

Issues on CARO, 2003 as amended in 2005

Genesis of this legislation:

- a) Dubious practices like loan to private companies, purchase /sale transactions by book entries and or at fictitious prices – not open to normal audit.
- b) Investing public lost heavily in some listed companies
- c) Recommendations of Daphtary – Sastri Report

Issues on applicability:

1. Whether share application money is covered?
2. What if the authorised capital or issued capital or subscribed capital exceeds Rs. 50 lacs?
3. Whether calls in arrears /forfeited shares account are to be considered?
4. Whether Bonus shares are covered?
5. Whether shares issued for consideration other than cash are covered?
6. Whether revaluation reserve is covered?
7. whether capital reserves are covered?
8. whether special reserves – statutory/non-statutory are covered?
9. whether debit balances of profit & loss account being accumulated loss, can be reduced from capital?
10. where the specified limits exceed only on the last day of the year, whether CARO will be applicable?
11. whether government companies are covered?
12. whether foreign companies are covered? If so, whether the operations outside India to be considered or not? What about liaison office?
13. whether branches of a company are covered?
14. whether exempt companies to report? If so, how to report?
15. The balances of loans should be as per bank's books or company's books? How to determine the balance in case of cash credit facility sanctioned but not fully utilised?
16. Whether credit card dues are covered?
17. where the turnover exceeds 5 crores, whether the turnover means turnover of sales or purchases? When do we take into account sales returns?
18. where the loans from private parties say NBFCs exceeds Rs. 25 lacs
19. Whether holding company/subsidiary company is covered, irrespective of the fact that the other counterpart company is covered?

Issues on Clause 4(i) on Fixed Assets

- (i) What constitute proper records?
- (ii) Whether records maintained in electronic media, constitutes proper records?
- (iii) How much is "substantial part"?
- (iv) When can you say that going concern concept is affected?
- (v) How do you say the discrepancies are properly dealt with?
- (vi) Whether physical verification to be done by auditors? If not, how does the auditor certify that physical verification has been conducted?
- (vii) What are reasonable intervals?

Issues on Clause 4(ii) on Inventories

- a) What is covered under the term – 'inventory'?
- b) How to report where there are practical difficulties to maintain records of WIP.
- c) How do you say the discrepancies are properly dealt with?
- d) Whether physical verification to be done by auditors? If not, how does auditor certify that physical verification has been conducted?
- e) What are reasonable intervals?
- f) How to determine the reasonableness or adequacies of the procedure of physical verification and report the inadequacies?

Issues on Clause 4(iii) on Loans

- A. Loans granted:
 - 1. Whether the clause applies to only those granted during the year or even those granted in the past and appear on the balance sheet?
 - 2. Whether it covers all loans granted to only those loans which are granted to parties covered in the register maintained u/s 301 of the Companies Act, 1956? Whether reporting under AS 18 covers the above? What if they new qualify or cease to be covered during the year?
 - 3. What if register u/s 301 is not maintained?
 - 4. When do you say that the rate of interest and other terms are prima facie prejudicial to the interest of the company?
 - 5. What if there are no stipulations as to rate of interest and repayment or other terms?
 - 6. What about loans repayable on demand?

7. When do you say the repayment of principal and interest is regular?
8. What do you mean by the term – overdue? When is a loan overdue?
9. What are reasonable steps for recovery of overdue loans?

B. Loans taken:

- (i) Whether the clause, applies to only those taken during the year or even those taken in the earlier years and still appear on the balance sheet?
- (ii) Whether it covers all loans granted to only those loans which are granted to parties covered in the register maintained u/s 301 of the Companies Act, 1956? Whether reporting under AS 18 covers the above?
- (iii) When do you say that the rate of interest and other terms are prima facie prejudicial to the interest of the company?
- (iv) What if there are no stipulations as to rate of interest and repayment or other terms? What about loans repayable on demand?
- (v) When do you say the repayment of principal and interest is regular?

Issues on Clause 4(iv) on Internal Control System

- a) How do you determine the adequacy of an internal control system?
- b) Whether reporting on internal control systems is to be restricted only in specified areas, such as purchase of inventory and fixed assets and sale of goods and services?
- c) What is a major weakness?
- d) What is continuing failure?
- e) If there is no internal audit, can it be said that there is no internal control?

Issues on Clause 4(v) on Contracts or arrangements referred to in Section 301 of the Companies Act, 1956.

1. As regards maintenance of the registers u/s 301 of the said Act, is your report in respect thereof in tandem with the report given by CS.
2. How do you reasonableness of the prices?
3. How to determine – 'prevailing market prices'? What if the supplier is a monopolist or the product is custom-made?

Issues on Clause 4(vi) on Deposits

- (i) Whether deemed deposits are covered?
- (ii) How to determine contraventions by the company?
- (iii) How to determine the order of any authority?
- (iv) How to report under this clause, in case where NBFC converted into bank or vice versa?

Issues on Clause 4(vii) on Internal Audit

- a) Whether non-existence of internal audit amounts to qualification in the report?
- b) Whether external auditors are mandatory?

Issues on Clause 4(viii) on Cost Records

- 1. How to determine whether the maintenance of cost record has been prescribed by the Central Government?
- 2. Whether to check on year to year basis?

Issues on Clause 4(ix) on Statutory dues

- (i) What constitutes statutory dues and other statutory dues?
- (ii) Whether all applicable statutes to be considered? If so, how to ensure that the same is done?
- (iii) What are disputed dues?
- (iv) Whether payment of Bonus/Gratuity to employees constitutes statutory dues?
- (v) Whether Electricity Bills are statutory dues? If so, in what circumstances?
- (vi) Is payment of TDS amounting to statutory dues?
- (vii) Whether all delays are to be reported?
- (viii) What details of the appeals are required to be mentioned or reported?
- (ix) Whether non-compliance, say, non-payment of professional tax, by the company would constitute disputed dues.
- (x) What statutes are covered in case of disputed dues?
- (xi) Where a show cause is issued and the matter is not decided, can it be said disputed dues?
- (xii) What if the demand is set aside, but the department goes in for appeal? What if the demand is confirmed, and the time to appeal by the company, has elapsed?

Issues on Clause 4(x) on Cash losses

- a) What are cash losses?
- b) What if cash losses are only for one of the years?
- c) Whether manufacturing company and service companies or trading companies are distinguished for reporting?
- d) Whether qualifications by previous auditor to be considered to determine the net worth? What if the qualification is not quantifiable?

Issues on Clause 4(xi) on default in repayment of dues

- 1. When does a default take place?
- 2. Whether all defaults to be reported?
- 3. What if renewal is not done? Can it be said that it is due?

Issues on Clause 4(xii) on loans granted against securities

- (i) What are adequate documents and records?
- (ii) Can the company give loans against securities unless authorised by the MoA.
- (iii) Whether the deficiencies to be reported, should relate only to documentation or even the systems?

Issues on Clause 4(xiii) on chit funds/nidhi

- a) How to determine the Chit Fund law applicability?
- b) What are adequate procedures? How to determine the same?
- c) What prudential norms?
- d) How to determine whether the repayment schedule is proper?

Issues on Clause 4(xiv) on dealing/trading of securities

- 1. What are proper records?
- 2. How to report that timely entries are done?
- 3. Whether to report shares and securities in the name of persons other than company?

Issues on Clause 4(xv) on guarantees for others

- (i) Whether the guarantee given by the company on behalf of others can be prejudicial to the interests of the Company?
- (ii) How do you determine whether it is prejudicial to the interest of the company?

Issues on Clause 4(xvi) on use of term loans

- a) Whether term loans obtained from entities/persons other than banks/financial institutions are also covered?
- b) Whether reporting is to be made on the term loans obtained during the year or outstanding as at the end of the year irrespective of the year in which they are obtained?
- c) Whether debentures are covered under this clause?
- d) What procedures to be adopted in case of term loans from banks, raised against title deeds, long term FDRs, NSCs etc., where the bank is not concerned with the purpose for which it is being obtained?

Issues on Clause 4(xvii) on short-term funds used for long term purpose

- 1. How to comply with reporting requirement under clause 4(xvii)?
- 2. What about core working capital?
- 3. If working capital loans are raised against fixed deposits, are they reportable?
- 4. If current assets are used for paying long term debts, are they reportable?

Issues on Clause 4(xviii) on preferential allotment

- (i) Whether a situation, where a limited company has already issued shares at a premium to outsiders and later on issued shares(at par or book value) to parties listed under section 301 of Act, the latter issue of share would be treated as being prejudicial to the interests of the company?
- (ii) Where a private limited company having four shareholders (being relatives)holding 25per cent each of the share capital of the company , are allotted shares in equal proportions at a value of , say, Rs.10 while the book value of shares is, Rs. 50, would it be reportable under this clause?
- (iii) Will issue of ESOPs by private companies be considered as preferential allotment?
- (iv) Would this clause apply to convertible bonds?

Issues on Clause 4(xix) on debentures

- a) Whether reporting is required to be done in respect of debentures issued during the year or outstanding as on the year end irrespective of the year in which they were issued?

- b) If the debentures have been issued towards the end of the year and the securities are created subsequently, what are the reporting responsibilities of the auditor under this clause?

Issues on Clause 4(xx) on end use of public issue

1. How to report in a case where the company has invested surplus funds, not immediately required, in short-term loans/investments?
2. Does this clause apply to monies raised by public issues during the year or even earlier years?

Issues on Clause 4(xxi) on frauds

- (i) What are the reporting responsibilities in case where frauds have been committed by the directors of the company but are not reported by the company and come to the knowledge of the auditors from private sources?
- (ii) Whether the total amount of frauds and the each major can be clubbed and disclosed? Whether individual amount involved in each fraud is to be separately listed out with the corresponding nature of fraud?
- (iii) What are the various kinds of frauds reported?

Other Issues

- a) Manner of reporting where CARO not applicable?
- b) Manner of reporting report in case of qualified report?
- c) Manner of report, in case of disclaimer?