

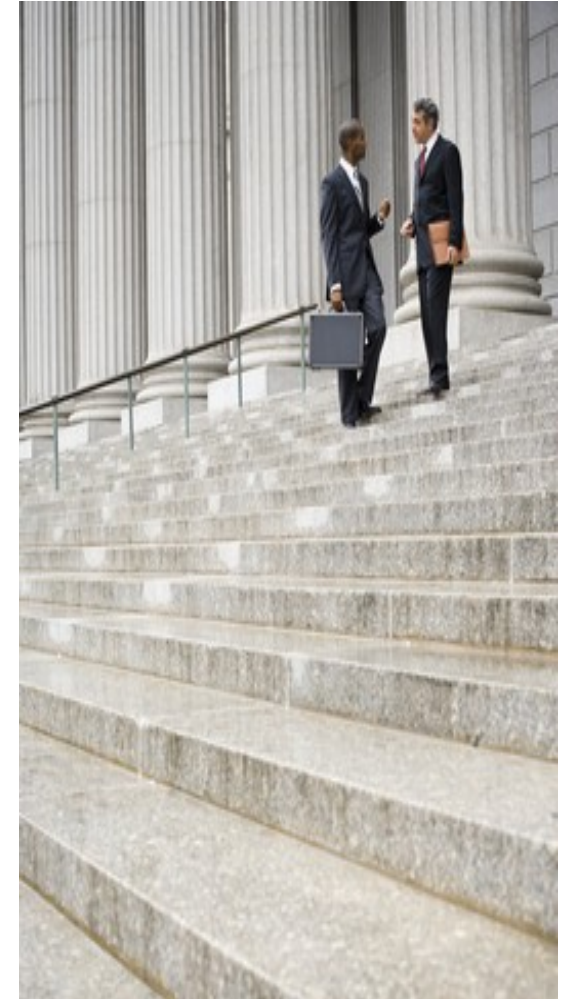
**COMPANIES  
(AUDITOR'S REPORT)  
ORDER, 2003**



# Salient features of CARO

Central Government in exercise of powers conferred under section 227(4A) of Companies Act, 1956 issued the Companies (Auditor's report) Order, 2003 ('CARO' or 'the Order') in suspension of its earlier Manufacturing and Other contained matters on which auditors have to make a statement in their audit report Companies (Auditor's Report) Order, 1989

- **CARO has been amended through notification No. GSR 766(E) dated 25 November 2004**
- **Authoritative literature issued by ICAI's statement on CARO**
  - **Statement on Companies (Auditor's Report) 2003**
  - **Issues on Companies (Auditor's Report) 2003**
  - **EAC Opinions**



- **General provisions regarding audit report**
- **Applicability of CARO**
- **Matters to be included clause wise and related implementation issues**

**General provisions  
regarding audit report**



# General provisions regarding audit report

- **The Order is supplemental to the existing provisions of Section 227 of the Companies Act, 1956 ('the Act')**
- **Provisions of sub Section (1A), (2), (3), and (4) of section 227 of the Act applicable to all companies, the Order exempts certain classes of companies**
- **Unlike provisions of Sec 227 (IA) of the Act, the auditor is required to comment on every statement in the Order**
- **The order does not limit the duties and responsibilities of the auditors**
- **Requires a Statement to be included in the audit report in respect of matters specified**

## Applicability of CARO

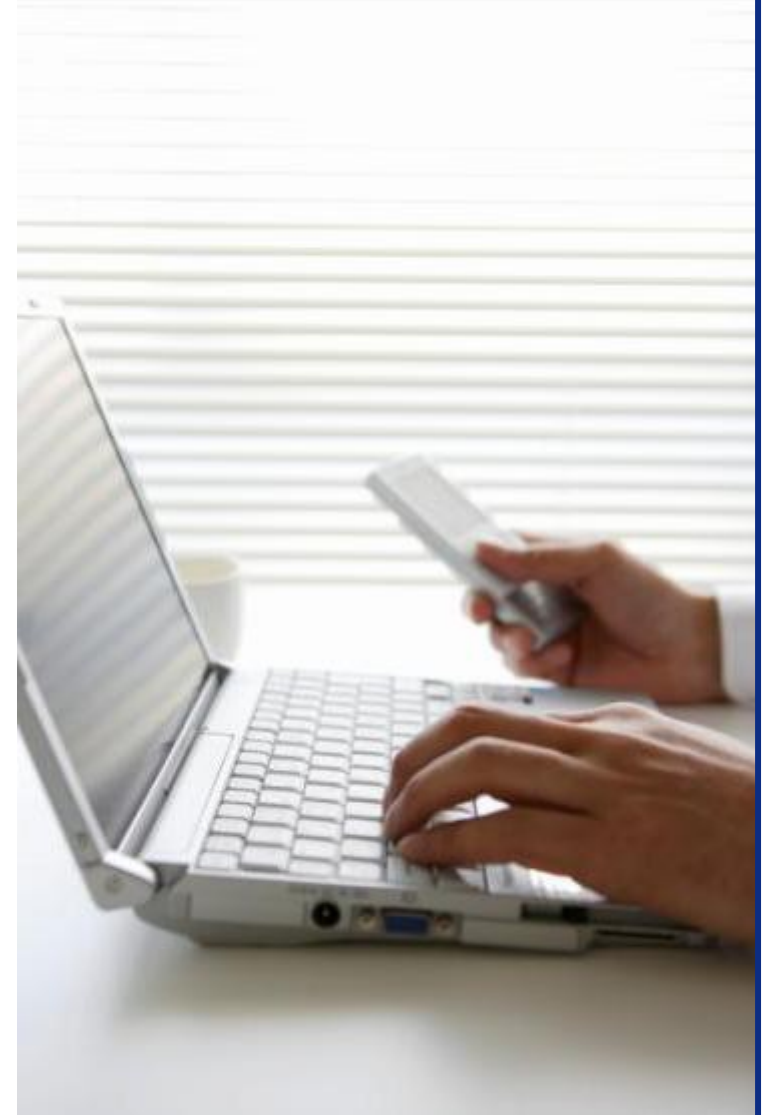


# Applicability of CARO

CARO applies to all companies **except** the following

- a banking company as defined in the Banking Regulation Act, 1949;
- an insurance company as defined in the Act ;
- a company licensed to operate under Section 25 of the Act ;
- Section 25 companies registered under the earlier Companies Act;and
- a private limited company with a paid-up capital and reserves not more than Rs. 50 lacs and which does not have outstanding loan exceeding Rs. 25 lacs from any bank or financial institution and does not have a turnover exceeding Rs. 5 crores at any point of time during the financial year

Also applies to foreign companies defined in Section 591 of the Act



# Other Issues related to applicability of CARO

- CARO applies to liaison office of a foreign company
- For determining applicability of CARO to a private company:
  - Debit balance in the profit and loss should be reduced in determining the amount of paid-up capital and reserves, but miscellaneous expenditure should not be so reduced
  - Credit balance in the profit and loss account to be treated as part of revenue reserve; to be added to figures of capital and paid-up reserves
  - Conditions prescribed for exemption to be examined throughout the year
  - Loans taken from a private bank or a foreign bank to be considered
- Applicable to audits of branches of a company also



A person is working at a desk with multiple computer monitors. The background monitor shows a dashboard with various charts and data. The foreground monitor shows a line graph with a green line. The person's hand is visible, holding a pen and pointing at the background monitor. A blue triangular overlay is on the left side of the image.

**Matters to be reported  
and related  
implementation issues**

## Clause 4(i) – Fixed assets – Reporting requirement

- Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets [Clause 4(i)(a)]
- 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 has been properly dealt with in the books of account [Clause 4(i)(b)]
- If a substantial part of fixed assets have been disposed off during the year, whether it has affected the going concern [Clause 4(i)(c)]



# Implementation issues

- The term 'Proper records' not defined; ICAI statement states:
  - Aggregate original cost, depreciation or amortisation to date and impairment loss, if any, under individual heads to tally with the figures shown in books of accounts
  - Not possible to specify any single form; depend upon mode of account keeping, number of operating locations, systems of controls etc.
- Records in the form of electronic fixed assets register to be accepted if :
  - The controls and security measures in the company are such that once finalised, the fixed assets register cannot be altered
  - Fixed assets register is in such a form that can be retrieved in a legible form

Maintain adequate documentation evidencing the evaluation of controls that seek to ensure the completeness, accuracy and inalterability of the register
- Auditor to observe physical verification of the fixed assets and the method of verification
- Fixed assets to be verified at **reasonable intervals** - factors to be considered include the number of assets, the nature of assets, the relative value of assets, difficulty in verification, situation and spread of the assets, etc

# Implementation issues

- **Substantial part of fixed assets cannot be defined as certain percentage of fixed assets since materiality levels may differ; determination of 'substantial part'**
  - depends upon the facts and circumstances of each case
  - auditor to exercise his professional judgement
- **While reporting on substantial disposal of fixed assets, also consider assets which have not been put to use but held for sale or abandoned due to non-viability of the project or any other reason**
- **Section 293(1)(a) of Act deals with the sale, lease or otherwise disposal of the whole or substantially the whole of the undertaking of the company**
  - **Where company has taken approval of shareholders for sale or disposal of whole or substantially whole of the undertaking, it may indicate disposal of substantial part of fixed assets**
  - **Auditor to apply appropriate audit procedures to report substantial disposal**

## Clause 4(ii) – Inventories

- Whether physical verification of inventory has been conducted at reasonable intervals by the management [Clause 4(ii)(a)]
- Are the procedures of physical verification of inventory 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 [Clause 4(ii)(b)]
- Whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account [Clause 4(ii)(c)]



# Implementation issues

- **Applies to inventories of construction companies also (flats/complexes under construction, building materials awaiting use etc.)**
- **Inventories does not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular**
- **Physical verification of inventories to be done at reasonable intervals; determine reasonable intervals considering**
  - **nature of inventories,**
  - **their location and**
  - **the feasibility of conducting a physical verification**
- **Auditor to ascertain whether the management has instituted adequate cut-off procedures for verification of inventories**

## Clause 4(iii) – Loans with Section 301 companies

- Has the company granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under Section 301 of the Act? If so, give the number of parties and amount involved in the transactions; [Clause 4(iii)(a)]
- Whether the rate of interest and other terms and conditions of loans given by the company, secured or unsecured, are prima facie prejudicial to the interest of the company ; [Clause 4(iii)(b)]
- Whether receipt of the principal amount and interest are also regular; [Clause 4(iii)(c)]
- If overdue amount is more than INR 1 lac, whether reasonable steps have been taken by the company for recovery of principal and interest ; [Clause 4(iii)(d)]
- Has the Company taken any loans, secured or unsecured from companies, firms or other parties covered in the register maintained under Section 301 of the Act. If so, give, the number of parties and the amount involved in the transactions; and [Clause 4(iii)(e)]
- Whether the rate of interest and other terms and conditions of loans taken by the company, secured or unsecured; are prima facie prejudicial to the interest of the company; and [Clause 4(iii)(f)]
- Whether payment of the principal amount and the interest are also regular [Clause 4(iii)(g)]

# Implementation issues

- Obtain a list of all loans granted by the company (irrespective of year end balance) during the year to parties listed in the register showing the
  - name of the party,
  - amount of loan,
  - maximum amount outstanding at any time during the year and
  - Year-end balance
- Applicable to all loans taken/granted whether during the year or whether brought forth as opening balances
- Disclosure required for all kinds of loans given in cash or in kind given to parties covered in the register
- Loans given to an employee who is also a relative of a director of the company at a concessional rate of interest need to be examined and commented upon
- Loans given at a time when parties not required to be entered in the register u/s 301 but during the year came within the ambit of section 297 or 299 to be reported under this clause
- No reporting required for loan transactions entered into with another company where directors are common but such directors do not hold more than two percent of the paid up share capital



# Implementation issues

- In case of loans repayable on demand, to determine whether payment of principal amount and interest are regular, repayment of loan become due as and when lending company demands the loan
- Regularity of payment of principal amount and interest to be restricted for companies, firms or other parties covered in the register maintained u/s 301 of the Act
- The term 'regular' should be taken to mean that principal and interest should normally be paid or received whenever they fall due respectively.
  - If due date not specified, assume that it falls due on each anniversary of the loan
- Reasonable steps for recovery of loan includes
  - Arrangement for raising finances, partial repayments, restructuring/compromise arrangements with the lenders, improvements in cash flow position etc.
- In case of no stipulation for repayment of the loan, auditor to mention this fact in audit report

## Clause 4(iv) – Internal control systems

Is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system?

### Implementation issues

- If 'major weakness' in internal controls existed in previous year and continues to exist in the current year, it would need to be reported
- For identifying major weakness, following may be referred:
  - Internal audit reports
  - Minutes of the meetings of board of directors and of audit committee
  - Previous year's working papers of statutory auditor
  - Current evaluation of internal controls



# Implementation issues

- **If statutory auditor detects failure during current audit and informs management, there are two possible situations:**
  - **Failure did not exist during the previous year; if weakness detected in the year of audit – it may be difficult to term it as continuing failure;**
  - **Failure existed during the previous year and it continues; it should be reported**
- **Determination of continuing failure in correcting a major weakness in internal controls to be done by auditor irrespective of existence of internal audit function of the company**
- **Requirement in regard to adequacy of internal controls and continuing failure to correct major weakness are not inter related**
  - **Adequacy of internal controls to be reported for purchase of inventories, purchase of fixed assets and sale of goods and services**
  - **Continuing failure to correct a major weakness in internal control to be reported**

## Clause 4(v) – Transactions with Section 301 companies

- Whether the particulars of contracts and arrangements referred to in Section 301 of the Act have been entered in the register required to be maintained under that section; and [Clause 4(v)(a)]
- Whether transactions made in pursuance of such contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time [Clause 4(v)(b)]  
(This information is required only in case of transactions exceeding Rs. 5 lakh rupees in respect of any one financial year.)

# Implementation issues

- **Aggregate value of all transactions entered into any of the companies/firms/parties covered in the register maintained under section 301 of the Act exceed the value of rupees five lakhs**
- **Reporting requirements restricted to transactions entered into a register u/s 301 of the Act**
- **If a company has entered into a transaction with the firm in which the directors are interested but not obtained approval of Central Government, auditor to state this fact;**
- **Auditor to examine whether the prices paid for transactions examined are reasonable, having regard to the prevailing market prices; auditor to examine**
  - **Price lists**
  - **Quotations**
  - **Records relating to prices at which similar transactions have been entered into**
  - **Also consider factors such as delivery period/schedule of implementation, the quality and quantity of product/service, credit terms, the previous records of supplier/buyer/client**

## Clause 4(vi) – Deposits from the public

- 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, 58AA or any other relevant provisions of the Act and the rules framed there under, where applicable, have been complied with. If not, nature of the contraventions should be stated; if an order has been passed by the Company Law Board or National Company Law Tribunal or Reserve Bank of India or any Court or any Tribunal whether the same has been complied with or not? [Clause 4(vi)]
- **Implementation issues**
  - Deemed deposits i.e. loans from shareholders, relatives or other parties are covered and need to be reported
  - Auditor cannot ascertain deposits accepted are within the limits on each day of accounting year – examine efficacy of internal control systems
  - Auditor to make inquiries from the management and obtain a representation for compliance with the requirements



## Clause 4(vii) – Internal audit system



- In the case of listed companies and/or other companies having a paid-up capital and reserves exceeding INR 50 lacs as at the commencement of the financial year concerned, or having an average annual turnover exceeding INR 5 crores for a period of three consecutive years immediately preceding the financial year concerned, whether the company has an internal audit system commensurate with its size and nature of its business. [Clause 4(vii)]
- **Implementation issues**
  - Mandatory application for listed companies irrespective of size of paid-up capital and reserves or turnover
  - NBFC converted into a banking company during the financial year will be exempted from order
  - Public company converted into a private company satisfying prescribed conditions will be exempted from order
  - Various factors such as size of the internal audit team, qualifications of the persons, areas covered etc to be examined by the auditor

## Clause 4(viii) – Maintenance of Cost records



- Where maintenance of cost records has been prescribed by the Central Government under clause (d) of sub-section (1) of Section 209 of the Act, whether such accounts and records have been made and maintained [Clause 4(viii)]
- **Implementation issues**
  - Auditor to report whether cost accounts and records have been made and maintained; ‘made’ applies in respect of cost accounts and ‘maintained’ applies in respect of cost records relating to materials, labour, overheads etc.
  - Auditor to report irrespective of whether cost audit required
    - MCA vide order dated 24 January 2012 directed specified class of companies to get their cost accounting records, in respect of financial years commencing on or after 1 April 2012, audited by a cost auditor, holding a valid certificate of practice under the provisions of Cost and Works Accountants Act, 1959
  - Extent of examination need to clearly brought out in audit report



## Clause 4(ix)(a) –Deposit of Undisputed statutory dues

- Is the Company regular in depositing undisputed statutory dues including Provident fund, Investor Education and Protection Fund, Employees' State Insurance, Income-tax, Sales-tax, Wealth Tax, Service Tax, Customs Duty, Excise Duty, Cess and any other statutory dues with the statutory authorities and if not, the extent of arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor[ Clause 4(ix)(a)]
- **Implementation issues**
  - “Any other statutory dues” includes all type of dues under various statutes which are applicable to the company having regard to the nature of its business (e.g. municipal taxes, electricity bills)
  - Foreign statues also covered
  - Dues under an independent contractual or legal relationship not covered
  - Non-payment of advance income tax also constitutes default
  - Default to be reported even if there are no arrears on the Balance Sheet date
  - If company has not provided for statutory dues payable, e.g. TDS not deducted and not recognised in the books of account should be treated as being payable and reported

## Clause 4(ix)(b) –Deposit of disputed statutory dues

- In case of Income Tax/ Sales Tax / Service Tax/ Customs Duty/ 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 shall be mentioned[ Clause 4(ix)(b)]
- **Implementation issues**
  - Disputed dues involves difference of opinion between the relevant department and the company
  - Amounts be reported under this clause :
    - amounts, which have been deposited on account of any dispute, shown as recoverable in the books (i.e. not charged off to the profit and loss account) need not be reported
    - amounts, which have been disputed at a forum, but have already been provided for on consideration of likely outcome, needs to be reported
    - amounts not provided also needs to be disclosed as long as they are not deposited
  - Show case notices (SCN)
    - Mere issuance of SCN by the concerned department – not a demand – so not to be reported
    - When combined with a demand – to be assessed individually
  - Details of disputed statutory dues for each year and each statute to be reported separately

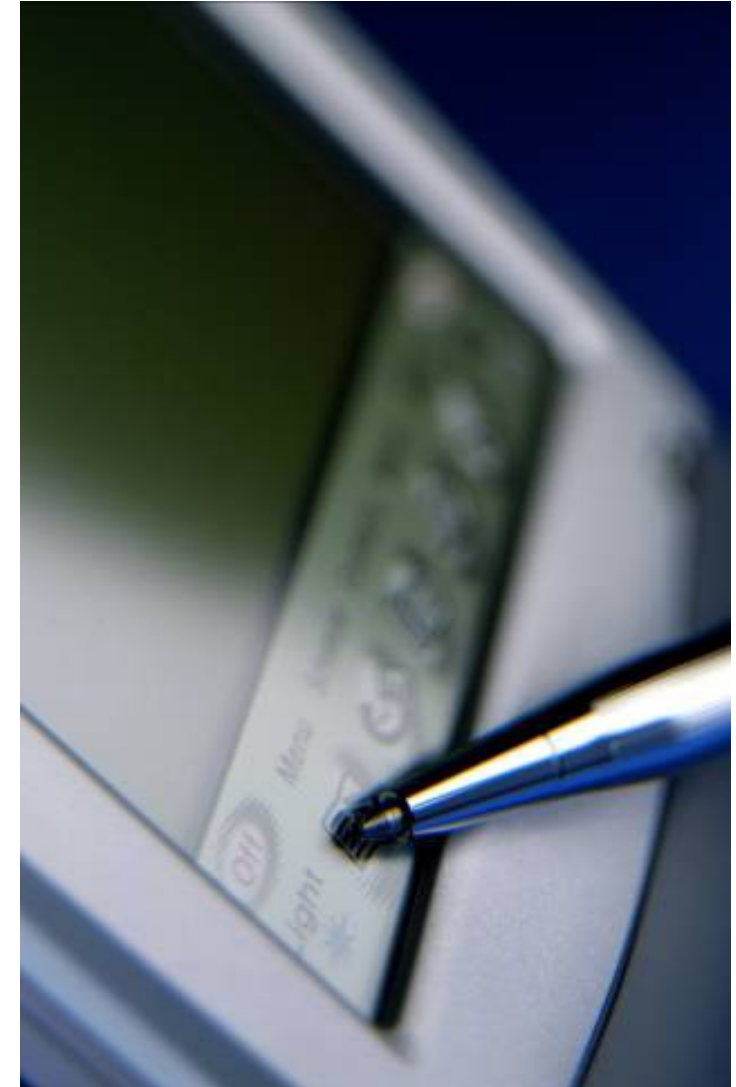
## Clause 4(x) – Accumulated losses and Cash losses



- Whether in case the company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year [Clause 4(x)]
- **Implementation issues**
  - Current year and previous year be reported separately when in one of the two years no cash loss has been incurred
  - “Cash loss” computation –
    - to be adjusted for the effect of qualifications in the respective audit periods to the extent the qualifications are quantified
    - Profit/loss shown in the profit and loss account to be adjusted for the effects of transactions of non-cash nature such as depreciation, amortisation, deferred tax expenses etc.
  - “Net Worth” – Sec 2(29A) defines it as total of paid-up capital and free reserves after deducting provisions or expenses as may be prescribed

## Clause 4(xi) – Default in repayment of dues

- Whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported [Clause 4(xi)]
- **Implementation issues**
  - All defaults existing at the balance sheet date should be reported irrespective of when those defaults have occurred
  - Word “default” not defined. ICAI Statement explains that “default” means non-payment of dues to banks, financial institutions or debenture holders on the last dates mentioned in the loan agreements
  - Submission of application for rescheduling /restructuring proposals to the lenders, which is in process, does not mean that default has not occurred
  - Disputes between the company and the lender on certain issues relating to repayments – auditor should give a disclaimer under this clause



## Clause 4(xii) – Loans and Advances secured by way of pledge



- Whether adequate documents and records are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities. If not, the deficiencies to be pointed out [Clause 4(xii)]
- **Implementation issues**
  - Per ICAI Statement- “Other securities” may be construed to mean bonds or promissory notes issued by the government or similar authority
  - What constitutes adequate records depends on the nature of the security
  - The auditor need not examine the adequacy of the security on the basis of which loans have been granted

## Clause 4(xiii) – Compliance with special statutes and regulations

- **Whether the provisions of any special statute applicable to chit fund have been duly complied with?**
- **In respect of nidhi/mutual benefit fund/societies:**
  - **whether the net-owned funds to deposit liability ratio is more than 1:20 as on the date of balance sheet;**
  - **whether the company has complied with the prudential norms on income recognition and provisioning against sub-standard/doubtful/loss assets;**
  - **whether the company has adequate procedures for appraisal of credit proposals/requests, assessment of credit needs and repayment capacity of the borrowers;**
  - **whether the repayment schedule of various loans granted by the nidhi is based on the repayment capacity of the borrower? [Clause 4(xiii)]**

## Clause 4(xiv) –Shares, Securities and Debentures

- 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 Act. [Clause 4(xiv)]
- **Implementation issues**
  - Auditor to report whether investments are held in the company's own name for companies which deal or trade in investments
  - When investments are intended or contracted to be sold immediately and not transferred in company's name, auditor to use his discretion to ascertain whether failure to transfer is understandable

## Clause 4(xv) - Guarantees given and Clause 4 (xvi) - Utilisation of funds

- 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 [Clause 4(xv)]
  - Loans taken by ‘others’ from sources ‘other than bank or financial institutions’ not covered
- Whether the term loans were applied for the purpose for which loans were obtained[ Clause 4(xvi)]
- **Implementation issues**
  - Cash credit, overdraft and call money accounts/deposits not covered as they are not terms loans
  - Term loans obtained from entities/persons other than banks/financial institutions not covered
  - One-to-one relationship with the amount of term loan and its utilization is not required
  - Funds are temporarily invested during construction phase to reduce the cost of capital – auditor to mention that pending utilisation of funds for the stated purpose, the funds were temporarily used for other purpose
  - Loans disbursed at the end of the year, not utilised for the stated purpose – auditor to report exception under this clause



## Clause 4(xvii) – Funds raised on short-term basis



- Whether the funds raised on short-term basis have been used for long-term investment. If yes, the nature and amount is to be indicated [Clause 4(xvii)]
- **Implementation issues**
  - Position should be seen on a cumulative basis (net position at the balance sheet date)
  - Auditor to restrict his examination and comments to figures and data given in the financial statements of the company
  - Long-term application of funds includes investment in fixed assets, long-term investments in shares, debentures and other securities and other assets of similar nature, repayment of long-term loans, etc.
  - Deposits (rent and other security deposits) for long term e.g. for a period of 3 to 7 years, but cancellable to be treated as long term investment of funds
  - Short term sources of funds include temporary overdraft facilities like cash credit, overdraft
  - Applicable to a branch of a foreign company

# Clause 4(xviii) – Preferential allotment of shares and Clause 4(xix) – Charge on debentures issued



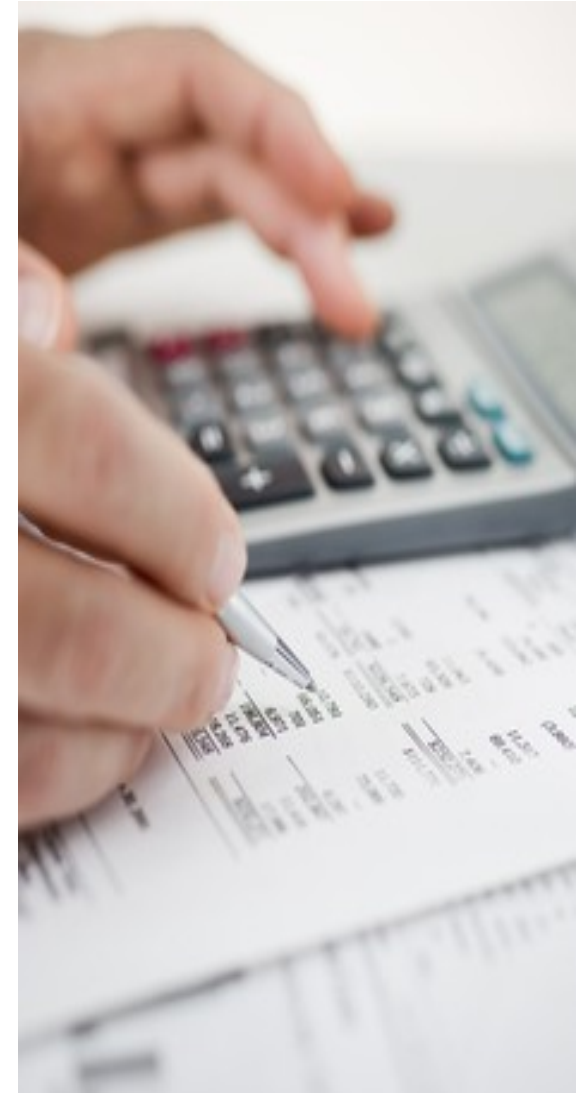
- Whether the company has made any preferential allotment of shares to parties and companies covered in Register maintained under Section 301 of the Act, and if so whether the price at which shares have been issued is prejudicial to the interest of the company[Clause 4(xviii).
- Whether security or charge has been created in respect of debentures issued?[Clause 4(xix)]
- **Implementation issues**
  - ESOP by private companies are covered under this clause and considered as preferential allotment
  - Auditor can use the work of expert to determine whether the price for the preferential allotment of shares is not prejudicial to the interest of the company, but must comply with SA 620
  - Debentures issued towards the end of the year and the securities or charges are created subsequently – to be reported with reasons for non-creation of security

# Clause 4(xx) – End use of money raised by public issues

- Whether the management has disclosed on the end use of money raised by public issues and the same has been verified. [Clause 4(xx)]
- **Implementation issues**
  - Applies to all monies raised through public issues that were unutilised at the beginning of the period covered by the audit report or were raised through an issue in the period covered by the report
  - Money raised from capital markets through ADS route – Covered under this clause
  - Surplus funds temporarily invested – auditor to mention that pending utilisation of funds for the stated purpose, the funds were temporarily used for other purpose

## Clause 4(xxi) – Fraud on or by the company

- Whether any fraud on or by the company has been noticed or reported during the year. If yes, the nature and amount involved is to be indicated [Clause 4(xxi)]
- **Implementation issues**
  - ICAI Statement recognises materiality – materiality of fraud to be considered while reporting
  - Auditor to report each fraud separately disclosing the amounts involved in the fraud
  - Fraud committed during the year and rectified during the year also to be reported



# Thank You

Aniruddha Godbole

