Companies Auditors Report Order (CARO) - 2003

By

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J K Industries Limited

- Genesis of MAOCARO
- Requirements dispensed with
- Requirements modified
- New Requirements

Genesis of MAOCARO

- ✓ Dubious practices like loan to private companies, sale and purchase transactions by book entries and / or at fictitious prices not open to Normal Audit.
- ✓ Investing public lost heavily in some listed companies.
- ✓ Daphtary-Sastri Committee recommendations.

Requirements Dispensed with under CARO

Requirements dispensed with under CARO

- ✓ Revaluation of Fixed Assets
- ✓ Comment on fair & proper valuation of Inventory
- ✓ Determination of any unserviceable stores and provision for the loss.
- ✓ Records for sale and disposal of byproducts and scraps.
- ✓ Personal expenses charged to revenue

Requirements Modified under CARO

Applicability (w.e.f. 1.07.2003)

Private limited company – Exempted if

- ✓ Paid up capital and reserves <= Rs. 50 lacs
- ✓ Not accepted any Public Deposit
- ✓ Aggregate Liability from any bank / FI <= Rs.10 lacs
- ✓ Turnover <= Rs. 5 crs.

Physical Verification of Inventory

- ✓ Inclusion of WIP, earlier not covered in MAOCARO.

Loan Transactions with parties covered by Section 301

- ✓ Disclose number of parties and amount involved
- ✓ If overdue amount is more than Rs. 1 lac, comment on reasonable steps for recovery to be made

- Reporting requirements already covered under AS – 18 (Related Party Transactions) and clause 32 of Listing Agreement for most of the parties.

Internal Control

- ✓ Disclosure of Continuing failure to correct major weaknesses.
- ✓ To ensure that weaknesses in controls does not continue.

Transactions (other than Loan) with Parties covered under section 301

- ✓ Ensure compliance with Section 297, 299 and 301.
- ✓ Reporting requirement only w.r.t. parties where transaction value > Rs. 5 lacs
- ✓ Comparison only with prevailing market prices

- Reporting requirement already covered under AS – 18, if required, necessary modification may be made there.

Fixed Deposit

- ✓ Internal Control system to ensure compliance of Section 58AA.
- ✓ Compliance with order of CLB, if any, to be reported.

Internal Audit System

- ✓ All listed companies
- ✓ Unlisted Companies with paid up share capital & free reserves >Rs. 50 lacs & Avg. annual turnover for last 3 yrs > Rs. 5 crs.

Deposit of Statutory Dues

- ✓ Coverage widened by including " Investor Education & Protection Fund, Cess and other Statutory dues".
- ✓ Reporting of non payment of undisputed PF and ESI dues, only if more than 6 months old

Financial Health – Report if

- ✓ Company registered => 5 yrs.
- ✓ Erosion in Net Worth => 50%
- ✓ Cash Losses in current and previous financial year

Records of loans and advances granted on pledge of securities

- ✓ Requirement extended to all companies
- ✓ Deficiencies to be reported

Nidhi / Mutual benefit fund / societies ;

- ✓ Disclose – If Net owned funds to deposit liability ratio is more than 1: 20 on B/S date
- ✓ Disclose Non- compliance with prudential norms on income recognition and provisioning
- ✓ Comment on Adequacy of procedures for appraisal of credit proposals / requests, assessment of credit needs and repayment capacity of the borrowers
- ✓ Comment whether the repayment schedule of loans is based on repayment capacity of the borrower.

Dealing in securities

- ✓ Requirement extended to all companies
- ✓ Word investment replaced by securities

New Requirements under CARO

Disposal of Substantial part of Fixed Assets (4(i)(c))

“If a substantial part of the Fixed Assets have been disposed off during the year, whether it has affected going concern”.

- ✓ What constitutes substantial part of Fixed Assets
- ✓ The Company need to substantiate that it continues to be a going concern, if substantial part of Fixed Assets has been disposed off

Disputed Statutory Dues – (4(ix)(b))

"In case dues of sales tax / income tax / custom tax / wealth tax / excise duty / cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending may please be mentioned".

- ✓ Maintainence of Proper records such as payment challans, Show Cause Notices, demand notices, advance tax payments etc
- ✓ Maintain Complete records of disputes – nature, amounts involved, forum etc.

- *All material dues are disclosed in Financial Statements either as liabilities or contingent liabilities.*
- *Various statutory authorities are there to monitor such compliance.*
- *then why is auditor expected to report ?*

Default in repayment of dues to FI's / Banks or debentureholders (4(xi))

"Whether the Company has defaulted in repayment of dues to a financial institution or bank or debentureholders ? If yes, the period and amount of default to be reported"

- ✓ Auditee to provide loan agreements, repayment schedule, restructuring / reschedulement and defaults to enable the auditor to comment on period and amount of default

- *Concept of materiality - disregarded*
- *Lending institution has effective monitoring mechanism in place*
- *Credit information bureau already publicizing the defaulters*
- *Underlying Security can be liquidated under SRAFESI Act 2002*

Guarantees given by the Companies for Loans (4(xv))

"Whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company"

- ✓ Auditor to check register of guarantees, minutes of Board meeting / General meeting, MOA / AOA, financial standing of the borrower, nature of security, limits under Sec. 372A etc.
- ✓ No comments required, if borrowings are made from sources other than Banks / FI's.

- *No need to report on instruments such as Letter of Comfort, Indemnity bonds and other similar instruments.*
- *The information is already being disclosed as Contingent Liability in the accounts*

Application / Usage of Term Loan Availed (4(xvi))

"Whether term loans were applied for the purpose for which the loans were obtained"

✓ Sanction letters of Loans, disbursement and usage to be closely monitored and documented preferably by using separate account.

- *Normally disbursement is made only after capital expenditure is committed through firm purchase order.*
- *Post disbursement monitoring by Lender through Project Progress report, site inspection, verifying deployment of promoters contribution, formal financial closure, future term loan proposals etc.*

Preferential allotment of shares to companies listed in Registers maintained under Section 301 (4(xviii))

"Whether the company has made any preferential allotment of shares to parties and companies covered in the Register maintained under Section 301 of the Act and if so whether the price at which shares have been issued is prejudicial to the interest of the Company".

✓ Auditor to check whether the issue price has been determined as per SEBI guidelines

- *For listed Companies - SEBI monitors the compliance through stringent guidelines.*
- *For Private Companies – Public Interest not affected*

Creation of Securities (4(xix))

"Whether securities have been created in respect of debentures issued ?"

- ✓ Whether Security / Charge has been created as per debenture trust deed

- Objective of reporting by auditor – Not clear

End Use of money raised through IPO (4(xix))

" Whether the management has disclosed on the end use of money raised by public issues and the same has been verified"

- ✓ Companies to maintain adequate records showing utilisation of funds raised through IPO.
- ✓ Monitoring is being done by SEBI through quarterly reports / Listing Agreement.

Uses of Short Term Funds for Long Term purposes and vice versa (4(xvii))

“Whether the funds raised on short term basis have been used for long term investment and vice versa. If yes, the nature and amount to be indicated”.

- ✓ Additional record showing uses of Short and Long Term Funds under respective category.
- ✓ No clarity on temporary make shift arrangements in the interest of the company

- *Cash Flow Statement clearly depicts the position*
- *Utilisation of Long Term funds for Short Term purposes is not prejudicial in any manner.*

Frauds (4(xxi))

"Whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated"

- ✓ Materiality - not addressed

Despite having numerous monitoring / regulatory agencies, there is a tendency to shift the onus elsewhere and create one more channel to dilute the regulatory responsibility

Thank You