THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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INDEX

CARO 2020 AND CHANGES IN MAIN AUDIT REPORT

- HEMAL SHAH

New reporting requirements

I. Auditors reporting under 2013 Act (applicable for audit periods beginning April 1, 2021)

Reporting on legal and regulatory Matters

	Main Audit Report	
Existing requirements	True and Fair view of financial statements	Other legal and Regulatory Matters such as books of accounts, adverse effect on functioning of company New requirements introduced: ◉ Funding transactions ◉ Compliance with dividend norms ◉ Audit trail – applicable for audit periods beginning April 1, 2023 (deferred from 2021-22 to 2022-23 by amendment rules dated 31.3.22) Existing: 12 New*: 5 Total: 17 *Including sub clauses
Amendments	No change	
Reporting framework/ guidance	Standards on Auditing e.g. SA 700, SA 701, 705, SA 706, SA 720	Guidance Note on adverse effect on functioning of company and maintenance of books and account

<table>
<tr><th></th><th colspan="2">Annexures to Audit Report</th></tr>
<tr><td>Existing requirements</td><td>Internal Financial Controls</td><td>CARO 2016
CARO 2020 substitutes existing requirements under CARO 2016<table><tr><td>New requirements introduced*</td><td>28</td></tr><tr><td>Existing requirements modified*</td><td>15</td></tr><tr><td>Existing requirements carried forwarded*</td><td>8</td></tr><tr><td>Existing requirements deleted*</td><td>(1)</td></tr><tr><td>Total</td><td>50</td></tr></table></td></tr>
<tr><td>Amendments</td><td colspan="2">No change</td></tr>
<tr><td>Reporting framework/ guidance</td><td>Guidance Note on ICFR</td><td>Significant changes to Sch III to align with CARO 2020 and new auditors reporting requirements – 10 specific disclosures added

Guidance Note on CARO 2020</td></tr>
</table>

II. <u>Contents of legal and regulatory section of the audit report</u>

As required by section 143 (3) of the Act, we report on following…..

a. Sought and obtained all information and explanations which were necessary for the audit
b. Proper books of account as required by law have been kept
c. Dealing with report on the accounts of branch office audited by other auditor (if applicable)
d. Balance sheet and profit and loss are in agreement with the books of account and returns
e. Financial statements comply with the accounting standards
f. Observations/ comments of the auditors which may have adverse effect on functioning of company (if applicable)
g. Directors disqualification
h. Qualification, reservation or adverse remark relating to maintenance of accounts and other

connected matters (If applicable)

i. Reporting on IFC (if applicable)

j. Reporting on managerial remuneration (pursuant to Section 197)

k. Rule 11 - **Other Matters to be Included in Auditors Report**

    a. Impact of pending litigations on financial position

    b. Required provision for material foreseeable losses on long term contracts including derivative contracts

    c. Delay in transferring amounts to IEPF

    d. Reporting on transactions to benefit the ultimate beneficiary

    e. Compliance with dividend norms

    f. Audit trail (from FY April 1, 2023 onwards)

III. Date of applicability of new auditor reporting requirements

What is the date of applicability of the reporting requirements relating to funding transactions and dividend?

Points for consideration

¤ Notified from April 1, 2021 – Not linked with any FY

¤ Schedule III amended to introduce disclosure for funding transactions – and are applicable from April 1, 2021 onwards

¤ Harmonious reading suggests that these reporting requirements are effective from **FY beginning on or after April 1, 2021**

¤ **General Instructions for preparation of Balance Sheet**

  ◊ Financial Statements shall contain the corresponding amounts (comparatives) for the immediately preceding reporting period **for all items shown in the Financial Statements including Notes** except in the case of first Financial Statements laid before the company after incorporation.

¤ Reporting on comparative information (FY 2020-2021) – as required to be disclosed as per Schedule III. Refer SA 710, Comparative Information - Corresponding Figures and Comparative Financial Statements:

- Corresponding figures approach
- Auditor's responsibility to obtain sufficient appropriate audit evidence about whether the comparative information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting framework;

IV. Transactions covered

What are the types of funding transactions that are covered in these reporting obligations?

Points for consideration

- Seems to involve following steps as illustrated below:

Step 1 :
Company A borrows INR 100 crores from bank in November 2021

→

Step 2 :
On December 2021 Company A invests INR 10 crores in equity shares of Company B (Intermediary) with an understanding that Company B would provide loan to Company C (Ultimate Beneficiary)

→

Step 3 :
Company B (ie. Intermediary) provides loan of INR 5 crores to Company C (i.e Ultimate Beneficiary) in January 2022

Key principles:

- ► Covers loans/ advances in the nature of loan - Normal business transactions e.g. supplier advance would not be covered
- ► Ultimate beneficiary must have been identified at the inception itself
- ► An understanding with the intermediary that it would transfer funds to the ultimate beneficiary should exist
- ► Time gap between the receipt of funds by the intermediary and transfer of funds to the ultimate beneficiary not relevant

- Schedule III requires management to provide necessary disclosures for transaction with 'ultimate beneficiaries' including that relevant provisions of the FEMA and Companies Act has been complied and the transactions are not violative of PMLA
- Auditor to comment that:
- Management representation has been obtained that (other than disclosures in the financial statements):

- No funds have been advanced/ loaned/ invested to 'Intermediaries' OR
- No funds have been received from 'Funding Parties'
- With an understanding that 'Intermediaries'/ 'Funding Parties' would lend/ invest/ provide guarantee/ security to 'Ultimate Beneficiaries'
- Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the Management representation (as above) is not materially misstated
- Understanding to lend/ invest/ provide guarantee/ security to 'Ultimate Beneficiaries' may be
- Explicit (evidenced through contractual agreements) or
- Tacit (verbal understanding) – significant level of judgement involved

V. Declaration or Payment of Dividend

Whether the auditors reporting obligation regarding compliance with section 123 apply to declaration or payment of interim dividend?

Points for consideration

- Under section 2(35) of the 2013 Act - dividend includes interim dividend. Accordingly, reporting obligation covers interim dividend

Whether the company is required to comply with the provisions of Companies (Declaration and Payment of Dividend) Rules, 2014 in case of declaration of dividend out of surplus of profit and loss account?

Points for consideration

- Dividend Rules prescribes certain restriction in the amount of dividend:
- If the company has incurred loss / has inadequate profits and the Company proposes to declare dividend out of free reserves
- Compliance with Dividend Rules required when dividend is declared out of previous years profits that has been 'transferred' to free reserves
- Free reserves relates to portions of earnings, etc which have been appropriated for general/ specific purpose
- Surplus of profit and loss refers to carry forward balance in Statement of Profit and Loss and do not represent amounts which have been 'transferred' to reserves.
- Schedule III to the 2013 Act includes a heading of 'Reserves and Surplus' thereby indicating a

distinction between a Reserve and Surplus

- Declaration of Dividend out of Surplus of Profit and Loss account will not tantamount to declaration of dividend out of reserves
- Reference should also be made to Secretarial Standard – 3 on Dividend and Guidance Note on Dividend issued by ICSI.

VI. Audit trail

Whether the company, in respect of financial years commencing on or after the April, 1, 2023, has:

- Used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and
- The same has been operated throughout the year for all transactions recorded in the software and
- The audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention

Points for consideration

- Management responsible to prepare and keep books of account (including books of account in electronic mode) which give a true and fair view of the state of the affairs of the company
- Rule 3 of the Accounts Rules amended to provide that every company which uses accounting software for maintaining its books of account, shall use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled
- Auditors reporting obligation applies to all companies – to the extent books of account are maintained electronically
- Transactions prior to April 1, 2023 are not required to be assessed by the auditor while reporting under this clause
- Intent seems to avoid fabrication of books through overwriting the books of accounts. Audit trails expected to easily track what changes have been made to the accounts and would require the company to explain the reasons thereof

Auditor to verify that the feature of recording audit trail facility has operated throughout the year. Auditor to modify the report - where the feature of audit trail has not operated throughout the year

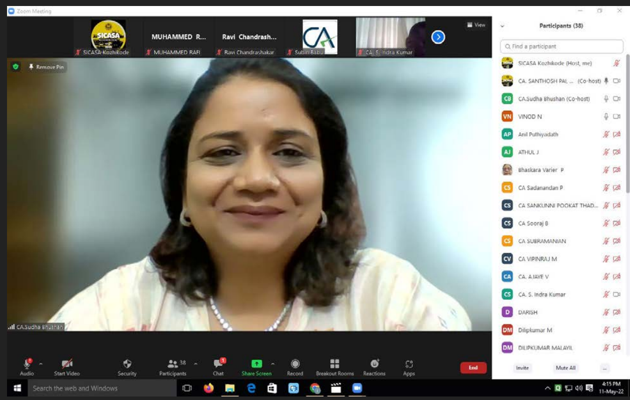
VII. Applicability for all companies

Whether auditors of all companies would need to report on the new reporting obligations?

Points for consideration

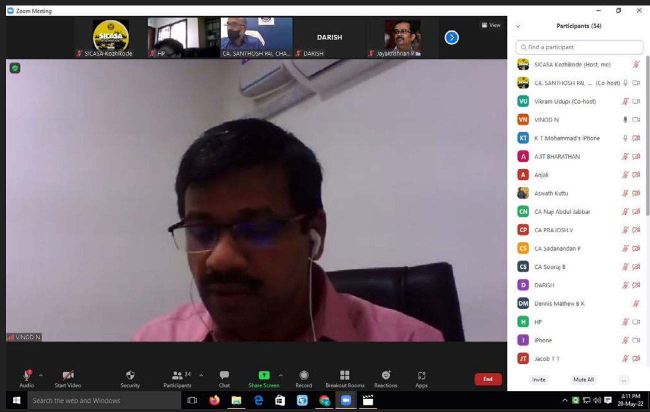
- Applies to auditors of:
- All class of companies (including section 8 companies)
- Foreign companies e.g. liaison office as defined under 2013 Act. Reference may be made to Rule 5(2) of Registration of Foreign Companies Rules:
- The provisions of Chapter X i.e. Audit and Auditors and rules made there under, as far as applicable, shall apply, mutatis mutandis, to the foreign company
- Applies to standalone and consolidated financial statements
- Consolidated financial statements may include certain group entities which are either not companies under the 2013 Act (e.g. LLP) or are incorporated outside India
- Auditors of such entities are not required to comply with these requirements – as provisions of 2013 Act does not apply to them
- In such case Group auditor to state that the comment has been made after considering only those entities on which provisions of 2013 Act apply at standalone level

ACTIVITIES - MAY, 2022



**VCM on FEMA Provisions and related Income Tax provisions for NRI Taxation
Speaker - CA. Sudha Bhushan, Mumbai. - 11.05.2022**

Seminar on Accounting Standards for Non Corporate Entities and Overview of changes in Accounting Standards. Speaker - CA. Vinod Balachandran - 14.05.2022



Virtual CPE Meeting on Practical Aspects of Internal Audit
Speaker - CA. Vikram, Bangalore - 20.05.2022

Seminar on Amendments u/s 80G of Income Tax Act, 1961
Speaker - CA. G Santhosh Pai, Chairman, Kozhikode Branch of SIRC of ICAI - 25.05.2022

Upcoming Programmes - June, 2022

June

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Virtual CPE Meeting
Topic - Important Case Laws Relating to ITC in GST
Speakers -CA. Prithive R., Chennai
CA. Prashanth C., Chennai

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Virtual CPE Meeting
Topic - Interpretation of Statutes
Speaker - CA. Indazar Nazar, Calicut

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VCM
Topic - Ethical Behaviour and Professional Enhancement
Speaker - CA. Parag Raval

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International Yoga Day Celebration

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Branch Formation Day 2022
CPE Seminar on Small and Medium Practice
Speaker - CA.Dayaniwas Sharma, Central Council Member, ICAI
Guests of Honour - CA. Satheesan P, SICASA Chairman, SIRC
CA. Jose Pottokarn, Central Council Member, ICAI

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Seminar on MSME Sector

Contributions to e-newsletter

Contributions in the form of articles, poems, jokes, travelogues etc. are invited from members for consideration in the monthly e-Newsletter. Interested members may email their contribution to *icaikoznewsletter@gmail.com* along with name, membership number and mobile number.


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