

REGULATORY UPDATE

**THE COMPANIES (AUDITOR'S
REPORT) ORDER, 2020**



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Background:

Companies Auditor Report Order(CARO) is an order which lists down the matters on which an auditor is required to report as per Section 143(11) of Companies Act, 2013. **Thus, auditor of those entities on which CARO is applicable is required to report on certain specific clauses as prescribed in the Order.**

Earlier it was CARO 2016 which has 16 clauses but on 25.02.2020 MCA notifies CARO 2020 which has 21 clauses. **CARO 2020 is applicable for audits of financial years commencing on or after 1 April 2021.**

The Institute of Chartered Accountants of India has issued a **Guidance Note on CARO 2020** which provides guidance on application of the CARO 2020. The CARO 2020 aims to **enhance the overall quality of reporting** by company auditors through **enhanced reporting disclosures.**

Applicability:

The Act applies to all Company including foreign company as defined in section 2(42) of the companies Act 2013, except:

- a. Banking Company, Insurance Company, Section 8 Company, One Person Company, Small Company and
- b. Private limited Company, not being subsidiary or holding of a public company, having paid up capital & reserve and surplus not more than Rs. 1 crore as on balance sheet date and which does not have total borrowings exceeding Rs. 1 crore at any point of time during the financial year and which does not have total revenue exceeding Rs. 10 crores during financial year as per the financial statements.
- c. The Order is also applicable to audit of branches of a company.

- d. The order specifically provides that it shall not apply to the auditor's report on consolidated financial statements except for clause (xxi).

Reporting Points for Auditors:

1. Amended Clauses

a. Clause (i) - Property, Plant & Equipment(PPE) and Intangible Assets

- New reporting on maintenance of proper records showing full particulars of intangible assets.
- Disclosure regarding title deeds of Immovable property (other than properties where the company is the lessee) now required, as per the format specified.
- Additional disclosures and reporting requirements for revaluation of PPE (including Right-of-Use assets) and intangible assets undertaken during the year. Specific reporting on whether revaluation of assets done by registered valuer and whether such revaluation exceeds 10% of the aggregate net carrying value of each class of assets.
- Whether proceedings initiated or pending for holding any benami property are properly disclosed in the financial statements.

b. Clause (ii) - Inventory

- Auditor needs to report frequency of physical verification conducted at reasonable intervals whether coverage and procedure of physical verification of inventory is adequate or not
- Disclosure regarding discrepancies of 10% or more noticed in aggregate in each class of inventory at the time of physical verification of Inventory and whether they have been properly dealt in books of accounts.
- Whether the company has been sanctioned working capital limits in excess of Rs. 5 Crore and the quarterly returns filed by the company with banks or financial institutions are in agreement with books of accounts or not.

c. Clause (iii) - Investment, Guarantees, Securities, Loans and Advances

- The ambit of reporting enhanced to include advances as well. In respect of loans and advances in the nature of loans, reporting on whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular. If the amount of loans and advances is overdue, the total amount that is overdue for more than 90 days has to be disclosed. Besides this, it is important to report whether reasonable steps have been taken by the company for recovery of the principal and interest.
- The ambit of financial transactions to be reported under this clause has been widened to include loan to any person as against the parties covered u/s 189 of Companies Act, 2013.
- Disclosure regarding whether investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are prejudicial to the company's interest.
- Disclosure regarding the loan or advance granted, renewed or extended or fresh loans has been settled against the overdue of existing loans.
- Disclosure regarding the loans or advances granted which are repayable on demand to promoters or related parties defined u/s 2(76) of Companies act, 2013.

d. Clause (v) - Deposits

- This clause has been amended & requires the auditor to further report the amounts which are deemed to be deposits.

e. Clause (vii) - Statutory Dues

- Clarification on payment of undisputed Goods and Service Tax on account of introduction of Goods and Service Tax in India.

- Increase in reporting requirement with respect to all statutory dues which are disputed. Earlier the reporting was limited with respect to disputed income tax, sales tax or service tax or customs duty, excise duty or value added tax.

f. Clause (ix) - Repayment of Loans or other Borrowings

- This clause has been amended to include the default in repayment of loans/borrowings or payment of interest to any lender
- It also requires the auditor to report whether the company has been declared as willful defaulter by any bank or financial institution or other lender
- Further it requires to report whether the term loans were applied for the purpose for which it was obtained
- Whether the funds raised on short term basis have been utilized for long term purposes.
- The reporting requirements include whether the company has taken funds to meet the obligations of its subsidiaries, associates or joint ventures.
- Whether loans were raised during the year on pledge of securities held in its subsidiaries, associates or joint ventures; details to be reported and if the company has defaulted in repayment of such loans raised.

g. Clause (xi) - Fraud

- The revised clause requires reporting on any fraud by the company or any fraud on the company, i.e., reporting on fraud is not limited to frauds committed by the officers or employees of the company while reporting under this clause.
- Whether auditor has reported under section 143(12) of the Companies Act, 2013 by filing Form ADT-4 with the Central Government.
- Additional disclosure regarding whether whistle-blower complaints, if any received during the year has been considered by the company.

h. Clause (xii) - Nidhi Company

- This clause requires the auditor to report the default in payment of interest on deposits or repayment thereof for any period.

i. Clause (xvi) - Registration requirements u/s 45-IA of the RBI Act,1934

- This clause has been amended & additionally requiring the auditor to report whether the company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration from RBI & whether the company is a CIC or exempted or unregistered CIC & continues to fulfil the criteria of a CIC.
- It further requires to report Total number of CIC, if the company has more than one CIC as part of the group.

2. Deleted Clause/ Merged Clause:

a. Clause (xi) – Managerial Remuneration

- This clause which required reporting on the **managerial remuneration** paid or provided as per the provisions of Section 197 has been deleted.

b. Clause (xiv) as per CARO 2016 – Preferential Allotment, Private Placement of Shares

- This clause which required reporting on compliance of Section 42 of companies act 2013 on the **Preferential allotment, private placement of shares or fully or partly convertible debentures** made has been merged with Clause (x) of CARO 2020.

3. Newly Inserted Clause:

a. Clause (viii) - Unrecorded Income

- This clause has been inserted which requires the auditor to report on transactions surrendered or disclosed as income during the year in tax assessments under the Income Tax Act, 1961 and whether the same has been properly recorded in the books of accounts during the year.

b. Clause (xiv) - Internal Audit

- New clause has been inserted which requires the auditor to report whether the company has an internal audit system commensurate with the size & nature of its Business.
- Whether the Internal audit report has been considered by the statutory auditor.

c. Clause (xvii) - Cash Losses

- New clause has been inserted which requires the auditor to report whether the company has incurred cash losses in the financial year & the immediately preceding financial year.

d. Clause (xviii) - Resignation of statutory Auditors

- New clause has been inserted which requires the auditor to report whether there has been any resignation of auditors during the year and whether the issues, objections or concerns by the outgoing auditor has been considered.

e. Clause (xix) - Material uncertainty on meeting liabilities

- Auditor need to analyse on the basis of financial ratios, ageing and expected dates of realization of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans and to report whether the auditor is of the opinion that no material uncertainty exists as on date of audit report & company is able to meet its liability within a period of 1 year from Balance sheet date.

f. Clause (xx) - Transfer to fund specified under schedule VII

- This clause has been inserted which requires the auditor to report whether in respect of ongoing projects, the unspent amount of the CSR activities has been transferred to special designated bank account and in case of other than ongoing projects the

unspent amount has been transferred to fund specified in Schedule VII within six months of expiry of financial year.

g. Clause (xxi) - Qualifications or adverse auditor remarks of group companies

- This clause has been inserted which requires the auditor to report on the qualifications or adverse remarks made by respective auditors in the CARO reports of the companies included in Consolidated financial statements along with the paragraph numbers of the CARO report containing the qualifications or adverse remarks.

Source:

<u>Particulars</u>	<u>Issue Date</u>	<u>Link</u>
Order on The Companies (Auditor's Report) Order, 2020	25 th Feb, 2020	https://www.mca.gov.in/Ministry/pdf/Orders_25022020.pdf
Guidance Note on The Companies (Auditor's Report) Order, 2020.	13 th June, 2020	https://resource.cdn.icai.org/60117aasb48979-a.pdf

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