

CHAPTER 2

ICAI issued revised guidance note on CARO 2020

This article aims to:

Provide an overview of the revised guidance provided by ICAI in the guidance note on CARO (Revised 2022).

Introduction

The Companies Act, 2013 (2013 Act) requires auditors of the specified class of companies to include a statement in their reports on specific matters as prescribed in the Companies (Auditors' Report) Order (CARO). In 2020, the Ministry of Corporate Affairs (MCA) revised CARO (CARO 2020) which is applicable to a wide range of companies for the financial years commencing on or after 1 April 2021. Consequently, the Institute of Chartered Accountants of India (ICAI) has issued a guidance note on CARO 2020 (guidance note) which provides guidance on application of the CARO 2020.

Further, to align the auditor's reporting requirements with the disclosures provided by the companies, on 24 March 2021, the MCA has issued a slew of amendments to the Schedule III to the 2013 Act¹. The amendments are effective from 1 April 2021.

The ICAI on 1 July 2022 issued a revised the Guidance note on CARO 2020 (Revised Edition 2022). The amendments incorporate the disclosure requirements of the Schedule III amended by MCA on 24 March 2021 and include other regulatory updates.

1. Schedule III to the 2013 Act provides general instructions for presentation of financial statements of a company under both AS and Ind AS.

Overview of the revised guidance

The following section discusses some of the key guidance under revised guidance note.

Applicability: CARO 2020 is applicable to all companies except certain class of private companies.

CARO 2020 provides applicability provisions for certain private companies including Non-Banking Financial Companies (NBFCs). The applicability provisions contain threshold limits relating to paid-up capital and reserves and surplus of a company.

The amended Schedule III to the 2013 Act categorises reserves and surplus under following categories:

- Capital reserve
- Securities premium
- Other reserves (specify nature)
- Retained earnings.

Considering the amendments under the Schedule III, the revised guidance note changed the definition of reserves and surplus for applicability of CARO to NBFCs (following Division III of the Schedule III).

Additionally, one of the applicability criteria of CARO 2020 is to consider the total income. The revised guidance provides that total income should be considered instead of total revenue

while determining the applicability of CARO 2020. Accordingly, total income would include revenue from operations and other income as per the Schedule III.

Clause 3(i)(a): Details of tangible and intangible assets – Maintenance of records

CARO 2020 requires an auditor to report whether a company is maintaining proper records and those records show full particulars, including quantitative details and situation of the property, plant and equipment.

The MCA through its notification dated 24 March 2021 had introduced a concept of audit trails by inserting proviso to Rule 3(1) of the Companies (Accounts) Rules, 2014. The amended rule provides that for the financial year commencing on or after the 1 April 2023, every company which uses an 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.

The revised guidance note has now included the reference of this requirement for the auditor to consider for reporting under the clause.

Clause 3(i)(c): Details of tangible and intangible assets - Title deeds not held in name of the company

The guidance note provides that in case a company under the lease agreement obtains Right of Use (ROU) assets which are covered under Ind AS 116, *Leases* then the same should also be considered by the auditor for reporting under the clause relating to tangible and intangible assets.

Additionally, guidance note now includes a reference of the Schedule III disclosure relating to details of title deeds of immovable properties. In this case while reporting on this clause, an auditor is required to review the disclosure provided as per the Schedule III for tangible and intangible assets.

Clause 3(ii)(b): Physical inventory verification and working capital sanction - Sanctioned working capital limits exceeding INR5 crore

This clause in CARO 2020 requires an auditor to comment on whether during any point of time of the year, the company has been sanctioned working capital limits in excess of INR5 crore, in aggregate, from banks or financial institutions on the basis of security of current assets. However, disclosure requirements under the Schedule III to the 2013 Act are not limited to working capital limits but cover all borrowings. Further, a monetary threshold has not been prescribed under the Schedule III to the 2013 Act.

The guidance note now clarifies that an auditor should review the Schedule III disclosures as well before making a comment under this clause.

Clause 3(iii)(c): Schedule of repayment of principal and interests for loans granted

CARO 2020 requires an auditor to report, in respect of loans and advances in the nature of loans, upon the stipulation of schedule of repayment of principal and payment of interest and on regularity of their repayments i.e., the principal and interest should normally be paid whenever they fall due.

The guidance note provided a format for an auditor to report under this clause. The revised guidance note has modified the reporting format and added an additional column for actual date of payment. Now the revised reporting format is as below:

Name of the Entity	Amount	Due date	Date of payment	Extent of delay	Remarks, if any
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(Emphasis added to highlight the change)

Clause 3(iii)(e): Renewal of loans/fresh loans to settle overdues of existing loans

CARO 2020 requires an auditor to report in respect of a loan or an advance in the nature of a loan granted which has fallen due during the year and has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties i.e., identification of instances of 'evergreening'² of loans/advances in the nature of loans.

The guidance note provides a format for an auditor to report under this clause. The revised guidance note has modified this format and added an additional column for gross amount of loans/advances in nature of loan granted during the year to those parties where the overdue amount was settled by renewal or extension or fresh loan. The revised format is as below:

Name of the parties	Aggregate amount of loans or advances in the nature of loans granted during the year	Aggregate overdue amount settled by renewal or extension or by fresh loans granted to same parties	Percentage of the aggregate to the total loans or advances in the nature of loans granted during the year
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(Emphasis added to highlight the change)

2. The term 'evergreening' is not defined in the 2013 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.

This amendment requires an auditor to report party-wise information of the loans renewed during the year. Also, the party-wise percentage is to be provided for loans renewed during the year. Earlier the requirement was to compute a percentage of loans renewed against the total loans and advances granted during the year.

Clause 3(iii)(f): Loans granted to promoters and related parties

CARO 2020 requires disclosure of gross amount of loans or advances in the nature of loans which are either repayable on demand or do not specify any terms or period of repayment. If a company has granted such loans, then specific disclosures would need to be provided for an aggregate amount of loans granted to promoters and related parties as defined under relevant provisions of the 2013 Act.

The amended Schedule III requires specific disclosure in case of loans and advances given to promoters, directors, Key Managerial Personnel (KMP) and other related parties. The revised guidance note now provides that an auditor should review such disclosures before making comment under this clause. However, it should be noted that the Schedule III disclosures include loans and advances given to promoters, directors, KMP and other related parties, whereas in CARO 2020 includes loans and advances given to all related parties and parties other than related parties.

Clause 3(iv): Compliance with requirements of Section 185 and 186 of the 2013 Act

CARO 2020 requires an auditor to report whether a company has complied with the provisions of Section 185 and 186 of the 2013 Act in respect of loans, investments, guarantees, and security provided in connection with loans. The revised guidance emphasises that while reporting under this clause, an auditor should verify not only on the loans and advances made by the company but also the guarantees given, security provided or acquisition of securities by the company.

Clause 3(ix)(c): Application of term loans

CARO 2020 requires an auditor to report whether term loans were applied for the purpose for which these loans were obtained. If not, then an auditor is also required to report the amount of loan so diverted and the purpose for which it is used. However, the Schedule III to the 2013 Act requires the management to provide disclosures in the financial statements where borrowings from banks and financial institutions were not used for the specific purpose for which it was taken at the balance sheet date and disclose details of where they have been used in the financial statements of the company itself.

The revised guidance note highlights that CARO 2020 requires auditors to report on the term loans from any party, whereas disclosures under the Schedule III are not limited to term loans but cover all borrowings from banks and financial institutions.

Therefore, the revised guidance note requires an auditor to review disclosures of the Schedule III as well before reporting under this clause.

Clause 3(ix)(f): Funds raised on pledge of securities held in subsidiaries, joint ventures or associates

Under CARO 2020, an auditor is required to report whether a company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies. In case the answer is affirmative, it requires an auditor to:

- Give details of such loans and
- Report if the company has defaulted in repayment of such loans raised.

The revised guidance note requires an auditor to mention nature of security and its amount (as per the carrying value in the financial statements) and reference to the relevant note in the financial statements should also be provided by the auditor.

Clause 3(xvi)(b): Companies registered with RBI

CARO 2020 requires an auditor to report on whether a company has conducted any non-banking financial or housing finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India (RBI) as per the RBI Act. Also, RBI through its circular 'Review

of regulatory framework for Housing Finance Companies (HFCs)' dated 22 October 2020 has provided definition of housing finance companies. The revised guidance note requires an auditor to consider this definition while reporting under this clause.

The definition provided by the RBI is as follows:

'HFC' shall mean a company incorporated under the 2013 Act that fulfils the following conditions:

- I. It is an NBFC whose financial assets, in the business of providing finance for housing, constitute at least 60 per cent of its total assets (netted off by intangible assets). Housing finance for this purpose shall mean providing finance as stated in clauses (a) to (k) of para below.
- II. Out of the total assets (netted off by intangible assets), not less than 50 per cent should be by way of housing financing for individuals as stated in clauses (a) to (c) of para below.

'Housing Finance' shall mean financing, for purchase/construction/reconstruction/renovation/repairs of residential dwelling units, which includes:

- a. Loans to individuals or group of individuals including co-operative societies for construction/purchase of new dwelling units
- b. Loans to individuals or group of individuals for purchase of old dwelling units

- c. Loans to individuals or group of individuals for purchasing old/new dwelling units by mortgaging existing dwelling units
- d. Loans to individuals for purchase of plots for construction of residential dwelling units provided a declaration is obtained from the borrower that he intends to construct a house on the plot within a period of three years from the date of availing of the loan
- e. Loans to individuals or group of individuals for renovation/reconstruction of existing dwelling units
- f. Lending to public agencies including state housing boards for construction of residential dwelling units
- g. Loans to corporates/Government agencies for employee housing
- h. Loans for construction of educational, health, social, cultural or other institutions/centres, which are part of housing projects, and which are necessary for the development of settlements or townships
- i. Loans for construction meant for the conditions in slum areas, for which may be extended directly to the slum dwellers

- on the guarantee of the Central Government, or indirectly to them through the State Governments
- j. Loans given for slum improvement schemes to be implemented by Slum Clearance Boards and other
- k. Public agencies
- l. Lending to builders for construction of residential dwelling units.



Clause 3(xix): Material uncertainty

CARO 2020 requires an auditor to comment on whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report about the company's capability 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 guidance note (previous edition) provided that an auditor should form an opinion on the basis of the following:

- Financial ratios
- Ageing and expected dates of realisation of financial assets and payment of financial liabilities
- Other information accompanying the financial statements, for example, the director's report
- Auditor's knowledge of the board of directors and management plans.

In the absence of disclosure of financial ratios in the financial statements, the guidance note (previous edition) required an auditor to refer to liquidity ratios to report under this clause. However, now the amended Schedule III requires disclosure of certain ratios in the financial statements. Considering the amendment, the revised guidance requires an auditor to review financial ratios as disclosed in the financial statements as part of the Schedule III requirements instead of liquidity ratios.

Clauses amended due to the Schedule III amendments

The revised guidance note has amended reporting guidance for following clauses to include disclosure requirements of the Schedule III to the 2013 Act. Also, the revised guidance note requires an auditor to consider the disclosure under the Schedule III relating to following clauses:

- *Clause 3(i)(e), Benami property:* Details of benami property held in terms of amount, beneficiaries, reference in the balance sheet, details of proceedings against the company along with status/nature, etc.
- *Clause 3(viii), Unrecorded income:* Provide details of unrecorded or undisclosed income in terms of any transaction not recorded in the books of accounts that has been surrendered or disclosed as income in the tax assessment.
- *Clause 3(ix)(b), Wilful defaulter:* Disclosure in case when a company is a declared wilful defaulter by any bank or financial institution.
- *Clause 3(xx), Unspent Corporate Social Responsibility (CSR) amount:* Where a company covered under Section 135 of the 2013 Act, the Schedule III requires disclosures such as amount required to be spent, expenditure incurred, shortfall, previous year

shortfall, reasons for shortfall, nature of CSR activities, etc. CARO 2020 also requires an auditor to report whether the company has transferred unspent amount in respect of other than ongoing projects to specified fund and relating to an ongoing project to the specified bank accounts.

Conclusion

The introduction of CARO 2020 and amendments to the Schedule III presentation and disclosure requirements are aimed at enabling the higher level of corporate governance and additional information with the regulators.

The revised guidance note suggests auditors should read CARO 2020 in conjunction with the corresponding amendments to the Schedule III in order to understand the presentation and disclosure requirements set forth therein and to carry out the audit procedures in accordance with those requirements.