes companies whose principal business is accepting fixed deposits from, and lending money to, members ;

- (b) "finance company" means a company engaged in the business of financing, whether by making loans or advances or otherwise, of any industry, commerce or agriculture and includes any company engaged in the business of hire-purchase, lease financing and financing of housing ;
- (c) "investment company" means a company engaged in the business of acquisition and holding of, or dealing in, shares, stocks, bonds, debentures, debenture stocks, including securities issued by the Central or any State Government or by any local authority, or in other marketable securities of a like nature ;
- (d) "manufacturing company" means a company engaged in any manufacturing process as defined in the Factories Act, 1948 (63 of 1948) ;
- (e) "mining company" means a company owning a mine, and includes a company which carries on the business of a mine either as a lessee or occupier thereof ;
- (f) "processing company" means a company engaged in the business of processing materials with a view to their use, a sale, delivery or disposal ;
- (g) "service company" means a company engaged in the business of supplying, providing, maintaining and operating any services, facilities, conveniences, bureaux and the like for the benefit of others ;
- (h) "trading company" means a company engaged in the business of buying and selling goods.

3. Auditor's report to contain matters specified in paragraphs 4 and 5. -

Every report made by the auditor under section 227 of the Companies Act, 1956 (1 of 1956), on the accounts of every company examined by him to which this Order applies for every financial year ending on any day on or after the commencement of this Order, shall contain the matters specified in paragraphs 4 and 5.

4. Matters to be included in the auditor's report.-

The auditor's report on the accounts of a company to which this order applies shall include a statement on the following matters, namely :-

(A) In the case of a manufacturing, mining or processing company :-

- (i) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets ; whether these fixed assets have been physically verified by the management at reasonable intervals ; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt within the books of account ;

- (ii) whether any of the fixed assets have been revalued during the year ? If so, the basis of revaluation should be indicated ;
- (iii) whether physical verification has been conducted by the management at reasonable intervals in respect of finished goods, stores, spare parts and raw materials ?
- (iv) are the procedures of physical verification of stocks followed by the management reasonable and adequate in relation to the size of the company and the nature of its business ? If not, the inadequacies in such procedures should be reported ;
- (v) whether any material discrepancies have been noticed on physical verification of stocks as compared to book records, and if so, whether the same have been properly dealt with in the books of account ?
- (vi) whether the auditor, on the basis of his examination of stocks, is satisfied that such valuation is fair and proper in accordance with the normally accepted accounting principles ? Is the basis of valuation of stocks same as in the preceding year? If there is any deviation in the basis of valuation, the effect of such deviation, if material, should be reported ;
- (vii) if the company has taken any loans, secured or unsecured from companies, firms or other parties listed in the register maintained under section 301 of the Companies Act, 1956 (1 of 1956), and/or from the companies under the same management as defined under sub-section (1B) of section 370 of the Companies Act, 1956 (1 of 1956), whether the rate of interest and other terms and conditions of such loans are prima facie prejudicial to the interest of the company ;
- (viii) if the company has granted any loans, secured or unsecured, to companies, firms or other parties listed in the register (s) maintained under section 301 and/or to the companies under the same management as defined under sub-section (1B) of section 370 of the Companies Act, 1956 (1 of 1956), whether the rate of interest and other terms and conditions of such loans are prima facie prejudicial to the interest of the company ;
- (ix) whether the parties to whom the loans, or advances in the nature of loans, have been given by the company 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 company for recovery of the principal and interest ;
- (x) is there an adequate internal control procedure commensurate with the size of the company and the nature of its business, for the purchase of stores, raw materials, including components, plant and machinery, equipment and other assets, and for the sale of goods ;
- (xi) whether the transaction of purchase of goods and materials and sale of goods, materials and services, made in pursuance of contracts or arrangements entered in the register(s) maintained under section 301 of the Companies Act, 1956 (1 of 1956), as aggregating during the year to Rs. 50,000 (rupees fifty thousand) or more in respect of each party, have

been made at prices which are reasonable having regard to prevailing market prices for such goods, materials, or services or the prices at which transactions for similar goods or services have been made with other parties ;

- (xii) whether any unserviceable or damaged stores, raw materials, or finished goods, are determined and whether provisions for the loss, if any, have been made in the accounts ;
- (xiii) in case the company has accepted deposits from the public, whether the directives issued by the Reserve Bank of India and the provisions of section 58A of the Companies Act, 1956, and the rules framed there under where applicable, have been complied with. If not, the nature of contraventions should be stated ;
- (xiv) is the company maintaining reasonable records for the sale and disposal of realisable by-products and scraps, where applicable ;
- (xv) in the case of companies having a paid-up capital exceeding Rs. 25 lakhs as at the commencement of the financial year concerned, or having an average annual turnover exceeding Rs. 2 crores for a period of three consecutive financial years immediately preceding the financial year concerned, whether the company has an internal audit system commensurate with its size and nature of its business ;
- (xvi) where maintenance of cost records has been prescribed by the Central Government under section 209(1)(d) of the Companies Act, 1956 (1 of 1956), whether such accounts and records have been made and maintained ;
- (xvii) is the company regular in depositing Provident Fund and Employees' State Insurance dues with the appropriate authority and if not, the extent of arrears of Provident Fund and Employees' State Insurance dues shall be indicated by the auditor ;
- (xviii) whether any undisputed amounts payable in respect of income-tax, wealth-tax, sales tax, customs duty and excise duty were outstanding, as at the last day of the financial year concerned, for a period of more than six months from the date they became payable, if so, the amounts of such outstanding dues should be reported ;
- (xix) whether personal expenses have been charged to revenue account ; if so, the details thereof should be reported ;
- (xx) whether the company is a sick industrial company within the meaning of clause (o) of sub-section (1) of section 3 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) ; if so, whether a reference has been made to the Board for Industrial and Financial Reconstruction under section 15 of that Act ;

(B) In the case of a service company :-

- (i) all the matters specified in clause (A) to the extent to which they are applicable ;
- (ii) whether the company has a reasonable system of recording receipts, issues

and consumption of material and stores and allocating materials consumed to the relative jobs, commensurate with its size and nature of its business :

- (iii) whether the company has a reasonable system of allocating man-hours utilised to the relative jobs, commensurate with its size and nature of its business ;
- (iv) whether there is a reasonable system of authorization at proper levels, and an adequate system of internal control commensurate with the size of the company and the nature of its business, on issue of stores and allocation of stores and labour to jobs.

(C) In the case of a trading company :-

- (i) all the matters specified in clause (A) to the extent to which they are applicable ;
- (ii) have the 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 a finance, investment, chit fund, nidhi or mutual benefit company :-

- (i) all the matters specified in clause (A) to the extent to which they are applicable ;
- (ii) whether adequate documents and records are maintained in a case where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities ;
- (iii) whether the provisions of any special statute applicable to chit fund, nidhi or mutual benefit society have been duly complied with ; and
- (iv) if the company 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 company in its own name except to the extent of the exemption, if any, granted under section 49 of the Companies Act, 1956 (1 of 1956).

5. Reasons to be stated for unfavourable or qualified answers.-

Where, in the auditor's report, the answer to any of the questions referred to in paragraph 4 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 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 question.