



CARO 2020 – Changes and challenges for small and medium audit firms

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Disclaimer

➤ The opinions expressed in this presentation are based on my understanding of the law and notifications made there under and this is not the opinion of the Institute of Chartered Accountants of India

MOTTO

Ya esa suptesu jagarti kamam kamam Puruso nirmimanah ।

Tadeva sukram tad brahma tadevamrtamucyate ।

Tasminlokah sritah sarve tadu natyeti Kascan । etad vai tat ।।

य एष सुप्तेषु जागर्ति कामं कामं पुरुषो निर्मिमाणः ।

तदेव शुक्रं तद् ब्रह्म तदेवामृतमुच्यते ।

तस्मिंल्लोकाः श्रिताः सर्वे तदु नात्येति कश्चन । एतद् वै तत् ।।

Auditor is a watchdog not a bloodhound



Changing times

Over a period of time the strategy, way of audit and reporting has changed.

The only thing that has remained constant is our responsibility.

Let us discharge it with due diligence and dedication



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Order issued by Central Government

Section 143 of Companies Act 2013 - Powers and duties of auditors and auditing standards

- The Central Government has multiple powers to dictate or direct matters to be included in Auditors report.
- Either by itself or in consultation with NFRA – The respective provisions are below.
- 143(3)(j) – such matters as may be prescribed
- 143(11) -The Central Government may, in consultation with the National Financial Reporting Authority, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein

Other notification under 143(3)(j)

- The Central Government in addition to introduction of CARO which becomes effective for audit periods commencing on or after April 1, 2021 has also issued notification requiring additional reporting requirements by using its powers under the above section.
- The reporting requirements under the above clause includes reporting on availability of audit trail in the accounting software for accounting periods commencing on or after April 1, 2022
- There are further reporting requirements mandated under the above clause the same is not covered in today's discussion.

Why now?

- ❖ The guidance note issued by ICAI in 2020 in the approach to the audit reads as under.
- ❖ It is possible that for the purposes of the Order, the auditor needs greater information from the management. The auditor and the management should ensure that there is sufficient advance planning regarding the manner in which the examination necessary for reporting on matters specified in the Order would be carried out by the auditor and the form in which the company should maintain its records so that they provide the necessary information and evidence to the auditor.

Applicability - Exclusions

- Exclusions from applicability
 - Banking Companies
 - Insurance companies
 - Section 8 companies
 - One person company
 - Private limited companies other than companies satisfying the below conditions
 - Having paid up capital and reserves over 1 crore.
 - Revenue in excess of Rs. 10 crores.
 - Conducts any business activity in India in any other manner.
 - Borrowings from bank and financial institutions in excess of Rs.1 crore.

Applicability

- All public limited companies.
- Private limited companies which are subsidiaries or holding company of public limited company.
- Private limited company other those excluded as mentioned earlier.
- Foreign companies - as defined under section 2(42) of the Companies Act 2013
 - (a) Has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
 - (b) Conducts any business activity in India in any other manner.”

CARO – comparison

CARO 2016 – 16 main clauses with 8 sub clauses

CARO 2015 – 12 main clauses with 10 sub clauses

CARO 2003 – 21 main clauses with 18 sub clauses

MAOCARO 1988 - 24 clauses

CARO 2020 - 21 Main clauses with 37 sub clauses.

CARO 2020 - is in line with various disclosures in revised Schedule III which is effective from financial year 2021- 2022.

As per original notification the order was applicable from financial year 2019-2020 but deferred repeatedly and now applicable from financial year 2021-2022.

CARO is not only the reporting requirement

The Order is not intended to limit the duties and responsibilities of auditors but only requires a statement to be included in the audit report in respect of the matters specified therein.

The auditor is required to cover on all the matters required to be covered under subsection 1 to 3 of section 143 of the Act and under subsection 5 of section 143 in addition to reporting under CARO.

Audit should be comprehensive and total in compliance with applicable auditing standards and companies act.

Other matters to be enquired upon

- Loans and advances made by the company on basis of security are properly secured & not prejudicial to the interest of the company.
- Transactions by way of book entries are not prejudicial to the interest of the company.
- Personal expenses have been charged to revenue account.
- Shares allotted if amount is received.
- To report only in case of deviation.

CARO – report to be complete

- the reporting under CARO should be complete and precise.
- mere mentioning that the clauses are not applicable will be not be due compliance with the order.
- incomplete replies to the queries will not be acceptable

3(i) – Plant, property and equipment

- heading changed from fixed assets to Plant, property and equipment to align with disclosure in FS and also to align with AS 10 and Ind As 16.
- New sub-clause on intangible assets introduced – Whether the company is maintaining proper records showing full particulars of intangible assets
- clause on physical verification no change except for PPE - SA 501 – Audit Evidence
- whether the title deeds of all the immovable properties (other than properties where the company is the lessee and lease agreements are duly executed in favour of lessee) disclosed in financial statements are held in the name of the company – if not to provide details – scope increased – SA 250 – Consideration of laws and regulations in audit of financial statements
- new clause on revaluation of both tangible and intangible assets – revaluation to be done by registered valuer and change over 10% to be disclosed – **new clause**
- new clause benami property under Benami Transactions (Prohibition) Act, 1988. – **to cover orders issued subsequent to date of balance sheet - new clause – SA 560 Subsequent events**

3(ii) Inventory

- Physical verification – Increase in scope of reporting
 - Whether in the opinion of the auditor the coverage and procedure of verification of inventory by the management is appropriate.
 - if the discrepancies is more than 10% or more in each class of inventory is noticed – dealt properly in books of account.- materiality level determined by order – no discretion to auditor
 - new clause covering specific category of companies where there are borrowings from banks or financial institutions having sanctioned limits in excess of Rs. 5 Crores at any point during the financial year.
 - are the quarterly returns filed with the banks and or financial institutions are in agreement with the books of account
 - Quarterly returns generally have information and data other than inventory – to confirm the total data and not to restrict to inventory only.



3(iii) – loans, advances and investments

- earlier the scope was restricted to parties covered under register-maintained u/s 189 of the companies Act 2013 – Related parties – Now covers all companies
- matters to reported
 - whether during the year the company has made any investments, provided guarantee or security or granted loans or advances in nature of loans whether secured or unsecured during the year then to report
 - **the aggregate amount during the year and outstanding so far as it relates to subsidiaries, joint ventures and associates.**
 - **the aggregate amount during the year and outstanding so far as it relates to other parties**
 - whether the investments made, guarantees provided security given and terms and conditions are not prejudicial to the interest of company
 - repayment of principal and interest are regular

3(iii) – loans, advances and investments -continued

- If the amount is overdue , state the total amount overdue more than 90 days and whether reasonable steps are taken for recovery of the loans. -
- whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, if so specify the aggregate amount of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year - New Clause – Evergreening of Loans – Not applicable for companies whose principal business is to give loans

3(iii) – loans, advances and investments –continued

- whether the company has granted any loans or advances in the nature of loans either **repayable on demand or without specifying any terms or period of repayment**, if so, specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013;
- The auditor is expected to quantify the amounts in each of the cases above.

3(iv) loans, investments guarantees and security

- There is no material change in this clause - The auditor need to verify and confirm the compliance of sections 185 and 186 of the Companies Act, and report on instances of non compliance

3(v) – deposits and deemed deposits

- In respect of deposits accepted by the company and amounts which are deemed to be deposits
 - Directives of RBI are complied with
 - Compliance with provisions of sections 73 to 76 and acceptance of deposit rules made there under.
 - nature non – compliances to reported
 - compliance with orders of NCLT , CLB , or RBI to be reported
- No change in reporting requirements from that of CARO 2016

3(vi) – Cost Records

➤ As in the earlier reports the auditor has to comment on adequacy of cost records maintained by the company wherever it is applicable

3(vii) – Payment of statutory dues

- regularity in payment statutory dues including GST (specific change in place of service tax and excise duty) with respective authorities – to report instances of material delays and any outstanding over 6 months.
 - Includes advance Income Tax - Guidance note of ICAI
- disputed statutory dues and forum where the dispute is contested with amount involved in dispute to be reported – No change

3(viii) – surrendered and disclosed amounts under Income Tax Act

This is a new clause

(viii) whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year;

3(ix) – Loans and borrowings by the company

- scope increased to cover loans from any person – earlier it was restricted to Government, banks and financial institutions.
- covers loans and other borrowings
- to report defaults by banks and financial institutions lender wise giving particulars of overdue amount / nature of overdue amount principal or interest / no of days of delay
- new sub clause – is the company declared as wilful defaulter by bank or financial institution
- applied for the purpose for which the loan is taken – instances of diversion to be reported

3(ix) – loans and borrowings by the company .. continued

- whether funds raised on short term basis have been used for long term purposes
- whether company has taken loans from any entity or person to meet obligations of subsidiary, associate or joint ventures - to give details of nature of transactions and amount involved
- details of loans raised by pledge of securities of subsidiaries, joint ventures, associates – to report on amounts availed along with defaults in repayment or compliance of terms of loans

3(x) – amounts raised by IPO/FPO/ Preferential basis

- now specifically covers allotments made on preferential basis / private placement basis in a separate sub clause
- covers fully / partially / optionally convertible debentures as against fully or partly convertible
- compliance with sections 42 and 62 of Companies Act 2013 to be confirmed
- the word amounts replaced by word **funds – wider coverage**
- to report on non-compliance, delays and subsequent rectifications on terms of issue

Amount and fund differentiated

Amount

Money i.e. bank notes and coins recognized by the government used in exchange of goods and services is known as Cash.

Generally an Asset

Narrow scope

Fund

Any sum of money in the form reserves which is saved for a certain purpose is known as Fund.

generally an liability

Wider in scope when compared to amount
could be in kind

To be supported by matching investment

3(xi) - frauds

- scope increased to cover all frauds on the company to cover all types of frauds as against by officers or employees earlier
- new clause requires reporting on the reports filed by auditor under section 143(12) by auditor – form ADT 4 – this shall require to consider the previous auditors report (in case of change of auditor) as the report would have been filed in period under review
- new clause requires consideration of whistle blower complaints – wherever applicable
- SA-240 - Compliance

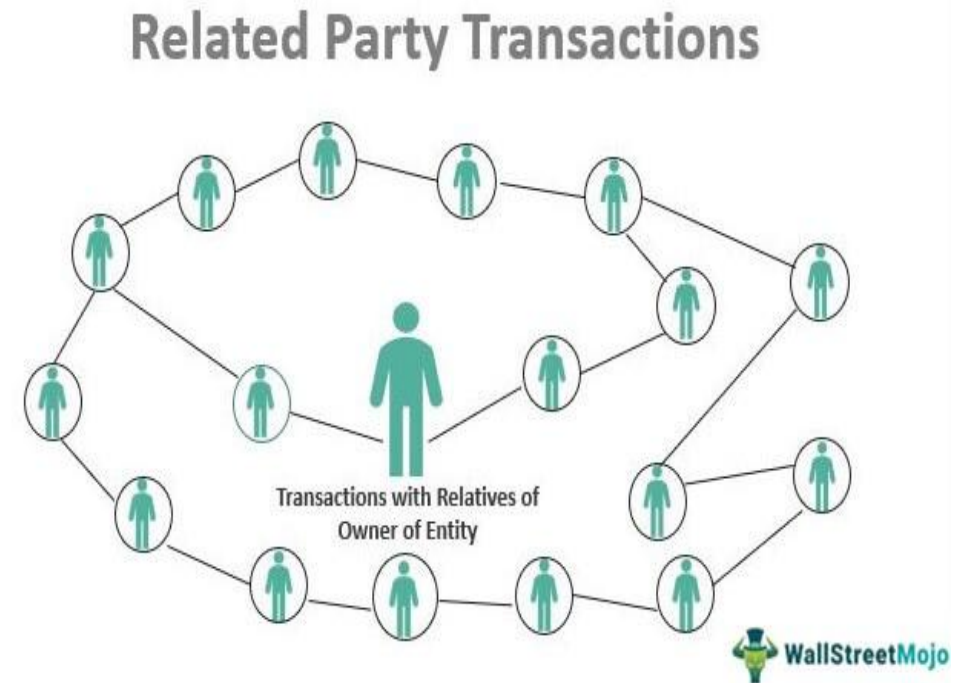


3(xii) Nidhi company

- Nidhi company u/s 406 of Companies Act 2013
- For better presentation split into 2 sub clauses
 - Own funds to deposit ratio 1: 20
 - Unencumbered deposits to be 10% (to ensure liquidity for repayment)
- New clause introduced requiring reporting of defaults on repayment of interest and principal

3(xiii) – Related party transactions

- No change from the requirements existing in the 2016 order.
- It needs to be noted that the auditor is assuring the compliance of sections 177 and 188 of companies act and
- further giving the assurance that the disclosures in the financial statements are in compliance with applicable accounting standards – AS 18 / IND AS 24
- Applicable auditing standards - SA 550 – related parties



3(xiv) – Internal Audit

- Adequacy of internal audit system commensurate to size and nature of business of the company
- Whether the statutory auditor has considered the reports of internal auditor at the time of framing his report
 - This is a new sub clause added which makes it obligatory to consider the internal audit reports and any adverse remark of the internal auditor could have a bearing on the final report to stakeholders

3(xv) – Non Cash transactions with Directors

- Restrictions under section 192 of Companies Act
- Transactions between
 - Director of the Company
 - Holding, subsidiary or associated company
 - Or persons connected with any of the above
- Prior approval of general body
- In event of contravention it is voidable at the option of the company
- Compliance with section 192 to be reported – Existing provision continued

3(xvi) – Non Banking Financial Companies

- is the company required to be registered u/s 45-IA of RBI act 1934 – if so is the registration obtained - no change
- has the company conducted any Non-Banking financial activity or housing finance activity without obtaining registration – new clause
- is the company a Core Investment Company (CIC) as defined under RBI regulations – does the criteria of CIC or exemption from criteria of registration continues – new clause
- whether the group has more than CIC as a part of the group if so mention the number of CIC – new clause

3(xvii) – cash losses

- whether the company has incurred cash losses in the current year and in the immediately preceding financial year – if yes to quantify the same
- the clause which was there earlier removed has been reintroduced

3(xviii) – Resignation of statutory auditors

- is there resignation of previous statutory auditors - Resignation to be differentiated from retirement
- to take into consideration in the report the issues, objections or concerns of the out going auditor
- Here it is to be noted that when there is resignation before the end of the term the incoming auditor needs to consider the issued in ADT-3 and
- It is to be noted that even in case of appointment on a regular vacancy by retirement the comments of out going auditor needs to be considered which is not covered under this clause

3(xix) – Financial ratios – going concern

- New Clause
- disclosure of financial ratios and aging is now an integral part of financial statements
- the auditor in his report based on analysis of financial ratios and other management plans has to report
 - whether there exists material uncertainty that the company would be able to meet its liability within 1 year of the date of balance sheet.
- the financial statements are prepared generally on going concern basis – in the event of uncertainty of the company being able to meet its liabilities – the question of true and fair view would arise

3(xx) – corporate social responsibility

- Compliance with provisions of section 135 – CSR of companies act along with the rules and regulations there under to be reported.
- These include
 - transfer to specified fund unspent amount in case of ongoing projects
 - transfer special account the unspent amount u/s 135(5) of the Companies Act in compliance with section 135(6) - within 30 days from end of financial year in case of on going projects
 - in case of projects not commenced within 6 months from end of financial year
- New clause



3(xxi) – Applicable only for consolidated financial statements

- This is the only clause applicable for report on consolidated financial statements
- here the auditor of consolidated financial statements has to report if there are adverse comments by component auditors
- the auditor of consolidated financial statements has to bring out the clause numbers of auditors report which have adverse or negative comments by the respective auditors

Reporting requirement

- Auditor's responsibility does not end with qualifying the report – basis of qualified or unfavourable answer to be given
- inability to express opinion should be substantiated by facts and reasoning

जातस्य हि ध्रुवो मृत्युर्ध्रुवं जन्म मृतस्य च ।
तस्मादपरिहार्येऽर्थे न त्वं शोचितुमर्हसि ॥ २७ ॥

*jātasya hi dhruvo mṛtyur dhruvaṁ janma mṛtasya ca
tasmād aparihārye 'rthe na tvam śocitum arhasi*

One who has taken his birth is sure to die, and after death one is sure to take birth again. Therefore, in the unavoidable discharge of your duty, you should not lament.

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