CARO 2016

Companies Auditor's Report Order, 2016

Background:

Section 143(11) of the Companies Act, 2013 requires that the auditor's report of specified class of companies should include a statement in the prescribed matters. These reporting requirements have been prescribed under the Companies (Auditor's Report) Order, 2015 issued by the Ministry of Corporate Affairs (MCA) on 10 April 2015.

Recent amendment [CARO – 2016]:

The committee set-up by MCA made recommendations on the matters to be included in the statement and on the basis of its recommendations, MCA issued draft Companies (Auditor's Report) Order, 2016 on 9 February 2016.

From which financial year CARO – 2016 is applicable?

The Ministry of Corporate Affairs, vide notification dated 29 March 2016, has issued the Companies (Auditor's Report) Order, 2016 which will be applicable from financial years commencing on or after **1 April 2015**. The new order introduced few new reporting requirement by curtailing few in comparison of Companies (Auditor's Report) Order, 2015.

- CARO 2016 **would be** applicable to:
    - every company (except companies that are excluded, see below), including
    - a foreign company as defined under section 2(42) of the 2013 Act.

- CARO 2016 **would not be** applicable to the auditor's report on consolidated financial statements.

A better way to understand CARO 2016 would be by comparing with the erstwhile report, CARO 2015.

Here are the few comparisons/ differences that are segregated based on different criteria:

Class of companies excluded from applicability of CARO – 2016

CARO 2016: Not applicable to Private Limited company (not being holding / subsidiary of Public Company) not having:

- Paid up capital + reserves & surplus more than **1 crore** as on balance sheet date.
- Total borrowings from banks and FIIs more than **1 crore** during the year
- Total revenue (including discontinuing operations) as per Schedule III to the 2013 Act more than **10 crores** during the FY as per financial statements.

CARO 2015: Not applicable to Private Limited company not having:

- Paid up Capital + reserves more than 50 Lacs as on balance sheet date.
- Loans outstanding from any banks and FIIs more than 25 Lacs during the year
- Turnover more than 5 crores at any point of time during the financial year.

SCOPE of applicability of CARO - 2016

Clause (i) – Fixed assets:

CARO 2016: Companies have to make additional reporting for such immovable assets **whose title are not owned by the company**.

CARO 2015: There is no such requirement specified in CARO 2015.

Clause (ii) - Inventory:

CARO 2016: The requirement has been curtailed to physical verification and treatment of discrepancies noticed. The auditor need not report for:

- Records maintained by the company for inventories.
- Reasonableness of the procedure followed by the management for inventory verification and their adequacy in relation to the size of the company & its nature of business.

CARO 2015: The auditor need to report on the records maintained, the procedure followed by the management and whether it commensurate with the size of the business.

Clause (iii) – Loans given by company:

CARO 2016: When the company grants any loans, secured or unsecured to the persons covered in the register maintained under section 189 of the Companies Act, 2013; the auditor has to report on:

- Whether the terms and conditions of the grant of such loan are **prejudicial** to the interest of the company.
- The amount over due for **more than 90 days** and what steps have been followed by the Company.

CARO 2015: It requires the auditor to report on amount overdue when the overdue amount exceeds one lakh rupees while the new CARO requires reporting on amount overdue for more than 90 days.

Clause (iv) – Loan to directors and investment by company:

CARO 2016: Auditor has to report on whether provisions of **section 185 and I86** of the Companies Act, 2013 have been complied with in respect of loans, investments, guarantees and securities given by the company.

CARO 2015: Instead of compliance requirements, the erstwhile report requires the auditor to comment on the adequacy of internal control system with the size of the company and the nature of its business, for:

- Purchase of inventory and fixed assets.
- Sale of goods and services and

Whether there is a continuing failure to correct major weaknesses in internal control system.

Clause (v) - Deposits & Clause (vi) – Cost records:

There is no change in the new CARO, 2016 vis-à-vis old CARO, 2015.

Clause (vii) – Statutory dues:

CARO 2016: Auditor **need not** require to report on whether the amount required to be transferred to investor education and protection fund in accordance with the relevant provisions of the Companies Act, 1956 and rules made thereunder has been transferred to such fund.

CARO 2015: Auditor need to report on whether the amount required to be transferred to investor education and protection fund in accordance with the relevant provisions of the Companies Act, 1956 and rules made thereunder has been transferred to such fund.

Clause (viii) of **CARO 2016** --------------------------- is same as --------------------------- ***clause (ix)*** of **CARO 2015**

Auditor has to report on whether any fraud has been committed by the officers or employees of the company; nature of the fraud and the amount involved is such fraud or any fraud reported during the year.

CARO 2015: Clause (viii) of CARO 2015 has been removed in the new CARO, 2016.

Clause (ix) - Utilization of IPO and Further Public Offer:

CARO 2016: Auditor has to report on whether moneys raised by way of:

- Initial Public Offer (IPO) [including debt instruments]
- Further Public Offer (FPO) [including debt instruments]
- Term loans are applied for the purposes for which those are raised and if not, the details together with delays or default and subsequent rectification, if any.

CARO 2015: This clause has been covered in the clause (viii) of CARO 2016.

Clause (x) of **CARO 2016** --------------------------- is same as --------------------------- ***clause (xii)*** of **CARO 2015**

Auditor has to report on whether the company has:

- defaulted in repayment of dues to a financial institution; bank; debenture holders.
- the period for which such default has continued.
- the amount of default with **lender wise details.**

CARO 2015: Clause (x) of CARO 2015 has been removed in the new CARO, 2016.

Clause (xi) – Approval of Managerial remuneration:

CARO 2016: Auditor has to report on whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 of Companies Act, 2013 read with Schedule V to the Companies Act, 2013. If not, state the amount involved and steps taken by the company for securing refund of the same.

CARO 2015: This clause has been covered in the clause (ix) of CARO 2016.

Clause (xii) – Nidhi Company:

CARO 2016: Auditor has to report on whether the Nidhi Company:

- has complied with the Net Owned Funds to Deposits in the ratio of **1: 20** to meet out the liability.
- is maintaining ten percent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liabilities.

CARO 2015: This clause has been covered in the clause (x) of CARO 2016.

Clause (xiii) – Related Party Transaction:

CARO 2016: Auditor has to report on 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 as required by the applicable accounting standards.

CARO 2015: There is no such requirement specified in CARO 2015.

Clause (xiv) – Private placement or Preferential issues:

CARO 2016: Auditor has to report on whether the company has made any preferential allotment or private placement of:

- shares or
- fully convertibles debentures or
- partly convertibles debentures during the year under review.

if so, 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.

CARO 2015: There is no such requirement specified in CARO 2015.

Clause (xv) – Non – cash transactions:

CARO 2016: Auditor has to report on whether the company has entered into any non-cash transactions with directors or persons connected with him & whether the provisions of section 192 of Companies Act, 2013 have been complied with.

CARO 2015: There is no such requirement specified in CARO 2015.

Clause (xvi) – Register under RBI Act, 1934:

CARO 2016: Auditor has to report on whether the company is required to be registered under section 45 IA of the Reserve Bank of India Act, 1934 & whether the registration has been obtained.

CARO 2015: There is no such requirement specified in CARO 2015.

Reasons to be stated for Unfavorable or Qualified answers or unable to express opinion:

1. Unfavorable or qualified answer:

Where, in the auditor's report, the answer to any of the questions referred above is unfavorable or qualified, the auditor's report shall also state the reasons for such unfavorable or qualified answer, as the case may be.

2. Unable to express opinion:

Where the auditor is unable to express any opinion in answer to a particular question, his report shall indicate such fact together with the reasons why it is not possible for him to give an answer to such question.

As per paragraph 4 of CARO – 2016, the auditor must give the reasons for unfavorable or qualified answers to the above 16 clauses referred in paragraph 3 of CARO – 2016. However, if the auditor is not able to express his opinion the fact and reason for the same should be indicated in the report.

Points to ponder:

- ✓ **Scope:** The MCA has relaxed the scope of CARO on the private companies by increasing applicability thresholds, thus, it would be applicable to less number of private companies.

- ✓ **Re-introduction of clauses from CARO 2003:** The MCA also re-introduced certain requirements from CARO, 2003 such as
  - reporting on terms and conditions of the grant of loans from certain parties or
  - net owned fund ratio for a Nidhi company.

  which demonstrates MCA's effort to keep CARO requirements from stakeholder's perspective.

- ✓ **Related parties:** The definition of related parties under accounting standards is different from the 2014 Act. Therefore, compliance in relation to clause relating to related parties under section 2(76), 188 and 177 of the 2013 Act vis-à-vis requirements of the accounting standards could be challenging.