

Issues on CARO 2003 with special reference to Documentation

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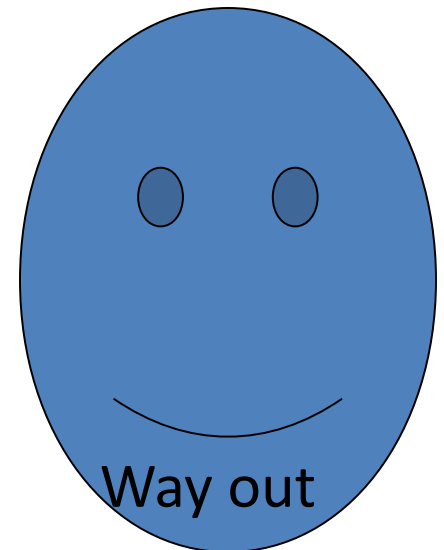
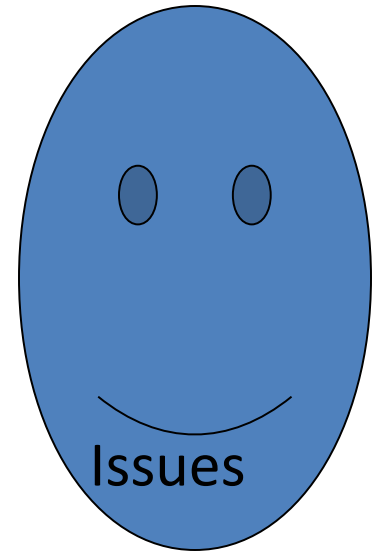
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Scope of Presentation

- Reporting Requirements – Basics.....
- Reporting Requirements – CARO, 2003
- Audit Documentation – General Approach
- Audit Documentation – CARO, 2003
- Audit Documentation – Way Forward



Reporting Requirements

Basics.....

Auditors' Report

- Companies Act, 1956
 - Section 227(2)–Deals with B/S., P&L, other Docs.
 - Section 227(3)-Addnl. Information (a) to (g)
 - Section 227(4) – Qualifications, etc. - Reasons
- Companies (Amendment) Act, 1965
 - Section 227(1A) - Inquiries

Auditors' Report

- MAOCARO, 1975
- MAOCARO, 1988
- CARO, 2003
- CARO, 2003 (As amended by November,

Auditors' Report

- Order – Emphasis on Auditor's Duties and extension to propriety aspect
- Order not to limit duties and responsibilities of auditor
- Disclosures / Qualifications / Adverse

Audit Documentation

General Approach

Why Documentation?

- Auditors increasingly being hauled up before Courts of law.
- *Self-Quality Improvement Process*:
 - Continuous self improvement
 - Self quality control
 - Inbuilt guard against complacency (A feeling of contentment or self-satisfaction, especially when coupled with an unawareness of danger, trouble, or controversy) and taking “anything for granted”.

Why Documentation?

- Existence of Big gap between the real scope of an audit and the public perception of an audit.
- Self-Defense in a Court of Law
- Evidence of Audit having been planned and performed

AAS-3 : Documentation

SA-230 Audit Documentation

(01/04/2009)

- Documentation – A Basic Principle Governing an Audit.
Documentation pertains to Working Papers
- Evidence of the auditor's basis for a conclusion about the achievement of the overall objective of the auditor -
sufficient and appropriate record
- Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory

Working papers...

- Aid in **planning** and **performance** of audit
- Aid in **supervision** and **review** of audit work
- Provide **evidence** of audit work performed to support the auditor's opinion

Broad Requirement of Work paper Content

- Audit plan
- Nature, timing and extent of audit procedures performed
- Evidence obtained
- Conclusions drawn

Factors Affecting Form & Content of Work papers

- Nature of engagement
- Form of audit report
- Nature/complexity of client's business
- Nature/condition of client's records
- Degree of reliance on internal controls
- Need for direction, supervision and review of work done by assistants

Principal requirements of WPs

- Design/ organization tailored to circumstances and needs of engagement
- Standardized (checklists, specimens)
- Audit procedures applied/documentated on client prepared schedules
- Recurring Audits- Files may be classified as permanent or current. SA 230

Extent of Documentation

- A matter of professional judgment
- Sufficiently complete and detailed for auditor to obtain overall understanding
- Significant matters requiring exercise of audit judgment must be included, along with auditor's conclusions

Qualities of Working Papers-I

- Working papers to have adequate audit evidence for assertions made in financial statements
- Working papers to agree with books of account, financials and are cross referenced
- Analysis of financial statements review
- Complete lead schedules
- Audit summary memorandum
- Evidence of Review of assistants' work

Qualities of Working Papers-II

- Each audit working paper should be headed with the following information :
 - Name of the client
 - Period covered by the audit
 - Subject matter
 - File-reference
 - Initials of the member of the audit team who prepared it and the date on which it was prepared,
 - In case of a working paper prepared by the client, the date of receipt and the initial of the audit team member who carried out the audit work thereon.
 - Initials of the member of the audit team who reviewed the working paper.

Audit Documentation

CARO, 2003

Why Documentation

(Para 3.4)

- Documentation constitutes ***Evidence*** as to –
 - Opinion is based on examination
 - Opinion formulation considered Information and Explanation (I&E)
 - Necessary I&E obtained complete in all respects

Adequate Documentation

(Para 3.5)

- Issue a questionnaire on all important matters
- Specific enquiries in writing on all important matters not covered by Order
- Obtain replies in writing duly signed by a responsible official
- Maintain a record of discussion with the management where explanation not recorded separately

Clause 1 : Fixed Assets

- Proper Records - full particulars, including quantitative details and situation



Professional
Judgment

- Physical Verification at reasonable intervals

- Material discrepancies properly dealt in books

Substantial part of fixed assets disposed – going concern...

Documentation

- Extract from Fixed Asset Register
- Papers indicating physical verification
- Sale documents for assets
- Note on effect of sale on Going Concern
- Questionnaire

Records of fixed assets maintained electronically-

- Whether constitutes compliance?
 - Existence of control not permitting alteration in records once entered
 - It can be retrieved in a legible form

What constitutes “substantial part of fixed assets” disposed off?

- The Order Silent on the word ‘substantial’
- Facts and circumstances of the case
- Sale or disposal of whole or substantially the whole of undertaking vis-à-vis sale of substantial part of the fixed assets - Effect on

Clause II : Inventories

- Physical verification at Reasonable intervals
- Procedure of physical verification
Reasonable and adequate - size of the company and the nature of business.
- Proper inventory records maintained

Documentation

- Extract from Inventory Register
- Papers indicating physical verification
- Check for abnormal waste / loss
- Questionnaire

“Inventory” consist of?

- Inventories are assets:
 - Held for sale in the ordinary course of business.
 - In the process of production for such sale or
 - In the form of materials and supplies to be consumed in the production process or in the rendering of services.

Maintenance of Stock Register for work-in-progress

- Cases where it is impracticable to maintain stock records of WIP
- Can at any point of time one can arrive or calculate the quantity and amount involved in WIP?
- Section 209 of the Companies Act 1956

Clause III [(a) – (d)] : Loans Granted

- Determine 301 parties – MRL
- Number of parties and amount involved
- Rate of Interest and Terms and conditions are prima-facie prejudicial
- Principal amount and interest received regular

Clause III [(e) – (g)] : Loans Taken

- Number of parties and amount involved
- Rate of Interest and Terms and Conditions
prima-facie Prejudicial
- Payment of the principal amount and interest
regular
 - What if Loan taken / given “on demand?”

Documentation

- MRL for 301 parties
- MRL for Rate of Interest and on Terms and Conditions (if required.....)
- Extract of Trial Balance for number of parties
- Analysis of maximum amount o/s.
- Questionnaire

Loans taken or given without stipulation of repayment-

Prejudicial?

- The company / borrowers' financial standing,
- Its ability to borrow / lend,
- Nature of security,
- Availability of alternative source of finance,
- The urgency of the borrowing.

AS- 18 parties listed vis-à-vis section 301Parties

- Two different terms.
- Clause to cover only parties to be listed in the Register maintained under section 301 of the Act.

Clause IV : Internal Control System

- Purchase of inventory and fixed assets
- Sale of goods and services
- Purchase of Services?
- Commensurate with the size of the company and nature of its business – Identify major weaknesses, if any.

Documentation

- Internal Control = Internal Check + Internal Audit
- Follow and document compliance with various SA issued by the ICAI on Internal Control
- Questionnaire

Clause V : Section 301 Contracts or Arrangement

- Completion of entries in Register as to transactions for Goods, material, and services with 301 parties
- Transactions >RS. 5 Lac are Reasonable having regard to the prevailing market prices at the relevant time;

Reasonableness of prices

- Monopoly Products
- Solitary Products
- Intangible Goods
- Films

Documentation

- Extract of the Register
- List of transactions
- Comparable market Rates, and justification for lower or higher rates
- Questionnaire

Clause VI : Public Deposits

- 3 (1) (iii) of the Companies Act 1956 – directors, shareholders, or their relatives
- Section 58A
- Compliance with RBI Directives-Examination of System

Documentation

- List of Loans / deposits taken
- Extract of Register / Ledger
- MRL that the lender is a relative
- Questionnaire

Clause VII : Internal Audit

- Listed companies
- Other companies.....
- Paid-up capital and reserves exceeding Rs.50 lakhs as at the commencement of the financial year
- Average annual turnover exceeding five crore rupees for a period of three consecutive financial years

Documentation

- Copy of internal Audit Report
- Queries raised and redressal thereof
- Questionnaire

Clause VIII : Cost Records

- Proper cost records as prescribed
- Documentation
 - Order of the Central Government for cost audit
 - MRL that Order is not applicable
 - Cost Audit Report, if applicable
 - Extract of cost records

Clause IX : Undisputed Statutory Dues

- Statutory dues to be deposited regularly
- Identification of undisputed amount (mere representation not to constitute the dispute)
- Period of more than six months
- Non Payment of Advance Tax / TDS / VAT / Service Tax
- Profession Tax

Documentation

- Proof that Amount is disputed
- Past assessment orders and extracts of appeal documents
- Challans
- Advance Tax estimate

Statutory Dues.....

- Bonus Payable under the Payment of Bonus Act
- Gratuity Payable under the Payment of Gratuity Act
- Not recognized in Books of Account
- Small delays

Clause X : Accumulated Losses

- Company registered for five years
- Accumulated losses at the end of the financial year not less than fifty per cent of its net worth
- Whether it has incurred cash losses in such financial year and in the immediately preceding financial year
- Computation of Accumulated Losses

Documentation

- Calculation of Accumulated Loss
- Computation of Net worth
- Base documents like B/s.
- Cash Loss means.....

Clause XI : Default in repayment of dues

- Company defaulted in repayment of dues to a financial institution or bank or debenture holders
- Period and amount of default
- What constitutes Default....dispute with lender
- RS6.....

Documentation

- Terms of Repayment
- Loan schedule
- Documents as to dispute

Clause XII : Adequacy of Documents

- Company granted loans and advances on the basis of security by way of pledge of shares, debentures, and other securities
- Maintaining adequate records only?
- Are securities adequate? Market quotes
- Fall in market price – Temporary / Permanent

Documentation

- Pledge documents
- D-MAT statements / physical inventory
- Market Quotes

Clause XIII : Chit Fund Companies

Clause XIV : Companies dealing in shares, etc.

- ***Company is dealing or trading in shares, securities, debentures and other investments,***
- ***Whether proper records maintained of the transactions and contracts***
- ***Whether timely entries made;***

Clause XIV : Companies dealing in shares, etc.

- ***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;***

Documentation

- Copy of D-mat statement
- Physical Inventory
- If shares not held in name of the Company -
Reasons

*Clause XV : Guarantees for loans taken by others
from banks and FIs*

- All guarantees are recorded properly
- Terms and conditions are not prejudicial to interests of company
- Contingent liability
- Guarantee against Loans from private Parties

Documentation

- Statement / MRL for Guarantees given
- Extract of Guarantee documents
- Representation from the management as to necessity for giving such guarantee
- Review of financial position of the person for whom the Company has stood guarantor

Clause XVI : Application of Term Loans

- Purpose of term loans
- Actual utilization of term loans...switchover to other segment / product
- Funds Flow Statement

Documentation

Issues

- Loan taken in last year....Application of funds to be reviewed in subsequent year?
- Long Term Loan for undefined purpose

Clause XVII : Application of Funds – Short-Term

- Whether funds raised on short-term basis used for long term investment;
- Nature and amount to be indicated

Documentation

- Preparing movement of funds – Source and Application
- Source of funds for acquisition of capital assets

Clause XVIII : Preferential Allotment

- Preferential allotment of shares to parties and companies covered in the Register maintained under section 301
- Price prejudicial to the interest of the company
- Identify 301 parties (Allottees)
- SEBI (Disclosure & Investor Protection) Guidelines 2000

Documentation

- Resolution under section 81 (1A) of the Companies Act 1956 – Right Shares offered to all – preferential?
- ESOP? Conversion of Debentures / FCCB / Warrants?
- CA Certificates issued under SEBI DIP Guidelines
- Computation of Value per share for unlisted Company
- MRL for justification or lower pricing

Clause XIX : Debentures

- Whether security or charges has been created in respect of debentures issued
- Proper Security or charge has been created in favour of Debenture Trust

Documentation

- ***Debenture Trust Deed***

Clause XX : Disclosure of End-use of funds – Public Issue

- Disclosure on the end use of money raised by public issues and verification
- Relationship between amount raised and amount used
- Temporary parking of funds in FDs.

Documentation

- Prospectus vis-à-vis application of Public Issue Fund

Clause XXI: Frauds

- ***Fraud on or by the company***
- ***Nature and the amount involved is to be indicated***
- Audit Plan to conform with SA-240 (old AAS 4)
- Reports of Internal Audit
- Enquiries made to management

Documentation

- MRL from Management
- Action taken
- Papers of Legal Action, if any
- Investigation Report on Fraud

Audit Documentation

Way Forward

Documentation Essentials

- Adopt a policy on documentation procedures that is supported by management and routinely followed by all staff.
- Preprinted form or computerized system for capturing all documentation and make it accessible to all firm members.
- Document all client interactions, except those that are strictly confidential.
- Make documentation notes with client interactions.

Documentation – Raising Practice Level

- Tangible reflection of caliber of high quality services
- A reminder to clients of what has been done for them
- More opportunities to offer new services
- Improves writing / communication skills of staff
- A Billable service