

# Reporting on CARO, 2016

11 June 2017



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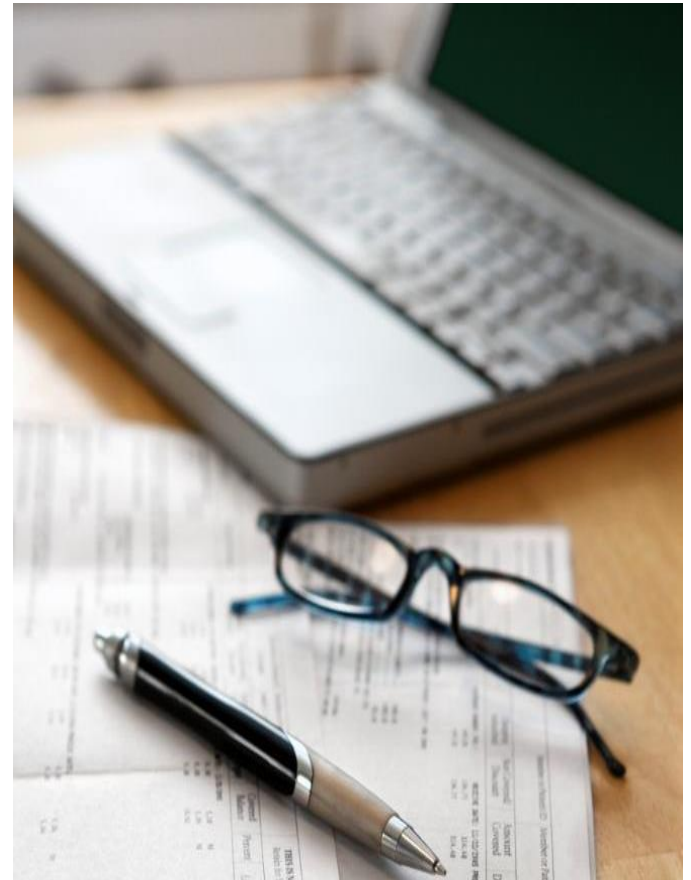
Clauses modified vis-à-vis CARO 2015

# Introduction & Applicability

## Companies (Auditor's Report) Order (CARO), 2016 ('CARO, 2016')

### Background

- Auditor's report issued under Section 143 of the Companies Act, 2013, should contain matters specified under applicable CARO [Section 143(11)];
- CARO, 2016 was issued by the Ministry of Corporate Affairs ('MCA') on 29 March, 2016;
- It contains 16 clauses as compared to 12 in CARO, 2015;
- Requires reporting on few additional matters by the auditor;
- Eliminates and modifies some of the reporting requirements of CARO, 2015.

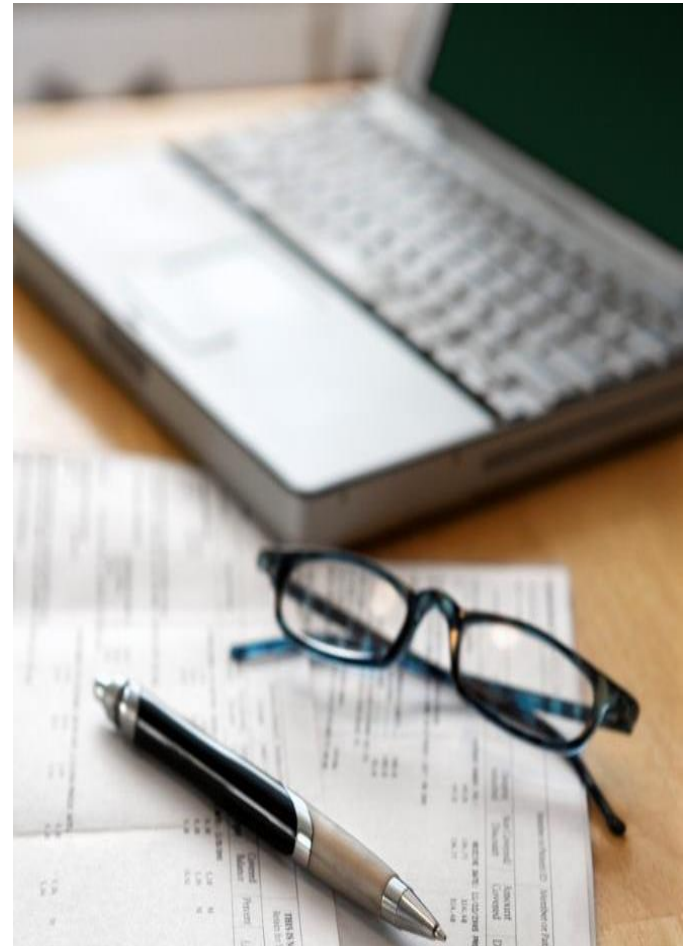


# Introduction & Applicability

## CARO 2016

### Applicability

- Applies to all companies including foreign companies except banking company, insurance company, Section 8 company, one person company (Section 2(62)) and small company (Section 2(85)).
- CARO 2016 is applicable for all audit reports issued by the auditor under Section 143 of the Companies Act, 2013 on the accounts audited by him under the Companies Act, 2013 for financial years commencing on or after 1 April 2015.

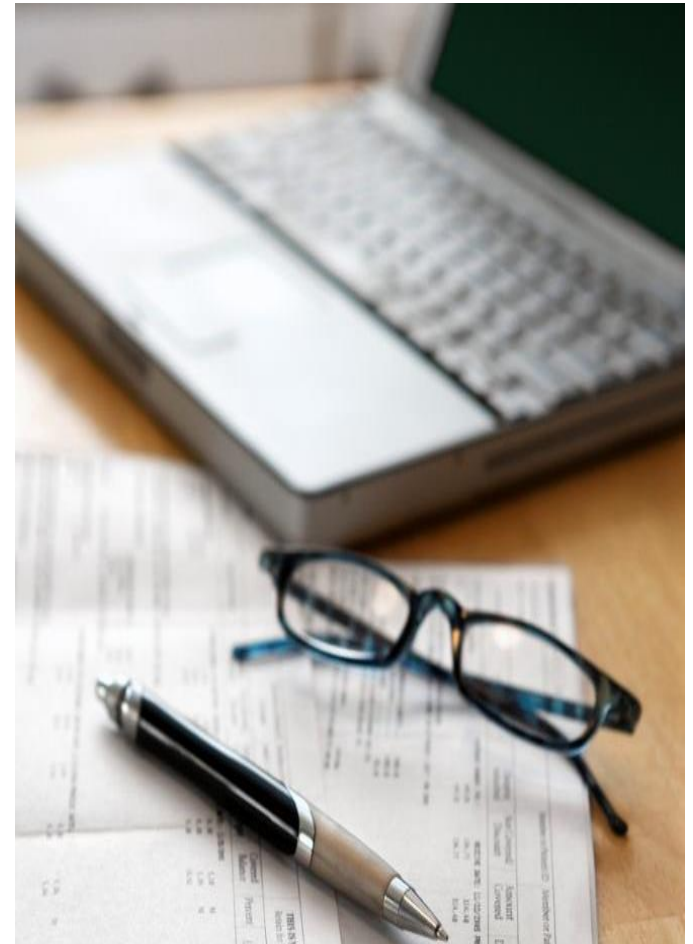


# Introduction & Applicability

## CARO 2016

### Applicability

- No change except CARO 2016 may not apply to a private limited company, not being a subsidiary or holding of a public company, where in respect of such private company:
  - ☐ paid up capital and reserves and surplus < Rs.1 crore (earlier limit - Rs.50 lakhs) [as at balance sheet date]; and
  - ☐ total borrowings from banks and financial institutions < Rs. 1 crore (earlier limit - Rs. 25 lakhs) [at any point in time during the financial year] and
  - ☐ total revenue (including revenue from discontinued operations) < Rs.10 crores (earlier limit - Rs.5 crores) [during the financial year] (earlier term used was turnover).
- Not applicable to the auditor's report on the consolidated financial statements





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# Clauses introduced in CARO 2016

## Clauses

### Fixed Assets

Auditor should report whether title deeds of immovable properties are held in the name of the company. If not, provide details thereof [Clause 3 (i) (c) of CARO, 2016].

**Comment:** Challenges in terms of availability of title deeds for old properties, reporting implications where title has not passed on to the company, In case of property held in co-operative societies, verification as to whether shares have been transferred in the name of the company.

Directors' responsibility under Section 134(5) also includes safeguarding of the assets of the company and accordingly directors must ensure that the properties held are in the name of the company – to plug in issue of benami properties

### Clauses

#### Loans and Investments

Auditor should report whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under Section 189 of the Companies Act, 2013. If so, whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest [Clause 3 (iii)(a) of CARO, 2016].

**Comment:** Similar requirement was there in the CARO, 2003, re-introduced here. LLP's are also covered in the scope.

Auditor should report in respect of loans, investment and guarantees and security, whether provisions of Section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof. [Clause 3(iv) of CARO, 2016].

**Point to ponder:** Issues related to 'ordinary course of business', 'accustomed to act', reliance on legal opinions for loans being in compliance with Section 185. Whether this Clause is equally applicable to the company which is borrower of loan?



### Clauses

#### Managerial Remuneration

Auditor should report whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of Section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same [Clause 3 (xi) of CARO, 2016].

#### Nidhi Company

Auditor should report whether the Nidhi Company has complied with the Net Owned Fund to Deposits in the ratio of 1: 20 to meet out the liability and whether the Nidhi Company is maintaining ten percent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability. [Clause 3 (xii) of CARO, 2016]

**Comment:** Similar requirement was there in the CARO, 2003, re-introduced here with additional reporting requirement for unencumbered deposits.

### Clauses

#### Related party transactions

Auditor should report whether all transactions with the related parties are in compliance with Section 177 and 188 of Companies Act, 2013, where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards. [Clause 3 (xiii) of CARO, 2016]

#### Points to ponder:

Verifying compliance with Section 188 would entail evaluating the arms' length aspect of related party transactions.

For disclosure of related party transactions which definition of related party should be applied – AS 18 or Companies Act 2013?

In case of private companies, should auditor report only those transactions to which Section 188 applies

### Clauses

#### Preferential Allotment/Private Placement

Auditor should report whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of Section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance. [Clause 3 (xiv) of CARO, 2016]

**Comment:** Similar requirement was there in the CARO, 2003, re-introduced here. Additional requirement to report where there are non-compliances.

**Point to ponder:** The use of word preferential allotment does not seem to synchronize with term 'private placement' as defined under Section 42 of the Companies Act, 2013.

### **Clauses**

#### **Non cash transactions**

Auditor should report whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether provisions of Section 192 of Companies Act, 2013 have been complied with. [Clause 3 (xv) of CARO, 2016]

#### **Points to ponder:**

Reporting is required only where there has been an acquisition of asset by or from the company and does not involve exchange of cash. If there is no cash exchanged then how would the transaction get consummated – one option could be by the Company assuming liabilities.

Prior approval of the company in a general meeting for such transactions is required.

Requirement to involve a registered valuer for calculating the value of assets acquired

### Clauses

#### **Non cash transactions – cont'd**

Auditor should report whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether provisions of Section 192 of Companies Act, 2013 have been complied with. [Clause 3 (xv) of CARO, 2016]

#### **Points to ponder:**

If the director or the person connected therewith is also a director of the holding company, a similar approval is required to be obtained by the holding company as well in its general meeting

Does not cover transaction where purchase liability was booked in one year and the settlement occurred in the subsequent year

Does not cover merger transactions approved by a court

### Clauses

#### NBFC Registration

Auditor should report whether the company is required to be registered under Section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained [Clause 3(xvi) of CARO, 2016].

**Comment:** Wide implications, many companies which accept deposits and provide loans to others would come under the scanner.

Auditor needs to evaluate the position of investment holding companies which are in the business of obtaining loans or funding and granting loans to or making investments in group companies.



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### Clauses

#### Inventory

Auditor should report whether the procedures of physical verification of inventory followed by the management are reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported. [Clause 3 (ii)(b) of CARO, 2015]

**Comment:** This is in line with the introduction of auditors' report on IFC

#### Internal Control System

Auditor should report is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system. [Clause 3(iv) of CARO, 2015]

**Comment:** This is in line with the introduction of auditors' report on IFC

### Clauses

#### Investor Education Fund

Auditor should report whether the amount required to be transferred to investor education and protection fund in accordance with the relevant provisions of the Companies Act, 1956 (1 of 1956) and rules made there under has been transferred to such fund within time [Clause 3(vii)(c) of CARO, 2015].

#### **Comment:**

This is being covered in the main audit report, hence deleted from CARO 2016.

#### Net Worth Erosion

Auditor should report whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year. [Clause 3(viii) of CARO, 2015]

**Comment:** It's a welcome step for many start-up companies running into losses in their initial phase.

### Clauses

#### Guarantee

Auditor should report whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company. [Clause 3(x) of CARO, 2015]

**Comment:** This requirement is covered by Clause 3(iv) of CARO, 2016, which requires auditor to ensure compliance with Section 185 and 186 of the Companies Act, 2013.

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# Clauses modified vis-à-vis CARO 2015

## Clauses

### Inventory

Auditor should report whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account. [Clause 3(ii) of CARO, 2016)

**Comment:** Requirement deleted as to maintenance of proper records and procedures followed for physical verification of inventory. This would be addressed by way of reporting on IFC.



### Clauses

#### Loans and Investments

Auditor should report whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under Section 189 of the Companies Act, 2013. If so,

- whether the schedule of repayment of principal and payment of interest has been stipulated and whether there payments or receipts are regular; [Clause 3(iii)(b) of CARO, 2016]
- 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. [Clause 3(iii)(c) of CARO, 2016]

**Comment:** Scope of reporting on repayment of loan and overdue amounts of loan has been widened. LLP's are also covered in scope

### Clauses

#### Default in repayment of Dues

Auditor should report on

- a) whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;
- b) where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).  
[Clause 3(vii) of CARO, 2016]

**Comment:** Requirement to report on wealth tax done away with.

### Clauses

#### Borrowings

Auditor should report whether the company has defaulted in repayment of loans or borrowings to a financial institution, bank, **Government** or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided). [Clause 3(viii) of CARO, 2016]

**Comment:** Following has been added in scope

- a) Loan from **Government**, and
- b) Lender wise detail to be provided, if there is default in repayment.

### Clauses

#### Application of term loans/Public Issue/Follow-on-Offer

Auditor should report whether moneys raised by way of initial offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported. [Clause 3(ix) of CARO, 2016]

**Comment:** Scope of reporting extended. In CARO 2015, reporting was restricted to term loans only, though the requirement to report on term loans and public issues existed in CARO 2003.

### Clauses

#### Fraud Reporting

Auditor should report whether any fraud by the company or any fraud on the company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated. [Clause 3(x) of CARO, 2016]

**Comment:** Modified to restrict reporting of fraud done by the officers and employees of the Company. This is in line with the requirement to report fraud under Section 143(12) of the Companies Act, 2013. From a plain reading it seems fraud on the company by persons other than officers or employees is not required to be reported.



**Q&A**



CARO 2016 Issued by Ministry of Corporate Affairs

CARO 2015 Issued by Ministry of Corporate Affairs

CARO 2003 Issued by Ministry of Corporate Affairs

# Thank you



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