Chapter 3

CARO 2020: Revamped and enhanced reporting

This article aims to:

Discuss the applicability of CARO 2020 and the reporting requirement relating to property, plant and equipment/intangible assets, benami property and title deeds of immovable property under CARO 2020 and related guidance provided by ICAI.

Introduction

The Companies Act, 2013 (2013 Act) requires auditors of specified class of companies to include a statement in their reports on specific matters as prescribed in the Companies (Auditors' Report) Order, 2016 (CARO 2016) which has been recently revised and issued as CARO 2020. CARO 2020 was initially made applicable for audits of Financial Year (FY) 2019-20 and onwards. However, it has been deferred by one year on account of the novel coronavirus (COVID-19) and is now applicable for audits of FY2020-21 and onwards.

CARO 2020 contains significant changes and several new reporting requirements vis-à-vis CARO 2016. Many of the requirements require exercise of judgement rather than application of a purely objective test. With a view to provide guidance on application of the CARO 2020, the Institute of Chartered Accountants of India (ICAI) has issued a guidance note on CARO 2020 (GN). The guidance note supersedes the guidance note issued by ICAI in April 2016.

In this article, we aim to provide an overview of the applicability of CARO 2020 and discuss reporting requirement relating to property, plant and equipment/ intangible assets and their revaluation, holding of a benami property by a company and title deeds of immovable property. We will also highlight the related guidance provided by ICAI in its guidance note.

Applicability of CARO 2020

Similar to CARO 2016, CARO 2020 is applicable to every company including a foreign company (as defined under the 2013 Act).

It will not apply to banks, insurance companies, companies licensed to operate under Section 8 of the 2013 Act, one person and a small company.

Additionally, it will not apply to a private limited company if it meets all of the following conditions:

1. It is not a subsidiary or holding company of a public company
2. Its paid-up capital and reserves and surplus do not exceed INR1 crore as on the balance sheet date
3. Its total borrowings do not exceed INR1 crore from any bank or financial institution at any point of time during the FY
4. Its total revenue as disclosed in Scheduled III to the 2013 Act (including revenue from discontinuing operations) do not exceed INR10 crore during the FY as per the financial statements.

CARO 2020 would be equally applicable to the audit of branch(es) of a company as to a company and audits of project office/liaison office established outside India.

Consolidated Financial Statements (CFS)

CARO 2020 is not applicable to the auditor's report on CFS. However, an auditor is required to state in its report details of companies included in CFS with qualifications or adverse remarks by their respective auditors. This would include reporting of qualification/adverse remark made by every individual component including the parent.

Period of compliance

ICAI in its GN clarified that compliance with the requirements of CARO 2020 by a company need to be evaluated with reference to the whole accounting year and not merely with reference to the position existing at the balance sheet date or a date at which an auditor makes its report.

Reporting under CARO 2020

Property, Plant and Equipment (PPE)

Currently, an auditor is required to report on maintenance of proper records including quantitative details and situation of fixed assets. In accordance with Indian Accounting Standards (Ind AS),16, *Property, Plant and Equipment* and Accounting Standard (AS) 10 (Revised), *Property Plant and Equipment,* the term 'fixed assets' has been replaced with PPE.

Accordingly, CARO 2020 requires an auditor to report whether the company is maintaining proper records showing full particulars, including quantitative details and situation of **PPE**. Similar to CARO 2016, it also requires reporting on whether these **PPE** have been physically verified by the management at reasonable intervals. Further, in case of any material discrepancies noticed on such verification, whether the same have been properly dealt with in the books of account.

(Emphasis added to highlight the change)

Guidance by ICAI

The reporting requirement would extend to cover right-of-use assets held by the company as a lessee, an investment property as defined under Ind AS 40, *Investment Property* and non-current assets held for sale.

For the purpose of this clause, companies would be required to maintain 'proper records' of all items of PPE including those which have been fully depreciated, impaired or retired from active use and held for disposal. The GN provides an illustrative list of details that should be part of PPE records e.g. details relating to year of purchase, original cost, useful life, component-wise breakup, adjustment for revaluation or for any increase or decrease in cost and accumulated depreciation.

The aggregate original cost, depreciation to date, and impairment loss, if any, as per these records under individual heads should reconcile with the figures shown in the books of account of the company.

The purpose of showing the situation of PPE is to make verification possible. Companies might have certain classes of PPE whose situation keeps changing, for instance, construction equipment which has to be moved to sites. In such cases, a company should maintain record of movement/custody of the equipment.

With respect to physical verification of PPE by management at reasonable intervals, it has been clarified that an annual verification might be considered a reasonable period, however it could be impracticable in some cases. Therefore, management may decide upon the periodicity of physical verification considering various factors such as number of assets, the nature of assets, the relative value of assets, difficulty in verification, etc. Where an annual verification of entire PPE is not carried out, it should be ensured that verification programme should be such that all assets are verified at least once in every three years. In this situation, an auditor would report the fact that all assets have not been verified during the year. If the auditor is satisfied regarding the frequency of verification then he/she should also make a suitable comment to that effect.

An auditor is required to exercise professional judgement while determining *material* discrepancies in a physical verification of PPE. While making this judgement, an auditor would not only consider the cost of the asset and its relationship to the total cost of all assets but also the nature of the asset, its situation and other relevant factors.

Intangible assets

CARO 2020 introduces a new reporting requirement as per which an auditor is required to comment on whether the company is maintaining proper records showing full particulars of intangible assets. The intangible assets could, *inter alia*, include, customer loyalty, patents, internet domain names, royalty agreements, operating rights and website development.

Guidance by ICAI

For the purpose of reporting under this clause, reasonable and sufficient description of the asset to facilitate identification should be made available by the company. Additional information that need to be recorded include, location of the asset, original cost details, date on which the asset becomes available for use by the company with documentary evidence, rate(s)/basis of amortisation, accumulated amortisation and particulars regarding impairment, etc.

Revaluation of PPE/intangible assets

CARO 2020 introduces a new reporting requirement as to whether a company has revalued its PPE (including right-of-use assets), intangible assets or both during the year. If so, it further requires reporting on whether the revaluation is based on the valuation by a registered valuer and specify the amount of change, if change is 10 per cent or more in aggregate of the net carrying value of each class of PPE or intangible assets.

Guidance by ICAI

Unlike the cost model which allows only downward adjustment in the carrying amount of an asset due to impairment loss, revaluation model allows both an upward and downward adjustment in the carrying amount of an asset as per the provisions of Ind AS 16/AS 10. As per the GN, for the purpose of reporting under this clause, revaluation would not include:

- Fair valuation of PPE upon first-time adoption of Ind AS
- Remeasurements (i.e., changes in value due to interest or foreign exchange rates)
- Changes to right-of-use assets due to lease modification as per Ind AS 116, *Leases.*

An auditor would be required to consider the requirements of Section 247 of the 2013 Act relating to valuation by registered valuers. Various other aspects that can be considered for reporting under this clause would include, date of revaluation carried by the company, methods and significant assumptions applied in estimating fair values and accounting treatment of revaluation surplus.

Benami property

Another new requirement added by CARO 2020 relates to reporting on whether any proceedings have been initiated or are pending against the company for holding any benami property[1] under the Prohibition of Benami Property Transactions Act, 1988 (as amended in 2016) (Benami Property Act) and rules made thereunder. If so, whether the company has appropriately disclosed the details in its financial statements.

Guidance by ICAI

The reporting under this clause would require ascertainment of whether proceedings have been initiated under the Benami Property Act by the Initiating Officer[2] during the year and/or any proceedings are pending against the company before the Initiating Officer/ Adjudicating Authority/Appellate Tribunal/High Court/ Supreme Court during any of the preceding financial years. The reporting is not applicable where the notice is received by the company as a beneficial owner.

For the purpose of reporting, appropriate disclosures in the financial statements 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. Also, it needs to be evaluated whether the liability is required to be disclosed as 'contingent liabilities' or whether provisions are required to be made.

Title deed of immovable property

CARO 2020 has modified the requirement relating to holding title of immovable properties by the company vis-a-vis CARO 2016. As per the modified requirement, an auditor is required to report on 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 they are not held in the name of the company, then following details (as given in the table below) are required to be provided.

(Emphasis added to highlight the change)

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)

1. Benami property means any property which is the subject matter of a benami transaction and also includes the proceeds from such property.
2. An authority who initiates the proceedings under the Benami Property Act.

Guidance by ICAI

The reporting under this clause would be only in respect of those immovable properties which form part of PPE and would cover an investment property as defined under Ind AS 40 and non-current assets held for sale.

The term 'immovable property' has not been defined under the 2013 Act. However, as per General Clauses Act, 1897, immovable property would include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth. Accordingly, Transfer Development Rights (TDRs), plant and machinery embedded in land, etc., will not be considered as an immovable property.

It is important to note that the management is responsible for legal determination of the validity of title deeds. Title deeds in general mean a legal deed or document constituting evidence of a right, especially to the legal ownership of the immovable property. For instance, documents that constitute title deed of an immovable property include registered sale deed, conveyance deed of land or land and building together, etc. transferred by any person including government to the company. An auditor would verify the title deeds available and reconcile the same with the PPE register.

Specific disclosure would be required in case the immovable property is being held by the promoter, director or their relative. The term 'relative' has not been defined under CARO 2020.

Though reporting in cases where immovable property is held by a company as a lessee and lease agreements are duly executed has not been covered under this clause, however, with respect to cases where there are discrepancies in lease agreements or it is not duly executed, it would be prudent to include in the report, facts of such case.

Support of a legal expert could be sought in case there is any dispute or litigation as to the title of the immovable property or where the auditor seeks clarity in matters related to the reporting under this clause.

Conclusion

CARO 2020 enhances the scope of matters to be provided in an auditor's report. While auditors would need to implement robust audit procedures along the requirements, companies on the other hand, would also need to ensure that they maintain proper and adequate records of the underlying information. Additionally, companies would need to start putting in place systems and processes to capture the new reporting requirements as envisaged by CARO 2020, such as:

- Maintenance of adequate records with respect to right-of-use assets and intangible assets held by the company including details of physical verification of right-of-use assets.
- Details of revaluation of PPE including right-of-use assets and intangible assets during the year along with maintaining records of registered valuers and the valuation reports issued by them.
- Details of proceedings initiated or pending against the company as the holder of a benami property including status of proceedings before the relevant authority.
- Maintenance of title deeds of all immovable properties held by the company along with details of immovable properties not in the name of the company (with specific distinction of those held by promoter, director or their relative or employee) and the reason for the same.