



Draft Companies (Auditor's Report) Order 2016

19 February 2016

First Notes on

Financial reporting

Corporate law updates

Regulatory and other information

Disclosures

Sector

All

Banking and insurance

Information, communication, entertainment

Consumer and industrial markets

Infrastructure and government

Relevant to

All

Audit committee

CFO

Others

Transition

Immediately

Within the next 3 months

Post 3 months but within 6 months

Post 6 months

Background

Section 143(11) of the Companies Act, 2013 (2013 Act) requires that the auditor's report of specified class of companies should include a statement on the prescribed matters. These reporting requirements have been prescribed under the Companies (Auditor's Report) Order, 2015 (CARO 2015) issued by the Ministry of Corporate Affairs (MCA) on 10 April 2015.

New development

The MCA had set-up a committee on 16 September 2015 to examine and recommend matters that should form part of the statement. This statement would be attached with the auditor's report under Section 143(11) for the Financial Year (FY) 2015-16 and thereafter.

The committee made recommendations on the matters to be included in the statement and on the basis of its recommendations, MCA issued draft Companies (Auditor's Report) Order, 2016 (CARO 2016) on 9 February 2016.

This issue of First Notes provides an overview of the draft CARO 2016 and is divided into following sections:

- Applicability of the CARO 2016
- Companies covered under the CARO 2016
- New reporting requirements prescribed in the CARO 2016
- Reporting requirements that have been carried forward with certain modification from the CARO 2015
- Reporting requirements of the CARO 2015 not carried forward.

Applicability

Every report made by the auditor under Section 143 of the 2013 Act for FY commencing on or after 1 April 2015 would include CARO 2016. It would be applicable to every company (except companies that are excluded, see below), including a foreign company as defined under Section 2(42)* of the 2013 Act.

The CARO - 2016 would not be applicable to the auditor's report on consolidated financial statements.

*Section 2(42) of the 2013 Act defines foreign company as any company or body corporate incorporated outside India which:

- has a place of business in India whether by itself or through an agent, physically or through electronic mode, and
- conducts any business activity in India in any other manner.

Companies exempted under the CARO – 2016

The following tables highlight the class of companies whose auditors are exempted to comment on matters prescribed under the CARO - 2016 (in comparison to CARO 2015):

Companies not covered under CARO 2016	Companies not covered under CARO 2015
<ul style="list-style-type: none"> ▪ 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 2013 Act ▪ One person company as defined under Section 2(62) of the 2013 ▪ Small company as defined under Section 2(85) of the 2013 Act ▪ Private company, not being a subsidiary or holding of a public company: <ul style="list-style-type: none"> – with a paid-up capital and reserves and surplus not more than INR1 crore – does not have total borrowings exceeding INR1 crore from any bank or financial institution at any point of time during the FY, and – does not have a total revenue as defined in Schedule III to the 2013 Act (including revenue from discontinuing operations) exceeding INR10 crore during the FY as per the financial statements. 	<ul style="list-style-type: none"> ▪ 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 2013 Act ▪ One person company as defined under Section 2(62) of the 2013 ▪ Small company as defined under Section 2(85) of the 2013 Act ▪ Private company: <ul style="list-style-type: none"> – with a paid-up capital and reserves not more than INR50 lakhs – does not have outstanding loan exceeding INR25 lakhs from any bank or financial institution, and – does not have a turnover exceeding INR5 crore at any point of time during the financial year.

Matters to be included in CARO 2016

As compared to CARO 2015, the reporting requirements under draft CARO 2016 have increased. The following table provides the reporting requirements in three sections:

- New requirements
- Requirements that have been carried forward with certain modifications
- Requirements that have been deleted as compared to CARO 2015.

New requirements

Fixed assets

Whether title deeds of immovable properties are held in the name of the company. If not, provide details thereof.

Loans and investments

In respect of loans, investments and guarantees, whether provisions of Section 185 and 186 of the 2013 Act have been complied with. If not, provide details thereof.

Managerial remuneration

Whether managerial remuneration has been paid/provided in accordance with the requisite approvals mandated by the provisions of Section 197 read with Schedule V of the 2013 Act? If not, state the amount involved and steps taken by the company for securing refund of the same.

New requirements (cont.)

Nidhi company

Whether the Nidhi company has complied with the net owned fund in the ratio of 1:20 to meet the liability and whether the Nidhi company is maintaining 10 per cent liquid assets to meet out the unencumbered liability.

Related party transactions

Whether all transactions with related parties are in compliance with Section 188 and 177 of the 2013 Act where applicable and the details have been disclosed in the financial statements, etc. as required by the accounting standards and 2013 Act.

Preferential allotment/private placement

Whether the company has made any preferential allotment/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 2013 Act have been complied with and the amount raised has been used for the purposes for which the funds were raised. If not, provide details thereof.

Non-cash transactions

Whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether provisions of Section 192 of the 2013 Act have been complied with.

Requirements that have been carried forward with certain modifications

Inventory

Whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, how they have been dealt with in the books of account.

Deleted requirement

- Are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business
- Whether the company is maintaining proper records of inventory.

Granting of loans to certain parties

Whether the company has granted any loans, secured or unsecured to companies, firms or other parties covered by Section 2(76) of the 2013 Act which defines related parties in reference to companies. If so,

- Whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest
- Whether receipt of the principal amount and interest are regular. If not, provide details thereof, and
- If overdue amount is more than INR5 lakh, whether reasonable steps have been taken by the company for recovery of the principal and interest.

New requirement

It relates to whether the terms and conditions are prejudicial to the company's interest and threshold of overdue amount has been increased from INR1 lakh to INR5 lakh.

Default in repayment of dues

Whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holder?

If yes, the period and amount of default to be reported (in case of banks and financial institutions, lender wise details to be provided).

New requirement

It relates to lender-wise details of period and amount of default.

Requirements that have been carried forward with certain modification (cont.)

Application of term loans/public issue/follow-on-offer

Whether moneys raised by way of public issue/follow-on offer (including debt instruments) and term loans were applied for the purposes for which those are raised.
If not, the details together with delays/default and subsequent rectification, if any, as may be applicable, be reported.

New requirement

It increases the scope to public issue and follow-on offer (including debt instruments). Earlier it was restricted to term loans only.

Fraud reporting

Whether any fraud by the company or any fraud on the company by its officers/employees has been noticed or reported during the year? If yes, the nature and the amount involved should be indicated.

New requirement

It is restricted to officers and employees of the company.

Requirements that have been deleted as compared to CARO 2015

Internal control system

Is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services.
Whether there is a continuing failure to correct major weaknesses in internal control system.

Deposit of statutory dues

Whether the amount required to be transferred to Investor Education and Protection Fund (IEPF) in accordance with relevant provisions of the Companies Act, 1956 (1 of 1956) and rules made thereunder has been transferred to such fund within time.

Accumulated losses and incurrence of cash losses

Whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than 50 per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year.

Guarantee for loans taken by others from banks or financial institutions

Whether the company has given any guarantee for loans taken by others from banks or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company.

Our comments

The issue of draft CARO 2016 is a step in the right direction, aimed at improving quality of auditors' reporting and increase relevance to the stakeholders of the financial statements. Another welcome relief for the companies is that it would not be applicable on consolidated financial statements. Following are our detailed comments:

- **Scope:** The MCA has relaxed the scope/application of CARO on the private companies by increasing applicability thresholds, thus, it would be applicable to less number of private companies.
- **Increase in the reporting requirements:** CARO 2016 enhances the reporting requirements and thereby, would increase the reporting responsibility of the auditors relating to following important clauses:
 - Utilisation of public issue/follow-on-offer/term loans (including, debt instruments)
 - Compliance of Section 42 (offer or invitation for subscription of securities on private placement)
 - Lender wise details in case of default of payment of dues to banks and financial institutions

- Loans given to related parties covered under Section 2(76) (i.e. section defining related party) instead of Section 189 (i.e. Section on register of contracts or arrangements in which directors are interested)
- Related party transactions (all transactions) under Section 188 and 177 of the 2013 Act
- Loans, investments and guarantees comply with Section 185 and 186 of the 2013 Act
- Nature and amount of frauds by officers and employees
- Non-cash transactions with directors or persons connected with him under Section 192 of the 2013 Act
- Managerial remuneration has been paid/provided in accordance with the requisite approvals mandated by the provisions of Section 197 read with schedule V to the 2013 Act.

The MCA requires auditors to comment on the above matters and companies would have to provide comprehensive information to their auditors. Compliance with the requirements of managerial remuneration, loans and investments, and related parties appear to be onerous since these requirements could also involve interpretation of the 2013 Act. Some of the other complex issues that are being debated are ‘what is an ordinary course of business’, ‘how is arm’s length to be determined’, ‘what does accustomed to act mean’. Companies may need to obtain legal opinions to interpret these matters and auditors would have to evaluate such legal opinions too. Additionally the disclosure on utilisation of public issue/follow-on offer proceeds is covered for listed companies under SEBI regulations and to include requirement in the CARO 2016 would be a duplication.

- **Re-introduction of clauses from CARO 2003:** The MCA also re-introduced certain requirements from Companies (Auditor’s Report) Order, 2003 (CARO 2003) such as reporting on terms and conditions of the grant of loans from certain parties or net owned fund ratio for a Nidhi company, which demonstrate MCA’s effort to keep CARO requirements relevant from stakeholders’ perspective.
- **Obligations removed:** The MCA has excused the auditor from obligation to report on timely transfer of amounts to the IEPF whereas Rule 11(c) of the Companies (Audit and Auditors) Rules, 2014 requires reporting of delays by auditors. This deletion is a welcome step as this will remove the duplication of reporting by the auditors. Additionally, an auditor is not required to report under CARO on third party frauds in relation to the company.
- **Internal Financial Control (IFC) reporting vs CARO 2016 clauses relating to maintenance of records of fixed assets and inventories including physical verification:** The 2013 Act requires companies and auditors to report whether IFC is adequate and operating effectively. CARO 2016 continues to have clauses relating to fixed assets and inventories which would be dealt with under IFC reporting. Therefore, the objective of continuing with these clauses in CARO 2016 is not clear.
- **Related parties:** The definition of related parties under accounting standards is different from the 2013 Act. Therefore, compliance in relation to clause relating to related parties under Section 2(76), 188 and 177 of the 2013 Act vis-à-vis requirements of the accounting standards could be challenging.

The draft CARO is available on the website of the MCA, and public comments on it are invited through e-mail till 23 February 2016. Therefore, we encourage you to provide comprehensive comments on the draft CARO.

The bottom line

The proposal to amend CARO indicates that MCA continues to enhance the reporting requirements by including issues that are expected to be relevant for stakeholders.

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IFRS Notes

The RBI issues directions to banks on Ind AS implementation



12 February 2016

On 11 February 2016, the Reserve Bank of India (RBI) issued a circular RBI/2015-16/315 requiring scheduled commercial banks to comply with the Indian Accounting Standards (Ind AS) for accounting periods beginning from 1 April 2018 onwards, with comparatives for periods ending on or after 31 March 2018. Ind AS would be applicable to both standalone financial statements and consolidated financial statements. This circular reiterates the timeline for Ind AS implementation by banks that was issued by the Ministry of Corporate Affairs (MCA) in its press release dated 18 January 2016. It also provides further direction on critical issues that banks need to consider in their Ind AS implementation plan.

Our IFRS Notes provides overview of the recent circular.

Missed an issue of Accounting and Auditing Update or First Notes?



Issue no. 5/2016 – Technology

This month the Accounting and Auditing Update focusses on the technology services sector and highlights key matters relating to accounting, financial reporting and regulatory areas relevant to this sector.

In this publication, we have highlighted key areas of impact due to adoption of Ind AS: revenue recognition, business combinations, share-based payment, financial instruments and segment reporting on technology service sector.

We also carry this month an interview section in our publication where we speak to a CFO/finance director of a leading company from the sector where we explore some key accounting and reporting, and topical matters relevant to this industry. This month's issue features an interview with Mr. Sanjay Puria, Group Chief Financial Officer, WNS. He shares his perspective on a wide range of issues.

Finally, apart from our regular round up of regulatory updates, this edition of the Accounting and Auditing Update provides a summary of the concept release by the U.S. Securities and Exchange Commission on enhanced responsibilities of the audit committee along with the Indian exposure draft on Auditing Standard 260, Communication with those charged with governance.



Report of the Companies Law Committee

6 February 2016

The Companies Law Committee (CLC) was constituted on 4 June 2015 to examine and making recommendations on the issues arising out of implementation of the Companies Act, 2013 (2013 Act) as well as the recommendation received from the Bankruptcy Law Reforms Committee, the High Level Committee on CSR, the Law Commission and other agencies. The CLC submitted its report to the government on 1 February 2016.

In making its recommendations, the CLC conducted extensive consultations with stakeholders and recommended amendments to both the 2013 Act and the Rules to the 2013 Act. It has proposed changes in 78 sections of the 2013 Act, which along with consequential changes, would result in about 100 amendments to the 2013 Act. It has proposed approximately 50 amendments to the Rules.

Our issue of First Notes summarises key recommendations of the CLC.



KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

In this month's call on 17 February 2016, we covered following topics

- Report of the Companies Law Committee
- Securities and Exchange Board of India (SEBI) issues the Frequently Asked Question (FAQs) on the SEBI Listing Regulations, 2015.

Feedback/queries can be sent to aaupdate@kpmg.com

Previous editions are available to download from: www.kpmg.com/in

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