

Salient Features of ICAI Guidance Note on Companies (Auditor's Report) Order 2016



The Ministry of Corporate Affairs issued the Companies (Auditor's Report) Order, 2016 (CARO 2016) vide Order dated 29th March 2016. CARO 2016 replaces the existing CARO 2015 and is applicable for the audits of financial year 2015-16 and onwards. CARO 2016 has made several significant changes and has introduced many new reporting requirements vis-à-vis CARO 2015. ICAI felt an urgent need to provide appropriate guidance to the members on CARO 2016 so that members can discharge their reporting responsibilities under the Order effectively and efficiently. The ICAI has issued the Guidance Note on CARO 2016 on April 23, 2016 for the benefit of the members. This Article provides an insight into the salient features of the Guidance Note on CARO 2016 issued by ICAI.

Overview of CARO 2016

CARO 2016 has been issued under the Section 143(11) of the Companies Act, 2013. It supersedes the existing CARO 2015 issued in April 2015. It is applicable for financial years commencing on

or after April 1, 2015, i.e., it is applicable for the audits of financial year 2015-16 and onwards. It has total 16 clauses compared to 12 clauses in CARO 2015. It applies to all companies including foreign companies except certain categories of companies, e.g., banking companies, insurance companies, Section 8 companies, one person companies and small companies, private limited companies

(Contributed by Auditing and Assurance Standards Board of ICAI. Comments can be sent at aasb@icai.in.)

which satisfy the conditions specified in the Order. CARO 2016 specifically provides that it does not apply to the auditor's report on consolidated financial statements. Another significant change made by CARO 2016 is that it requires reporting on only those matters which are applicable to the company. CARO 2016 has made certain changes regarding its applicability to private limited companies. First of all, a condition for exemption has been added that the private limited company should not be a subsidiary or holding company of a public company. Secondly, the threshold limits regarding the Paid up Capital and Reserves, Total Borrowings and Total Revenue have been raised as shown in the table given below:

S. N.	Criteria	Limit in CARO 2015 (In ₹)	Limit in CARO 2016 (In ₹)
1	Paid up Capital and Reserves and Surplus	50 lakh	1 Crore
2	Total Borrowings	25 lakh	1 Crore
3	Total Revenue	5 Crore	10 Crore

Changes Made By CARO 2016 Regarding the Matters To Be Included In The Auditor's Report

CARO 2016 has made several significant changes and has introduced many new reporting requirements vis-à-vis CARO 2015 in respect of the matters which are required to be included in the auditor's report. It has also omitted some of the reporting requirements covered in CARO 2015. These changes are aimed to make the reporting more relevant and useful for the users of the audited financial statements of companies. The major changes made by CARO 2016 are discussed below:

I. New Requirements Added By CARO 2016

CARO 2016 has added seven new clauses relating to:

- (1) Compliance with Sections 185 and 186 in case of loans, investments, guarantees and security.
- (2) Payment of Managerial Remuneration in accordance with applicable provisions of the Act and Rules.
- (3) Nidhi Companies- compliance with Net Owned Funds to Deposits requirements.
- (4) Compliance with Sections 177 and 188 in case of transactions with related parties.
- (5) Preferential allotment or private placement of

The contents of the Guidance Note can be divided into four Sections. Section 1 includes 'Opening Guidance,' Section 2 is about 'Matters to be included in the Auditor's Report', Section 3 includes 'Form of Report and Board's Report' and Section 4 includes Appendices.

- shares/debentures– Compliance with Section 42 and end use of funds raised.
- (6) Compliance with Section 192 in case of non-cash transactions with directors or persons connected with him.
 - (7) Requirement to obtain registration under section 45-IA of the RBI Act, 1934.

CARO 2016 has also added a new sub-clause relating to "Title deeds of immovable properties" under the clause "Fixed Asset" and a new sub-clause relating to "whether the terms and conditions of grant of such loans are not prejudicial to the company's interest" under the clause "Loans granted to parties".

II. Requirements Omitted By CARO 2016

CARO 2016 has omitted three clauses relating to:

- (1) Adequate internal control system for the purchase of inventory and fixed assets and for the sale of goods and services.
- (2) Accumulated losses not less than fifty per cent of the net worth of company.
- (3) Guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company.

CARO 2016 has also omitted the sub-clause relating to "Procedures of physical verification of inventory" under the clause "Inventories" and the sub-clause relating to "Amount required to be transferred to investor education and protection fund" under the clause "Statutory Dues".

III. Requirements Changed By CARO 2016

In addition to introducing some new requirements and omitting some existing requirements, CARO 2016 has also made some changes in the existing requirements. Important changes made are as follows:

- The reporting requirement on 'maintaining proper records of inventory' has been removed under the clause "Inventory".

- ‘Limited Liability Partnerships’ have been included in the list of parties under the clause “Loans granted to Parties”. Further, this clause now requires reporting of any amount overdue for more than 90 days. Earlier monetary limit of ₹1 Lakh given in CARO 2015 has been removed.
- ‘Wealth tax’ has been removed from the list of taxes under the clause “Regularity in depositing Statutory Dues”.
- ‘Government’ has been included in the list of parties under the clause “Defaults in repayment of loans, borrowings, dues”. Further, this clause now requires lender wise reporting in case of defaults to banks, financial institutions and Government.
- Funds raised by way of ‘Initial Public Offer (IPO)’ and ‘Further Public Offer (FPO)’ have been included under the clause “End Use of funds raised”. So now this clause will cover IPO, FPO and term loans.
- Under the clause ‘Fraud by or on the Company’, the reporting requirement in case of ‘fraud on the company’ has been limited to cover fraud by its officers or employees only. Earlier, the requirement in CARO 2015 covered all frauds on the company whether committed by third parties.

Salient Features of the Guidance Note on CARO 2016

The Guidance Note supersedes the Statement on CARO 2003 issued by ICAI for audits of financial statements for the periods beginning on or after April 1, 2015. The Guidance Note contains detailed guidance on the requirements of each of the 16 Clauses covered by CARO 2016 and the various issues and intricacies involved therein. Guidance on each Clause of CARO 2016 has been covered by a separate paragraph in the Guidance Note for easy reference. Guidance on each Clause of

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CARO 2016 has been divided into two distinct parts namely (1) Relevant Provisions and (2) Audit Procedures and Reporting, for better readability and understanding. The “*Relevant Provisions*” part covers the requirements of particular clause and explains what is expected from the auditor under the clause. The “*Audit Procedures and Reporting*” part covers the audit guidance e.g. audit considerations, relevant audit procedures to be performed by the auditors. This part also provides the suggested reporting format, wherever applicable. The Guidance Note includes Illustrative Checklist on all the clauses of CARO 2016. The relevant provisions of the Companies Act, 2013 and the Rules thereunder, as also the text of the Sections of other Acts referred in CARO 2016, have been given in the Appendices of the Guidance Note to make the Guidance Note self-contained reference document for the members. The Guidance Note has taken into account the various pronouncements of ICAI e.g. Standards on Auditing, Accounting Standards, Indian Accounting Standards (Ind AS), Guidance Notes on Accounting as well as Auditing Aspects etc. and the relevant guidance covered in these ICAI’s pronouncements has been included in the Guidance Note at appropriate places. There are a number of terms used in CARO 2016 which have not been defined or explained in the Companies Act, 2013 and the Rules thereunder e.g. immovable properties, title deeds, prejudicial to the company’s interest, Government, non-cash transactions, persons connected with director etc. For better understanding of the requirements of the Order, efforts have been made to explain/clarify those terms by taking appropriate references from the ICAI’s pronouncements, Other laws, dictionary meaning etc.

Aspects Covered By the Guidance Note on CARO 2016

The contents of the Guidance Note can be divided into the following four Sections:

- Section 1– Opening Guidance (Paragraphs 1 to 32 of the Guidance Note).
- Section 2– Matters to be included in the Auditor’s Report (Paragraphs 33 to 52 of the Guidance Note).
- Section 3– Form of Report and Board’s Report (Paragraphs 53 to 67 of the Guidance Note).
- Section 4– Appendices.

The paragraphs below provide a brief description of the aspects covered by these Sections:

Section 1: Opening Guidance

This Section covers the aspects regarding issuance of CARO 2016, purpose of the Guidance Note, Status and relationship of the Order vis-à-vis main audit report under Section 143 of the Act, Applicability of the Order, Companies covered by the Order, Companies not covered by the Order, Guidance/Clarification on various terms for ascertaining applicability of the Order (e.g. Private limited company, Paid up capital and reserves and surplus, Borrowings, Financial institution, Revenue), Period of Compliance, Nature of reporting under the Order, Interaction with management, Applicability of Standards on Auditing issued by ICAI, Concept of audit materiality while reporting under the Order, Concept of professional judgement, Documentation requirements etc.

Section 2: Matters to Be Included In the Auditor's Report

This Section provides detailed guidance on the following reporting requirements of CARO 2016:

- o Fixed Assets.
- o Inventories.
- o Loans granted to Parties covered in the register maintained under Section 189.
- o Compliance with Sections 185 and 186 in case of Loans, Investments, Guarantees and Security.
- o Acceptance of Deposits.
- o Maintenance of Cost Records.
- o Regularity in depositing Statutory Dues.
- o Defaults in repayment of loans/borrowings/dues to Financial Institution, Bank, Government or Debenture holders.
- o End use of moneys raised through IPO/ FPO/ term loans.
- o Frauds by the company or on the company by its officers/employees.
- o Payment of Managerial Remuneration in accordance with applicable provisions of the Act and Rules.
- o Nidhi Company– compliance with Net Owned Funds to Deposits requirements.
- o Compliance with Sections 177 and 188 in case of transactions with Related Parties.
- o Preferential allotment or private placement of shares/ debentures– compliance with Section 42 and end use of funds raised.



- o In case of Non-cash transactions with directors or persons connected with directors- Compliance with Section 192.
- o Requirement to obtain registration under Section 45-IA of RBI Act, 1934

Section 3: Form Of Report and Board's Report

This Section contains detailed guidance on various aspects of reporting by auditors under CARO 2016. It covers the aspects regarding Manner of reporting on clauses, Inclusion of management's explanations in reporting, Reporting in case of unfavourable/adverse comments, Impact of unfavourable comments under CARO on the main audit report under Section 143 of the Act, Impact of unfavourable comments both under the CARO as well as under the main audit report under Section 143 of the Act, reporting in situations where the auditor's answer to questions is unfavourable or qualified, reporting in situations where the auditor is unable to express any opinion on any specified matter.

Section 4: Appendices

This Section covers the following aspects:

- Text of CARO 2016.
- Comparison of requirements of CARO 2016 vis-à-vis CARO 2015.
- Illustrative Checklist on all the clauses of CARO 2016.
- Text of various Sections of the Companies Act, 2013 and Related Rules which are referred in CARO 2016.
- Text of Sections of Other Acts referred in CARO 2016.

Complete guidance note has been hosted on the ICAI website www.icaai.org. ■

Corrigendum

In the article on CARO 2016 published on page 113 of May 2016 issue, in Point 3 of the table under the sub-head 'The Changes', Please read the amount of turnover for applicability of CARO, 2015 as 5 crore instead of 10 crore and in CARO 2016, as 10 crore instead of 5 crore. The typographical error is regretted.