Decoding the Changes in CARO, 2016 vis-à-vis CARO, 2015

The Ministry of Corporate Affairs had set-up a Committee on 16th September, 2015 to examine and recommend matters for inclusion in the statement to be attached with Auditor's Report under Section 143(11) of Act, 2013 for the financial year 2015-16 onwards. Accordingly, the draft Companies (Auditor's Report) Order, 2016 had been placed on the Ministry's website and was kept open for public comments. The Ministry notified the Draft Order with a few changes on 29th March, 2016 as CARO, 2016 which replaces the Existing CARO, 2015. CARO, 2016 is applicable for financial years commencing on or after 1st April, 2015. Implementation of new CARO, 2016 will make the reporting by auditors more meaningful for the stakeholders of the financial statements. These changes in the reporting by auditor were required, keeping in view the frauds that came up in India in the recent past. Reporting under CARO, 2016 will require auditor to be more alert & perform the procedures more diligently than before, as the reporting requirements are more specific & stringent than before. The author, in the article, has made an attempt to simplify the changes brought in by the CARO, 2016 in comparison to CARO, 2015. Read on to know more…

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As the Financial Year comes to an end, and the auditors are on their toes to complete the audits & issue their audit reports, MCA has come up with a amended Companies' (Auditor's Report) Order, 2016 to be followed for the financial year beginning on or after 1st April, 2015. The author believes

that this should be appreciated by the industry because, the new CARO 2016 is a step in the right direction, aimed at improving quality of auditors' reporting and increase relevance of the audit report to the stakeholders of the financial statements. These amendments are required by the economy keeping in view the increasing number of defaults being made by the companies be it in Repayment of Dues to banks or in payment of statutory dues.

The Changes

Changes in Applicability:

CARO, 2016 has excluded, the One Person Companies & Small Companies from its purview, i.e. CARO is not applicable to OPCs & Small Companies. In addition to that, the conditions to be satisfied by a private limited company, not being a subsidiary or holding of a public company, to remain out of the purview of CARO, 2016 have been relaxed, this can be better understood with the help of following table:-

Particulars	CARO 2015 (Amt. in INR)	CARO 2016 (Amt. in INR)
1. Paid up Capital & Reserves & Surplus	Not Exceeding 50 Lakhs	Not Exceeding 1 Crore
2. Total Borrowings from Banks or Financial Institutions	Not Exceeding 25 Lakhs	Not Exceeding 1 Crore
3. Total Revenue as per Schedule III	Not Exceeding 10 Crore	Not Exceeding 5 Crore

Changes in Matters to be included in Auditors' Report

Apart from the changes in applicability as explained above, there are numerous changes brought in relation to the matter that are required to be reported upon by the auditors in his auditors' report in respect CARO, 2016. The changes are brought in, to make the reporting more meaningful for the stakeholders of the financial statements. The author has classified the changes into three parts, viz, new reporting Requirements, Old Requirements which have undergone certain modifications & Deleted Requirements.

New Requirements

MCA has introduced eight new reporting requirements in the CARO, 2016, to make the reporting more exhaustive & meaningful for the stakeholders of the financial statements. A brief summary of each new point is as under:

1. **Fixed Assets:** MCA has added one additional reporting requirement in relation to fixed asset, i.e. *"Whether title deeds of immovable properties are held in the name of the company".*

   This new addition made by MCA has made the reporting more meaningful for the stakeholders of the financial statements, as in case there are any immovable properties, where the title is disputed or are not in the name of the company, will get reported in the auditors' report & make this information available to the stake holders.

2. **Loans & Investments:** MCA has added an additional reporting requirement in relation to Loans granted to entities covered under section 189 of the Companies Act, 2013, i.e. *"Whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest".*

   This reporting requirement, is not new for the industry, this requirement existed in CARO, 2003 as well. The purpose of this reporting is to inform the stakeholders that the loans given to the related parties are not prejudicial to the interest of the company. This makes our reporting meaningful in the sense, that the companies will be cautious while setting the terms for such loans & any malicious intentions will be brought into the knowledge of the stakeholders.

3. **Managerial Remuneration:** The auditors reporting under CARO are now required to report *"Whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with schedule V to the Companies Act".*

   This reporting keeps a check on the amount being paid by the companies as managerial remuneration and also ensures reporting of non-compliance of the provisions of Companies' Act in relation to managerial remuneration. MCA has took one step further and asked the auditor

to report, the steps taken by the management to recover the amount paid, if the amount paid is not approved in accordance to the provisions of the act.

4. **Nidhi Company:** There has been introduced a new reporting requirement specifically in respect of Nidhi companies, i.e. *"Whether the Nidhi Company has complied with the Net Owned Fund to Deposits in the ratio of 1: 20 to meet out the liability and whether the Nidhi Company is maintaining ten percent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability".*
The requirement of reporting the maintenance of Net Owned Fund (NOF) to Deposits ratio was also there in CARO, 2003 but somehow escaped CARO, 2015. This requirement aims to provide the information to the stakeholders of Nidhi companies, that whether the company is in a position to repay the liabilities as & when they arise.

5. **Related Party Transactions:** MCA has introduced a reporting requirement as to *"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 etc. as required by the applicable accounting standards."*
The introduction of this reporting requirement helps the auditor in reporting the non-compliance of the relevant sections of the Companies Act, & Accounting Standard 18 or Ind-AS 24, Related Party Disclosures. These non-compliances of Accounting Standard or the Act, often go unreported in the Auditors' report because their impact is usually not pervasive on the financial statements. Introduction of this requirement will strengthen the auditors' stand in respect of such transactions.

6. **Preferential Allotment/Private Placement:** A reporting requirement has been introduced that *"Whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to 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."
This requirement is not new in itself. It is rather a carried forward from the CARO, 2003, with the exception that CARO 2003 talked about confirming that the price at which such shares have been issued should not be prejudicial to the interest of the company, this reporting has not been included because the 2013 Act mandates u/s 62(1)(c)' obtaining valuation report for preferential allotment.
The main reason behind such reporting is to confirm whether the issue of shares or debentures by way of preferential allotment/ private placement is in compliance with law or not and to control the use of funds flowing in the company by such issue.

7. **Non-Cash Transactions:** The CARO, 2016 requires the auditor to report, *"Whether the company has entered into any non-cash transactions with directors or persons connected with him".*
The objective behind the introduction of this requirement is to empower the auditor to report the non-compliance with section 192 of the Companies Act, 2013, which provide certain conditions to be fulfilled before entering into non-cash transactions with directors and persons connected with them.

8. **Compliance with RBI Act, 1934:** MCA has come up with a new reporting requirement in relation to the Non-Banking Financial companies (NBFCs), i.e. *"Whether the company is required to be registered under section 45-I of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained".*

As per section 45IA of the RBI Act, NBFCs cannot commence or carry on the business of NBFC without obtaining certificate of registration and without having specified Net Owned Funds (NOF). The auditor needs to verify that the certificate of registration as NBFC under Section 45-I of the RBI Act is valid for the period under audit & if it is not so, the auditor is to report the same in his auditors' report.

Old Reporting Requirements which have Undergone Certain Modifications

In addition to introducing eight new reporting requirements as explained in comparison to CARO, 2015. MCA has also made some significant modifications in the existing reporting requirements to make them more useful for the stakeholders of the financial statements.

1. **Inventory:** In CARO, 2015, there were 3 points to be reported upon in relation to Inventory. This reporting requirement has been liberalised. Although CARO, 2016 contains only one point to be reported in relation to Inventory but the third point as per CARO, 2015 i.e. reporting whether any discrepancy were noticed in the physical verification & the manner of dealing with such discrepancy has been included in the first point itself.
   So, effectively, only the reporting in respect of procedure followed by the management in physical verification of inventory and whether those procedures are adequate in relation to the size & operation of the company has been done away with.

2. **Loans:** In the CARO, 2015, in case of reporting of loans granted to entities covered u/s 189 of the Companies Act, 2013, Limited Liability Partnerships were not covered explicitly whereas, CARO, 2016 has rectified that loophole.
   Under CARO, 2015, the reporting was restricted to whether the receipt of principal & interest of the loans granted are regular or not, whereas CARO, 2016 has gone a step forward and demanded the auditors to report that whether the schedule of repayment of loans has been stipulated or not. This reporting requirement has strengthened the auditors in the cases, where various companies grant loans to the related entities and don't stipulate the repayment schedule in the agreement.
   In addition to this, MCA has also removed the minimum monetary limit of Rupees One Lakh, for the overdue amount to be reported under CARO, 2016 & specifically added that any amount overdue for more than 90 days needs to be reported in the auditors' report, whereas in CARO, 2015, the period for which the loan should be overdue to be eligible to be reported was left to the judgement of the auditor.

3. **Cost Records:** There is a minor change in reporting in relation to maintenance of cost records, i.e. now, the auditor is also required to report whether the maintenance of cost records u/s 148(1) has been specified by Central Government in relation to the company being audited.

4. **Statutory Dues:** There has been no significant change in reporting under this clause, the reference to Wealth Tax & Cess has been removed from this, making them out of scope of reporting under this clause.
   Although, the change has been brought because of abolishment of Wealth Tax by the Finance Act, 2015. In view of the author, this change, unintentionally removed from scope the existing demands of Wealth tax & Cess which are in dispute & the case is pending for decision. This point needs to be reviewed.

5. **Repayment of Dues:** CARO, 2016 has included in this point, default is repayment of amount due to Government.
   In addition to this, MCA has strengthened the reporting under this clause, by specifically providing for reporting lender wise details in case of dues to Banks, Financial Institutions & Government. This will enable the Banks & Financial Institutions to verify that whether the reporting done by the auditor or in other words the information & explanation provided to the auditor by the company is true or not. On the other hand, auditor needs to be more stringent while reporting under this clause, as his report can be easily challenged by Banks, FIs & even Government, in case of incorrect reporting.

Also, the point in relation to reporting whether the amount required to be transferred to the Investor Education & Protection Fund (IEPF) as per the Companies Act has been transferred or not is done away with. The rationale behind deleting this point is that, the same is required to be reported as per Rule 11 of Companies (Audit and Auditors) Rule, 2014.

6. **Application of funds raised:** The scope of reporting under this point has been broadened by CARO, 2016 to include money raised by way of Initial & Further Public Offers.
The reporting has been made more exhaustive by making it mandatory to report the delay or default in application of the money so raised and subsequent rectification of such applications. This clause will help the banks & other lenders to verify that whether the money raised from them is utilised for the said purpose in its entirety or the same has been used for some other purpose during the year but rectified at the end of the year to defeat the purpose of the law.

7. **Fraud:** The reporting in relation to frauds on the company has been restricted by CARO, 2016 to cover only frauds by its officers or employees.
Such restriction, though has reduced the work of the auditor but has simultaneously made the reporting more liberal as now, reporting of frauds on the company by outside parties is not mandatory to report as per CARO, 2016 though the same is mandatory to be reported as per Companies Act, 2013.

Requirements that Have been Deleted in Comparison to CARO, 2015

MCA has deleted 4 points to be reported upon, in comparison to CARO, 2015, a brief description of the points so deleted is as under:

1. **Internal Control System:** In CARO, 2015, auditor was to report whether the internal control system for purchase of inventory, fixed assets & for sale of goods & services is commensurate with the size of the company and the nature of its business, this reporting requirement has been done away with in CARO, 2016.
In the author's view, the rationale behind removing such reporting requirement is, since

w.e.f the financial year, 2015-2016, the auditors are required to report on the Internal Control over Financial Reporting of the companies, which is a much broader concept than Internal Control & cover Internal Control too, this reporting is made redundant.

2. **Extent of Accumulated losses:** The reporting requirement regarding accumulated losses exceeding fifty percent of its net worth & incurring cash losses by the company, in case of companies incorporated for not less than five years has been done away with in CARO, 2016.

3. **Guarantee by the Company:** The reporting requirement in relation to the guarantees given by the company for the loans taken by others, where the terms & conditions are prejudicial to the interest of the company is also deleted by MCA.

Conclusion

A broader analysis of the amendments brought in by the CARO, 2016 makes it clear that MCA desires to strengthen the auditors to report the non-compliances with the provisions of law by the companies & it has not restricted its scope to the Companies Act but has also covered RBI Act, Accounting Standards & other Statues, which depicts MCA's focus on good Corporate Governance.

References: *The Gazette of India, Dated 29th March, 2016 for CARO,2016 &*
The Gazette of India, Dated 10th April, 2015 for CARO, 2015. ■