

A close-up photograph of a hand holding a silver pen, writing on a document. The background is blurred, showing the texture of the paper and the hand. The lighting is warm, highlighting the pen and the hand.

CARO 2020

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National Conference on Company Law

Corporate Laws & Corporate Governance Committee – ICAI

Hosted by WIRC of ICAI



Section 1

New reporting requirements

Auditors reporting under 2013 Act (applicable for audit periods beginning April 1, 2021)

Reporting on legal and regulatory Matters

Main audit report

Annexures to audit report

Existing requirements

True and Fair view of financial statements

Other legal and Regulatory Matters such as books of accounts, adverse effect on functioning of company

New requirements introduced:

- ▶ Funding transactions
- ▶ Compliance with dividend norms
- ▶ Audit trail – applicable for audit periods beginning April 1, 2023 (deferred from 2021-22 to 2022-23 by amendment rules dated 31.3.22)

Existing	12
New*	5
Total	17

*Including sub clauses

Guidance Note on adverse effect on functioning of company and maintenance of books and account

No change

Amendments

Standards on Auditing e.g. SA 700, SA 701, 705, SA 706, SA 720

Reporting framework/
guidance

Internal Financial Controls

No change

Guidance Note on ICFR

CARO 2016

CARO 2020 substitutes existing requirements under CARO 2016

New requirements introduced*	28
Existing requirements modified*	15
Existing requirements carried forwarded*	8
Existing requirements deleted*	(1)
Total	50

*Significant changes to Sch III to align with CARO 2020 and new auditors reporting requirements – **10 specific disclosures added***

Guidance Note on CARO 2020

Contents of legal and regulatory section of the audit report

As required by section 143 (3) of the Act, we report on following.....

- a. Sought and obtained all information and explanations which were necessary for the audit
- b. Proper books of account as required by law have been kept
- c. Dealing with report on the accounts of branch office audited by other auditor (if applicable)
- d. Balance sheet and profit and loss are in agreement with the books of account and returns
- e. Financial statements comply with the accounting standards
- f. Observations/ comments of the auditors which may have adverse effect on functioning of company (if applicable)
- g. Directors disqualification
- h. Qualification, reservation or adverse remark relating to maintenance of accounts and other connected matters (If applicable)
- i. Reporting on IFC (if applicable)
- j. Reporting on managerial remuneration (pursuant to Section 197)
- k. Rule 11 - **Other Matters to be Included in Auditors Report**
 - a. Impact of pending litigations on financial position
 - b. Required provision for material foreseeable losses on long term contracts including derivative contracts
 - c. Delay in transferring amounts to IEPF
 - d. **Reporting on transactions to benefit the ultimate beneficiary**
 - e. **Compliance with dividend norms**
 - f. **Audit trail (from FY April 1, 2023 onwards)**

Date of applicability of new auditor reporting requirements

What is the date of applicability of the reporting requirements relating to funding transactions and dividend?

Points for consideration

- ▶ Notified from April 1, 2021 – Not linked with any FY
- ▶ Schedule III amended to introduce disclosure for funding transactions – and are applicable from April 1, 2021 onwards
- ▶ Harmonious reading suggests that these reporting requirements are effective from **FY beginning on or after April 1, 2021**
- ▶ **General Instructions for preparation of Balance Sheet**
 - Financial Statements shall contain the corresponding amounts (comparatives) for the immediately preceding reporting period **for all items shown in the Financial Statements including Notes** except in the case of first Financial Statements laid before the company after incorporation.
- ▶ Reporting on comparative information (FY 2020-2021) – as required to be disclosed as per Schedule III. Refer SA 710, Comparative Information - Corresponding Figures and Comparative Financial Statements:
 - ▶ Corresponding figures approach
 - ▶ Auditor’s responsibility to obtain sufficient appropriate audit evidence about whether the comparative information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting framework;

Transactions covered....contd

What are the types of funding transactions that are covered in these reporting obligations?

Points for consideration

- ▶ Schedule III requires management to provide necessary disclosures for transaction with 'ultimate beneficiaries' including that relevant provisions of the FEMA and Companies Act has been complied and the transactions are not violative of PMLA
- ▶ Auditor to comment that:
 - ▶ Management representation has been obtained that (other than disclosures in the financial statements):
 - ▶ No funds have been advanced/ loaned/ invested to 'Intermediaries' OR
 - ▶ No funds have been received from 'Funding Parties'
 - ▶ With an understanding that 'Intermediaries' / 'Funding Parties' would lend/ invest/ provide guarantee/ security to 'Ultimate Beneficiaries'
 - ▶ Based on such audit procedures that the auditor has considered **reasonable and appropriate in the circumstances**, nothing has come to their notice that has caused them to believe that the Management representation (as above) is not materially misstated
- ▶ Understanding to lend/ invest/ provide guarantee/ security to 'Ultimate Beneficiaries' may be
 - ▶ Explicit (evidenced through contractual agreements) or
 - ▶ Tacit (verbal understanding) – significant level of judgement involved
- ▶ Is this applicable in CFS? And for transactions between the holding company and subsidiary company which are eliminated in CFS?

Transactions covered

What are the types of funding transactions that are covered in these reporting obligations?

Points for consideration

▶ Seems to involve following steps as illustrated below:

Step 1: Company A borrows INR 100 crores from bank in November 2021



Step 2: On December 2021 Company A invests INR 10 crores in equity shares of Company B (*Intermediary*) with an understanding that Company B would provide loan to Company C (*Ultimate Beneficiary*)



Step 3: Company B (ie. Intermediary) provides loan of INR 5 crores to Company C (i.e. Ultimate Beneficiary) in January 2022

Key principles:

- ▶ Covers loans/ advances in the nature of loan - Normal business transactions e.g. supplier advance would not be covered
- ▶ ☑ Ultimate beneficiary must have been identified at the inception itself
- ▶ ☑ An understanding with the intermediary that it would transfer funds to the ultimate beneficiary should exist
- ▶ Time gap between the receipt of funds by the intermediary and transfer of funds to the ultimate beneficiary not relevant

Declaration or Payment of Dividend

Whether the auditors reporting obligation regarding compliance with section 123 apply to declaration or payment of interim dividend?

Points for consideration

- ▶ Under section 2(35) of the 2013 Act - dividend includes interim dividend. Accordingly, reporting obligation covers interim dividend

Whether the company is required to comply with the provisions of Companies (Declaration and Payment of Dividend) Rules, 2014 in case of declaration of dividend out of surplus of profit and loss account?

Points for consideration

- ▶ Dividend Rules prescribes certain restriction in the amount of dividend:
 - ▶ If the company has incurred loss / has inadequate profits and the Company proposes to declare dividend out of free reserves
- ▶ Compliance with Dividend Rules required when dividend is declared out of previous years profits that has been **'transferred'** to free reserves
 - ▶ Free reserves relates to portions of earnings, etc which have been appropriated for general/ specific purpose
 - ▶ Surplus of profit and loss refers to carry forward balance in Statement of Profit and Loss and do not represent amounts which have been 'transferred' to reserves.
 - ▶ Schedule III to the 2013 Act includes a heading of 'Reserves and Surplus' thereby indicating a distinction between a Reserve and Surplus
 - ▶ Declaration of Dividend out of Surplus of Profit and Loss account will not tantamount to declaration of dividend out of reserves
 - ▶ Reference should also be made to Secretarial Standard – 3 on Dividend and Guidance Note on Dividend issued by ICSI.

Audit trail

Whether the company, in respect of financial years commencing on or after the April, 1, 2023, has:

- ▶ Used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and
- ▶ The same has been operated throughout the year for all transactions recorded in the software and
- ▶ The audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention

Points for consideration

- ▶ **Management responsible to prepare and keep books of account (including books of account in electronic mode) which give a true and fair view of the state of the affairs of the company**
- ▶ Rule 3 of the Accounts Rules amended to provide that every company which uses accounting software for maintaining its books of account, shall use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled
- ▶ Auditors reporting obligation applies to all companies – to the extent books of account are maintained electronically
- ▶ Transactions prior to April 1, 2023 are not required to be assessed by the auditor while reporting under this clause
- ▶ Intent seems to avoid fabrication of books through overwriting the books of accounts. Audit trails expected to easily track what changes have been made to the accounts and would require the company to explain the reasons thereof
- ▶ Auditor to verify that the feature of recording audit trail facility has operated throughout the year. Auditor to modify the report - where the feature of audit trail has not operated throughout the year

Applicability for all companies

Whether auditors of all companies would need to report on the new reporting obligations?

Points for consideration

- ▶ Applies to auditors of:
 - ▶ All class of companies (including section 8 companies)
 - ▶ Foreign companies e.g. liaison office as defined under 2013 Act. Reference may be made to Rule 5(2) of Registration of Foreign Companies Rules:

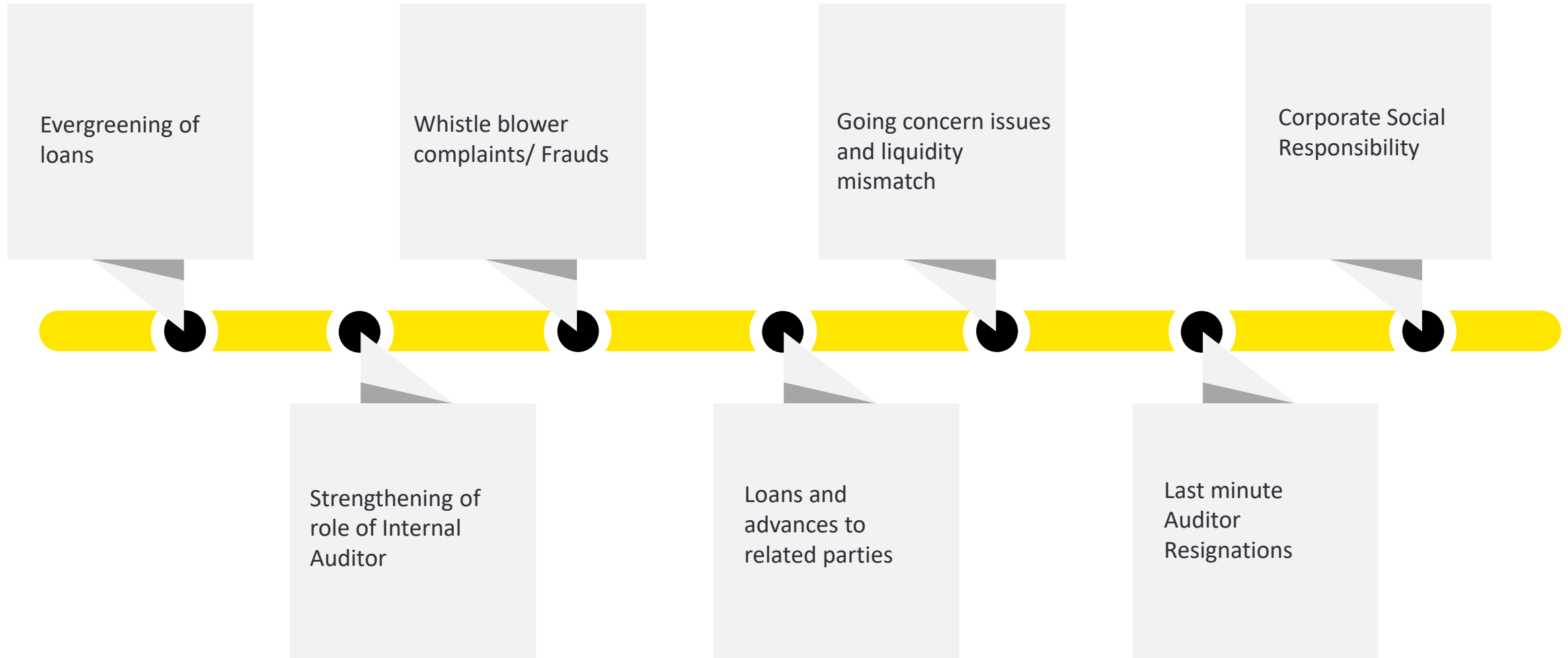
The provisions of Chapter X i.e. Audit and Auditors and rules made there under, as far as applicable, shall apply, mutatis mutandis, to the foreign company
- ▶ Applies to standalone and consolidated financial statements
- ▶ Consolidated financial statements may include certain group entities which are either not companies under the 2013 Act (e.g. LLP) or are incorporated outside India
 - ▶ Auditors of such entities are not required to comply with these requirements – as provisions of 2013 Act does not apply to them
 - ▶ In such case Group auditor to state that the comment has been made after considering only those entities on which provisions of 2013 Act apply at standalone level

A person in a dark suit is pointing towards the camera with their right hand. They are holding a document or folder in their left hand. The background is a bright, out-of-focus office space with windows.

Section 2

CARO 2020

Why change in CARO



Implications of Change

- Is it too much expected from Auditor?
- Is it factual reporting or judgement required
 - Qualifications or adverse remarks?
 - Title deeds not in the name of the company
 - Discrepancy of 10% or more in each class of inventory arising out of audit adjustments
 - Short term funds raised by subsidiary and used for long term purpose based explicit parent support
 - Discrepancies in returns/statements filed with Bank/FIs
 - Reports of Internal Auditors for the period under audit
- Implications of comments on main audit report and report on ICFR to be considered

CARO 2020 - Overview

- ▶ Applicability – No change
 - ▶ Applicable to every company including foreign company except
 - ▶ Banking company, insurance company, section 8 companies, one person company, small company and private companies within the threshold (not being a subsidiary or holding company of a public company; and SC + R&S ≤ 1 crore and borrowing from bank or FI ≤ 1 crore and total revenue ≤ 10 crores)
 - ▶ Order not applicable to Investment Trusts and Real Estate Investment Trusts governed by SEBI Infrastructure Investment Trust Regulations
- ▶ **CARO 2020 shall not apply to the auditor’s report on the consolidated financial statements except one specific clause whereby**
 - ▶ **Qualification/Adverse remarks in CARO in the audit report of components which are consolidated in the CFS will be required to be reported.**
- ▶ **The new/revised clauses (including sub-clauses) have been bifurcated into the following :-**

Particulars	Count
New reporting requirements under CARO 2020	28
Reporting requirements modified	16
Reporting requirements carried forward with no modifications	7
Reporting requirement of CARO 2016 deleted	(1)
Total	50

Maintenance of Fixed Asset Register, Revaluation of PPE and Intangibles

Key considerations

Maintenance of Fixed Asset Register:

- ▶ Fixed asset register to also cover investment property, ROU assets and intangible assets including intangible assets generated on business combination

Title Deeds:

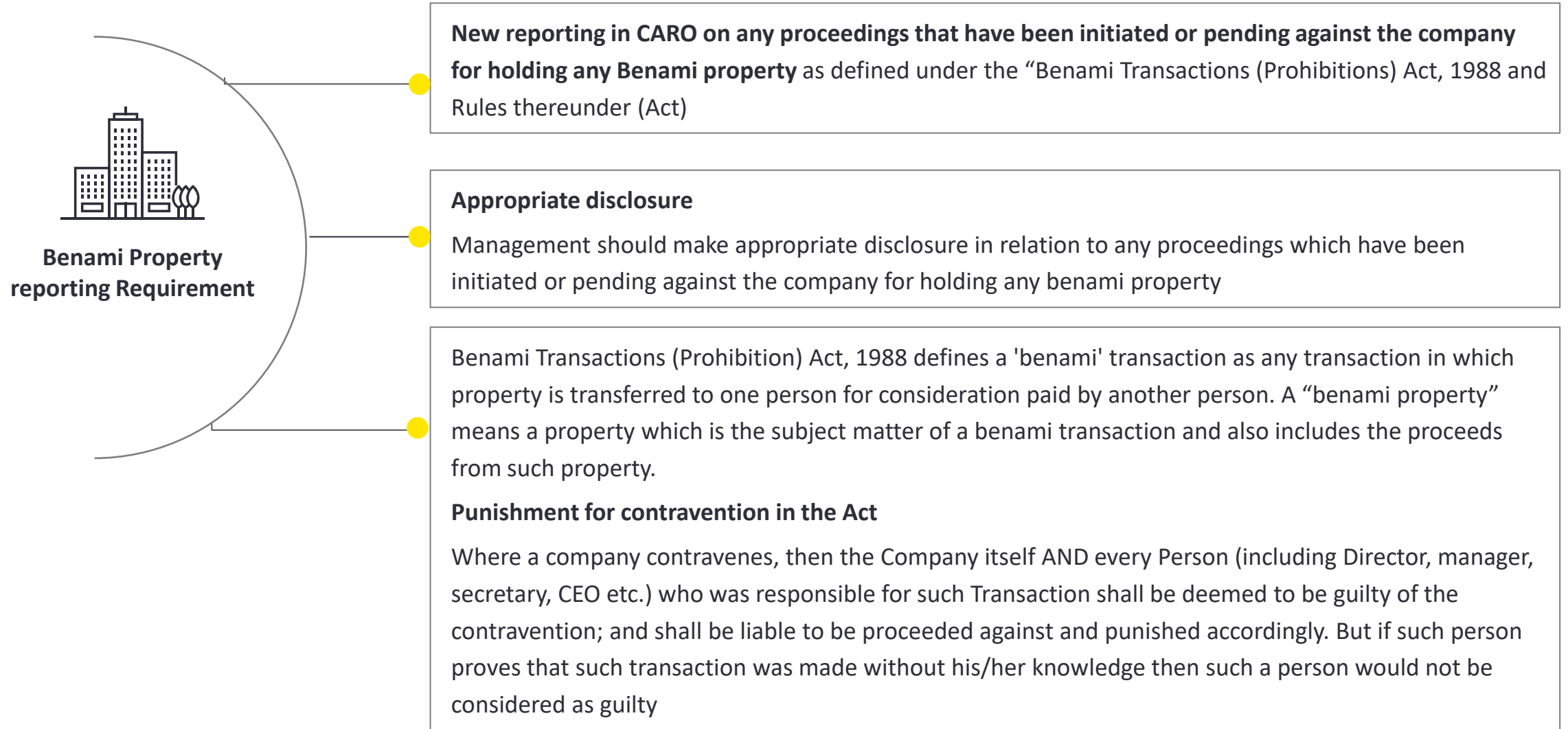
- ▶ Title deeds – all the immovable property are covered for reporting except assets taken on lease and lease agreements are duly executed
- ▶ Properties considered as stock in trade eg in real estate industry, then reporting is not triggered
- ▶ Reporting is triggered for assets taken on lease if lease agreements are not duly executed
- ▶ What about companies not following Ind AS and hence not implemented Ind AS 116?
- ▶ Additional disclosures (e.g.: name of the title owner, relationship, period, reasons) whose title deeds are not in the name of the Company

Revaluation:

- ▶ Verify that disclosure is made for companies following revaluation model – since under cost model revaluation is not permitted
- ▶ Reporting on whether the company has revaluated its PPE or intangible assets and whether revaluation has been carried out by a Registered valuer
- ▶ Additional reporting of change $\geq 10\%$ in aggregate in the net carrying value of each class of PP&E or intangibles assets; Change can be up/downward
- ▶ Whether ROU measurements due to lease modification or fair valuation of PPE for first time adoption of Ind AS covered for reporting ?

Additional reporting on disclosure of new/ pending proceedings in respect of benami properties in financial statements

Proceedings initiated/pending against company for holding Benami Property



Physical verification of inventories

Whether physical verification of inventory has been conducted at reasonable intervals by the management and

- ▶ **Whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate;**
- ▶ **Whether any discrepancies of 10% or more in the aggregate for each class of inventory** were noticed and if so, whether they have been properly dealt with in the books of account;

Key considerations

Additional reporting on coverage and procedure followed. Management to conduct physical verification of inventories. Auditor expected to examine methods, procedures and the coverage:

- ▶ Periodicity of verification depends upon the nature of inventories, location and the feasibility of conducting a verification
- ▶ Coverage and procedure will normally not be appropriate if it is not reasonable and adequate in relation to the size of the company and nature of its business

Only in cases where discrepancy of 10% or more arises in value, for any class of inventory, the auditor has to report the fact and also report whether they have been properly dealt with in the books of account. For the purpose of reporting under this clause, materiality threshold as may be applicable for the auditee is not relevant

Whether auditor is required to report following for a class of inventory:

- ▶ *Scenario 1: Discrepancies more than 10% in value but less than 10% in quantity – Reporting triggered*
- ▶ *Scenario 2: Discrepancies less than 10% in value but more than 10% in quantity – No reporting triggered*

Discrepancy of 10% or more to be assessed for each class of inventory separately

- ▶ Whether during any point of time of the year, the company has been sanctioned working capital limits in excess of INR 5 crore, in aggregate, from banks or FIs on the basis of security of current assets;
- ▶ Whether the quarterly returns or statements filed by the company with such banks or FIs are in agreement with the books of account of the Company, if not, give details

Key considerations

- ▶ Difference between disclosure under Schedule III and CARO (Schedule III disclosure for the management are wider):
 - ▶ Working capital (Schedule III – any borrowing)
 - ▶ Exceeding Rs 5 crores (Schedule III – no limit)
- ▶ Assess that disclosure has been made if the company has borrowings ‘during any point of time of the year’ from banks or FI on the basis of security of current assets
 - ▶ Covers funds based and non fund based credit facilities
 - ▶ Disclosure is required considering borrowings sanctioned even if the same is unutilized during the period/ as at the end of the reporting period
 - ▶ No disclosure required for limits sanctioned on the basis of assets **other than current assets**
 - ▶ Disclosure required where borrowings have been availed based on security of current assets of other Group entities
- ▶ Fresh sanction as well as limits renewed or due for renewal during the reporting period should be considered in determining the sanctioned amount

Working capital limits

- ▶ Ensure that disclosure is confined to the quarterly returns/ statements (e.g.. ageing analysis) even if monthly statements are submitted
- ▶ *The auditor is not required to audit such quarterly returns/ statements, but only required to compare the same with the books of account and report disagreement, if any..*
- ▶ Auditor not required to audit the books of the account on the basis of which such statements/ quarterly returns have been prepared and submitted to the banks/ FIs. However, while opining on this clause, the auditor should consider:
 - ▶ The impact of modifications, if any, to the audit opinion e.g. audit opinion is modified as proper records were not maintained
 - ▶ Appropriateness of underlying internal controls established for generating reliable information including impact of continuing Internal control weaknesses
- ▶ Auditors to ensure managements process for the disclosure is thorough and compare Returns/ statements with books of account
- ▶ How subsequent audit adjustments while finalising the audit, impacting numbers submitted in these quarterly returns to be dealt with?

Investments, guarantees, loans and advances

Sub - clause (iii): Whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so,-

a) whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate-

A) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to subsidiaries, joint ventures and associates;

B) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to parties other than subsidiaries, joint ventures and associates;

b).....

Key Consideration

- ▶ Reporting loans/advances in the nature of loans granted, guarantee or security provided to all parties (as against those parties covered under Section 189 of the Act in the erstwhile clause)
- ▶ Sub-clause (a) & (e) not applicable to companies who are in the principal business of giving loans (e.g. FIs, NBFCs). However other sub clauses are applicable even to companies who are in the principal business of giving loans
- ▶ Requires determination of gross amounts (i.e. without considering subsequent settlements) of all loans, advances in the nature of loans, guarantees, security provided **during the year** to subsidiaries, joint ventures, associates and to any other parties
- ▶ Loans given in cash or in kind – reporting required; loans squared up during the year to be reported
- ▶ Guarantees to cover financial guarantees only and not performance guarantees
- ▶ Auditor to ensure compliance with sections 179, 180, 185, 186, 187 of the Companies Act, 2013

Investments, guarantees, loans and advances

Whether supplier advances are covered within the ambit of this clause?

Points for consideration

- ▶ *It is clarified that the auditor's comments on all the six clauses are to be made with **reference to all the loans/advances in nature of loans granted, guarantee or security provided to companies, firms, limited liability partnerships or any other parties.***
- ▶ *Whether an advance is in the nature of a loan would depend upon the circumstances of each case*
- ▶ The clause includes loans/ advances in nature of loans but do not cover advances unless such advances are in the nature of loans. Key principles for identifying advances in the nature of loans are:
 - ▶ Amount/ period of advance - whether far in excess of the value of an order/ far in excess of the period as per normal trade practice
Another way to consider is the operating cycle i.e. the time between the purchase of the raw material and the delivery of the finished product by the supplier. An advance which exceeds this period would normally be an advance in nature of loan
 - ▶ A stipulation regarding interest may normally be an indication that the advance is in the nature of loan

Investments, guarantees, loans and advances – whether prejudicial

Whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, If so,

a).....

b) whether the 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 not prejudicial to the company's interest;

Key considerations

- ▶ Applicable to all companies including companies like NBFCs whose principal business is to grant loan
- ▶ For loans/advances in nature of loans, the “terms and conditions” would primarily include rate of interest, security, terms and period of repayment and restrictive covenants, nature of entity
- ▶ For investments made, the auditor would have to give due consideration to the factors connected with such an investment, including company's ability to make such investment, financial standing of the investee company, sources of fund, valuation of the proposed investment, covenant's attached, etc
- ▶ Whether the clause covers reporting of loans/ advances in nature of loans, investments, guarantees and security which were given in previous years and existing on the date of applicability of CARO 2020?
 - ▶ Clause 3 refers to “*Whether during the year the company.....*” and hence reporting obligation applies prospectively
 - ▶ Reference should be made to reporting u/s 143(1)(a) under Companies Act, 2013 which requires auditor to report whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its member

Evergreening of loans and advances

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 [not applicable to companies whose principal business is to give loans];

Key considerations

- ▶ Covers instances of 'evergreening' of loans/ advances in nature of loans
- ▶ Auditor to consider loans falling due as on the balance sheet date and which were renewed/extended/settled post balance sheet date and before the date of audit report
- ▶ Consider amendment in the Companies (Audit and Auditors) Amendment Rules, 2021
- ▶ In case of complex group structures, it would be difficult to establish a clear audit trail for the transactions and thus making it difficult to identify any such transaction
- ▶ Determining the Total Loans and Advances in the nature of loans could pose challenges
- ▶ *The term 'evergreening' is not defined in the Act. However, in general parlance it implies an attempt to mask loan default by giving new loans to help delinquent borrowers to repay/adjust principal or pay interest on old loans.*
- ▶ Intent seems to mask loan default. Conversion of interest into loan is an attempt to provide extended time period to the borrower

January 2021

- ▶ Loan obtained Rs 100
- ▶ Repayable on September 2021
- ▶ Interest rate 10% pa



September 2021

- ▶ Total amount due Rs. 105
- ▶ Interest is converted in to loan
- ▶ Rs 105 provided as fresh loan

Loans and advances

Other clauses for loans and advances

Clause (iii) (c) –

in respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

Clause (iii) (d) –

if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

The above two clauses are also applicable to companies whose principal business is to give loans

This may put significant challenges for NBFCs

Acceptance of Deposits

clause (V): In respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the directives issued by RBI and the provisions of Section 73 to 76 or any other relevant provisions of the Companies Act, 2013 and rules made thereunder are complied with, if not, the nature of contravention to be stated.....

Key Consideration

- ▶ Scope has been extended to amounts which are deemed to be deposits
- ▶ Earlier coverage was limited to deposits which is continuing
- ▶ Examples of deemed deposits include:
 - ▶ Advance from customers outstanding for more than 365 days
 - ▶ Shares not allotted within 60 days and share application money not refunded within 15 days

Clause (VII) : Statutory dues

Key considerations

- This clause is same as CARO 2016 except the following :
- Auditor to report on timely payment of **GST** along with other undisputed statutory dues
- Reporting of **all unpaid statutory dues** which are disputed. In CARO 2016, reporting was restricted to specified dues (i.e. income tax, sales tax, service tax, custom duty, excise, VAT)

Undisclosed income

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

Key considerations

- ▶ Limited to examination of those transactions, which were hitherto unrecorded in the books of account and which were surrendered or disclosed as income in the tax assessments under the IT Act
- ▶ Company must have voluntarily admitted to the addition of such income - demonstrated on the basis of the income tax returns
 - ▶ Statement retracted on the ground that such disclosure was obtained under force, coercion, etc. cannot be treated as surrendered or disclosed by the company
- ▶ Proper recording, by implication, includes proper disclosure thereof in the financial statements of the company - Disclosure in the financial statements should be sufficient to enable the users understand the impact of such transactions
- ▶ Auditor to evaluate implications of applicable accounting standards i.e. Ind AS 8/ AS 5
- ▶ Whether additions made by the income tax authorities (but disputed by the company) warrant reporting under this clause?

Repayment of borrowings

Sub - clause (ix)(a): 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 the amount of default to be reported as per the format below

Nature of borrowing, including debt securities	Name of lender (lender wise details to be provided in case of defaults to banks, financial institutions and Government)	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any
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Reporting requirements and points for discussion

- ▶ Enhanced and wider reporting requirements - Default in repayment of loans or other borrowings or interest thereon to any lender is required to be reported whereas previously it was restricted to a financial institution (FI), banks, Government or debenture holders only
- ▶ “Default” would mean non-payment of dues to lenders on the last dates specified in loan documents or debentures trust deed
- ▶ Auditor to report
 - ▶ amount of all defaults committed during the year and the number of days of default (consider period upto date of audit report)
 - ▶ amounts remaining unpaid, period and amount of all defaults existing at the balance sheet date irrespective of when those defaults have occurred.
- ▶ Lender wise details in the format to be given where defaults to banks, FIs or Government; for other lenders – Aggregate for each type of lender may be given – e.g. debenture holders
- ▶ Consider loans/borrowings/interest repayable on demand with no terms specified
- ▶ Consider application for re-schedulements/restructuring proposals to lenders

Repayment of borrowings

Key considerations

- ▶ Companies adopting Ind AS
 - ▶ Borrowings need to be considered on the basis of legal form rather than on the basis of the substance of the arrangements as required in terms of Ind AS 32 and 109. eg. redeemable preference shares though considered as financial liabilities/borrowings under Ind AS, will not be considered for reporting under this clause
- ▶ Challenges for NBFCs and highly leveraged companies
 - ▶ Voluminous transactions – Auditor to review company’s internal control systems and test the design and operating effectiveness of company’s treasury activities and liquidity
 - ▶ Obtain and review latest credit rating report and whether there is mention of any defaults
- ▶ Wilful defaulter – consider additional disclosures under Schedule III
 - ▶ If the company has not been declared as wilful defaulter but has received a show cause notice as per RBI circular, auditor to disclose this fact
 - ▶ Auditor to obtain representation from management that company neither has been declared as wilful defaulter nor has it received any show cause notice
 - ▶ If company is legally disputing bank’s/financial institution’s declaration of the company – Perform procedures under SA 501 (Audit Evidence)

Short term funds for long term purpose

Whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated

Key considerations

- ▶ Intent is to assess the financial health of an entity
- ▶ Auditor to determine the long-term sources and the long-term application of funds using the data contained in the financial statements
- ▶ Determination of direct relationship between particular funds and an asset from the balance sheet may not be feasible
 - ▶ A more practical approach would be to determine the overall picture of the sources and application of funds of the company
- ▶ Whether the current/ non-current classification of assets and liabilities have any bearing while reporting under this clause?
 - ▶ *current maturities of long-term loans are to be treated as long term sources of funds for the purpose of reporting under this clause.*

Fraud reporting

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 the amount involved is to be indicated;

Key considerations

- ▶ As compared to CARO 2016 - auditors responsibilities been widened by removing the words “officers/ employees”
 - ▶ Auditor to report whether any fraud has been noticed or reported either on the company or by the company during the year and is not limited to frauds by the officers or employees of the company.
- ▶ Auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements.
- ▶ Auditor to consider reporting under other clauses e.g. whistleblower, undisclosed income
- ▶ Whether reporting under this clause is triggered where investigation for allegations of fraud is in progress?
- ▶ Auditor to assess implications on auditor’s report and state that the investigation is in progress for allegation of fraud. Involves critical evaluation of facts and circumstances including:
 - ▶ Management attitude – serious or casual
 - ▶ Investigation plan – whether covers possible exposures including criminal or civil
 - ▶ Involvement of external experts
 - ▶ Estimation of the impact on financial statements basis the evidence on hand
- ▶ Concept of materiality may be considered while reporting under this clause

Whistle blower complaints

Whether the auditor has considered whistle-blower complaints, if any, received during the year by the company? Which steps auditor may take to 'consider' whistle-blower complaints?

Key considerations

- ▶ Auditor to consider every complaint received (including anonymous) while deciding the nature, timing and extent of audit procedures
- ▶ Auditor to evaluate whether whistle blower complaints are investigated and resolved by the company in an appropriate and timely manner
- ▶ Evaluate that the whistle-blower mechanism is as per applicable laws and regulation
- ▶ Auditor to obtain all whistle-blower complaints from management which are not required and have not established whistle blower mechanism on a voluntary basis
- ▶ Not required to consider whistle-blower complaints pertaining to earlier years while reporting under this clause
- ▶ The auditor should enquire from the management about investigation of all whistle blower complaints received and the findings, if any. The auditor shall review the minutes of audit committee and board meetings to identify whistle blower complaints, if any.
- ▶ Assess consequential implications on the auditor's report
- ▶ Auditor to consider the nature, timing and extent of audit procedures, assess consequential implication e.g. impact on true and fair view, CARO clause on fraud, fraud reporting to central government
- ▶ Concept of materiality may be considered while reporting under this clause

Whistle blower complaints

What are the reporting implications in the following scenarios?

Scenario 1

Whistleblowing complaints received and satisfactorily dealt with during the year

Scenario 2

Whistleblowing complaints:

- ▶ Received during the year, and
- ▶ Satisfactorily dealt with before the audit report

Scenario 3

Whistleblowing complaints:

- ▶ Received during the year, and
- ▶ Is in the process of investigation

Scenario 4

Whistleblowing complaints received after the year end but before the audit report date

Implication:

Scenario 1, 2 and 3

- ▶ Reporting obligation under CARO is triggered as the whistleblowing complaints were received during the year

Scenario 4

- ▶ Management and auditor to address the complaint, irrespective of reporting obligations under CARO

Internal audit

Whether the company has an internal audit system commensurate with the size and nature of its business

Whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor

Key considerations

- ▶ Section 138 of the 2013 Act mandates internal audit system for listed companies and other prescribed class of companies
- ▶ Audit Committee/ Board (in consultation with the internal auditor) to formulate the scope, functioning, periodicity and methodology for conducting the internal audit
- ▶ Auditor to consider the requirements of SA 610 including:
 - ▶ Size of the internal audit department and Qualifications of the persons undertaking internal audit
 - ▶ Reporting responsibility of the internal auditor - Higher the level to which the internal auditor reports, the greater would be his independence
- ▶ Consider all the internal audit reports covering period upto the end of the FY under audit prior to finalising audit report - Auditor should set this expectation clearly with senior management / TCWG
- ▶ Where some or all internal audit reports are not available, or provided at very short notice or do not adequately address the plan and scope required, the statutory auditor should consider appropriate reporting in this clause as well as consider its effect on the overall control environment with regard to reporting on internal financial controls over financial reporting (ICFR).

Internal audit

What are the reporting implications in the following scenarios?

Scenario 1

Some internal audit reports (for period upto YE) received at a very short notice

Scenario 2

Some internal audit reports (for period upto YE) not received

Points for discussion

- ▶ *The statutory auditor should consider the internal audit reports shared by the company till the date of completing the audit. Where some or all internal audit reports are not available, or provided at very short notice or do not adequately address the plan and scope required, the statutory auditor should consider appropriate reporting in this clause as well as consider its effect on the overall control environment with regard to reporting on internal financial controls over financial reporting (IFCoFR).*
- ▶ Modified/Factual reporting – stating the inability to obtain reports. ICAI guidance note provides the following wordings:
We were unable to obtain [any/ some/ on timely basis] of the internal audit reports of the company, hence the internal audit reports have not been [entirely] considered by us.

Material uncertainty in repayment of liabilities when they fall due

Disclosures required under Schedule III

On the basis of the financial ratios, ageing and expected dates of realisation 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, whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date;

Key considerations

- ▶ Emphasis is on the company's ability to meet its liabilities – different from assessment of going concern
- ▶ Test of existence of material uncertainty is to be as on the date of audit report for the position of liabilities existing at the date of BS
- ▶ One-to-one relationship between the unpaid liabilities and the realisable financial assets not required - Evaluation to be done on an overall basis
- ▶ Whether a paragraph relating to material uncertainty on going concern would also have reporting implications under this clause?
 - ▶ *The emphasis in this clause, is on the company's ability to meet its liabilities. If the main audit report contains a paragraph on "material uncertainty related to going concern", it should be duly considered while making comment under this clause.*
 - ▶ *There can be a situation wherein going concern assumption may be appropriate due to support letters provided by the holding company, but the company may not be able to meet its liabilities falling due within a period of one year from the balance sheet date*
 - ▶ Going concern is an assumption that the entity will continue for the foreseeable future. Reporting under this clause and going concern are related but separate assessments. Outcome of these assessments can be different - Company can be capable of meeting its liabilities when due but may have going concern challenges

Material uncertainty in repayment of liabilities when they fall due

Auditor of Company A concluded that a material uncertainty related to going concern exist

Going concern triggers:

- ▶ Net-worth eroded to the extent of 60%
- ▶ Expected to continue to incur losses in next 2 years
- ▶ Loss of a major customer (20% of revenue) during the year
- ▶ No default in payment of liabilities
- ▶ Credit downgrade due to negative business environment

Mitigating factors

- ▶ Unused financing facilities
- ▶ New financing facilities can be obtained by pledging unencumbered assets
- ▶ Cost reduction measures implemented
- ▶ Process of identifying new investors

Points for consideration

Even though material uncertainty to going concern exists, it doesn't appear that material uncertainty exists for meeting the liabilities since:

- ▶ Material uncertainty to going concern primarily arises due to net-worth erosion and continuing business losses
- ▶ No concern around liquidity position
- ▶ The unused financing facilities and new financing facilities that can be obtained by pledging unencumbered assets would be sufficient to meet liabilities (when fall due) within 1 year from the balance sheet date

Material uncertainty in repayment of liabilities when they fall due

*Auditor of Company A concluded that a material uncertainty related to going concern **DONOT** exist*

Going concern triggers:

- ▶ Reduction in gross margin
- ▶ Liquidity position stretched – financing facilities exhausted:
 - ▶ Delay in payment of certain liabilities
 - ▶ Doubt that liabilities due within 1 year would be settled within due date

Mitigating factors

- ▶ Unconditional Support letter from Parent (parent has strong financial position)
- ▶ New products with high margin introduced after YE
- ▶ In-principal approval (not binding) from lenders for new financing facilities
- ▶ Close monitoring of recovery of trade receivables

Points for consideration

- ▶ Auditor concluded that the holding company has the ability to discharge the financial liabilities of the company as and when they fall due
- ▶ Auditor to state this fact in CARO while also state the facts on the financial position of the company

Material uncertainty in repayment of liabilities when they fall due

Other issues

- ▶ Consider subsequent period transactions between the date of balance sheet and the date of audit report; refer SA 560 - Subsequent Events
- ▶ Liabilities to be examined for payment should exist at the date of balance sheet which falls due within a period of one year from the balance sheet date
- ▶ “Liabilities falling due within one year” and “current liabilities” are different as
 - ▶ classification of current/non-current is based on operating cycle which could be shorter/longer than 1 year
 - ▶ Current liability as per Schedule III is where the company does not have unconditional right to defer the obligation
- ▶ Classification of liabilities into current and non-current in the financial statements as per the requirements of Schedule III of the Act
- ▶ Financial assets and financial liabilities may be identified as per Ind AS 32
- ▶ Final comment of the auditor is “.....the company is capable of meeting its liabilities” and hence it includes non current and non financial liabilities also which are falling due in next 12 months

Clause (XVII) : Cash Losses

Reporting on cash losses

- CARO 2003 contained reporting for the amount of cash losses incurred by the Company in the current year and in the immediately preceding year.
- No such provision was there in CARO 2016. The same has been reintroduced.
- Term “cash loss” is not defined.
- Following non-cash items to be adjusted for arriving at cash losses. The starting point would be profit/loss as per P&L (without OCI)
 - Depreciation, Amortization
 - impairment losses/ reversals
 - fair value changes
 - revaluations
 - Unrealised exchange fluctuation
 - deferred tax
- Cash profit/loss realised and recognised in OCI should be considered. Subsequent reclassification to P&L should not be considered
- In case of restatement, net profit/loss after such restatement should be considered
- In case of any qualifications, figures of cash losses for current year and previous year should also be adjusted for impact of qualification to the extent these are quantified

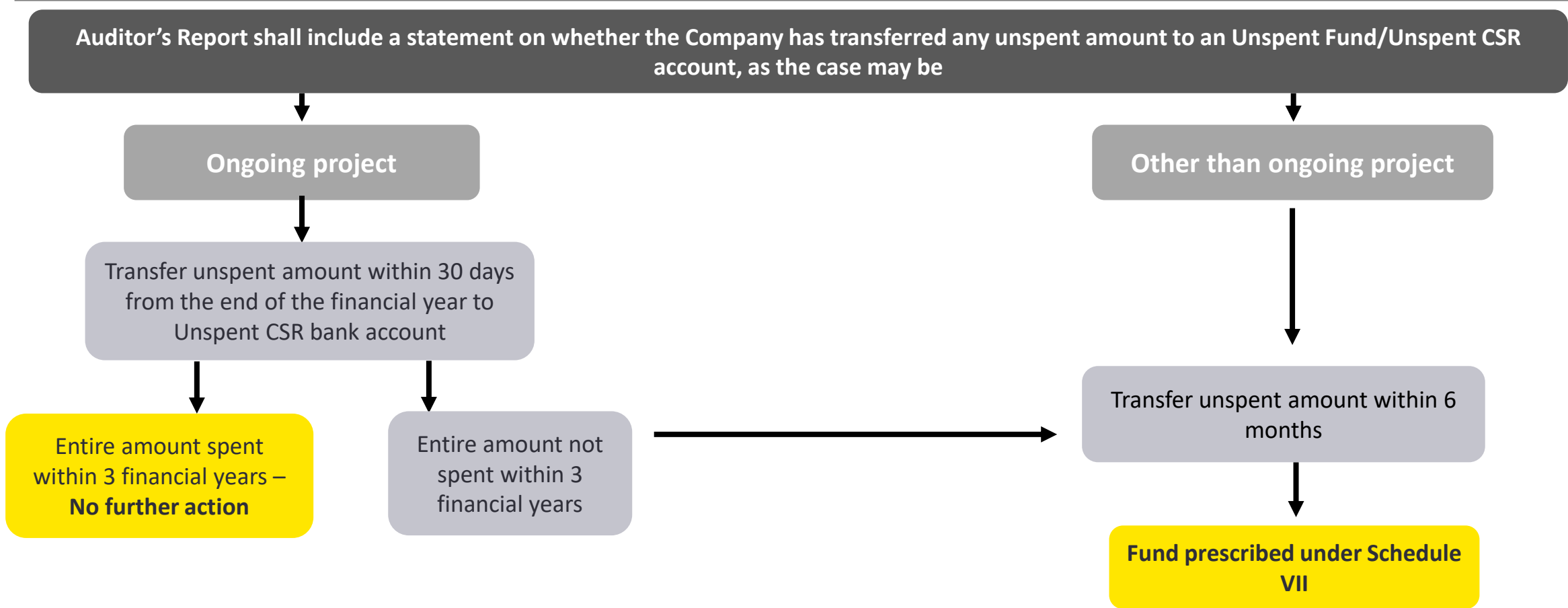
Auditors resignation

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

Key considerations

- ▶ **Applicable where incoming auditor is appointed during the year to fill a casual vacancy caused by resignation of the auditor created in the office of the previous auditor under section 140(2) of the 2013 Act**
- ▶ Incoming auditor (prior to accepting the position as auditor) to communicate with the previous auditor to know the reasons for the change in order to be able to safeguard his own interest, the legitimate interest of the public and the independence of the existing accountant (as required by ICAI Code of Ethics)
- ▶ Incoming auditor to obtain copy of letter of resignation (as submitted to management) and copy of Form ADT 3 (as submitted to ROC)
- ▶ Incoming auditor to consider the reasons for resignation and also refer to last audit/ review report of the outgoing auditor to understand the modifications to audit/review opinion
 - ▶ As part of obtaining 'no objection' from outgoing auditor, the incoming auditor should enquire in respect of modifications/ adverse comments of the outgoing auditor in the last issued audit/review report, since CARO casts an obligation on the incoming auditor
- ▶ Compliance to be ensured with ICAI pronouncements including:
 - ▶ *Listed entities*: SEBI Circular - Resignation of statutory auditors from listed entities and their material subsidiaries
 - ▶ *Others*: ICAI Implementation Guide on Resignation/ Withdrawal from an Engagement to Perform Audit of Financial Statements

Clause (XX) : Corporate Social Responsibility



CSR routed through trust/society/Section 8 company – the auditor still needs to satisfy the above rules are complied with

Reporting on consolidated financial statements

Whether there have been any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the consolidated financial statements, if yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks

Key considerations

- ▶ Reporting under this clause is required in the audit report on consolidated financial statement and not standalone
- ▶ Requirement is to provide the paragraph numbers of the CARO report containing the qualifications or adverse remarks, accordingly, text of those paragraphs are not required to be reproduced
- ▶ Qualification or adverse remarks used in this clause refers to the unfavourable or qualified answers in CARO
 - ▶ Does not mean a qualification/adverse opinion as per SA 705
- ▶ Qualification/adverse remark given by the component auditors is presumed to be material to the component. Principal auditor not required to re-evaluate the materiality from a consolidation perspective
- ▶ *Though the principal auditor would need to apply his professional judgement to conclude which responses amount to a qualification/ adverse remark, **he may also take inputs from the component auditor and request him as part of the group reporting instructions to comment on which clauses amount to a qualification/adverse remark. But the ultimate responsibility would be that of the principal auditor***
- ▶ *Situations where the component auditor has reported on the financial statements of the component to the principal auditor but has not issued his statutory audit report by the date of the principal auditor's audit report - the principal auditor should clearly mention while reporting on this clause, the name of the component and the fact that CARO report of that component has not been issued by its auditor till the date of principal auditor's report*

Reporting on consolidated financial statements

Scenario 1

- ▶ Statutory audit reports AVAILABLE for all components

Scenario 2

- ▶ Statutory audit reports NOT AVAILABLE for any component
- ▶ Component auditor would PROVIDE INFORMATION on CARO in its audit report on group pack prepared for consolidation purpose

Scenario 3

- ▶ Statutory audit reports NOT AVAILABLE for any component
- ▶ Component auditors UNABLE to complete audit of group pack prepared for consolidation purpose

Points for discussion

- ▶ Basis the statutory audit report of the component, principal auditor to identify clauses having qualification/ adverse remarks
- ▶ Cross reference to be made to the Other Matters paragraph which state the fact of reliance placed on audit report of the component auditor

Points for discussion

- ▶ Basis the audit report on group pack, principal auditor to identify clauses having qualification/ adverse remarks
- ▶ Principal auditor to state the name of such entities and the fact that statutory report of these component has not been issued till the date of principal auditor's report
- ▶ Cross reference to be made to the Other Matters paragraph which state the fact of reliance placed on audit report of the component auditor

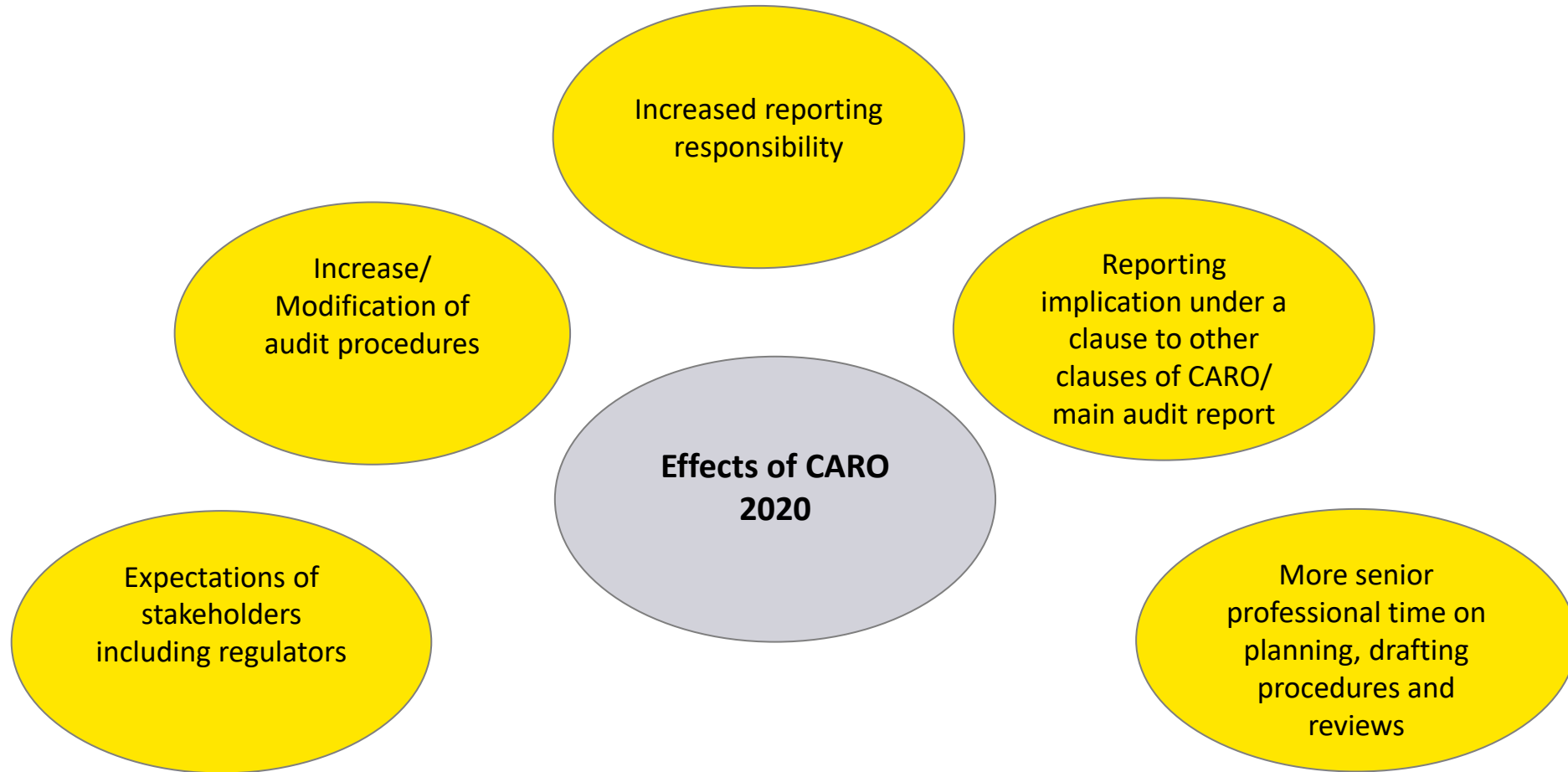
Points for discussion

- ▶ Principal auditor to state the name of such entities and the fact that CARO report of these component has not been issued till the date of principal auditor's report
- ▶ Cross reference to be made to the Other Matters paragraph which state the such components are unaudited.

Interplay between Schedule III and reporting under CARO 2020

No	CARO Reporting and Sch III
1	Title deeds of all the immovable properties are held in the name of the company. If not, provide prescribed details [Clause 3(i)(c)]
2	For revalued PPE (including Right of Use assets) or IA whether the revaluation is based on the valuation by a Registered Valuer and specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of PPE or / IA [Clause 3(i)(d)]
3	Proceedings initiated/ pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, and rules
4	For sanctioned working capital limits in excess of five crore rupees secured by current assets, whether the quarterly returns are in agreement with books of account, if not, give details; [Clause 3(ii)(b)] - Sch III covers all borrowings and no monetary threshold
5	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 to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in section 2 (76) Clause 3(iii)(f)] – Sch III – transactions with promoters, etc to be disclosed
6	Transactions not recorded in the books have been surrendered or disclosed as income during the year in tax assessments under Income Tax Act, if so, whether the previously unrecorded income has been properly recorded in the books of account during the year [Clause 3(viii)]
7	Whether the company is a declared wilful defaulter by any bank or financial institution or other lender [Clause 3(ix)(b)]
8	Whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported [Clause 3(ix)(c)] – Sch III covers all borrowings and where used
9	Whether any material uncertainty exists that company is capable of meeting its liabilities within a period of one year from the balance sheet date on the basis of the financial ratios , ageing and expected dates of realisation 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 [Clause 3(xix)] – Sch III – 8 ratios to be disclosed with management comments for changes > 25% from PY
10	CSR compliance – Whether unspent amount transferred to a specified fund within a period of 6 months of the expiry of the FY. For any ongoing project, unspent amount transferred to special account [Clause 3(xx)] Sch III - Details of CSR - amount to be spent, shortfall, total of previous years, reason for shortfall and nature of CSR activities

Conclusion



Thank
you

