CARO 2020 and other reporting standards

One Day workshop on Financial Reporting

SIRC of ICAI

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Reporting requirements

True and Fair View
Compliance with Accounting Standards
Financial Controls
Fraud reporting > 1 crore
Disqualification of Directors
LODR
KAM
ICFR
CARO

Auditor report – the tool for auditor

- Stake holders interest and value to the society
- Mitigation of Liability – auditor can safeguard his interest by making appropriate disclosure and documentation
- Promoter corporate governance: Internal controls, compliance issues etc.
- Value addition to client
- Demonstration of diligence and professional competence

Introduction – CARO 2020

- Issued by the Ministry of Corporate Affairs (MCA)
- Effective for audits of financial years commencing on or after April 1, 2021
- The Central Government, in exercise of the powers conferred, under section 143(11) of the Companies Act, 2013, issued the CARO 2020
- Interconnection with Schedule III to Companies Act, 2013
- Enhances transparency and accountability in financial reporting
- Audit – General approach
- Apply standards on audit

Enhances transparency

 Detailed Reporting Requirements	Loans, statutory dues, property records etc.
 Compliance Checks	Statutory dues, loans, guarantees
 Material disclosures	Physical verification, title deeds etc
 Related party transactions	Loans, Audit committee, investment etc.
 Controls	Fraud reporting, Internal audit, NBFC guidelines

Companies not covered by the order

- Banking company
- Insurance company
- Section 8 Company
- One person company
- Small company
- Private Company:
  - Paid up capital and Reserves and surplus < 1 crore [BS date] and
  - Borrowing from bank/financial institution < 1 crore [anytime] and
  - Total revenue < 10 crore [FY]

Key objectives



Improve quality of financial reporting



Provide more detailed disclosures



Assist stakeholders in understanding the financial health of the company



Strengthen audit mechanisms

Property, Plant & Equipment

- Maintenance of proper records – tangible and intangible
  - [including ROU, Investment property and noncurrent assets held for sale]
- Physical verification by management
  - Process of Physical verification
  - Material discrepancies
- Reporting on title deeds of immovable properties
  - Scenario of LLP to Company
  - Mortgaged assets

- **Schedule III**: Title deeds not available to be disclosed

Challenges for auditor:

- Verifying documentation, such as title deeds, for all immovable properties.
- Assessing the adequacy of records and identifying potential title-related disputes.
- Identifying discrepancies in cases where records are poorly maintained or asset tagging is not implemented

Property, Plant & Equipment

Challenges for auditor:

- Large-scale operations or geographically dispersed locations make physical verification challenging.
- Determining whether expenses qualify for capitalization or should be charged to revenue (e.g., repair vs. capital improvement).
- Misclassification of assets (e.g., investment properties reported as PPE or vice versa).
- Ensuring appropriate allocation of costs, such as borrowing costs or dismantling costs.
- **Impairment**: Complexities in determining impairment for specialized assets with limited secondary markets
- **Revaluation**: Verifying the reasonableness of revaluation assumptions and compliance with accounting standards
- **Lease:** Ensuring accurate calculation and presentation of right-of-use (ROU) assets and lease liabilities
- **Disposals**: Verifying the authorization and documentation for disposals

Inventory and working capital

- Verify physical verification of inventory and reporting discrepancies ≥10%.
  - Interval, coverage and reconciliation with books
  - 10% for each class of inventory

- For companies availing working capital >₹5 crore, ensure quarterly returns/statements submitted to banks align with financial records.
  - Unsecured limit

Schedule III: Company to disclose borrowings and reco with quarterly returns

Challenges for auditor:

- Difficulty in verifying inventory located at third-party warehouses or in transit.
- Inability to conduct physical verification during disruptions (e.g., pandemic or lockdowns).
- Ensuring that management has adequately addressed and **corrected discrepancies**.
- Verifying whether current assets (e.g., inventory, receivables) used as collateral are correctly valued.

Loans and advances

- Whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances
  - Transactions made during the year
  - Analyze loan agreements to **confirm repayment terms and compliance.**
- Details of loans to related parties and others
  - List of related parties, LODR Regulations, Transactions squared off during year
- Reporting on terms of loans lent
  - Validate interest rates offered on loans compared to market rates.

- If the amount is overdue, state the total amount overdue for more than **90 days**, and whether reasonable steps have been taken by the company for recovery of the principal and interest

- Compliance with Section 185 and 186

- Schedule III: Dues from Related parties to be disclosed

Loans and advances

Challenges for auditor:

- Transactions routed through subsidiaries, joint ventures, or other entities may not be transparently disclosed.
- Section 186: Validating interest rates and terms to ensure they align with statutory requirements
- Reviewing loan agreements, guarantee documents, and security contracts to confirm fairness and transparency of terms
- Evaluating the creditworthiness of borrowers and the sufficiency of collateral for secured loans
- Verifying adequate disclosures in notes to account as per Ind AS or AS requirements
- Evaluating whether guarantees have been issued for transactions that lack genuine business purposes
- Dealing with instances where documentation or approvals are incomplete or unavailable

Loans borrowed

- Highlight defaults in repayment of borrowings or interest
  - Defaults during the year or all?
  - Reschedule of loan
- Report if the company is declared a willful defaulter.
  - Obtain data from CIBIL

- **Schedule III:** Wilful defaulter details to be disclosed

Challenges of auditor:

- Wilful defaulter: Banks and lenders may be slow to share this information
- Companies may avoid disclosing disputes where willful default status is under litigation or arbitration
- Tracking and verifying the company's compliance across all lenders
- Auditors may rely on old or incomplete data, leading to inaccurate reporting.
- Determining whether guarantees or other financial arrangements make the company liable for group defaults

Loans - end use of borrowings

- Ensure funds raised are used for stated purposes.
  - Includes borrowings from entities other than bank
  - Temporary usage during construction period
  - Loan received during year end and hence pending usage
  - General funds
- Report diversions, if any.
- Funds used for short terms used for long term purposes
  - Long term funds < Long term application?
  - Fund flow analysis
  - Money is fungible
- 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
  - Check for new loans lent
  - Review of transactions with all related parties
  - If cash flows are positive, then even lending to associate is fine

- **Schedule III**: End use not in terms of borrowing to be disclosed

Loans - end use of borrowings

- IPO – initial or further including Debt
  - LODR
- Private/preferential allotment
  - PAS 4 for private placement
  - SHA to be reviewed

Challenges for auditors:

- Lack of clear definitions of permissible uses in loan agreements
- Delays in project completion can make it difficult to assess whether funds were utilized appropriately
- Difficulty in tracking indirect diversions or misclassification of expenditures

Compliance with Statutory Dues:

Undisputed: > 6 months

- Reporting on arrears of statutory dues
- Statutory dues v/s contractual dues
- Regularity: Customs v/s GST
- Non payment of advance income tax?
- Expenses accounted for MIS purposes [monthly]
- Lumpsum payment in a multi branch entity having complex ecosystem

Disputed: Mention the forum

- Stay obtained for demand
- Appeal filed by entity
- Vivad se viswas

Compliance with Statutory Dues:

Challenges for auditor:

- Keeping up with frequent changes in tax laws and regulations, such as GST amendments or new labor laws
- Understanding and interpreting complex regulatory requirements.
- Identifying instances of non-compliance and assessing their impact on reporting
- Reviewing pending litigation or appeals to identify disputed amounts
- Lack of reconciliation between statutory liabilities and financial statements

Fraud reporting

- Noticed / reported
- This reporting doesn't relieve auditor from his audit responsibilities
- Review Internal audit reports
- Minutes of audit committee
- Voluntary disclosure of income and reasoning

Whistle blower complaints

- Every listed company.
- Companies which accept deposits from the public.
- Companies which have **borrowed** money from banks and public financial institutions in excess of **fifty crore rupees**.

Challenges to auditor

- Identifying fraud risks and performing detailed audit procedures to detect fraud.
- Difficulty in detecting transactions authorized by top-level executives.
- Difficulty in obtaining confirmations or evidence from external parties
- Internal audit functions may not adequately address or identify fraud risks

Related party

- Compliance with Section 177 and 188
  - Normal course of business and at arms length price
  - Wholly owned subsidiary (CFS)
  - Disclosure of RPT

- Non-Cash Transactions with Directors or Related Persons
  - MBP

Challenges for auditor:

- Changes in related parties during the year due to mergers, acquisitions, or changes in management
- Omission or misreporting of transactions due to management oversight or intentional concealment.
- Lack of documentation or benchmarks for pricing

Internal audit

- Review internal audit reports for actionable findings.
- Internal auditor may or may not be an employee of entity
- Scope of IA and assessment of risks
- Independence of IA
- Follow up by IA team
- Audit documentation about assessment of IA function
- Impact of IA on FS to be verified and updated by Management
- Impact on IFC

Challenges for Auditor:

- Assessing the adequacy and effectiveness of internal controls requires additional **testing and documentation.**
- Absence of formalized internal audit charters or frameworks

Internal audit

Challenges for Auditor:

- Internal auditors reporting directly to operational management, leading to potential conflicts of interest.
- Focus on routine financial and operational areas while ignoring strategic risks (e.g., cybersecurity, compliance, fraud).
- Lack of technical expertise in specialized areas (e.g., IT systems, forensic audits).
- Internal audits conducted in phases may lead to delayed reporting.
- Reports may lack actionable insights or sufficient evidence

Registration under Section 45-IA of RBI Act

- Financial income
- Net owned funds
- Valid NBFC Registration
- RBI communication
- CIC - Core investment Company (90%): Registered and exempted

Cash losses

- Term cash loss not defined
- Cash loss = PAT + Depreciation + impairment loss + non cash
- Impact on solvency and going concern status.

Challenges for audit:

- Whether the Company has incurred cash losses in the financial year and in the immediately preceding financial year.
- Ensuring the availability of accurate financial data for the immediately preceding year
- Confusion between accounting losses and cash losses.
- Adjusting for one-off transactions that do not reflect ongoing cash flow performance.
- Assessing whether cash losses indicate broader financial distress.
- Ensuring that intercompany transactions are appropriately treated.

Auditor Resignation

- Give explanation while resigning – both as per LODR and Implementation Guidance
- ADT 3
- Minutes of audit committee and BOD

Challenges for auditor:

- Identifying and understanding the technical or operational concerns raised
- Evaluating the significance of objections in the context of the audit scope and reporting.
- Identifying possible red flags indicating fraudulent or unethical practices.
- Assessing the adequacy of procedures performed by the outgoing auditor
- Identifying areas that require rework or additional testing

Material Uncertainty in Financial Position

- Financial ratios
- Analyse financial liabilities as on BS date
- Review of correspondence with lenders
- Obtain subsequent payment status
- Recoverability of financial assets
- Comfort letters
- MIS/Interim FS/Cash flow for 12 months
- Guarantee to others

Challenges for audit:

- Management's projections may be overly optimistic or lack sufficient supporting evidence.
- Interpreting ratios in cases of significant industry variations or economic volatility
- Determining which ratios are most relevant to the company’s operations and risk profile.
- Difficulty in estimating realisation timelines for overdue or disputed receivables.
- Identifying all liabilities, **including contingent** and off-balance-sheet items.
- Limited access to relevant non-financial data.
- Impact of sector-specific challenges, such as supply chain disruptions or market volatility.

Unspent CSR Funds

- CSR
- Ongoing and other than ongoing
- **Ongoing** Projects: Unspent CSR amounts must be transferred to a designated account **within 30 days** of the end of the financial year.
- Other Projects: Unspent CSR amounts should be transferred to a government-specified fund **within 6 months**.

- Trust controlled by entity
- Provision for Unspent amount ongoing projects
- Disclosure in FS

Challenges for audit:

- Incomplete or inaccurate records of CSR expenditure.
- Discrepancies between CSR disclosures in the financial statements and actual compliance with Section 135.

CFS – Qualifications

- Discuss with component auditor
- Qualification in Parent SFS also to be considered
- Materiality – NA

Challenges for audit:

- Component AR not available
- Incomplete or inconsistent documentation by component auditors.
- Assessing the cumulative effect of qualifications or adverse remarks from multiple entities
- Variability in materiality thresholds among component auditors.
- Avoiding omissions or misstatements in the CARO report.

Other clauses

- Deposits/ deemed to be deposits
- Maintenance of cost records
- Unrecorded income

Recommendations for CARO

- **Comprehensive Planning:** Understand the scope of CARO 2020 during the audit planning phase.
- **Effective Communication:** Regular interaction with management to gather the required information.
- **Detailed Documentation:** Maintain sufficient documentation to support conclusions.
- **Training and Awareness:** Equip audit teams with training on CARO 2020 requirements and related clauses.
- **FAQs at office**

Thank you

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