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2 September 2020

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01

Series of knowledge sharing calls



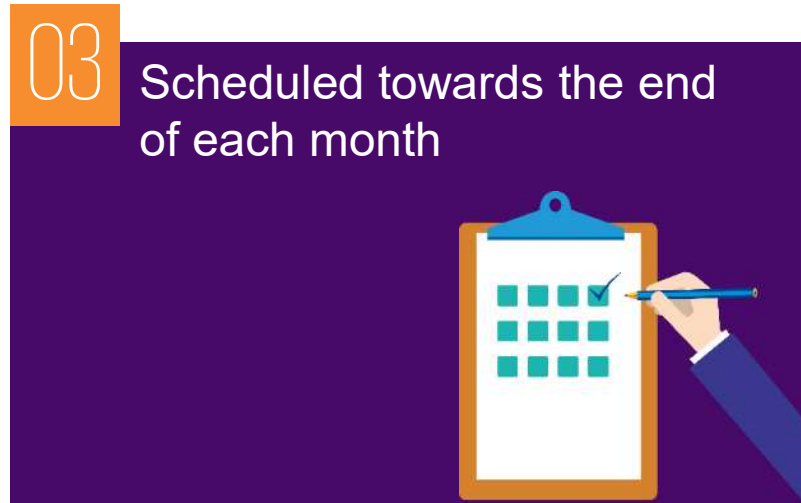
02

Covering current and emerging reporting issues



03

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04

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Speaker for the webinar



Ruchi Rastogi

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CARO 2020: An overview



Overview of CARO 2020



The Ministry of Corporate Affairs (MCA) issued Companies (Auditor's Report) Order, 2020 (CARO 2020) applicable for each report issued by auditors of specified class of companies under Section 143 of the Companies Act 2013 (2013 Act) for financial year commencing on or after 1 April 2020.

No change in applicability requirements as compared to CARO 2016 other than requirements of reporting on Consolidated Financial Statements (CFS).

In case there are any qualifications or adverse remarks by the auditors of companies included in CFS, then principal auditor is required to include reference to such remarks in CARO to CFS.

CARO 2020 includes several new clauses and has revised certain existing clauses of CARO 2016. The new CARO has increased the reporting requirements for auditors and put greater onus on companies to share information with the auditors and users of the financial statements.

The Institute of Chartered Accountants of India (ICAI) issued Guidance Note on CARO 2020 on 1 July 2020 to provide guidance relating to reporting requirements under CARO 2020.

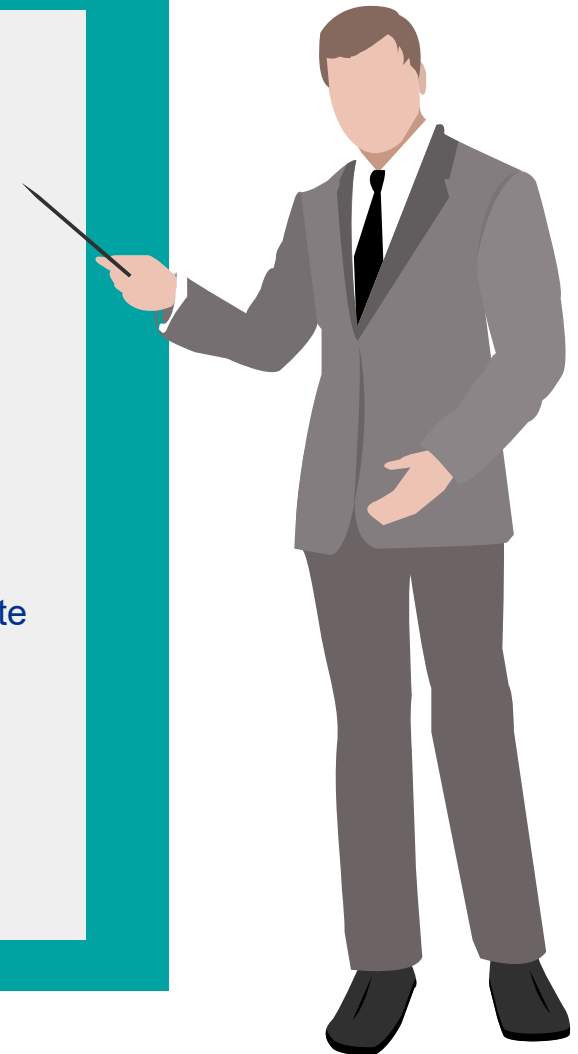


Companies exempted under CARO 2020



Auditors of following class of companies are exempted to comment on matters prescribed under the CARO 2020:

- Banking company as defined under Section 5(c) of the Banking Regulation Act, 1949
- Insurance company as defined under the Insurance Act, 1938
- Companies incorporated with charitable objects, etc. i.e. companies licensed to operate under Section 8 of the 2013 Act
- One person company as defined under Section 2(62) of the 2013 Act
- Small company as defined under Section 2(85) of the 2013 Act
- Private company, not being a subsidiary or holding company of a public company having:
 - Paid-up capital and reserves and surplus not more than INR1 crore as on the balance sheet date
 - Total borrowings not more than INR1 crore from any bank or financial institution at any point of time during the financial year, and
 - Total revenue (including revenue from discontinuing operations) upto INR10 crore during the financial year as per the financial statements (revenue as disclosed in Schedule III to the 2013 Act).



CARO 2020 reporting requirements



Property, Plant and Equipment



Modified clause

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 (PPE)**
- B. **Whether the company is maintaining proper records showing full particulars of Intangible assets.**

Clause 3(i)(b)

Whether these **PPE** 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.



Key considerations

- The clause changes the terminology from fixed assets to PPE – to align with Ind AS and AS.
- The clause incorporates details regarding intangible assets.
- This clause requires a company to maintain and require periodic verification of PPE and intangible assets register to ensure proper documentation of PPE and intangible assets. Asset register to include:
 - Details of items self-financed or assets on lease
 - Details of PPE that have been fully depreciated or have been retired from active use and held for disposal
 - Details of PPE that have been fully impaired during the period
 - Bifurcation between self-generated intangible assets and acquired intangible assets
 - Details of investment property and assets held for sale.

Property, Plant and Equipment (cont.)



Modified clause

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 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) |
|-------------------------|----------------------|-----------------|--|---|--|
|-------------------------|----------------------|-----------------|--|---|--|

Key considerations

- This clause requires disclosure of all immovable properties that are not held in the name of the company (in specified format).
- A reconciliation of title deeds with PPE register is required.
- The clause also requires disclosure when any immovable property is held in the name of a promoter, director, their relative or employee.

Property, Plant and Equipment (cont.)



Clause 3(i)(d)

New clause

Whether the company has revalued its PPE (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 per cent or more in the aggregate of the net carrying value of each class of PPE or intangible assets.



Key considerations

- Consider requirements of AS 10 and Ind AS 16 - that if a single item of PPE is revalued, then the entire class of PPE to which that item belongs should be revalued.
- The clause requires disclosure if change due to revaluation is 10 per cent or more in the aggregate of the net carrying value of each class of PPE or intangible asset.

AS 10 – Property, Plant and Equipment

Ind AS 16 - Property, Plant and Equipment

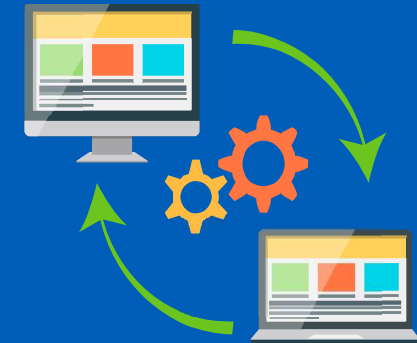
Property, Plant and Equipment (cont.)



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.

New clause



Key considerations

- The clause requires appropriate disclosure in the financial statements when any proceeding is initiated or is pending regarding benami property
- The disclosure would include:
 - Nature of property
 - Carrying value of the property in the books of account
 - Status of proceedings before the relevant authority
 - Consequential impact on the financial statements and/or the liability that may arise in case the proceedings are decided against the company.
- In case proceeding are initiated post balance sheet date but before the signing of the auditor's report, the auditor would be required to report in case such proceeding relates to a property owned by the company as on the balance sheet date.

Inventory and working capital facilities



Modified clause

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 per cent 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.
- b) Whether during any point of time of the year, the company has been sanctioned working capital limits in excess of INR5 crore, 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.

New clause



Key considerations

- Discrepancy to be evaluated on the basis of total value of inventory and not quantity.
- 10 per cent threshold for reporting to be applied on net basis after adjusting excesses and shortages within the class of an inventory and based on value for each class of inventory.
- For determining qualifying threshold of INR5 crore, companies to consider:
 - Sanctioned limit of loan and not utilisation of loan
 - Balance outstanding for **any day** during the year and not at year end
 - Limits of all banks and financial institutions in aggregate (limits sanctioned without security of current assets excluded)
 - Credit facilities reckoned should be both fund-based and non-fund based.
- Comparison of books of account with quarterly returns and statements.

Investments, guarantees, securities, loans and advances



Clause 3(iii)(a)

Whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate:

- 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.

New clause



Key considerations

- Loans include long-term and short-term loans, whether given in cash or in kind to any party(ies), and includes loans squared up during the year.
- Whether an advance is in the nature of loan would depend upon the circumstances of each case.
- Information to be reported in respect of all parties and all kinds of loans.
- Companies would be required to maintain a register for loans or advances in the nature of loans, or guarantee, or security to all the parties to facilitate reporting under this clause.
- Subsidiary/associate/joint venture should be identified as per the definition under the 2013 Act.

Investments, guarantees, securities, loans and advances (cont.)



Modified clause

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.



Key considerations

- Need to evaluate terms and conditions of all:
 - Loans including long term or short term loans or given in cash or kind
 - Advances in the nature of loans
 - Guarantee/security
 - Investments made.
- The clause requires critical evaluation of advances to determine advances in nature of loans.
- Companies would be required to justify loans/guarantees are not prejudicial to the interest of the company (e.g. loans given at zero per cent interest).
- Reporting requirement under this clause is applicable to all companies, including companies engaged in the financing business.

Investments, guarantees, securities, loans and advances (cont.)



Clause 3(iii) (c)

Modified clause

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.

Clause 3(iii) (d)

The amount is overdue, state the total amount overdue for more than 90 days, and whether reasonable steps have been taken by the company for recovery of the principal and interest.



Key considerations

- The clause includes all loans and advances in nature of loans granted during the year to any party and also all loans and advances in nature of loans having opening balances
- The term 'regular' means that the principal and interest should normally be received whenever they fall due, respectively.
- Whether reasonable steps have been taken by the company for recovery of principal and interest would depend on facts and circumstances of each case, including the amounts involved. For example, issue of reminders, an advocate's/solicitor's notice, obtaining enhanced security, etc.
- Management of a company would need to provide the steps taken to recover the principal and interest in writing.

Investments, guarantees, securities, loans and advances (cont.)



New 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 overdues 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].



Key considerations

- The clause requires identification of instances of 'ever-greening'¹.
- The clause is not restricted to 'overdue' loans but also extends to situations where fresh loans are given close to settlement date.
- The clause also includes loans falling due on balance sheet date and that are renewed/extended/settled post balance sheet date but before date of audit report.

¹ ICAI guidance note defines ever-greening as an attempt to mask loan default by giving new loans to help delinquent borrowers repay principal or pay interest on old loans.

Investments, guarantees, securities, loans and advances (cont.)



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 Section 2(76) of the 2013 Act.

New clause



Key considerations

- Report the gross amount of loans or advances in the nature of loans that are granted to promoters or related parties which:
 - Are repayable on demand, or
 - Without specifying any terms or period of repayment.

Default in repayment of loans



Clause 3(ix)(a)

Modified clause

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. | | | | |

Key considerations

- Default in relation to this clause means non-payment of dues to lenders on the last dates specified in loan documents or debentures trust deed, as the case may be.
- New format includes reporting requirement relating to debt securities and information to be provided lender-wise.
- The clause covers defaults in payment of loans or other borrowings (including principal and interest) to any lender.
- The clause also covers rescheduled/restructured loans, disputed loans and loans and borrowings on demand.
- Period upto the audit report for reporting delay in number of days and amount that remains unpaid is to be considered.

Wilful defaulter



Clause 3(ix)(b)

New clause

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



Key considerations

- Whether a company has been declared as a wilful defaulter or has been issued a show-cause notice by any lender, bank, financial institution or government as per the procedure specified by RBI* (including such bank, financial institution or other lender which has not lent to the company)
- Information on willful defaulters can be obtained from 'credit information companies' and website of RBI and of lender banks/financial institutions and information available in public domain.
- The guidance note limits the scope of 'other lender' to government/government authorities
- Information at the balance sheet date and on the date of the audit report would be considered.

*RBI – Reserve Bank of India

Diversion of loans



Clause 3(ix)(c)

New clause

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.



Key considerations

- Term loans obtained from entities or persons other than banks and financial institutions would be considered for this clause.
- Diversion would be examined as per the instances defined in the RBI circular and whether the company has granted loans to other parties, including related parties or invested in other companies.
- In case a term loan has not been utilised for the purpose for which it is raised, then an auditor would report the amount of loan diverted and the purpose for which it is used.
- Establishing a one-to-one relationship with the amount of term loan and its utilisation is not necessary. Company may have a common account for different projects from which subsequent utilisation is made.
- General purpose term loans would also be evaluated from the perspective of diversion of funds.

Short-term funds used for long-term purposes



Clause 3(ix)(d)

New clause

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



Key considerations

- Clause requires a statement regarding the nature of application of funds if the company has financed long-term assets out of short-term funds.
- Comparison would be required for long-term sources and long-term application of funds.
- Movement of funds should be supported by relevant documentation.
- Review would be required of balance sheet, cash flow statement and current ratio.

Funds borrowed to meet obligations of subsidiaries, etc.



Clause 3(ix)(e)

New clause

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.



Key considerations

- The term 'entity' in this clause would include banks, financial institutions, company, limited liability partnership, trust, government, or others irrespective of the legal form.
- Auditor needs to consider new loans or advances given during the year, meeting the obligations of subsidiaries, etc. during the year and new investments (equity or debt) made during the year.
- Obligation would mean the amounts that subsidiaries, associates, or joint ventures were required to pay themselves to their vendors, lenders, employees or statutory authorities.
- The clause covers both long term and short term funds taken:
 - During the year even if these have been repaid before the year end
 - In earlier years and were repaid during the year or are outstanding as at the year end.

Loans raised on the pledge of securities



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.

New clause



Key considerations

- Securities held in its subsidiaries, joint ventures or associate companies” means the investment of the company in such subsidiary, joint venture or associate company.
- Default includes both repayment of principal and payment of interest.
- This clause covers all loans taken during the year even if these have been repaid during the year.



Q&A



Links to previous recordings of VOR



| Month | Topics | Link |
|--|--|----------------------------|
| November 2019 (Special session) | <ul style="list-style-type: none">• Focus on technology sector- Impact of recent tax amendments and certain challenge | Click here |
| January 2020 | <ul style="list-style-type: none">• The Taxation Laws (Amendment) Act, 2019• Ind AS Transition Facilitation Group (ITFG) clarifications - Bulletin 22• Updates relating to SEBI regulations• Updates relating to the Companies Act, 2013 | Click here |
| February 2020 (Special session) | <ul style="list-style-type: none">• Significant challenges for technology sector in relation to business combination | Click here |
| April 2020 | <ul style="list-style-type: none">• COVID-19: Potential financial reporting impacts | Click here |
| July 2020 | <ul style="list-style-type: none">• COVID-19: Key financial reporting considerations for interim reporting• CARO 2020 – Key considerations• Ind AS 116, <i>Leases</i> – Exposure draft on COVID-19 related rent concessions issued by ICAI• Additional relaxations provided by the Securities and Exchange Board of India (SEBI) and the Ministry of Corporate Affairs (MCA) amid COVID-19. | Click here |

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Accounting and Auditing Update



First Notes



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