

CARO 2020 - Enhanced Auditor Reporting Requirements

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Background:

The MCA in exercise of powers conferred under subsection (11) of Section 143 of the Companies Act, 2013 has issued Companies (Auditor's Report) Order, 2020 (hereinafter referred to as "CARO 2020") on 25th February, 2020 which was initially applicable for audit reports relating to FY 2019-2020. However, CORONA rescued the CA's as its applicability is deferred to financial years starting on or after 1st April, 2020. The legacy of such reporting by auditors dates back to 1988 when it first started with reporting on about 24 clauses under the Manufacturing and Other Companies (Auditors Report) Order, 1988. However, with the passage of time, such a reporting has seen many amendments and the reporting was reduced to 12 clauses in 2015, which was further increased to 16 clauses in 2016. With changing environment, increasing corporate scams and misstatements in financial reporting by corporates, authorities felt need for the auditors of companies to provide greater insight and information to the stakeholders and the users on specific matters relating to financial statements and business which has given rise to CARO 2020. The order now requires to report on various matters contained in 21 clauses and 38 sub-clauses.

Applicability:

The applicability and exemptions to certain classes of companies remains same as its predecessor (CARO 2016). The non-applicability of CARO reporting to consolidated financial statements also remains same with one change **which requires reporting by the auditor of parent company of adverse comments in CARO reports of all the companies forming part of its consolidation.**

Analysis of amendments in CARO 2020:

There are **mainly 30 changes** which consist of **4 new clauses**, **3 clauses reintroduced** from earlier versions of CARO, **14 new sub-clauses** and **9 modifications to existing clauses**. The table below gives details of all such clauses along with responsibility of the auditor for auditing and reporting in brief which is based on the guidance note issued by ICAI.

Sr. No.	Clause of CARO 2020 (New / Modified / Reintroduced)	New / Modified Reporting requirements	Guidance by ICAI for auditing / reporting on new requirements
1	3(i)(a)(A) & (B) – Modified and split into 2 sub-clauses	(A) Whether the company is maintaining proper records showing full particulars including quantitative details and situation of property, plant & equipment (PPE) . (B) Whether Company is maintaining proper records showing full particulars of Intangible Assets .	(i) There is effectively no change here except for change in terminology to make it compliant with revised Schedule III terminology (i.e., from fixed assets to PPE and Intangible Assets). (ii) Right of use assets ("ROU") as defined in Ind AS 116 – Leases,

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			<p>Investment property as per Ind AS 40 and non-current assets held for sale as per Ind AS 105 are required to be considered for the purpose of reporting under this clause.</p> <p>(Page 17 & 18 of GN)</p>
2	3(i)(c)– Modified	<p>Whether title deeds of immovable properties are held in the name of the Company.</p> <p>The revision in the clause requires following additional details in cases where title deed is not in the name of the Company;</p> <ul style="list-style-type: none"> • Name of the person as per title deed and whether he is promoter, director, their relatives, or employee of the Company • Period (Range) for which the property is held by above person • Reason for not being held in the name of the Company (also indicate if any dispute) 	<p>Documents which are generally referred to for checking the owner in case of immovable property are registered sale deed / transfer deed / conveyance deed etc.</p> <p>In case of mortgaged immovable properties, auditor may obtain confirmation from Banks/FI with whom the same is mortgaged.</p> <p>(Page 33 of GN)</p>
3	3(i)(d) – New	<p>Whether Company has revalued its PPE, ROU, Intangible Assets. If yes, whether such revaluation is based on valuation by registered valuer. Also, auditor is required to specify the change in amounts if it is 10% or more of net block of respective class of PPE or Intangible Assets.</p>	<p>It may be noted that reporting under this clause would be limited to revaluation model since under cost model revaluation is not permitted. Further, reporting under this clause will cover both upward and downward revaluation under revaluation model. Changes to ROU assets due to lease modifications under Ind AS 116 are not considered as revaluation and hence not required to be reported.</p> <p>(Page 37 of GN)</p>
4	3(i)(e) – New	<p>Whether any proceedings have been initiated or are pending against the Company for holding any benami property under The Benami Transactions (Prohibition) Act, 1988 and rules made thereunder. If so, whether the Company has appropriately disclosed the details in Financial Statements.</p>	<p>Following audit procedures are mainly required for purposes of reporting under the said clause.</p> <ul style="list-style-type: none"> • Management enquiries • MRL • Review of legal & professional fees ledger

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			<ul style="list-style-type: none"> • Minutes of various committee meetings <p>Following disclosures are required to be given in financial statements with respect to benami properties':</p> <ul style="list-style-type: none"> • Nature • Carrying Value • Status of proceedings • Consequential impact on financials including liability that may arise in case proceedings are decided against the Company (also, if liability is required to be provided or shown as contingent liability) <p>The reporting is not required if the Company is the beneficial owner of the benami property. (Page 40 of GN)</p>
5	3(ii)(a) – Modified	<p>Whether the coverage and procedure of physical verification of inventories by management is appropriate in the opinion of the auditor.</p> <p>Whether discrepancies of 10% or more were noticed in the aggregate for each class of inventory during its physical verification and if so, whether they have been properly dealt with in the books of accounts.</p>	<p>This is reintroduced from legacy reporting.</p> <p>The 10% criteria is to be looked from value perspective only. All discrepancies of 10% or more in value for each class of inventory is to be reported irrespective of materiality threshold for the Company. (Page 45 of GN)</p>
6	3(ii)(b) – New	<p>Whether during any point of time of the year, the Company has been sanctioned working capital limits in excess of Rs. 5 crore in aggregate from banks or financial institutions on basis of security of current assets.</p> <p>Whether quarterly returns or statements filed by the Company with such banks or financial institutions are in agreement with the books of accounts of the Company, if not, give details.</p>	<ul style="list-style-type: none"> • Sanctioned limit (Fresh /Renewed) is to be considered and not utilized limits. • Non fund-based limits like LC, BG etc. are considered as working capital. • If utilized limits exceed Rs. 5 crore with sanction below Rs. 5 crore, the same is not required to be reported.

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			<ul style="list-style-type: none"> • Any unsecured sanctioned limit is to be excluded from reporting. • The auditor is just required to match the inventory value as reported in quarterly returns / statements submitted to banks / FI with value as per books of accounts and report disagreement, if any. The auditor is not required to audit the accuracy of the inventory values reported. • Quarterly returns / statements to be verified include stock statements, book debt statements, credit monitoring arrangement reports, ageing analysis of debtors or other receivables and other financial information to be submitted to Banks / FI. (Page 50 of GN)
7	3(iii)(a)(A) & (B)– Modified	Whether company has provided loans or advances in nature of loans or stood guarantee or provided security to any other entity and if so, indicate aggregate amounts of transaction during the year and outstanding as at balance sheet date for subsidiaries, JV, associates and others . Reporting under this clause is not applicable to companies whose principal business is to give loans.	The better way would be to disclose the requisite details in financial statements and give reference in CARO. The format of reporting is given in GN issued by ICAI on page 60. (Page 54 of GN)
8	3(iii)(e) – New	Whether any loans or advance in nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues. If so, specify aggregate amounts of such fresh / renewed loans granted and % of such loans to total loans as at balance sheet date. Reporting under this clause is not applicable to companies whose principal business is to give loans.	The objective of reporting on this clause is to identify instances of evergreening of loans / advances in nature of loans. The auditor should obtain list of all parties to whom loan or advance in nature of loan has been granted and check for dues with respect to such loans. The auditor would be required to enquire with respect to uncleared dues on such loans, if

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			<p>any. If the same are renewed or extended, it would require reporting under this clause. If they are settled through receipt of fresh loan, the same would be visible in party's ledger in form of inflow first and outflow thereafter.</p> <p>Format for reporting is specified on page 68 of GN. (Page 55 of GN)</p>
9	3(iii)(f) – New	Whether Company has granted any loans or advances in nature of loans either repayable on demand or without specifying any terms or period of repayment, if so, specify the aggregate amount, % to total loans and aggregate loans granted to promoters, related parties as defined in section 2(76) of Companies Act, 2013.	<p>The auditor should prepare master file containing party wise details of various terms & conditions of loans or advances in nature of loans given and the same should be updated as and when required. The parties can be tagged as promoter or related party as per definition of 2(69) or 2(76) of companies act respectively.</p> <p>Format for reporting is specified on page 69 of GN. (Page 55 of GN)</p>
10	3(v) – Modified	In respect of deposits accepted or amounts which are deemed to be deposits , whether RBI directives or Companies Act sections 73 to 76 have been complied with. If not, nature of contraventions to be stated along with compliance of order, if any, passed by CLB / NCLT / RBI etc.	<p>Deemed deposits as defined under rule 2(1)(c) of the Companies (Acceptance of Deposits) Rules, 2014 defines deposits to include any receipt of money by way of deposit or loan or in any other form, by a company but does not include amounts specified therein.</p> <p>Examine form DPT-3 filed by the Company. (Page 75 of GN)</p>
11	3(vii)(a)&(b)– Modified	Whether Company is regular in depositing undisputed statutory dues including GST and if not, the extent of arrears of outstanding dues, or if not deposited on account of dispute, then the amounts involved and the forum where the dispute is pending shall be mentioned.	<p>The modification is only to the extent of reporting on GST along with other statutory dues. (Page 84 of GN)</p>

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12	3(viii)– New	Whether any transactions not recorded in the books of accounts have been surrendered or disclosed as income during the year in tax assessments under the Income Tax Act, 1961, if so, whether the previously unrecorded income has been properly recorded in the books of accounts during the year.	<p>Reporting is required only if the Company has voluntarily disclosed in its return or surrendered during search/seizure. Thus, if addition is made by IT authorities and the Company has disputed such additions, reporting under this clause is not required.</p> <p>Review all tax assessments completed during the year and subsequent to balance sheet date but before signing of auditor’s report.</p> <p>Reporting is also required for adequate disclosure in financial statements or impact as per AS / Ind AS after due consideration to exceptional items, materiality, prior period errors etc. (Page 98 of GN)</p>
13	3(ix)(a) – Modified	Whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender , if yes, the period and amount of default to be reported.	<p>Preference share capital would not be considered as borrowings for reporting under this clause.</p> <p>Whether ICD taken would be considered as borrowings for the purpose of reporting under this clause will require evaluation. (Page 101 of GN)</p>
14	3(ix)(b) – New	Whether company is a declared willful defaulter by any bank or FI or other lender.	<p>Reporting under this clause is restricted to willful defaulter declared by banks or FI or any other lender (irrespective of whether such bank / FI has lent to the Company) as the same are governed by RBI master circular RBI/2014 - 15/73DBR.No.CID.BC.57/20.16.003/2014-15 dated July 1, 2014 on willful defaulters.</p> <p>The GN clarifies that such declaration should be restricted to</p>

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			<p>the relevant financial year under audit till the date of audit report.</p> <p>With respect to willful defaults to other lenders, the same would be reported only if the government authority declares company as willful defaulter.</p> <p>Auditor may check information on websites of credit information companies like CIBIL, CRIF, Equifax & Experian. Auditors may also check RBI websites, CRILC database and information available in public domain.</p> <p>(Page 106 of GN)</p>
15	3(ix)(d) – Reintroduced	Whether funds raised on short term basis have been utilized for long term purposes, if yes, the nature and amount to be indicated.	<p>Practical approach to verify such a possibility is to analyze the cash flow position containing overall sources and application of funds. Also, certain companies do follow Asset Liability Management department which tracks the maturity lifecycle of different assets and liabilities.</p> <p>Review of bank statements specifically during the period of receipt of short-term loans / working capital loans and its application thereafter can sometimes provide direct nexus between receipts and application.</p> <p>(Page 114 of GN)</p>
16	3(ix)(e) – New	Whether the company has taken any funds from an entity or person on account of or to meet obligations of its subsidiaries, associates, or JV, if so, details thereof with nature of such transactions and amount in each case.	<p>First check point would be whether loans or advances are given during the year or investments (equity or debt) are made in order to meet obligations of subsidiaries, associates, or JV. Reporting under this clause would cover funds taken from all entities and not restricted to banks & FIs. The reference details could be</p>

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			disclosure of related party transactions. Format for reporting is specified on page 120 of GN. (Page 117 of GN)
17	3(ix)(f) – New	Whether the Company has raised loans during the year on pledge of securities held in its subsidiaries, JV, associates, if so, give details thereof and also report if the company has defaulted in repayment of such loans.	The reporting may be cross referenced to reporting under 3(ix)(a) Format for reporting is specified on page 123-124 of GN. (Page 120 of GN)
18	3(xi) – Modified	Whether any fraud by the Company or any fraud on the company has been noticed or reported during the year, if yes, the nature and amount of involved to be indicated.	<p>The modification has widened the reporting responsibility of the auditor by removing the specific requirement of reporting on frauds by the officers or employees of the Company. Thus, all frauds by the company or on the company should be reported here.</p> <p>The auditor is not responsible to discover the fraud. His responsibility is limited to reporting on frauds if he has noticed any during the course of his audit or if management has identified and reported.</p> <p>Auditor should review minutes of meetings of various committees, internal auditors report etc. to identify if frauds were discussed or reported. Additionally, the auditor will also have to obtain written representations from management while reporting under this clause.</p> <p>Reporting under this clause will not relieve the auditor from complying with section 143(12) of companies act which is specifically covered by new clause 3(xi)(b) as given below. (Page 138 of GN)</p>

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19	3(xi)(b) – <i>New</i>	Whether any report is filed under 143(12) by the auditors in Form ADT-4 as prescribed in rule 13 of Companies (Audit & Auditors) Rules, 2014 with Central Government.	<p>The objective of reporting under this clause is to check and report on the compliance of section 143(12) in terms of reporting of frauds noticed by the auditors in the company committed by officers of employees of the company to central government in Form ADT-4 after seeking comments from board/audit committee (if the amount of fraud exceeds Rs. 1 crore).</p> <p>The reporting liability under 143(12) also lies with company secretary performing secretarial audit, cost accountant doing cost audit and thus statutory auditor is required to report under this clause reporting by aforesaid professionals on frauds noticed by them during their audits. (Page 144 of GN)</p>
20	3(xi)(c) – <i>New</i>	Whether the auditor has considered whistle blower complaints, if any, received during the year by the Company.	<p>The objective of reporting under this clause is to make the auditor confirm that he has gone through all whistle blower complaints and performed / planned his audit procedure accordingly thereby addressing financial statements presentation or disclosure related concerns raised by whistle blowers.</p> <p>Check whether requirement of whistle blower mechanism is mandated by law (SEBI LODR and section 177(9) of Companies Act).</p> <p>If the same is not mandated by law, the auditor may ask from the management all the whistle blower complaints received and action taken on the same. (Page 147 of GN)</p>

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21	3(xiv)(a) – Reintroduced	Whether the company has an internal audit system commensurate with the size and nature of its business	The auditor should evaluate the internal audit function/system like size of internal audit team, the scope covered in the internal audit, internal audit structure, professional compatibility of the team performing internal audits, reporting responsibility, independence etc. to comment on the above clause. (Page 161 of GN)
22	3(xiv)(b) – New	Whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor.	The objective of reporting under this clause is just to obtain confirmation from the statutory auditor that he has gone through the internal audit reports and considered implications of its observations on the financial statements, if any. Reporting under this clause will require the auditor to coordinate closely with the Internal Auditor so that he considers the work done by the internal auditor for his audit purposes, compliance with SA 610(Revised), “Using the Work of Internal Auditors”, is mandatory for the statutory auditor. (Page 167 of GN)
23	3(xvi)(b) – New	Whether the Company has conducted any non-banking finance or housing finance activities without valid Certificate of Registration (“CoR”) from RBI.	The auditor is required to first identify whether the company is engaged in non-banking financial or housing financial activities. If yes, the auditor should discuss with management with regards to registration requirements of RBI for such companies and report accordingly. (Page 181 of GN)
24	3(xvi)(c) – New	Whether the Company is Core Investment Company (“CIC”) as defined by RBI regulations and whether it continues to fulfil the criteria of CIC. If the Company is exempted or unregistered CIC, whether it continues to fulfil the exemption criteria.	The auditor is required to identify whether the activities carried on by the Company, assets composition as at previous year end etc. satisfy the conditions for it to be considered as CIC.

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			<p>It should also go through RBI master direction – Core Investment Companies (Reserve Bank) Directions, 2016 which are applicable to all CIC. (Page 183 of GN)</p>
25	3(xvi)(d) – New	Whether the group has more than one CIC as part of the group, if yes, indicate number of CIC's which are part of the group.	<p>Companies in the group is defined in Core Investment Companies (Reserve Bank) Directions. (Page 187 of GN)</p>
26	3(xvii) – Reintroduced	– 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.	<p>The term cash loss is not defined in the Act, accounting standards and Ind AS. Thus, for accounting standards compliant companies it can be calculated by making adjustments of transactions of non-cash nature like depreciation, impairment etc. to profit / loss after tax figure.</p> <p>Similarly, for Ind AS Companies, profit/loss (excluding OCI) can be adjusted for non-cash transactions like depreciation, lease amortization or impairment. Further, cash profits / cash losses realized and recognized in OCI (not reclassified to P&L) should be adjusted to above profit / loss to arrive at cash profit / loss for the company.</p> <p>Adjustments like deferred tax, foreign exchange gain/loss and fair value changes should also be given effect to since they are non-cash in nature. (Page 189 of GN)</p>
27	3(xviii) – New	Whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.	<p>The reporting on this clause is applicable in where new auditor is appointed during the year to fill casual vacancy under 140(2) of the Act.</p>

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			<p>The incoming auditor who is required to report on this clause should take into account following before reporting on this clause.</p> <ul style="list-style-type: none"> • ICAI code of ethics. • Reasons stated by the outgoing auditor in Form ADT-3 filed with ROC in compliance with 140(2) read with rule 8. • Implementation guide by ICAI on resignation / withdrawal from engagement to perform audit of financial statements. • Compliance with SEBI circular applicable for auditors of listed companies. <p>(Page 191 of GN)</p>
28	3(xix) – New	<p>On the basis of the financial ratios, ageing and expected dates of realization of financial assets and payments of financial liabilities, other information accompanying the financial statements, the auditors knowledge of the board of directors and management plans, whether the auditor is of opinion that no material uncertainty exist as on date of audit report that company is capable of meeting its liabilities existing as at balance sheet date as and when they fall due within period of one year from balance sheet date.</p>	<ul style="list-style-type: none"> • Prepare list of liabilities with due dates falling within next one year. • Check payments subsequent to balance sheet date till the date of issuing auditors report. • Obtain plan from management indicating realizable value of assets and payments of liabilities. • Ratios to be considered are current ratio, acid-test ratio, cash ratio, asset turnover ratio, inventory turnover ratios, accounts receivable ratio etc. • Other details which should be obtained from management post balance sheet date are MIS, cash flow projections etc. <p>Adverse reporting under this clause should have similar reporting in the main report regarding going concern as specified in SA 570.</p> <p>(Page 196 of GN)</p>

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29	3(xx)(a) – <i>New</i>	Whether in respect of other than ongoing projects, the Company has transferred unspent amount to a fund specified in schedule VII of the Companies Act within period of six months of expiry of FY in compliance with 135(5) of Companies Act.	The auditor should ask the management to prepare a project wise report on amounts spend during the year and considered under CSR activities. (Page 204 of GN)
30	3(xx)(b) – <i>New</i>	Whether any amount remaining unspent under 135(5) of Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with 135(6) of Companies Act.	Clause (a) requires unspent amount not relating to any ongoing project to be transferred to specified fund as per schedule VII of the Act and Clause (b) requires unspent amount relating to ongoing projects to be transferred to special bank account opened for CSR activities. (Page 209 of GN)

Conclusion:

The additional reporting requirements would require additional details from the management and thus it is very important that an auditor should have a dialogue with the management immediately for the later to gear up. Also, it is important for the auditor to understand the process followed by the management for collection and processing of the required information and its control environment which will give him comfort while complying with reporting requirements. Lastly, it is important for the auditors to take suitable management representations wherever accuracy and completeness of information provided by the management cannot be confirmed by the auditor to safeguard its position. The Auditor would have to factor additional time for reporting and the documentation will have to be robust and full proof for future reference and as a safeguard against the enhanced reporting responsibility. Lastly, reporting under CARO 2020 will no longer remain a tick in the box procedure or boiler plate reporting.