COMPLIANCE TO OTHER STATUTE

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Background

Auditors have regularly come under the scanner of market regulators due to the scams unearthed at large corporates, including financial institutions such as the most recent ones at Infrastructure Leasing & Financial Services (IL&FS) and Dewan Housing Finance Corporation Ltd. (DHFL). These scams could have been identified at a much early stage if the auditors acted as independent vigilantes and if internal control measures were not compromised with, frequently.

With a view to plug these gaps, the Ministry of Corporate Affairs (the "MCA") has notified the Companies (Auditor's Report) Order, 2020 (the "Order") on February 25, 2020, superseding the Companies (Auditor's Report) Order, 2016 (the "CARO 16"). Under this Order, every auditor is required to include all matters prescribed therein while preparing the annual audit report of a company. Initially this requirement was applicable on all audit reports prepared by auditors from the financial year April 01, 2019 onwards. However, due to the on-going COVID-19 pandemic and with a view to relax the compliance burden of companies, the MCA by a notification dated March 24, 2020 postponed the applicability of the Order to all audit reports prepared from the financial year April 01, 2020 onwards. The New Clauses are highlighted in *Italics*

I. Reporting for Nidhi Company: Clause (xii)

Within one year of incorporation, a Nidhi company must satisfy the following conditions and the same needs to be reported in CARO under Clause 3 (xii):

- **Minimum number of Members:** The minimum number of members must be 200.
- **Net owned funds:** The Net owned funds must be Rs. 10 lakhs. (Net owned funds is the aggregate of paid-up capital and free reserves reduced by the accumulated and intangible assets as appearing in the last balance sheet.)
- **The ratio of net owned fund to deposit:** The net owned funds and the deposits shall be in a ratio not exceeding 1: 20 that is Net Owned Funds: Deposits = 1:20.
- **Unencumbered Term Deposit:** Unencumbered term deposits should be not less than 10% of the outstanding deposits as specified in Rule 14 of Nidhi Rules 2014.

Auditors Certificate: *Every Nidhi Company is required to have an Auditor Certificate certifying whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof.* The auditor should ask the management for computation of deposit liability and net owned fund based on requirement given this helps him to verify that the ratio of deposit liability to net owned fund based on requirement given this helps him to verify that the ratio of deposit liability to net owned funds is by the requirements. Comments of the auditor should be based upon a statement provided by management and verification of the same by the auditor. The Auditor Certificate shall be annexed to the Auditor report of the Company.

II. Compliance to RBI – NBFC Rules Clause (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;

Check the financials for the year under consideration.

Check if the: (i) income from financial asset is 50% or more of its total income and (ii) financial assets are 50% or more of its total assets.

(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;

If both the above conditions are fulfilled, or if the company is engaged in housing finance activities: If yes, check if it is registered as an NBFC. If not applicable, report that it is not required to be registered

(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;

Check if the criteria as a CIC is fulfilled. If yes, report that it continues to fulfil the criteria. If not, report accordingly

(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;

If more than one CIC companies, in the group, report accordingly.

III. Undisclosed Income as per Income Tax Act

Reconciliation of Income Tax and Companies Act: *Details of any transaction not recorded in the books of accounts that has been surrendered or disclosed as income during the year in the tax assessments.*

It is in the imperative interest of the Management to disclose all the tax filings, assessment orders where an addition is made on the undisclosed income by the Assessing Officer. Any communication between the management and the Income Tax Department, where Management has defended the claim of undisclosed income should also be disclosed.

Usually Assesses doesn't recognise Undisclosed Income in its Books of Accounts though the same has been offered to tax in Income Tax Assessment. Such Assessment may arise mainly on account of Survey, Search and Seizure provision attracted under Income Tax Act, Surrender or disclosure under Laws related to Benami Properties or Black Money provisions.

This clause requires that the Auditor will state whether the Company had been recognised Undisclosed Income in its Books of accounts if the same has been disclosed in any Income Tax Assessment during the year. Hence users of Auditor's Report will be aware of Undisclosed Incomes of the company.

With this regard, a new clause is inserted which requires auditors to report whether previously non recorded Income has been recorded properly based on outcome of the assessment under Income Tax Act.

To Conclude:

CARO 2020 has ushered a new standard of transparency in reporting the health of an auditee company. Some of the new items included in the Auditor's Report will also facilitate identification of early warning signals and early reporting of frauds to the Reserve Bank of India. The benefits of the new reporting would outweigh the additional compliance burden.