Chapter-5 CARO

Reporting Under CARO, 2020

In exercise of the powers conferred by section 143(11) of the Companies Act, 2013, the Central Government, after consultation with the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013, has issued the Companies (Auditor's Report) Order, 2020, (CARO, 20) dated 25th February 2020. Its applicability is from **FY 2020-21 onwards.**

1. Applicability of Companies (Auditor Report) Order, 2020

The CARO, 2020 is an additional reporting requirement. **The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2O13.** However, the Order specifically **exempts the following classes of companies**:

- **a banking company;**
- **an insurance company;**
- **a company licensed to operate u/s 8 of the Companies Act**
- **a One-Person Company as defined in Sec. 2(62) of the Companies Act**
- **a Small Company as defined in Sec. 2(85) of the Companies Act; and**
- **a private limited company, not being a subsidiary or holding of a public company,**

- having a Paid-up capital & Reserves & Surplus **not more than ₹1 Cr. as on the balance sheet date, and**
- which does not have total borrowings **exceeding ₹1 Cr**. from any bank or financial institution **at any point of time during the financial ye**ar, **and**
- which does not have a **total revenue** as disclosed in Schedule III to the Companies Act, 2013 (including revenue from discontinuing operations) **exceeding ₹10 Cr. during the financial year** as per the financial statements.

Important points to be remembered while studying applicability of CARO 2020

1. This order is an order on the auditor's of the company.
2. CARO is not applicable to Audit Report of Consolidated Financial Statement.
3. CARO is applicable to Branch Auditor's.
4. NBFC's are not exempted from applicability of CARO.
5. Private Limited Companies are also not exempted from the purview of CARO.
6. While computing Paid up Share Capital for the applicability of CARO, the following points must be kept in mind:
   - To be exempt from applicability of CARO, a Private Limited Company should have Paid up Capital and Reserves & Surplus not more than 1 crore as on Balance Sheet Date.
   - Paid up share capital includes Equity Share Capital and Preference Share Capital.
   - Share application money is not considered part of capital.
   - While calculating Paid up Capital, amount of calls unpaid should be deducted therefrom, and amount originally Paid-up on Forfeited Shares should be added to the figure of Paid-Up Capital.

   Definitions of PSC:

   a) **Sec.2(64): "Paid –Up Capital"** means aggregate amount of money credited as paid-up is equivalent to the amount received as paid up in respect of Shares issued. It also includes any amount credited as paid up in respect of shares of the Company.

   b) **ICAI Guidance Note:** Paid –Up Share Capital means that part of the Subscribed Share Capital for which consideration in Cash or otherwise has been received. This includes Bonus Shares allotted by the Corporate Enterprises.
7. While computing **Borrowings** for the applicability of CARO , the following points must be kept in mind:
   - To be exempt from applicability of CARO, a Private Limited Company should have Borrowings not more than 1 crore at any point of time during the Financial Year.
   - All types of Borrowings from Banks and Financial Institution are to be considered **. (Short Term, Long Term ,Overdraft facility, Cash Credit, Dues in respect of credit card etc.)**
   - The term "Banks" includes Private Banks and Foreign Banks also as per Banking Regulations Act, 1949.
   - The term "Financial Institution" used in CARO includes a Scheduled Bank and NBFC's.

8.While computing Total Revenue for the applicability of CARO , the following points must be kept in mind:

- To be exempt from applicability of CARO, a Private Limited Company should have Revenue as per Schedule 3 not more than 10 crores at any time during the Financial Year.
- The term "Revenue" shall include not only Sale of goods and services but also include other incomes like sale of scrap, interest on investment etc.
- All sales returns are to be deducted from Sales for the purpose of CARO and Tax Audit.
- Indirect Taxes are to be included in Revenue as Sales if inclusive method of accounting are to be followed and not to be included if exclusive method of accounting is followed. {If question is silent, assume that exclusive method of accounting is followed.}

2. Auditor's report to contain matters specified in paragraphs 3 and 4 -

Every report made by the auditor u/s 143 of the Companies Act, 2013 on the accounts of every company examined by him to which this Order applies for the financial years commencing on or after 1st April 2020, shall contain the matters specified in paragraphs 3 and 4, as may be applicable.

The Order shall not apply to the auditor's report on consolidated financial statements except Para 3(xxi).

3. Matters to be included in the auditor's report

The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:-

Sr.no.		Details
[Para 3(i)] Property, Plant and Equipment	**Adequacy of Records**	(a) (A) whether the company is maintaining proper records showing full particulars, including quantitative details and situation **of Property, Plant and Equipment.** (B) whether the company is maintaining proper records showing full particulars of intangible assets;
	Physical verification	(b)whether these Property, Plant and Equipment have been physically verified by the management at **reasonable intervals**; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

	Title Deeds	(c) whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof in the format below:-

Description of property	*Gross carrying value*	*Held in name of*	*Whether promoter, director or their relative or employee*	*Period held – indicate range, where appropriate*	*Reason for not being held in name of company**
-	-	-	-	-	**also indicate if in dispute*

	Revaluation of Property, Plant and Equipment	(d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; **specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;**
	Proceedings ,if any against the company for holding Benami Property	(e)whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements;
[Para 3(ii)] Inventories	**Physical Verification**	(a) 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.

	Working Capital Limit	(b) **whether during any point of time of the year,** the company has been sanctioned **working capital limits in excess of ₹5 crore, in aggregate,** from banks or financial institutions on the basis of security of current assets; whether 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, if not, give details.
[Para 3(iii)] Investments, Guarantee / Security, Loans or Advances		(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) 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;
		(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;
		(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.
		(e) 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];
		(f) 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 thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013.
Para 3(iv) Compliance of provisions of Sec. 185 & 186		(iv) in respect of loans, investments, guarantees, and security, whether provisions of sections 185 and 186 of the Companies Act have been complied with, if not, provide the details thereof.
[Para 3(v)] Public Deposits		(v) in respect of deposits accepted by the company or amounts which are **deemed to be deposits**, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules made thereunder, where applicable, have been complied with, if not, the nature of such contraventions be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not;
[Para 3(vi)] Cost Records		Whether maintenance of cost records has been specified by the CG u/s 148(1) of the Companies

		Act, 2013 and whether such accounts and records have been so made and maintained.
[Para 3(vii)] Statutory Dues		(a) Whether the company is regular in depositing undisputed statutory dues including **Goods and Service Tax,** 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 at the last day of the financial year concerned for a period of **more than 6 months** from the date they became payable, shall be indicated. (b) Where statutory dues referred above 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).**
Para 3(viii) Unrecorded Income		(viii)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;
Para 3(ix) Repayment of Dues.		(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****	***Amount not paid on due date***	***Whether principal or interest***	***No. of days delay or unpaid***	***Remarks, if any***

	***lender-wise details to be provided in case of defaults to banks, financial institutions and Government.**				

		(b) whether the company is a **declared wilful defaulter** by any bank or financial institution or other lender; (c) 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; (d) whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated; (e) 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 so, details thereof with nature of such transactions and the amount in each case; (f) whether the company has raised **loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies,** if so, give details thereof and also report if the company has defaulted in repayment of such loans raised;
Para 3(x) Application of Money raised by public issue and preferential allotment	**Application of Money raised by public issue**	(x)(a) whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year 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;
	Preferential allotment	(b) whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially, or optionally convertible) during the year and if so, whether the

		requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance.
[Para 3(xi)] Fraud		(xi)(a) 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. (b)whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in **Form ADT-4** as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government. (c) whether the auditor has considered **whistle-blower complaints**, if any, received during the year by the company.
Para 3(xii) Nidhi Companies		(xii)(a) whether the Nidhi Company has complied with the **Net Owned Funds to Deposits i**n the ratio of **1:20** to meet out the liability. (b) whether the Nidhi Company is maintaining ten per cent. unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability. **(c) whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof.**
Para 3(xiii) Transactions with related Parties		(xiii)whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act where applicable and the details have been disclosed in the financial statements, etc., as required by the applicable accounting standards;
Para 3(xiv) Internal Audit System		(xiv) (a) whether the company has an internal audit system commensurate with the size and nature of its business. (b) whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor;
Para 3(xv) Non cash		(xv)whether the company has entered into any non-cash transactions with directors or persons

transactions with directors		connected with him and if so, whether the provisions of section 192 of Companies Act have been complied with.
Para 3(xvi) Registration. with RBI		(xvi) (a) whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 (2 of 1934) and if so, whether the registration has been obtained. (b) whether the company has conducted any Non-Banking Financial or Housing Finance activities **without a valid Certificate of Registration** (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934. (c) 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. (d) whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group.
Para 3(xvii) Cash Losses		(xvii)whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses;
Para 3(xviii) Considerations of issues raised by outgoing auditor		(xviii)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;
Para 3(xix) Existence of Material uncertainty as to company ability to meet its liabilities		(xix)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;**

Para 3(xx) Transfer of unspent CSR amount		(xx) (a) whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act. (b) whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with the provision of sub- section (6) of section 135 of the said Act.
Para 3(xxi) Qualifications or adverse remarks in CARO Reports of group companies		(xxi)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.

4. Reasons to be stated for unfavourable or qualified answers-

(a) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is **unfavourable or qualified**, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.

(b) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

Questions on CARO 2020

1.Physical verification of only 30% (in value) of items of inventory has been conducted by the company. The balance 70% will be conducted in next year due to lack of time and resources.

Reporting for Physical Verification of Inventory: clause (ii) of Para 3 of CARO, 2020 requires the auditor to state in his report whether physical verification of inventory has been conducted at reasonable interval by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate. What constitutes “reasonable intervals” depends on circumstances of each case. The periodicity of the physical verification of inventories depends upon the nature of inventories, their location and the feasibility of conducting a physical verification. The management of a company normally determines the periodicity of the physical verification of inventories considering these factors. Normally, wherever practicable, all the items of inventories should be verified by the management of the company at least once in a year. The auditor in order to satisfy himself about verification at reasonable intervals and about coverage and procedures applied, should examine the adequacy of evidence and records of verification.

In the given case, the management conducted the physical verification of inventory only upon 30% (in value) of the total inventory for the reason of lack of time and resources. The above requirement of CARO, 2020 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedures of inventory verification are inadequate and unreasonable. He may also consider the impact on financial statements and report accordingly.

2. K Ltd. took a term loan from a nationalized bank in 2015 for ₹ 200 lakhs repayable in five equal instalments of ₹ 40 lakhs from 31st March 2016 onwards. It repaid the loans due in 2016 & 2017, but defaulted in 2018, 2019 & 2020. As the auditor of K Ltd, what is your responsibility assuming that company has sought reschedulement of loan?

Reporting for Default in Repayment of Dues: As per clause (ix) of Para 3 of CARO, 2020, the auditor of a company has to report whether the Company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, and if yes, the nature of borrowing, name of lender , period and amount of default to be reported. The Auditor is also required to report whether the company is a declared wilful defaulter by any bank or financial institution or other lender. **In this case,** K Ltd. has defaulted in repayment of dues for three years. Application for rescheduling will not change the default position. Hence, the auditor shall report in his CARO report that the Company has defaulted in its repayment of dues to the bank to the extent of ₹ 120 lakhs and evaluate its consequential impact on the audit report as well.

3. LM Ltd. had obtained a term loan of ₹ 300 lakhs from a bank for the construction of a factory. Since there was a delay in the construction activities, the said funds were temporarily invested in short term deposits.

Term loan invested in short term deposits: As per clause (ix) of Para 3 of CARO, 2020, an auditor needs to state in his report that whether the term loans were applied for the purpose for which the loans were obtained.

In the present case, the proceeds of the term loan obtained by LM Ltd. have not been put to use for construction activities and have been temporarily invested in short term deposit.

Here, the auditor should report the fact in his report that pending utilization of the term loan for construction of a factory, the funds were temporarily used for the purpose other than the purpose for which the loan was sanctioned, as per clause (ix) of Para 3 of CARO, 2020.

4. For the purpose of assessing applicability of CARO, what kind of loans need to be considered?

Borrowings from banks or financial institutions can be long term or short term and are normally in the form of term loans, demand loans, export credits, cash credits, overdraft facilities, bills purchased or discounted. Outstanding balances of such borrowings should be considered as borrowing outstanding for the purpose of computing the limit of rupees one crore. Non-fund based credit facilities, to the extent such facilities have devolved and have been converted into fund-based credit facilities, should also be considered as outstanding borrowings. The figures of outstanding borrowing would also include the amount of bank guarantees issued by the company where such guarantee(s) has (have) been invoked and encashed or where, say, a letter of credit has been devolved on the company. In case of term loans, interest accrued and due is considered as a borrowing whereas interest accrued but not due is not considered as a borrowing. Further, in case the company enjoys a facility, say, a cash credit facility, whose balance is fluctuating in nature, the Order would apply to the company in case on any day during the financial year concerned, the amount outstanding in the cash credit facility exceeds Rs. one crore as per books of the company along with other borrowings. The aggregate borrowings disclosed in the financial statements would need to be considered based on applicable generally accepted accounting principles in India (Ind AS/ AS).

5.Whether CARO is Applicable to the auditor of consolidated financial statement?

Order shall not apply to the auditor's report on consolidated financial statements except clause (xxi) of paragraph 3.

6.What documents constitute title deed?

Following documents mainly constitute title deeds of the immovable property:-

(i) Registered sale deed / transfer deed / conveyance deed, etc. of land, land & building together, etc. purchased, allotted, transferred by any person including any government, government authority / body / agency/ corporation, etc. to the company.

(ii) In case of leasehold land and land & buildings together, covered under the head property, plant and equipment (fixed assets), the lease agreement duly registered with the appropriate authority.

7.Should the auditor examine the cost record in detail while reporting under CARO?

CARO does not require a detailed examination of Cost Records. The Auditor should, therefore, conduct a general review of Cost Records to ensure that the records as prescribed are made and maintained. The word "made" applies in respect of Cost Accounts, and the word "maintained" applies in respect of Cost Records relating to Materials, Labour, Overheads, etc.

Question based on PPE Revaluation Para 3(i) (d)

8. Following is the information given for a Ceramics Ltd which is a listed company.

Trichy Plant Gross value-₹ 20 Lakhs
Depreciation for current year- ₹ 2 Lakhs

The company revalued its plant by Mr Sundaram who is a registered valuer under Companies Act,2013 and he valued the plant at ₹ 25 Lakhs. Comment whether CARO reporting will be required or not by the auditor.

As per Para 3 (i)(d) the auditor will check whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change**, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets.**

Based on the above clause, Net carrying value of Plant = Gross Value of Plant- Depreciation

= 20-2 = 18 Lakhs

The revalued Value of plant is ₹ 25 Lakhs from 20 Lakhs i.e., ₹ 5 Lakhs which is more than 10 % of net carrying value of plant .(18 Lakhs x 10%)= 1.8 Lakhs. Hence, the auditor will report such change in valuation of plant.

Question based on Physical verification of inventory Para 3(ii)

9. Raheja Steel has following inventory items during FY 2019-20 .

Inventory item (Raw Materials)	Book value (₹ in Lakhs)	Physical Verification value (₹ in Lakhs)
Iron Ore	2	1.8
Limestone	3	2.5
Silica	1	1
Total	6	5.3

Is CARO reporting required as per CARO 2020?

As per Para 3 (ii) 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.

Based on the above provisions, Since the discrepancy of ₹ 70000 (600000-530000) exceed the 10 % of aggregate of the raw materials (600000 x 10% = 60,000) .The reporting will be done under Para 3 (ii) by the auditor.

Question based on Internal Audit System Para 3(xiv)

10. The CFO of Sitara Limited which is a listed company, finds that there is a lot of irregularities in the accounting records of the company. There is no internal audit system in the company. Is the reporting required under CARO 2020?

As per Para 3 (xiv) Internal Audit System, whether the company has an internal audit system commensurate with the size and nature of its business. Since the company doesn't have a proper internal audit system ,CARO reporting will be required under Para 3 (xiv).