CARO, 2020

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CARO is reporting by Auditor's on certain clauses mentioned in the order. Any qualification is highlighted in Italics. CARO is annexed to the main Audit Report in which an Auditor gives assurance on whether the Accounting Standard and Companies Act compliances were complied with.

In CARO, 2020, there is no change in the applicability on the class of companies.

Given below is the impact analysis of CARO, 2020 and is divided into four sections:

- New Clauses
- Re-instatement from old CARO versions
- Deletion of Clauses
- Brief Comparison of CARO, 2020 with CARO, 2016

NEW CLAUSES

1.1. Fixed Assets - Immovable Properties [Clause 3(i)]

1.1-1. ***Disclose immovable properties whose title is not held by the company [Clause 3(i)(c)]***

a) CARO 2020 requires disclosure of land and building and other immovable properties which are recognised as fixed assets (or say Property, plant and equipment)/ investment property of the company but the title of such assets is not with the body corporate. Of course, if an entity has obtained an asset on lease then the disclosure is not required for such assets. In case such immovable properties exist then disclosure is required for:-

- Property description,
- Amount capitalised,
- Title owner,
- Whether title with promoter, director or their relative or employee,
- Range of period for which property held and
- Rationale why property was not held in the name of company.

b) One of the rationales is that accounting provisions do not have mandate in order to recognise an item as an asset the title must be held by the company. As per AS 10, Property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and are expected to be used during more than a period of twelve months. In case a land and building is held to derive rental income then AS 13 defines that an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise can be recognised as investment property.

c) Another rationale for such disclosure is that the exposure of financial institutions is increasing. Loans given by lenders to entities is based upon certain ratios which are then dependent upon on the amount of fixed assets recognised in the financial statements and when the title does not belong to company then financial institutions and other users would like to know this upfront.

1.1-2. Disclose revaluation for fixed assets or intangible assets happened during the year[Clause 3(i)(d)]

CARO 2020 requires that in case a company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year then disclose

a) Whether the revaluation is based on the valuation by a Registered Valuer

b) Specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets

Accounting standards 10 allows companies to follow either cost model or revaluation model. In case a company follows revaluation model then a revaluation surplus is recognised in the balance sheet as revaluation surplus. Further changes in the revalued amount are recognised in revaluation surplus or statement of profit and loss depending upon certain conditions.

Auditors are now required to highlight any revaluation done upfront in the CARO report.

1.1-3. Disclosure required for Benami Transactions [Clause3(i)(e)]

This is a new clause and it is a big change. CARO 2020 requires disclosure for transactions even if proceedings are initiated (even if not complete) OR proceedings are pending against a company for holding any benami property.

1.2. Working capital loan above Rs 5 crore - Auditors to tally returns or statements filed with banks with accounting books [Clause 3(ii)(b)]

This is another big change which is going to impact significantly. In case, a company has availed working capital loan(s) from banks or financial institutions by pledging current assets and the sanction limit(s), by combining limits of all banks or financial institutions, and the sanction limit(s) exceed Rs 5 crores then auditors are required to certify that quarterly results or the statements filed by the company are in line with the accounting books.

Companies file a lot of accounting data (past information and projected statements) to banks and financial institutions to obtain working capital limits. The lender, on the other hand, is concerned about the accuracy of such data filed. The government has now put auditor as in-charge that the numbers and statements filed with banks are in line with the books of accounts.

Considering the above provisions, auditors shall now be doing a pre-audit whenever the management is obtaining new working capital loan or increasing their existing limits. Although, CARO shall be filed by the end of the financial year but the auditors shall insist upon management to get approval when the management and lenders are handshaking.

In case the auditor does not agree with the financial data filed with the lender, management is required to provide the details and both management and auditors shall agree to disagree. On the other hand, lenders may not see this as a happy situation.

1.3. Highlighting incomes disclosed in tax assessments but not properly accounted in books of accounts [Clause 3(viii)]

CARO 2020 aims to highlight the companies which have not been disclosing/ offering income properly. Accounting and income tax provisions differ in terms of the timing and amount of recording of income. CARO 2020 wants auditors to specifically consider that in case a company has offered or disclosed income during income tax assessments then whether such income was properly treated as per accounting provisions.

1.4. Wilful defaulter [Clause 3(ix)(b)]

In case a company has defaulted in repayments of loans, other borrowings or interest then the company need to make disclosure in the CARO report. Further, in case an entity has been disclosed as wilful defaulter by any financial institution (including banks) then auditor needs to highlight such fact in the CARO 2020 report.

A wilful defaulter is a company/ individual that has an ability to repay the loan but has failed to do so.

1.5. Reporting of Whistle-blower complaints [Clause 3(xi)(c)]

CARO 2020 requires an auditor to report whether it has considered whistle-blower complaints received against the company.

1.6. Non-Cash Transactions [Clause 3(xv)]

Whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act have been complied with;

1.7. Carrying on NBFC Business or becoming a Core Investment company [Clause 3(xvi)]

CARO 2020 requires an auditor to check whether an entity which is carrying on non-banking financial business, housing finance activities or is a Core Investment Company (CIC) and has obtained a valid registration certificate from the Reserve Bank of India as per Reserve Bank India Act, 1934.

Further in case of CIC, auditor also needs to check whether any company which is exempted or unregistered continues to fulfill the required criteria as mentioned by RBI from time to time. If there are a group of CICs, then the auditor need to provide no. of CIC companies under that group.

Core investment companies are NBFCs holding at least 90% of their net assets in the form of investment in equity shares, preference shares, debt or loans, debentures, bonds in group companies.

1.8. Resignation of Statutory auditors [Clause 3(xviii)]

Resignation of auditors often casts a doubt on the management and CARO 2020 aims to highlight this. The new CARO requires disclosure in case a statutory auditor has resigned. Further, it also requires the new auditor to take into consideration the reason why previous auditor resigned, and issues raised by the previous auditor.

1.9. Uncertainty in repayment of Liabilities [Clause 3(xix]

CARO 2020 requires a specific certification that no material uncertainty exists in a company to pay its liabilities within a period of one year from the due date. This new clause has increased the auditor's responsibility to determine and disclose the financial health of an entity to meet its liabilities existing in the balance sheet.

To assess this, an auditor has to consider:

a) Financial Ratios
b) Ageing and expected dates of realisation of financial assets and Payment of financial liabilities
c) Other information accompanying financial statements
d) Auditor's knowledge of the Board of Directors and management plans

The disclosure required in this clause would enable the auditor to determine whether an entity is financially stable. This clause is more about assessing the validity of fundamental accounting assumption of going concern. Auditor may plan to assess the going concern assumption in accordance with Standards on Auditing (Revised) 570 *Going Concern* and then respond to the CARO clause.

1.10. Unspent amount on Corporate Social Responsibility (CSR) expenditure [Clause 3(xx)]

Section 135 of the Companies Act, 2013 requires certain class of companies to spend 2% of their average net profits of past 3 years in pursuance of its Corporate Social Responsibility Policy.

The present provisions already require that any amount remaining unspent on CSR activities (except due to some ongoing project) shall be transferred by the company within a period of thirty days from the end of the financial year to a special account to be opened by the company in that behalf for that financial year in any scheduled bank to be called the Unspent Corporate Social Responsibility Account, and such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within a period of three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII of the Companies Act, 2013, within a period of thirty days from the date of completion of the third financial year. In case the company contravene such provision then there are penal provisions in the Act.

Now, CARO specifically requires disclosure of any unspent amount.

1.11. CARO for Consolidated Financial Statements [Clause 3(xxi)]

CARO 2020 recognises the fact that the there can be few matters which should be addressed via CARO report for consolidated financial statements. The previous CARO was not applicable to auditor's report on consolidated financial statements but CARO 2020 provides an exception.

RE-INSTATEMENT OF CLAUSES FROM PREVIOUS CARO VERSIONS OTHER THAN CARO 2016

Following clauses have been re-instated from previous CARO versions:

(a) whether the company has an internal audit system commensurate with the size and nature of its business;

(b) whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor; Clause 3(xiv)

a) whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses; Clause 3(xvii)

DELETION OF CLAUSE FROM CARO, 2016

The clause Managerial remuneration [Clause 3(xi))] has been deleted from CARO, 2016

BRIEF COMPARISON OF CARO, 2020 WITH CARO, 2016

Particulars	*CARO, 2020*	*CARO, 2016*
[Para 3(i)] - Fixed Asset	✓	✓
[Para 3(ii)] – Inventories	✓	✓
[Para 3(iii)] - Loans secured or unsecured granted by company	✓	✓
Para 3(iv)] - Compliance of section 185 and 186 of Companies Act, 2013	✓	✓
Para 3(v)] - Deposits accepted by company	✓	✓
Para 3(vi)] - Maintenance of Cost Records	✓	✓
Para 3(vii)] - Payment of Undisputed Statutory Dues	✓	✓
Para 3(viii)] - Incomes disclosed in tax assessments	✓	
Para 3(ix)] - Default in repayment of loans	✓	✓
Para 3(x)] - Moneys raised by Initial Public Offer	✓	✓
Para 3(xi)] - Fraud	✓	✓
Para 3(xii)] - Nidhi Company	✓	✓
Para 3(xiii)] - Related Party Transactions	✓	✓
Para 3(xiv)] - Internal Audit System	✓	
Para 3(xv)] - Non- Cash Transactions	✓	✓
Para 3(xvi)] - Registration under section 45- IA	✓	✓
Para 3(xvii)] - Cash Losses	✓	
Para 3(xviii)] - Resignation of Statutory Auditors	✓	
Para 3(xix)] - Uncertainty in repayment of Liabilities	✓	
Para 3(xx)] - Unspent amount on CSR Expenditure	✓	
Para 3(xxi)] - CARO for Consolidated Financial Statements	✓	

Note: Clause no. mentioned in CARO, 2020 has been taken as base for above comparison.

THANK YOU

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