

CLAUSE COVERING AUDIT OF ASSET / LIABILITIES



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Clause 3(i)(a)(A):

Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment;

Modifications/ Additional Requirement:

The said clause has been there in the earlier versions too. CARO 2020 has changed the terminology from Fixed Assets to Property, Plant and Equipment to be in line with the Accounting Standards and Schedule III.

Points for Consideration:

- i. Though order does not define what constitutes proper records for PPE, these records have generally been referred as Fixed Asset Register ('FAR'). Records that a FAR should include to be determined as proper records is a matter of professional judgement. However, ICAI Guidance Note on CARO 2020 ('ICAIGN') provides a detailed list (not all inclusive) of records that FAR should include for Auditor's verification. The FAR should contain records in respect of all items of PPE, self-financed or right to use assets (under Ind AS 116) acquired through finance lease. If case records are not updated or inadequate, the auditor would have to seek alternative information for such portion. Based on materiality and other factors the auditor has to make judgement as regards reporting on adequacy in maintenance of proper records.
- ii. It is necessary that the aggregate original cost, depreciation to date, and impairment loss, if any, as per these records under individual heads should reconcile with the figures. In case of differences, based on materiality of the value, the auditor to make judgement as regards the criticality and relevance of the difference while reporting under the said clause.

Clause 3(i)(a)(B):

Whether the company is maintaining proper records showing full particulars of intangible assets:

Modifications/ Additional Requirement:

Requirement for reporting on maintenance of records for intangible assets has been newly introduced by CARO 2020. Similar to 3(i)(a)(A), this sub-clause requires reporting as regards, maintenance of proper records for intangible assets, however in case of intangible assets due to the nature of such assets, the specific point on quantity details and situations of assets is not applicable.

Points for Consideration:

- i. Refer comments at (i) for Clause 3(i)(a)(A) above for what constitutes proper record, auditors reporting in the absence of adequate records and non-reconciliation with books of accounts.
- ii. Many companies may not have a property detailed listing of the intangible assets and rights held by them except for payments made or expenses capitalized on an individual basis. This will create difficulties for the management to compile the comprehensive list item wise and right wise of all the intangible assets and reconciling the same with the books of account. Auditors should advise management to carry out a one-time exercise re-construct the records along with necessary corresponding documentation which will facilitate easy identification in future (by management) and verification (by auditor).
- iii. Auditor to cross check the existence and use of assets from sources like revenue generated, application made, registration under the relevant Act, license copies, payment receipts, legal agreement etc.
- iv. Auditor while reporting under this clause should consider self-generated intangible assets to the extent permitted by relevant accounting standards and their classification.
- v. Wherever required, an appropriate management representation should be obtained regarding the completeness of the data.

Clause 3(i)(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;

Modifications/Additional Requirement:

The said clause does not have any change as compared to CARO, 2016.

Points for Consideration:

- i. Auditor to consider the following assets for the purpose of reporting under this clause:
 - right of use (ROU) assets covered under Ind AS 116, where the auditee, under a lease agreement, obtains the right to use an asset
 - investment property as defined under Ind AS 40
 - non-current assets held for sale as defined under Ind AS 105
- ii. Though physical verification is the responsibility of the management, it is necessary that auditor satisfies himself that such verification was actually done and that there is adequate evidence on the basis of which he can arrive at such a conclusion.

- iii. What constitutes “reasonable intervals” depends upon the circumstances of each case. The factors to be taken into consideration in this regard include the number of assets, the nature of assets, the relative value of assets, difficulty in verification, situation and geographical spread of the location of the assets, etc. The management may decide about the periodicity of physical verification of property, plant and equipment considering the above factors. There might be cases where annual verification is impracticable to carry out. However, ICAI's GN states that even in such cases verification programme should be such that all assets are verified at least once in every three years.
- iv. Where verification of all assets is not made during the year, it will be necessary for the auditor to report that fact, but if he is satisfied regarding the frequency of verification he should also make a suitable comment to that effect.
- v. The auditor is required to state whether any material discrepancies were noticed on verification and, if so, whether the same have been properly dealt with in the books of account. The latter part of the statement is required to be made only if the discrepancies are material. The auditor has, therefore, to use his professional judgement to determine whether a discrepancy is material or not.
- vi. If a material discrepancy has been properly dealt with in the books of account it is not necessary for the auditor to give details of the discrepancy or of its treatment in the accounts but he is required to make a statement that a material discrepancy was noticed on the verification of property, plant and equipment and that the same has been properly dealt with in the books of account.

Clause 3(i)(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 the title deed holder is a 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

Modifications / Additional Requirement:

- i. Said clause has been carried from CARO 2016, with the reporting requirements being more detailed and in prescribed tabular format to ensure consistency in reporting.
- ii. Further, in CARO 2016 there was no reporting required for non-availability of title deeds, where the company is a lessee and the lease agreement is executed in favour of the company.

Points for Consideration:

- i. Reporting of title deeds for immovable property not held in the name of the company (including prescribed tabular format) has been amended in Schedule III requirements. Accordingly, Auditor to ensure that CARO reporting and reporting in financials is the same. In case of deviation same to be pointed out by the auditor in the audit report wherever applicable.
- ii. Promoter and relative has not been defined by the Order. Identifying the promoters beyond what is reported in the financial statements by the Company will not be a straight forward exercise for the auditors. For the purpose compiling the information which is required to be updated in Column 4 of the prescribed tabular format Auditor may refer the following
 - definition of Promoter and Relative as per Section 2(69) and Section 2(77) respectively of Companies Act, 2013 ('Act')
 - reviewing the prospectus, annual return, secretarial and other records of the company
 - Management representation, even in a case where there are no such parties.
- iii. Investment property (as defined under Ind AS 40) and non-current assets held for sale (as defined under Ind AS 105) needs to be considered by the auditor for reporting under this clause.
- iv. Only those immovable property which are either classified as property, plant and equipment, investment property or non-current assets held for sale are covered in the scope of reporting in the said clause. Thereby, immovable properties classified inventory (by real estate Company) are outside the scope of verification and reporting under this clause. Further, Transfer Development Rights (TDRs), plant and machinery embedded in land, etc., are not considered as an immovable property.
- v. The Order is silent as to what constitutes 'title deeds'. In general, title deeds mean a legal deed or document constituting evidence of a right, especially to the legal ownership of the immovable property. In case of leased assets, title deeds would imply the lease agreements and related documents.
- vi. In many instances, the title deed document of the immovable properties are not available with the Company as same has been mortgaged with the banks/financial institutions etc. for securing the borrowings and loan raised by the company. External confirmation from the lender that the title deed of the company held by it as security needs to be obtained in addition to the verification of board resolution for pledging of the immovable properties as security. Recording of charges and borrowing sanction letter may be additionally reviewed.
- vii. In case original title deeds have been lost / misplaced, the auditor along with the reporting of the said fact may consider other evidences such as property tax challan, electricity bills, water bill, land records from municipal or other governmental department, FIR/complaint filed with for the loss of document, application for duplicate document etc.
- viii. Title deeds not in the name of the Company in case of jointly held, details to the extent of the Company's share to be reported.

- ix. In case of business combination or change in the name of the company, the procedural formalities for transfer of property in name of the company may be pending.

Clause 3(i)(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;

Modifications / Additional Requirement:

This sub-clause requires the auditor to state whether the company has revaluated either PPE or intangible assets or both of the asset category and if so whether the revaluation is based on report of registered valuer. The amount of revaluation needs to be provided by auditor in cases whether the revaluation amount is greater than 10% (upward and downward) or more of the net carrying value of each class of PPE/intangible asset.

Points for Consideration:

- i. For the purpose of reporting under this clause, revaluation shall not include:
 - Fair valuation of PPE upon first time adoption of Ind AS, acquisition of assets/business on slump sale or under business combination
 - Re-measurements (i.e., changes in value due to interest or foreign exchange rates).
 - Changes to ROU assets due to lease modification as per Ind AS 116.
- ii. Revaluation should be based on report by registered valuer. All the basic data, assumptions and details submitted to the valuer are correct. Auditor using the work of registered valuer does not tantamount to using the work of an auditor's expert as laid out in SA 620, "Using the Work of an Auditor's Expert". However, the auditor shall consider the principles enunciated in SA 500, "Audit Evidence", with regard to using the work done by a management's expert.
- iii. The auditor should check the computation as regards the change in % since reporting is required if the change is 10% or more. Revaluation shall not include changes in value due to exchange differences, capitalisation of borrowing cost, etc.
- iv. If company has carried out multiple valuation for different purposes; such as submission to bank, for the purpose of impairment testing and for the revaluation; then the auditor would have to exercise his professional judgement to confirm the management's explanation for the difference in valuation reports and whether the difference itself is material in nature or not.
- v. Similar disclosure requirements have been mandated for the company in the financial statements under amended Schedule III requirements. Accordingly, auditor needs to ensure that there is no material inconsistency between the financial statements disclosures (by company) and in Order (by auditor).

Clause 3(i)(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;

Modifications / Additional Requirement:

Reporting under this clause and reviewing the applicability of the aforesaid Act has been made applicable for the first time in CARO 2020. It may be noted that reporting under this clause is limited to the adequacy of disclosure in the financial statements and to cases where proceedings are initiated with the company being treated as a benamidar.

Points for Consideration:

- i. The reporting is applicable only when proceedings are initiated or pending against the company as 'benamidar'. Hence if notice is received but no proceedings are initiated then no reporting is applicable under the said clause. Further, the reporting is also not applicable where the notice is received by the company as a beneficial owner.
- ii. In addition to inquiring with the management and obtaining management representation letter whether all proceedings initiated / pending auditor may also review the following:
 - Scrutinise the legal expense account to ascertain whether any expenses have been incurred by the company in respect of a proceedings under the aforesaid Act.
 - Review the minutes of the board of directors, audit committee, risk management committee and other secretarial records to verify whether any reference to proceedings against the company under the aforesaid Act has been made.
- iii. This is a new topic for the auditor and auditor would have to familiarise himself with the legal requirements of the aforesaid Act. Auditor may also obtain independent confirmation from the legal counsel as to whether any proceedings are initiated or pending against the company, especially where proceedings are for the properties for those not reflected in the books of account.
- iv. Information regarding the proceedings for the Benami Property has also been added in the revised Schedule III. Auditor is to review the said disclosure and ensure the completeness and appropriateness of the said disclosure and report in the Order accordingly.
- v. Depending on facts and circumstances of each case auditor needs to exercise its professional judgement to determine whether any liability needs to be recognised or a mere disclosure in contingent liability would suffice.
- vi. Where the proceedings are initiated post balance sheet date but before the signing of the auditor's report, the auditor should consider the requirements of SA 560, "Subsequent Events" for the purpose of reporting under this clause.

Inventories and other current assets**Clause 3(ii)(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;

Modifications / Additional Requirement:

- i. Commenting on whether management has carried out physical verification of the inventory at reasonable intervals is the same as required under CARO 2016.
- ii. Now whether the procedures followed and coverage of verification were in order or not is an additional requirement when as compared to CARO 2016. Same has been reinstated from CARO 2015.
- iii. Further, CARO 2016 required to comment whether material discrepancies between book stock and physical stock were noticed and properly dealt with in the books or not. What is material was again a subjective matter and accordingly same has been replaced by CARO 2020 with objective measurement criteria of discrepancies of 10% or more.

Points for Consideration:

- i. What constitutes "reasonable intervals" depends on circumstances of each case. Based on the size, nature, complexity of the business, nature of inventories, their location and feasibility of conducting physical verification an auditor would have to determine what would satisfy as 'reasonable interval'. Wherever practicable, all the material items of inventories should be verified by the management of the company at least once in a year.
- ii. To ensure that the coverage and procedures of physical verification is appropriate an auditor may review the instructions provided by management for the physical verification exercise, cut-off procedures properly followed or not, controls in place to avoid double counting and minimisation of the movement of the items.
- iii. Auditor can confirm whether the difference between the book stock and physical stock has been properly dealt in the books as far as quantitative impact is considered. However, in the absence of specific reason for the differences, i.e. whether on account of normal processing/handling loss or some other reasons, auditor cannot confirm the nature of impact in the financial statements for the said differences.
- iv. The threshold limit of discrepancies of 10% should be applied to the value and not to the quantity. If the inventory has been valued at net realisable value ('NRV'), then the discrepancy of 10% needs to be compared with NRV only.

Clause 3(ii)(b):

Whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, 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;

Modifications / Additional Requirement:

- i. This is a new reporting requirement wherein the auditor has to review quarterly returns or statements filed by the company with banks and financial institutions in case the sanctioned working capital limits with them are in excess of Rs. 5 crores in aggregate and to report if these are not in agreement with the books of accounts.

Points for Consideration:

- i. Reporting is applicable when the total sanction limit (both fund based and non-fund based) and not utilisation exceeds 5 crores. Utilisation can be less than the sanctioned limit of 5 crores and reporting is still applicable since sanctioned limit is 5 crores. Alternatively, sanctioned limit may be less than 5 crores and utilisation may exceed 5 crores due excess withdrawn. However no reporting is applicable since sanctioned limit is less than 5 crores.
- ii. Sanctioned limit is to be tested at any point in time during the year i.e. even for a single day and not at the end of the year. Further sanctioned limit would include fresh sanction as well as renewal during the year. Also working capital limits sanctioned to the company without the security of the current assets is to be excluded for the purpose of threshold limit of 5 crores.
- iii. The auditor should obtain a list of the statements or returns which are submitted to the banks/ financial institutions and compare the same with the books of account as to its accuracy or otherwise. The auditor is not required to audit the statements/returns of books of account based on which statements/ records have been prepared but only report the discrepancies, if any.
- iv. Additionally the auditor may inquire/ review the process of compiling the information for quarterly submission. Inquire the checks and balances adopted by the Company to ensure accuracy at the time of preparing statements. Quarterly closing of books and locking of trial balance that would restrict backdated entry/ changes in financial information submitted to the banks/ financial institutions. This would give satisfactory comfort to the auditors in terms of reporting positively in the said clause.
- v. Auditor is supposed to compare all the financial information and not inventory details alone which included in Statements/ return submitted to banks/ financial institutions.
- vi. The auditor needs to exercise his professional judgement to determine the materiality and the relevance of the discrepancy to the users of financial statements while reporting under this clause.
- vii. Under schedule III, the disclosure requirement scope is much broader as compared to CARO 2020 since it requires disclosure irrespective of the quantum of sanctioned limit of Rs 5 crores.

Investments, Loans, Advances and Guarantees

Clause 3(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,-

Clause 3(iii)(a):

- (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;

Modifications/ Additional Requirement:

Bifurcation of aggregate amount and balance outstanding of loans, advances, guarantee and security given between subsidiaries, joint ventures, associates and other parties is the new requirement. Reporting is extended to all parties and not only the parties covered in the register maintained under Section 189 of the Act.

Points for Consideration:

- i. The reporting is required only if the specified transactions have been entered into 'during the year'.
- ii. Loans and advances given during the year and squared off during the year also needs to be consider while reporting under the said clause.
- iii. Reporting is only limited to Financial Guarantees i.e. guarantee given by company to banks of financial institutions for the loan taken by third party.
- iv. Disclosure of the requisite information is to be given for all kinds of loans whether long term or short term, secured or unsecured, given in cash or in kind etc.
- v. The auditor should ensure compliance with all the requirements of sections 179, 180, 185, 186, 187 of the Act and rules there under.
- vi. Auditor may also refer the ICAI's Guidance Note on Audit of Investments, Audit of Loans and Advances and Audit of Liabilities. These may be used for planning and performing the audit procedures for loans, advances, guarantee and security provided by the company.
- vii. Auditor should obtain a written representation from the management that (i) there are no guarantees issued up to the year-end which are yet to be recorded; and (ii) all obligations in respect of guarantees have been duly recorded in the register of guarantees and disclosed.

Clause 3(iii)(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;

Modifications / Additional Requirement:

In CARO 2016 reporting was required whether loans given by the company are prejudicial to the interest of the company or not. CARO 2020 has expanded the scope by covering investments made, guarantee or security provided and also advances granted in the nature of loans.

Points for Consideration:

- i. What tantamount to advances is in the nature of a loan would depend upon the facts and circumstances of each case and involve significant judgements of the auditors based on their past experience and understanding of the business.
- ii. In case of loans/advances in nature of loans, the "terms and conditions" would primarily include rate of interest, security, terms and period of repayment and restrictive covenants, nature of entity i.e. whether given to a start-up or an entity having established track record etc.
- iii. To assess whether investments made by the company are prejudicial to the interests of the company or not, auditor needs to consider various factor such as nature of investment, financials and business profile of the investee, investment made from owned funds or borrowed funds, asset liability mismanagement, etc.
- iv. Holding company supporting the financial position of its loss-making subsidiary by infusing equity would not construed as prejudicial to the interest of the holding company.
- v. Whether the guarantee is prejudicial to the interest of the company, the auditor needs to consider various factor such as financial standing of the party on whose behalf the company has given the guarantee, party's ability to borrow, the nature of the security offered by the party, the availability of alternative sources of finance and the urgency of the borrowing, if available, for which the company has given guarantee and so on.

Clause 3(iii)(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;

Modifications / Additional Requirement:

CARO 2020 has extended the scope of clause by including advances in the nature of loan in additions to loan.

Points for Consideration:

- I. Auditor needs to examine the relevant document such as loan agreement, letter of understanding/arrangement wherein the schedule of repayment of principal and payment of interest has been stipulated.

- ii. As per ICAIGN, if no such relevant document is available which contains the schedule of repayment auditor shall report that there is no stipulation of schedule of repayment of principal and payment of interest and may report that he is unable to make specific comment on the regularity of repayment of principal & payment of interest.
- iii. In case management reports that repayment terms are as per verbal mutual understanding with the borrower, then auditor may adopt alternative audit procedures such as obtaining the said confirmation from the borrower, review the cash flow from the borrower, etc. Based on the alternative audit procedures, auditor may exercise his professional judgement and report accordingly.
- iv. The word 'regular' would mean that principal and interest are received as and when they are due as per the agreed terms.
- v. In case where the schedule of repayment of principal and payment of interest is stipulated but repayment of principal or payment of interest is not regular then the auditor may report the fact and may give number of cases and remarks, if any.
- vi. Said clause is applicable to NBFC's as well. Accordingly, there might be instances where NBFC has restructured loans and advances (in compliance with RBI guidelines) more specifically during Covid-19 times. These may results in moratorium on repayments or conversion of overdue interest into funded interest term loans. In such cases auditor will have to report under the said clause since original stipulated terms are not adhered to

Clause 3(iii)(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;

Modifications / Additional Requirement:

There is no changes in clause as compared to CARO 2016 except for the fact that advances in the nature of loans is also included now.

Points for Consideration:

- i. Auditor to report amount overdue for ninety days and not outstanding as the year end reporting date. An amount is considered as overdue when the payment has not been received on the due date as per the lending arrangement or any other specified document.
- ii. Auditor to take into consideration the facts and circumstances of each case to determine whether 'reasonable steps' have been taken by the management for the recovery of the overdue amounts. Auditor to review the documents such as demand letter, reminders or despatch of advocate's or solicitor's notice, communication to increase the security for delay, recovery notice etc. Reasonable steps need not necessarily be legal action only.
- iii. Auditor to comment whether reasonable steps have been taken by management for recovery even in case where overdue is not more than 90 days.
- iv. In case of NBFC, where there is any non-payment of instalments (including interest) during the moratorium period shall not be construed as 'overdue' for the purpose of this clause. However, the auditor may bring out this fact while reporting under the said clause.

Clause 3(iii)(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 over dues 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];

Modifications/ Additional Requirement:

This clause is a new reporting requirement as per CARO 2020. This clause is inserted to identify instances of 'ever greening' of loans/advances in the nature of loans.

Points for Consideration:

- i. In respect of loans falling due as on the balance sheet date and which were renewed/ extended/ settled post balance sheet date and before the date of audit report, the same should also be considered for reporting under this clause. Further, same matter would also get reported next year.
- ii. Percentage of loans renewed / extended should be calculated on the loans and advances in the nature of loan granted during the year and not on the outstanding balances as on the date of renewal/extension.
- iii. Loans falling due on or before the balance sheet date, but renewed or extended after the balance sheet date but before the date of the audit report (events occurring after the balance sheet date) needs to be considered and reported in the said clause in the financial year in which it falls due. Same again needs to be reported in the financial year in which it is renewed/extended.

Clause 3(iii)(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;

Modifications / Additional Requirement:

This is new clause reporting requirement.

Points for Consideration:

- i. Auditor to obtain the list of promoters as per Section 2(69) and relatives as per Section 2(76) of the Act and compare the same with loans/advances in the nature of loans schedule.
- ii. Auditor to review the loan agreements/ mutually agreed letter of arrangement to test whether the specified documents does contain any schedule of repayment or not or whether the lending arrangement is repayable on demand.
- iii. In the absence of the specified document auditor to inquire with the management, borrower for the repayment terms and report accordingly in the said clause.

Deposits, Loans and Borrowings

Clause 3(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.				

Modifications / Additional Requirement:

In CARO 2020, scope of the clause has been expanded to all borrowings and not just restricted to borrowings from financial institutions, bank, government or dues to debenture holders.

Points for Consideration:

- I. For the purpose of reporting under the said clause borrowings do not include public deposits as the reporting on public deposits is covered by clause (v) of the Order. Further preference share capital should also not be considered as borrowings even if classified as borrowings in the Ind AS financial statements as per Ind AS 32.
- ii. Default has not been defined in the order, however a default would mean non-payment of dues to lenders when the same is due. Even a single day delay would amount to delay for the purpose of delay.
- iii. Auditor should report the following defaults to be in compliance with the reporting requirement with description of the default in the remarks column for understanding the nature of default.
 - Defaults committed during the year and outstanding at the end of the year
 - Default committed during the year and the same is made good before the end of the year
 - Opening default not made good till the end of the year.
- iv. The auditor should consider the period up to the date of the audit report for reporting of the delay in number of days or the amount that remains unpaid and may provide appropriate remarks for the same.
- v. Submission of application for rescheduling does not mean that no default has occurred. If the rescheduling has been approved by the lender before the balance sheet date the auditor should state the fact of rescheduling of loan in the CARO report.
- vi. Where reschedulement of the loan has been approved subsequent of the balance sheet date, the auditor should report the defaults during the year. However the fact of reschedulement may be mentioned in the remarks column.

- vii. Rescheduling of loans on account of Covid-19 package would not be considered as default.
- viii. In case there is default on repayment as per the prevailing terms and conditions due to a dispute with the lender, same needs to be considered as default for the purpose of reporting under the said clause. Additionally, a brief nature of the dispute can be mentioned in the remarks column.
- ix. Where there is no repayment schedule specified or repayable on demand, auditor needs to obtain a representation from the management stating there has been no demand from the lender for loans/borrowing/ interest. If the nature and quantum of such loan is substantial then auditor may obtain the said confirmation from the lender itself instead of management representation.

Clause 3(ix)(b):

Whether the company is a declared wilful defaulter by any bank or financial institution or other lender;

Modifications / Additional Requirement:

This a new clause reporting requirement in CARO 2020

Points for Consideration:

- i. For the purpose of this clause reporting should be restricted to the declaration of wilful defaulter by banks and financial institutions based on the transparent mechanism implemented by Reserve Bank of India for identification of wilful defaulters. Further, in case of other lender declaration of wilful defaulter should be restricted by that of government/ government authorities only.
- ii. When an auditor is obtaining confirmations of outstanding loans and interest from banks/ financial institutions may include a question whether the company has been declared a wilful defaulter.
- iii. Auditor may also confirm whether the company has been declared as wilful defaulter by calling for company's CIBIL score. Additionally, auditor may also access the information available on the websites of credit information companies (CIBIL, CRIF, Equifax and Experian) to obtain insights whether company has been reported as wilful defaulter or not.
- iv. If the company has not been declared a wilful defaulter but has received a show-cause notice in accordance with the RBI Circular, the auditor may consider disclosing this fact in his report under this clause. Auditor to obtain signed representation letter from the management that the company has neither been declared as a wilful defaulter nor has received any show cause notice.
- v. If the company has been declared as wilful defaulter after the balance sheet but before the date of audit report, then the auditor needs to report the same in the said clause.

Clause 3(ix)(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;

Modifications / Additional Requirement:

This a new clause reporting requirement in CARO 2020

Points for Consideration:

- i. Term loan has not been defined by the Order. Term loans normally have a fixed or pre-determined repayment schedule. Cash Credit, overdraft and call money accounts/deposits are not considered as termed loans.
- ii. The order is silent as to whether term loans from entity/person other than banks/financial institutions would also be covered in the clause reporting or not. Going by literal interpretation of the clause term loan even sanctioned by entity/person other than banks/financial institutions also needs to be examined for the purpose of reporting in the said clause.
- iii. Diversion of funds has also not been defined by the Order. However RBI has defined diversion of funds in its master circular RBI/2014-15/73 DBR.No.CID.BC.57/20.16.003/14-15 dated July 1. 2014 on "Wilful Defaulters" (as updated from time to time)
- iv. Auditor should ascertain the purpose for which term loans were sanctioned and compare the same with actual utilisation of loans. Auditor needs to report the fact if funds were not utilised for the purpose for which they were obtained.
- v. It is not necessary or not possible to establish a one-to-one relationship with the amount of term loan and its utilisation. Since quite often the amount of term loan obtained is deposited in the common account of the company wherein it loses its individual identity and from utilisation is made in future. In such cases, one should not conclude that the term loan has not been utilised for the purpose for which it was obtained.
- vi. At time funds are temporarily invested to reduce the borrowing cost or other business purposes. The auditor should state the fact that pending utilisation of the term loan for the stated purpose, the funds were temporarily used for the purpose other than for which loan was sanctioned but were ultimately utilised for the stated end-use.
- vii. Term loans may not be utilised for the stated purpose in the year under consideration as it was received during the fag end of the year. Auditor needs to report that term loan obtained during the year has not been utilised for the stated purpose as it was received at fag end of the year. However while reporting under the said clause auditor also needs to considered the status of term loan utilisation as on the date of audit report i.e. events occurring after the balance sheet date.
- viii. In a case where it is concluded that term loan has not been utilised for the stated purpose then auditor needs to report the fact that term loan was not utilised for the stated purpose, amount of term loan, amount diverted and the purpose for which it was used.
- ix. Under Ind AS certain loans may be determined as compound financial instrument and a portion of it may be classified as equity as a result of split accounting. However, auditor needs to consider the entire proceeds (transaction value) for the purpose of reporting under the said clause.

Clause 3(ix)(d):

Whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated;

Modifications / Additional Requirement:

This is a new clause in CARO 2020 compared against CARO 2016. However, the said requirement was there in the CARO version earlier to CARO 2016.

Points for Consideration:

- I. Clause requires the auditor to comment whether there is asset-liability mismanagement. Since there would be liquidity problems as soon as short term sources of fund fall due for payment but realisation of funds is blocked in long term assets.
 - ii. Money being fungible, it may not be possible to establish a direct linkage between the funds and its utilisation. To assess whether short term funds have been used for long term purposes, auditor will have to examine the sources and deployment of fund on an overall basis only.
 - iii. Auditor may review/examine the following to assess whether short term funds have been utilised for long term purposes:
 - Difference between long term funds and long term assets would indicate the extent to which short term funds have been used to finance long-term assets of the company.
 - Generally, current ratio of less than 1 indicates that the short-term funds has been used for long term purposes.
 - Review the Ind AS 107 disclosure of maturity analysis of financial liabilities showing contractual repayment within various time bucket under liquidity risk management disclosure.
 - Cash flow statement to be reviewed to understand the sources and application of fund during the year under consideration.
 - iv. Based on his overall examine auditor concludes that short term funds have been utilised for long term purposes then nature of funds need to be reported. Nature of application of funds is only possible when there is a direct linkage between the fund and its utilisation. Hence it would be difficult for the auditor to report the nature of funds in the absence of adequate audit evidence supporting the said reporting.

Clause 3(ix)(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;

Modifications / Additional Requirement:

This is a new clause reporting requirement in CARO 2020.

Points for Consideration:

- i. Funds have not been defined by the Order leaving ambiguity as to whether funds would cover both borrowed funds and share capital as well. On simple reading of the clause suggests that even funds raised by issue of shares should be considered for examination by the auditor.
- ii. Auditor to report under the said clause if the company has taken any funds (long term or short term) and has also granted loans or advances to or investments in its subsidiaries, associate companies or joint ventures during the year. If during the year company has not given any loans or advances or made any investments in the subsidiaries, associate companies or joint ventures, then auditor need not report under the said clause.
- iii. Order does not define 'Obligation'. However, obligation would generally mean a debt security or a commitment to pay a particular sum of money. Therefore, obligation of subsidiary, joint venture or associate would mean the amounts that such subsidiaries, joint venture or associate companies are required to pay themselves either to their vendors, lenders, employees, or statutory authorities.
- iv. If as per the cash flow statement, company has cash inflows from operation activities, cash inflows from investing activities and cash flow from issue of equity instruments, then auditor may conclude that borrowed funds have not been utilised for funding the obligations of subsidiary, associate companies and joint venture.
- v. If company has paid to any vendors or other parties on behalf of the subsidiary, associate companies or joint ventures then the same would get covered for the purpose of reporting under the said clause.
- vi. For the purpose of this clause all funds taken during the year whether repaid or outstanding at year end or taken in earlier years and repaid or outstanding at the end of the year needs to be considered.
- vii. Auditor is supposed to report the nature and amount of transactions where company has obtained funds to meet the obligation of its subsidiary, associate companies and joint venture. Nature of application of funds is only possible when there is a direct linkage between the fund and its utilisation. Hence it would be difficult for the auditor to report the nature of funds in the absence of adequate audit evidence supporting the said reporting.

Clause 3(ix)(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;

Modifications / Additional Requirement:

This is a new clause reporting requirement in CARO 2020.

Points for Consideration:

- i. Auditor needs to report whether the company has defaulted on the loans obtained by pledging the securities held by it in its subsidiaries, joint venture or associate companies. Auditor only needs to mentioned yes or no and not give details of default as the same is already provided in clause 3(ix)(a).

- ii. Reporting is required only for loans taken during the year irrespective of the fact whether the same has been repaid or outstanding at the year end. Further, loans taken in the earlier years and outstanding as at the balance sheet date need not be considered for the purpose of this clause.
- iii. Default would include both repayment of principal and interest as well.
- iv. Clause mentions pledging of securities of subsidiary, associate companies and joint venture. Security has not been defined by the Order. However, as per the definition of securities as per Companies Act, 2013 securities is not restricted to equity shares alone.

Conclusion

Amendment of CARO 2020 has brought in major changes, leading to a stringent and vigilant approach to Auditor's quality of reporting. Reporting in CARO 2020 is also more objective (quantitative reporting) than subjective (yes or no) as was required in CARO 2016. Management will be preparing itself for reporting in the financial statements for the additional requirements as per Schedule III amendment which are mirror reporting for few clauses added in CARO 2020. Since this is the first time of testing and examining of the additional and modified clauses, it would be efficient if auditor proactively shares the list of documents and additional details it would require to sign off the CARO 2020 reporting framework.

