CARO 2020: A question of accountability

Auditors and business are wary of the new audit guidelines

SUDIPTO DEY
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In March this year the government, as part of a relief package to business from the pandemic-induced countrywide lockdown, decided to postpone the applicability of new audit disclosures by one year. Companies Auditor's Report Order (CARO 2020) guidelines — now applicable from this financial year — were brought in to curb corporate scams by introducing more transparency and accountability in the audited financial numbers.

The stringent guidelines require companies to disclose more information in their audit report. It has expanded considerably the ambit of the statutory auditor's role — requiring them to seek and verify the additional disclosures by the company, red-flag concerns and present its guidance on financial health of the business.

Unsurprisingly, a push-back is on. There has been hectic lobbying by corporations and auditors alike with the government and the regulators to seek more clarity in the CARO guidelines. They also claim difficulties in collating and verifying financial data owing to the pandemic-related movement restrictions across the country.

Prem Sikka, professor of Accounting and Finance, University of Sheffield, United Kingdom, is not surprised by this resistance to greater scrutiny of financial numbers. "The auditors are appointed and remunerated by the companies. They are hardly going to bite the hand that feeds them."

Incidentally, the fresh demands of the CARO guidelines are not new for auditors. The latest ones are an improvement on the existing rules, last revised in 2016. However, additional accountability comes with increased scope of information that companies need to share in their audit reports. This necessitates a larger volume of compliance requirements to be met by the company. "Companies would need to gear up to meet the increased expectations of the auditors as they seek to fulfil their enhanced responsibilities," said Jamil Khatri, partner in audit firm BSR & Co.

The pet peeve of most statutory auditors has been that clients, citing stress in the business environment, are unlikely to compensate them for the cost involved in vetting and verifying the enhanced reporting requirements.

One particular contentious issue is related to scrutiny of whistle-blower complaints. "Additional guidance, including a definition of a whistle-blower complaint, is required to enable an auditor to appropriately consider such complaints," said a partner in one of the large audit firms. Different companies follow different policies when it comes to taking cognisance of such complaints. For instance, some anonymous complaints are not entertained as part of whistle-blowing policy. There are companies that only entertain complaints from an employee or a director in the company, or from within the group. As a result, third-party complaints are not considered. There are questions over whether the auditor should vet complaints that are not considered by the board or the audit committee. The general feeling in the audit fraternity is that their oversight should be limited to complaints related to financial frauds.

"In large corporate structures, identifying and reporting frivolous complaints is a challenging task. Auditors, being an independent professional, may not have access to all," Gaurav Pingle, a company secretary, admitted.

There are several reporting requirements under CARO 2020 in relation to the identification of *benami* (or fraudulent) transactions and wilful default of loans by companies. Auditors say they find it challenging to verify unidentified transactions if the company does not disclose them.

Similarly, stringent checks and balances have been put in place to check the practice of ever-greening of loans — funds given by companies to pay interest, or give new loans to repay old loans. Companies have to give details of loans or advances in nature of loans, or guarantee or security given to any entity. This has to be supplemented with terms and conditions under which loans have been given, details of overdue amount, among others.

"Earlier the reporting was not so detailed and was to be given for related parties only," said Kolkata-based chartered accountant Vivek Agarwal.

Before the latest guidelines, the reporting requirement was to give details of default of any loan taken from financial institutions. Now companies have to disclose whether they have been declared as wilful defaulter. There is also a need to explain whether short-term funds were used for long-term purpose, and vice versa. Auditors also worry the documentation to support reporting of loans given and taken will be voluminous.

But what is causing many auditors real anxiety is the need to stick their neck out to assess the ability of a loss-making company, or a company with a negative net worth, to discharge its liability based on the review of financial ratios and liquidity.

"How can the auditor report whether the company will be able to meet future liabilities when the management themselves will not be able to give a clear picture?" Agarwal asked. Some feel the responsibility in this regard should be a part of reporting by directors instead of the auditors. Further, companies also have to realise that some of the additional reporting would be judgemental in nature, and may differ from auditor to auditor, experts pointed out.

However, one thing most in the accounting fraternity agree on is that, going forward, there is a need for a more structured sharing of information between the auditors and the company. For that, the regulators have to play a key role in educating all stakeholders in the process, they added.

Sikka highlighted a more existential issue plaguing the audit fraternity across countries as they come under the spotlight in the face of increasing financial scams and frauds: "We continue to ask auditors to do all kind of things, but we also need more transparency in audits themselves."

Reality checks

Key issues in CARO 2020 that fox auditors)

Treatment of whistle-blowing complaints

- Complaint resolution mechanism not fully evolved in India
- Auditors want clearer guidelines for considering a complaint for scrutiny and their oversight limited to financial frauds

Reporting of *benami* transactions

- No defined method of reporting *benami* transactions, wilful defaults
- Such deals challenging to verify if the company does not disclose them

Reporting of loans; ability to meet future liabilities

- Companies have to provide details of loans, advances, guarantee, etc
- Disclosures have to be made of defaults, wilful defaulter status
- Reporting company's ability to meet future liabilities is subjective