CARO 2020

– An ever-increasing Conundrum of Reporting or a move towards early warning signals?

INTRODUCTION

The Central Government, in consultation with the NFRA, has issued the revised Companies (Auditors' Report) Order, 2020, ('CARO 2020' or the 'Order') on 25th February, 2020, vide order number S.O. 849(E). It replaces the erstwhile Companies (Auditors' Report) Order, 2016 ('CARO 2016'). It has been made applicable in respect of audit reports issued by the statutory auditor for the reporting periods beginning from 1st April, 2021.

APPLICABILITY

Reporting under CARO 2020 is applicable to all companies other than the following:

i. Banking companies,
ii. Insurance companies
iii. One person companies,
iv. Small companies,
v. Section 8 companies,
vi. Private companies with
   a. paid up share capital and reserves and surplus as on the balance sheet date up to Rs 1 crore, and
   b. Total borrowings during the year up to Rs 1 Crore, and
   c. Turnover during the year up to Rs 10 crores.

The scope of reporting is widely extended and puts an onus on the companies covered to maintain additional documentation to enable the auditor to report under the Order. As the reporting requirement will apply from current financial year 2021-22, it will be necessary for the companies to be aware of maintaining the details beforehand to avoid absence of documentation and explanation at the time of audit.

ADDITIONAL REQUIREMENTS

Following are the <u>additional requirements of CARO 2020</u> as against the erstwhile CARO 2016:

i. Tangible and Intangible Assets:
   a. Company needs to maintain full particulars of <u>intangible assets</u> (both self-generated and acquired), including original cost, date of purchase and put to use, useful life, details of any revaluations made, details of any amortisations made, etc.

b. Details of any revaluations made to tangible or intangible assets, and its corresponding valuation report.
c. Details of any pending proceedings under the Prohibition of Benami Property Transactions Act, 1988, where the company is being treated as a benamidar, should be disclosed in the financial statements, including the details of the proceedings and its impact.

ii. **Current Assets:**

a. Company should document the Physical Verification of Inventory process on detail and the same should include the coverage and procedure. Discrepancy above 10% or more in aggregate for each class of inventory also needs to be reported.
b. Where banks or financial institutions have sanctioned working capital limits secured against current assets of more than Rs. 5 crores during the year, quarterly statements or returns filed by the company in respect of such loans with the banks or financial institutions should be maintained and should be in agreement with the financial statements. In case the same are not in agreement necessary clarification / reconciliations needs to be given.

iii. **Loans, Advances, Guarantees, Security:**

a. The company needs to maintain a separate list of loans, advances, guarantees and securities provided in favour of subsidiaries, associates and joint ventures during the year and balances outstanding as at the balance sheet date. This is in addition to details of loans, advances, guarantees and securities provided in favour of parties other than subsidiaries, associates and joint ventures and balances outstanding as at the balance sheet date. (Not applicable to companies whose principal business is to give loans)
b. Details of all loans which have fallen due during the year, including the method of repayment or receipt of such loans, needs to be documented, even if the tenure of such loans have been renewed or extended. Also, details of any fresh loans provided to the same party or their related concerns up to the date of the audit report needs to be provided. (Not applicable to companies whose principal business is to give loans)
c. The aggregate amount of loans or advances provided during the year without specifying any terms or period of repayment, or repayable on demand, and the percentage of such loans to the total loans granted. Such details must be provided separately for related parties.
d. While obtaining confirmations of outstanding loans and interests from banks, financial institutions or government / government authorities, the company also needs to specify to the auditor whether they have been declared a wilful defaulter by such lenders as on the date of the audit report. Any show-cause notice issued in this respect must be provided to the auditor, along with a signed declaration from the management. The latest CIBIL report of the company needs to be furnished.
e. If any loans have been taken to meet the obligations of subsidiaries, associates or joint ventures during the year, details of the same need to be provided.
f. Utilisation of funds of loans borrowed by the company, including those other than term loans, will need to be explained.
g. Information of loans raised by the company during the year on the pledge of securities held in its subsidiaries, associates or joint ventures, and defaults in repayment of principal or interest of

such loans. Documentation relating to creation and modification of charges, including Form CHG-1. If the lender has invoked such security, such fact also needs to be disclosed to the auditor.

iv. Legal Requirements:

a. All whistle-blower complaints received by the company during the year must be reported to the auditor, wherever whistle-blower mechanism is applicable. The manner of resolution of such complaints should also be discussed with the auditor.
b. Details of the internal audit functions of the company, if any, including any explanations required by the auditor about the professionals forming a part of the internal audit function and internal audit reports submitted.
c. For companies to whom corporate social responsibility (CSR) is applicable as per section 135 of the Companies Act, 2013, the board approval of CSR policy as recommended by the CSR Committee, the agenda and minutes of such CSR Committee and the workings of the amount required to be spent. In respect of unspent amounts, the details of payments made, bank account earmarked, or amounts transferred to the fund as per Schedule VII for a period of six months post the balance sheet date also needs to be scrutinised.

v. Miscellaneous

a. Details of incomes which have been disclosed in the income tax returns by the company voluntarily but not recorded in the financial statements, i.e. undisclosed income, have been properly recorded during the year or not. Appropriate disclosures need to be made in the financial statements for such transactions.
b. In case of Nidhi Companies, if there is any default in payment of interest on deposits, or any delay in repayments, the details of the same need to be furnished.
c. Expected date of realisation of assets and liabilities existing on the date of the balance sheet. The auditor also had to analyse various financial ratio as on the balance sheet and audit report dates, interim financial information prepared after the balance sheet date to comment on the going concern status.
d. The CARO report of the companies which are included in the consolidated financial statements.

It is important to note that the above requirements as per CARO 2020 are over and above the existing requirements as per CARO 2016.