CARO, 2020 – Scope extended to Forensics?

The Ministry of Corporate Affairs has on 25th February,2020 notified the Companies (Auditors Report) Order, 2020, and applies for the financial years commencing on or after the 1st April,2019.

The order has widened the scope of Audit and Disclosures to be provided by the Auditors by leaps and bounds. Items include almost forensic details like granting of a loan to repay a loan, evergreening of loans, or purely subjective view like capability of meeting liabilities based on ratio analysis, management plans, etc.

There have been no changes in the applicability clause. It has been kept the same as in CARO, 2016. However, for Consolidated Financial Statements on point D(4) below is applicable.

The amendments have been divided in 4 categories-

A. Forensic Analysis
B. Comprehensive Reporting
C. Critical Disclosures
D. Others Changes

The aspect-wise details in each category are as under.

A. Forensic Analysis

These aspects require detailed analysis into the books of accounts of the company and opens various avenues of reporting.

1) Cash Losses

Cash loss, if any, must be calculated and reported.

2) Capability to meet Liabilities

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.

The auditor has to do a walkthrough to ultimately justify the "Going Concern" of the entity in lights of Standards of Auditing (SA) 570.

B. Comprehensive Reporting

These aspects require collection of data and huge reporting in applicable case.

1) Inventories

- Along with comment on interval of physical verification, now auditors must comment on the appropriateness of coverage and procedure for verification applied by the management.

- Materiality of Discrepancy has been defined as a difference of 10% or more in each class of inventory. Comments of auditors are drawn on proper adjustment of the same in financial statements.

- Whether during any point of time of the year, the Company has been sanctioned working capital limits in excess of Rs. 5 crores, in aggregate, from banks or financial institutions, and the auditor has to report that the quarterly returns or statements filed by the Company with such banks or financial institutions are in agreement with the books of account of the Company.

2) Investments, Loans & Guarantees by company

- 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 *(Earlier only related parties were covered)*
  If Yes, disclose the aggregate amount of loan provided and the balance outstanding on the balance sheet date separately for Associates, Subsidiaries and JVs and for others. *(Not applicable on Companies whose principal business is to give loans)*

- Whether any new loan has been given to settle old loan or there has been extension in existing loan. Disclosure of aggregate amount and % age of such loan to total loan granted during the year is to be reported. *(Not applicable on Companies whose principal business is to give loans)*

- 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. Disclose of aggregate amount and % age of such loan to total loan is to be given along with the amount of loan to promoters & related persons.

3) Repayment of Loans

- Whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender *(Earlier only financial institution, banks, government or dues to debenture holders were covered).*
  Party-wise details in specified format is to be reported

- Auditor has to report whether the company is a declared wilful defaulter by any lender.

- Whether term loans were applied for the purpose for which the loans were obtained. If not, amount diverted is to be reported.
- Whether funds raised on short term basis have been utilised for long term purposes. If Yes, nature and amount is to be reported.

- Whether the Company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures. If Yes, nature and amount is to be reported.

- Whether the Company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies. If Yes, nature and amount is to be reported and whether the company has defaulted on such loans.

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C. Critical Disclosures

These disclosures have been newly incorporated and can pose critical impact on the CARO and company.

1) Incomes Disclosed under Schemes

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, and whether the same has been properly recorded in the books of accounts during the year is to be reported..

2) Registration under RBI Act

- Whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria.

- Whether the Group has more than one CI C as part of the Group. If yes, the number of CICs which are part of the Group is to be reported.

3) Resignation of Auditors

Whether there has been any resignation of the statutory auditors during the year, and If yes, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditor.

4) Fraud Reporting

- Whether any fraud report has been filed by the auditor in Form ADT-4 u/s 143(12).

- Whether whistle-blower complaints, if any received by the company, have been considered by the auditor.

5) Corporate Social Responsibility

- Whether the company has transferred unspent amount of ongoing project to a specified fund as per section 135(5) of the companies act.
- Whether the company has transferred unspent amount to a specified fund as per section 135(6) of the companies act.

Both these sections have not been notified yet. However, companies should take this reporting requirement as an alarm to undertake the required CSR spending.

6) Fixed Assets

Whether any proceedings have been initiated or are pending on the company under Benami Transactions (Prohibition) Act, 1988 and Rules made thereunder, and, whether the same have been disclosed in the financial statements.

7) Disclaimer of Opinion

Where the auditor is unable to express an opinion on any specific matter, he must indicate such fact together with the reason as to why it is not possible for them to give an opinion on the same

D. Other Changes

Theses are amendments which might not effect the reporting as mush as the ones above, but are important nevertheless.

1) Fixed Assets

- Whether proper records showing full particulars of Intangible assets are maintained or not.

- In case of revaluation of Any asset (Tangible, Intangible, Rights to use an asset, etc), whether the same is based on valuation of a registered valuer.

  In Case there a change of more than 10% in net carrying amount of assets, the same must be reported.

2) Preferential Allotment and Private Placement of Shares

Whether the requirements of Section 42 and Section 62 of the Companies Act, 2013 have been complied with during allotment of securities and the funds raised have been used for the purposes for which the funds were raised. If not, details in respect of amount involved and nature of non-compliance is to be reported.

3) 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.

4) Consolidated Accounts

The reporting of any qualifications or adverse remarks by the respective auditors in the CARO Reports of the companies included in the consolidated financial statements is to be done in the consolidated statements.

Our Comments

The amendment gives a very clear view on the intent of the MCA to increase Governance of the companies and to safeguard the stakeholder's interests. There is a huge increase in the responsibility of auditors and they need to proceed with caution.

However, clarifications are required on various aspects like reporting on CSR, calculation of Cash Loss, ratios to be considered for commenting on ability to pay liabilities, extent of reporting of loans, source of information regarding proceedings under Benami Act, etc.

We expected clarity in the near future with discussions and notifications and will keep you posted on the same.

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