Companies (Auditor's Report) Order, 2020

Why in News?

The Union Ministry of Corporate Affairs (MCA) has announced the notification of the Companies (Auditor's Report) Order, 2020 (CARO 2020).

What changes did the Order introduce?

- It has introduced several **changes to the rules governing audit reports of companies**, with a view to increase transparency.
- These changes may enhance the role of auditors and bring their incentives into more clear alignment.
- It proposed that **non-audit services** not be provided to audit clients.
- It said so to prevent revenue from such services impinging upon the decisions taken by the auditor when writing its report.
- The auditors should provide reports that are as **factual** and **complete** as the information they are provided by the company in question.

What are the transferred responsibilities?

- The 2020 CARO has now sought to transfer greater responsibility for **providing complete information to its auditors**.
- Auditors have essentially been forced to demand more information, in what will be a net positive for shareholders and other stakeholders.
- It is true that the **paperwork burden** will significantly increase.
- The 2020 CARO requires auditors to comment on 50 matters, including sub-clauses, where 2016 CARO required comment on only 21 matters.
- This is a significant expansion in scope and it remains to be seen how much it adds to transaction cost and delays in practice.

How the auditor's report should?

- The auditors are now required to **report on how the company is using its connections** with subsidiaries and joint ventures i.e.,
    1. Are loans being raised to finance them? or
    2. Are loans being taken out against them?
- The auditor will also have to **examine what the auditors of the subsidiary** have said in their annual reports.
- They should also report these auditor's reports in the holding company's

report if they find “adverse” remarks.

- Several requirements seem designed to ease the load on banks, such as
    1. The requirement to specify the amount of loans that don’t have terms for repayment, and
    2. The requirement to specify whether the company has itself loaned money to related parties.
- The provision, the auditor has been directed to provide an opinion on the main financial ratios of the firm, may simply go too far.

What is the significance of CARO?

- The CARO 2020 restricts itself to enhancing the information available to both investors and financial institutions.
- It should be considered to be a major step forward for transparency in accounts.
- It is important that **audit companies implement the rules** in both letter and spirit.

Why regular audit matters?

- There have been some recent high-profile examples of companies that have knowingly deceived their auditors.
- Yet a regular audit is not a forensic exercise, and instead relies on the companies to turn over information in a timely and accurate fashion.
- If they do not do so, the entire process is naturally called into question.

Source: Business Standard

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