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# AUDIT

## Advanced Auditing Assurance & Professional Ethics

CA SACHIN & ATUL AGARWAL




For
MAY/SEP 26 & JAN 27
Exams

CONCEPT
BOOK

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# ADVANCED AUDITING ASSURANCE & PROFESSIONAL ETHICS

## MAY/SEP 2026 & JAN 2027 Exams



## Concept Book

This Concept Book is prepared in Multicolor:

- ☐ Headings in ORANGE box
- ☐ Sub-headings in BLUE
- ☐ Main Content in BLUE
- ☐ Keywords in RED
- ☐ Examples in RED

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# Advanced Auditing Assurance & Professional Ethics

Edition: 2026

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# ADVANCED AUDITING ASSURANCE & PROFESSIONAL ETHICS

## About the Book

नमस्कार दोस्तों, राधे राधे !!

This Concept Book is prepared by **CA Sachin Agarwal (AIR 16) & CA Atul Agarwal (AIR 1)**. Atul Agarwal is a **Gold Medalist** in Audit with **Ever Highest Marks** in Auditing in the History of ICAI. **It contains all concepts of CA Final Audit in 245 pages.**

This book is fully prepared as per **ICAI Syllabus.** All special points relating to **ICAI Questions** and **Case Scenarios** are also covered in this book.

This book has been prepared for those **learning the subject for the first time as well as for last day revision before the exam.** On first time reading, refer this book along with lectures or revision videos. On last day before exam, you can refer only keywords marked in RED in this book.

**Best wishes**

*CA Sachin Agarwal & CA Atul Agarwal*

Reach out to us at following for Classes, Test Series, Notes, Question Banks and Guidance

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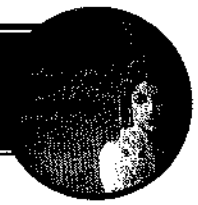

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# STANDARDS ON AUDITING



## Quality Control and Engagement Standards

| Types of Quality Control and Engagement Standards issued by ICAI | |
|---|---|
| **Standard on Quality Control (SQC)** | Applied to all engagements relating to establishment & maintenance of quality control system in CA firms. |
| **Standard on Auditing (SA)** | Applied in audit of historical financial information. |
| **Standard on Review Engagements (SRE)** | Applied in review of historical financial information. |
| **Standard on Assurance Engagements (SAE)** | Applied in assurance engagements dealing with matters other than historical financial information. |
| **Standard on Related Services (SRS)** | Applied to non-assurance engagements involving application of agreed upon procedures, compilation engagements and other related services. |

## Number and Title of All Quality Control and Engagement Standards

| No. | Title of the Standard |
|---|---|
| SQC 1 | Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements |
| SA 200 | Overall Objectives of the Independent Auditor and the Conduct of an Audit as per SA |
| SA 210 | Agreeing the Terms of Audit Engagements |
| SA 220 | Quality Control for an Audit of Financial Statements |
| SA 230 | Audit Documentation |
| SA 240 | The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements |
| SA 250 | Consideration of Laws and Regulations in an Audit of Financial Statements |
| SA 260 | Communication with Those Charged with Governance |
| SA 265 | Communicating Deficiencies in Internal Control to TCWG and Management |
| SA 299 | Joint Audit of Financial Statements |
| SA 300 | Planning an Audit of Financial Statements |
| SA 315 | Identifying and Assessing ROMM through Understanding the Entity and its Environment |
| SA 320 | Materiality in Planning and Performing an Audit |
| SA 330 | The Auditor's Responses to Assessed Risks |
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| SA 450 | Evaluation of Misstatements Identified during the Audits |

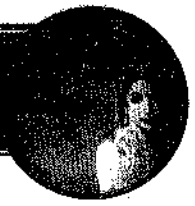
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| | |
|---|---|
| SA 500 | Audit Evidence |
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| SA 600 | Using the Work of Another Auditor |
| SA 610 | Using the Work of Internal Auditors |
| SA 620 | Using the Work of an Auditor's Expert |
| SA 700 | Forming an Opinion and Reporting on Financial Statements |
| SA 701 | Communicating Key Audit Matters in the Independent Auditor's Report |
| SA 705 | Modifications to the Opinion in the Independent Auditor's Report |
| SA 706 | Emphasis of Matter and Other Matter Paragraphs in Independent Auditor's Report |
| SA 710 | Comparative Information – Corresponding Figures and Comparative Financial Statements |
| SA 720 | The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements |
| SA 800 | Special Considerations – Audits of FS Prepared as per Special Purpose Framework |
| SA 805 | Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement |
| SA 810 | Engagements to Report on Summary Financial Statements |
| SRE 2400 | Engagements to Review Historical Financial Statements |
| SRE 2410 | Review of Interim Financial Information Performed by Independent Auditor of Entity |
| SAE 3400 | The Examination of Prospective Financial Information |
| SAE 3402 | Assurance Reports on Controls at a Service Organisation |
| SAE 3420 | Assurance Engagements to Report on Compilation of Pro Forma Financial Information Included in a Prospectus |
| SRS 4400 | Engagements to Perform Agreed Upon Procedures Regarding Financial Information |
| SRS 4410 | Compilations Engagements |



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# SQC 1 – Quality Control for Firms that Performs Audit, Reviews & Other Assurance and Related Services Engagements



## Basics

- As per this Standard on Quality Control (SQC), firm should establish a system of quality control designed to provide it with reasonable assurance that firm and its personnel comply with professional standards and regulatory and legal requirements.
- **Applicability**

  - SQC 1 is applicable to all type of engagements including engagement of related services.
  - SQC 1 applies to all CA firms.
  - SQC 1 deals with quality at firm level. SA 220 deals with quality at particular audit level.

- **Some Important Definitions**

| | |
|---|---|
| **Firm** | Sole proprietor, partnership, or any entity of CAs. |
| **Engagement Partner (EP)** | Full-time practicing CA in firm who is responsible for engagement. |
| **Engagement Team** | All personnel (EP and staff) performing engagement. |

- **Elements of a System of Quality Control**

Firm's system of quality control shall include policies & procedures addressing following elements:

(1) Leadership responsibilities for quality within the firm
(2) Ethical requirements
(3) Acceptance and continuance of client relationships and specific engagements
(4) Human resources
(5) Engagement performance (review & documentation)
(6) Monitoring

## Leadership Responsibilities for Quality within the Firm

Firm's leadership and the examples it sets significantly influence internal culture of firm to perform work that complies with professional standards and regulatory and legal requirements.

Following considerations shall be taken by leader (CEO/Senior Partner) while upholding quality of firm:

(i) Firm assigns its management responsibilities so that commercial considerations do not override quality of work performed.

(ii) Firm policies and procedures addressing compensation, promotion and performance evaluation, with regard to its personnel are designed to demonstrate its overriding commitment to quality.

(iii) Firm devotes sufficient resources for development of quality control policies and procedures.

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## Ethical Requirements

Ethical requirements relating to audits and reviews of financial information, and other assurance and related services engagements are contained in the Code of Ethcis.

- Code establishes following fundamental principles of professional ethics:
  - (i) Integrity
  - (ii) Objectivity
  - (iii) Professional competence and due care
  - (iv) Confidentiality
  - (v) Professional behaviour

- Code includes independence requirement for assurance engagements, firm should establish policies and procedures to:
  - ➢ Communicate its independence requirements to its personnel
  - ➢ Identify circumstances & relationship that create threats to independence & take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards.

  Example

  Using same engagement partner on assurance engagement over long period may impair quality of performance and may create familiarity threat. For determining appropriate safeguard, firm should consider following matters:
  - ✓ Nature of engagement including extent to which it involves public interest.
  - ✓ Length of service of engagement partner on engagement.

  Safeguard to eliminate this threat include rotating the engagement partner. In case of audit of FS listed entities, engagement partner shall be rotated after a period not more than 7 years (Mandatory Requirement).

Note:

At least annually, firm should obtain written confirmation of compliance with independence from all firm personnel.

## Acceptance and Continuance of Client Relationships and Specific Engagements

Firm should establish policies and procedures for acceptance and continuance of client relationships and specific engagements, to provide it with reasonable assurance that it will undertake or continue relationships and engagements only where it:

(a) Has considered the integrity of client.
(b) Is competent to perform the engagement and has capabilities, time and resources to do so.
(c) Can comply with ethical requirements.

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**Matters to be considered with regard to Integrity of Client**

With regard to the integrity of a client, matters that the firm considers include:

(i) Identity and business reputation of client's principal owners, key management and TCWG.

(ii) Nature of client's operations, including its business practices.

(iii) Information concerning attitude of client's principal owners, key management and TCWG towards interpretation of accounting standards and internal control environment.

(iv) Whether client is aggressively concerned with maintaining firm's fees as low as possible.

(v) Indications of inappropriate limitation on scope of work.

(vi) Indications that client might be involved in money laundering or other criminal activities.

(vii) Reasons for proposed appointment of firm and non-reappointment of previous firm.

**Matters to be considered with regard to Capabilities & Competency**

In determining whether firm has capabilities, competence, time and resources to undertake new engagement, matters that the firm considers include whether:

(i) Firm personnel have knowledge of relevant industries or subject matters.

(ii) Firm personnel have experience with relevant regulatory or reporting requirements.

(iii) Firm has sufficient personnel with necessary capabilities and competence.

(iv) Experts are available, if needed.

(v) Firm would be able to complete engagement within reporting deadline.

**If firm obtains information that would have caused it to decline engagement if that information had obtainable earlier, firm can consider possibility of withdrawing from engagement and client relationship.**

Issues that need to be addressed before deciding to withdraw / Policies and procedures on withdrawal from engagement and client relationship include following:

- Discussing with client's management/TCWG regarding action that firm might take based on relevant facts and circumstances.
- If firm determines that it is appropriate to withdraw, discussing with appropriate level of client's management/TCWG withdrawal from engagement and reasons for withdrawal.
- Considering whether there is a professional, regulatory or legal requirement for firm to report withdrawal to regulatory authorities.
- Documenting significant issues, conclusions and basis for conclusions.

## Human Resources

Firm should establish policies and procedures to provide it with reasonable assurance that it has sufficient personnel with capabilities and competence necessary to perform its engagements.

Firm should assign responsibility for each engagement to an engagement partner. Firm should establish policies and procedures requiring that:

- Identity & role of engagement partner are communicated to key members of management/TCWG.
- Engagement partner has capabilities, competence, authority and time to perform the role.
- Responsibilities of engagement partner are clearly defined and communicated to that partner.

## Engagement Performance

Firm should establish policies and procedures to provide it with reasonable assurance that engagements are performed as per professional standards and regulatory and legal requirements.

### (1) Review of Engagement Work (Normal Review)

More experienced engagement team members (including engagement partner) review work performed by less experienced team members. Reviewers consider whether:

(i) Work performed as per professional standards and regulatory and legal requirements.
(ii) Significant matters raised for further consideration.
(iii) Appropriate consultations have taken place and resulting conclusions documented.
(iv) Work performed is appropriately documented.
(v) Evidence obtained is sufficient and appropriate to support the report.
(vi) Objectives of engagement procedures have been achieved.

### (2) Consultation in Difficult or Contentious Matters

- Consultation should take place in difficult or contentious matters pertaining to engagement.
- Consultation includes discussion with professional individuals within or outside the firm to resolve difficult or contentious matter.
- It helps to promote quality and improves application of professional judgment.
- Complete documentation should be maintained on issues involved and results of consultation.

### (3) Engagement Quality Control Review

| | |
|---|---|
| **Engagement Quality Control Review** | Process for evaluation of significant judgments & conclusions made by engagement team before report is issued. |
| **Engagement Quality Control Reviewer (EQCR)** | Any person (CA who is not part of engagement team) with sufficient experience to evaluate significant judgments & conclusions made by engagement team. |

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| Requirement of Engagement Quality Control Review | Audit of FS of Listed Entities – Mandatory<br>Any Other Engagement – Optional |
|---|---|

- Following aspects need to be considered while performing Engagement Quality Control Review for audit of FS of listed entity:
  - (i) Engagement team evaluation of firm's independence in relation to specific engagement.
  - (ii) Significant risks identified during engagement and responses to those risks.
  - (iii) Judgments made about materiality and significant risks.
  - (iv) Significance of corrected & uncorrected misstatements identified during engagement.
  - (v) Matters to be communicated to management/TCWG and regulatory bodies.
  - (vi) Whether working papers selected for review reflect work performed for significant judgments.
  - (vii) Whether appropriate consultation has taken place on difficult or contentious matters.
  - (viii) Appropriateness of report to be issued.
- Documentation by EQCR for Engagement Reviewed

  Policies and procedures on documentation of engagement quality control review should require documentation that (For engagement reviewed, EQCR shall document that):
  - ➢ Procedures required by firm policies on quality control review have been performed.
  - ➢ Engagement quality control review has been completed before report is issued.
  - ➢ Reviewer is not aware of any unresolved matters that would cause reviewer to believe that significant judgments & conclusions made by engagement team were not appropriate.
- Other Points
  - ➢ This review does not reduce the responsibilities of engagement partner.
  - ➢ It is necessary to maintain objectivity of EQCR. Therefore, participation in engagement is to be avoided at all costs. Engagement partner may consult EQCR during engagement without compromising his objectivity.

**(4) Differences of Opinion**

- If there is difference of opinion between engagement team, engagement partner and EQCR, report shall be issued only after resolution of differences.
- If recommendations of EQCR are not accepted by engagement partner, matter shall be resolved by following established procedures like by consulting with another practitioner or firm or professional or regulatory body.

**(5) Engagement Documentation (Working Papers)**

| | |
|---|---|
| **Assembly** | Firm should establish policies and procedures to complete assembly of final engagement files on timely basis after engagement reports have been finalized.<br>In case of Audit Engagements – Engagement files shall be completed within 60 days after date of auditor's report. |

| | |
|---|---|
| **Safety & Accessibility** | ▪ Policies and procedures should be designed to maintain safe custody, integrity, accessibility and retrievability of engagement documentation.<br>▪ Original paper documentation may be electronically scanned for inclusion in engagement files. Firm implements procedures requiring engagement teams to:<br>➢ Generate scanned copies that reflect full content of original documentation.<br>➢ Integrate scanned copies into engagement files, including indexing & signing.<br>➢ Enable scanned copies to be retrieved and printed. |
| **Retention** | Engagement documentation has to be retained for sufficient period.<br>In case of Audit Engagements - Retention period is minimum 7 years from date of auditor's report. |
| **Ownership** | Engagement documentation is the property of firm. |

## Monitoring

Firm should establish policies and procedures to provide it with reasonable assurance that policies and procedures relating to system of quality control are operating effectively.

Quality control of engagements has to be monitored taking into account following factors:

- Entrusting responsibility of monitoring process to a partner or other experienced person in firm.
- Deciding whether quality control system of firm has been effectively implemented.
- Dealing with complaints and allegations against firm or its employees of non-compliance with professional standards or regulatory requirements by a person within or outside the firm.
- Taking action when deficiencies or non-compliance in firm system of quality control are identified.
- Taking appropriate actions against personnel who did not conform to quality control policies.

## Complaints and Allegations

**For dealing with complaints and allegations:**

(i) Firm should establish policies and procedures to deal appropriately with:
  (a) Complaints and allegations that work performed by firm fails to comply with professional standards and regulatory and legal requirements; and
  (b) Allegations of non-compliance with firm system of quality control.

(ii) Complaints and allegations may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties.

(iii) Firm should establish clearly defined channels for firm personnel to raise concern without fear

(iv) Firm investigates such complaints and allegations as per established policies and procedures. Investigation is supervised by a partner with sufficient experience and authority.

(v) If results of investigations indicate non-compliance, firm takes appropriate action.



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## Mechanisms for Review of Quality Control

- Peer Review Board
  - Peer review means examination and review of systems and procedures to determine whether the same have been put in place by Practice Unit for ensuring quality of assurance services as per technical, professional and ethical Standards.
  - Peer review Board is constituted by ICAI Council.
  - Objective of Peer review board is to ensure that, in carrying out assurance assignments technical, professional and ethical standards are complied with by members of ICAI.
- Quality Review Board (QRB)
  - QRB is set up by Central Government. It consists of members nominated by CG & ICAI Council.
  - Functions of QRB are:
    - ✓ To make recommendations to Council for quality of services provided by members of ICAI.
    - ✓ To review quality of services provided by members of ICAI.
    - ✓ To guide members of ICAI to improve quality of services.
- National Financial Reporting Authority (NFRA)
  - NFRA has been constituted in terms of Section 132(1) of Companies Act,2013.
  - It has power to enforce compliance with standards and oversee quality of service or undertake investigation of auditors of certain companies such as listed, insurance, banking companies etc.
  - QRB can review quality of services provided by members of ICAI other than entities specified under NFRA and those referred to QRB by NFRA.

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# SA 200 – Overall Objectives of Independent Auditors & Conduct of an Audit in Accordance with SA

## Introduction

- This SA requires auditor to obtain reasonable assurance whether FS are free from material misstatement.
- Reasonable assurance is a high level of assurance to reduce audit risk to an acceptably low level. It is not an absolute level of assurance because there are inherent limitations of audit.

## Inherent Limitations of Audit

Due to inherent limitations of audit, there is unavoidable risk that some material misstatements of FS may not be detected even though audit is properly planned and performed as per SAs.

| | |
|---|---|
| **Inherent limitations of audit arise from:** | ➢ Nature of financial reporting.<br>➢ Nature of audit procedures.<br>➢ Need for audit to be conducted within reasonable time and at reasonable cost. |

**Certain assertions or subject matters where it is difficult to detect material misstatements due to potential effects of inherent limitations include:**

(i) Fraud involving senior management or collusion.
(ii) Existence and completeness of related party relationships and transactions.
(iii) Occurrence of non-compliance with laws and regulations.
(iv) Future events or conditions that may cause entity to cease to continue as a going concern.

## Professional Skepticism and Professional Judgment

**Professional Skepticism**

- It is an attitude that includes a questioning mind, being alert to conditions that indicate misstatement due to error or fraud & a critical assessment of audit evidence.
- Auditor shall plan & perform audit with professional skepticism.

**Professional Judgment**

- It is application of relevant training, knowledge & experience provided by auditing, accounting & ethical standards for making informed decisions.
- Auditor shall exercise professional judgment in planning & performing audit.

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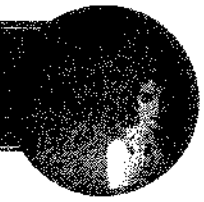
## Fundamental Responsibilities of Management & TCWG relating to Conduct of Audit

- Preparation & presentation of FS as per FRF.
- Design, implementation and maintenance of internal control to enable preparation of FS that are free from material misstatement.

| | | | |
|---|---|---|---|
| ▪ Provide auditor: | All information relevant to preparation and presentation of FS. | Any additional information, that auditor requests from management/TCWG. | Unrestricted access to those within entity from whom auditor can obtain evidence. |

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# SA 210 – Agreeing the Terms of Audit Engagement



## Introduction

As per this SA, objective of auditor is to accept or continue audit engagement only when preconditions for audit are present and there is common understanding between auditor & management/TCWG about terms of audit engagement.

## Preconditions for an Audit

**To establish whether preconditions for audit are present, auditor shall:**

- Determine whether FRF applied in preparation of FS is acceptable.
- Obtain agreement from management that it acknowledges its responsibility for:
  - (i) Preparation & presentation of FS as per FRF.
  - (ii) Design, implementation and maintenance of internal control to enable preparation of FS that are free from material misstatement.
  - (iii) Provide the auditor:

| All information relevant to preparation & presentation of FS. | Any additional information, that auditor requests from management/TCWG. | Unrestricted access to those within entity from whom auditor can obtain evidence. |
|---|---|---|

## Agreement on Audit Engagement Terms [Audit Engagement Letter & what does it contains]

- Auditor shall agree terms of audit engagement with management/TCWG.
- **Agreed terms of engagement shall be recorded in Audit Engagement Letter & shall include:**
  - (i) Objective & scope of audit of FS.
  - (ii) Responsibilities of Auditor.
  - (iii) Responsibilities of Management.
  - (iv) Identification of applicable FRF for preparation of FS.
  - (v) Reference to expected form and content of any report to be issued by auditor.
- If management/TCWG impose a limitation on scope of auditor's work in terms of audit engagement and auditor believes that limitation will result in disclaiming an opinion on FS, auditor shall not accept such a limited engagement.

## Circumstances that may Warrant the Revision in Terms of Audit Engagement

**Factors where it is appropriate to revise terms of engagement or to remind entity of existing terms:**

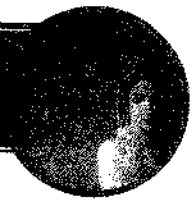
- Any indication that entity misunderstands the objective & scope of audit.

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- Any revised or special terms of engagement.
- Recent change in senior management.
- Significant change in ownership.
- Significant change in nature & size of entity's business.
- Change in legal or regulatory requirements.
- Change in FRF adopted in preparation of FS.
- Change in other reporting requirements.

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# SA 220 – Quality Control for an Audit of Financial Statement



## Introduction

- This SA deals with responsibilities of auditor regarding quality control procedures for audit of FS.
- Engagement Partner has to implement quality control procedures at particular audit engagement level that provide him with reasonable assurance that audit complies with professional standards and regulatory and legal requirements.
- SA-220 is modelled on lines of SQC 1. It describes responsibilities of EP for following matters:

(1) Leadership responsibilities for quality on audits
(2) Ethical requirements
(3) Acceptance and continuance of client relationships and audit engagements
(4) Assignment of audit engagement team
(5) Engagement performance
(6) Monitoring

## Additional Responsibilities of Engagement Partner in relation to an Audit Engagement

| | |
|---|---|
| **Leadership Responsibilities for Quality on Audits** | Actions of engagement partner and appropriate messages to engagement team, in taking responsibility for overall quality on each audit engagement emphasis:<br>▪ Importance to audit quality of:<br>➢ Performing work that complies with professional standard & legal requirement.<br>➢ Complying with firm quality control policies and procedures.<br>➢ Issuing appropriate auditor's report.<br>➢ Engagement team ability to raise concerns without fear of reprisals.<br>▪ Fact that quality is essential in performing audit engagements. |
| **Ethical Requirements** | To ensure compliance with independence requirements that apply to audit, EP shall:<br>▪ Obtain relevant information from firm to identify circumstances that create threats to independence.<br>▪ Evaluate information on identified breaches to determine whether they create threat to independence for audit engagement.<br>▪ Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards. |
| **Engagement Performance** | For Engagement Quality Control Review, EP shall:<br>▪ Determine that EQCR has been appointed.<br>▪ Discuss significant matters arising during the audit engagement with EQCR.<br>▪ Not date the auditor report until engagement quality control review is completed. |

# SA 230 – Audit Documentation

## Introduction

- This SA deals with auditor's responsibility to prepare audit documentation for audit of FS.
- Audit documentation means record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached. (Terms such as working paper/work papers also used).
- Purpose of Audit Documentation
  - Assisting engagement team to plan, perform and supervise audit.
  - Enabling engagement team to be accountable for its work.
  - Retaining record of significant matters for future audit.
  - Enabling conduct of quality control review and external inspection.

## Timely Preparation of Audit Documentation

- Audit documentation should be prepared on timely basis.
- Documentation prepared after audit work has been performed are likely to be less accurate than documentation prepared at the time when such work is performed.

## Form, Content and Extent of Audit Documentation

### (1) Factors Influencing the Amount of Working Papers required to be Maintained for Audit

Form, content & extent of audit documentation depends on following factors:

- Size & complexity of entity.
- Nature of audit procedure to be performed.
- Identified ROMM.
- Significance of audit evidence obtained.
- Nature & extent of exceptions identified.
- Need to document a conclusion not determinable from evidence obtained.
- Audit methodology & tools used.
- Timely preparation of audit documentation.

### (2) Documentation of Compliance with SAs

- Audit documentation provides evidence that audit complies with SAs. However, it is neither necessary nor practicable for auditor to document every matter.
- It is unnecessary for auditor to document separately compliance with matters for which compliance is demonstrated by documents included within audit file. For example:
  - Existence of documented audit plan demonstrates that auditor has planned the audit.

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- Existence of signed engagement letter in audit file demonstrates that auditor has agreed terms of audit engagement with management/TCWG.
- Auditor's report containing qualified opinion demonstrates that auditor has complied with requirement to express qualified opinion.
- In relation to requirements that apply generally throughout audit such as professional skepticism, there are number of ways in which compliance with them may be demonstrated within audit file.

## Assembly of Final Audit File

- Auditor shall assemble audit documentation in an audit file & complete administration process on a timely basis within 60 days after date of auditor's report.
- After assembly is completed, auditor shall not delete or discard audit documentation of any nature before end of its retention period which is not shorter than 7 years from date of auditor's report.
- If auditor finds necessary to modify or add documentation after completion of assembly of final audit file, auditor shall document:
  (i) Specific reasons for making them.
  (ii) When & by whom they were made & reviewed.

## Ownership of Audit Documentation [Auditor's Responsibility to Provide Access to Working Papers]

- Audit documentation is property of auditor.
- Auditor may at its discretion make portions of working papers available to client, provided such disclosure does not undermine validity of work performed and independence of auditor or his personnel.
- However, if there is a request by regulator to provide access to working papers, it has to be complied with after informing the client.
- Therefore, it is auditor's responsibility to provide access to his audit working papers to regulators whereas it is at auditor's discretion to make portions of his working paper to client.

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# SA 240 – The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements



## Introduction

- This SA deals with auditor's responsibilities relating to fraud in audit of FS.
- Misstatement in FS can arise from fraud or error. Fraud is an intentional act by one or more individuals among management/TCWG, employees or third parties to obtain unjust or illegal advantage whereas error is an unintentional act.
- Auditor shall be concerned with fraud that causes material misstatement in FS. Two types of intentional misstatements are relevant to the auditor:
  (i) Misstatements resulting from fraudulent financial reporting
  (ii) Misstatements resulting from misappropriation of assets

## Fraudulent Financial Reporting

Fraudulent Financial Reporting involves intentional misstatements or omission of amounts or disclosures in FS to deceive users of FS.

It may be accomplished by following (sources of fraudulent financial reporting):

- Manipulation, falsification or alteration of accounting records.
- Misrepresentation or intentional omission of significant information in FS.
- Intentional misapplication of accounting principles.

It often involves management override of controls. Fraud can be committed by management overriding controls using techniques such as:

- Recording fictitious journal entries to manipulate operating results.
- Inappropriately adjusting assumption & changing judgments.
- Omitting, advancing or delaying recognition of transactions in FS.
- Concealing or not disclosing facts.
- Altering records & terms.

## Misappropriation of Assets

Misappropriation of Assets involves theft of entity's assets and is perpetrated by employees in small & immaterial amounts. It can also involve management who are able to disguise & conceal misappropriations in ways that are difficult to detect.

It may be accomplished by following:

- Embezzling receipts.
- Stealing physical assets or intellectual property.

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- Causing entity to pay for goods and services not received.
- Using entity's assets for personal use.

## Fraud Risk Factors

- Fraud Risk Factors means events or conditions that indicate incentive or pressure to commit fraud or provide an opportunity to commit fraud.
- Hence, Fraud Risk Factors are classified according to 3 conditions - Incentives/Pressures, Opportunities and Attitude/Rationalization.
- Fraud Risk Factors can be related to misstatements arising from:
  (i) Fraudulent Financial Reporting
  (ii) Misappropriation of Assets

| Examples of Fraud Risk Factors relating to Fraudulent Financial Reporting are: | |
|---|---|
| Incentives/ Pressures | ➢ High degree of competition.<br>➢ Significant declines in customer demand.<br>➢ Recurring negative cash flows or operating losses.<br>➢ New accounting, statutory, or regulatory requirements.<br>Excessive pressure exists for management to meet requirements of third parties due to following:<br>➢ Profitability of investors, creditors or other external parties.<br>➢ Need to obtain additional debt or equity financing to stay competitive.<br>➢ Marginal ability to meet listing requirements or debt repayment.<br>➢ Adverse effects of reporting poor financial results on pending transactions.<br>Information available indicates that personal financial situation of management/ TCWG is threatened by entity's financial performance arising from following:<br>➢ Significant financial interest in entity.<br>➢ Compensation being contingent upon achieving aggressive targets.<br>➢ Personal guarantees of debts of entity.<br>➢ Excessive pressure on management to meet financial targets. |
| Opportunities | ➢ Significant related-party transactions not in ordinary course of business.<br>➢ Significant estimates that involve subjective judgments.<br>➢ Significant unusual or highly complex transactions.<br>➢ Significant bank accounts or branch operations in tax-haven jurisdictions. |
| Attitude/ Rationalization | ➢ Known history of violations of laws and regulations.<br>➢ Management failing to remedy known significant deficiencies in internal control.<br>➢ Recurring attempts by management to justify inappropriate accounting. |

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| | Relationship between management and auditor is strained due to following:<br>➢ Frequent disputes with auditor on accounting, auditing or reporting matters.<br>➢ Unreasonable demands on auditor such as unrealistic time constraints regarding completion of audit or issuance of auditor's report.<br>➢ Restrictions on auditor that inappropriately limit access to people or information.<br>➢ Domineering management behaviour in dealing with auditor. |
| | |
| **Examples of Fraud Risk Factors relating to Misappropriation of Assets are:** | |
| Incentives/ Pressures | ➢ Personal financial obligations may create pressure on management & employees to misappropriate assets.<br>➢ Adverse relationship between entity & employees may motivate employees to misappropriate assets. Adverse relationship may be created by – future layoffs, recent changes to benefit plans, rewards inconsistent with expectations. |
| Opportunities | ➢ Large amount of cash on hand.<br>➢ Inventory/fixed assets are of small size and high value.<br>➢ Inadequate internal control over assets<br>✓ Inadequate segregation of duties or independent checks.<br>✓ Inadequate management oversight of employees responsible for assets.<br>✓ Inadequate record keeping of assets.<br>✓ Inadequate system of authorization and approval of transactions.<br>✓ Inadequate physical safeguards over cash, inventory or fixed assets.<br>✓ Lack of complete and timely reconciliation of assets.<br>✓ Lack of timely and appropriate documentation of transactions.<br>✓ Lack of mandatory vacations for employees performing key control functions.<br>✓ Inadequate IT understanding which enables IT employees to misappropriate. |
| Attitude/ Rationalization | ➢ Disregard for internal control.<br>➢ Behavior indicating dissatisfaction with entity.<br>➢ Changes in lifestyle. |

## Responsibilities of TCWG/Management and Auditor in case of Fraud

| **Responsibility of TCWG/Management** |
|---|
| Primary responsibility for prevention and detection of fraud is of TCWG/management of entity. |
| **Responsibility of Auditor** |
| ▪ Auditor is responsible for obtaining reasonable assurance that FS as a whole are free from material misstatement whether caused by fraud or error. |

## SA 240 – The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements

Due to inherent limitations of Audit, there is unavoidable risk that some material misstatement may not detected even though audit is properly planned & performed as per SAs.

Risk of not detecting material misstatement resulting from fraud is higher than from error. This is because fraud may involve organized schemes designed to conceal it.

Risk of not detecting material misstatement resulting from management fraud is greater than employee fraud because management can manipulate accounting records, present fraudulent financial information or override control procedures.

- Auditor shall identify and assess ROMM due to fraud at FS level and assertion level. It is a presumption that there are risks of fraud in revenue recognition, cash balance etc in case of lack of controls in these areas. Risk of fraud is a significant risk.
- Auditor shall determine overall responses to address assessed ROMM due to fraud.
- If auditor identified or suspects a fraud, he shall communicate the fraud to management. If fraud involving management, he shall communicate to TCWG. Auditor shall also determine whether there is a responsibility to report the fraud to regulatory authorities.
- In case of companies, auditor shall report fraud as per section 143(12) of Companies Act, 2013 and Clause (xi) of paragraph 3 of CARO, 2020.

### Responses to assessed ROMM due to Fraud at FS Level and Assertion Level

In determining overall responses to address assessed ROMM due to fraud at FS level, auditor shall:

- Assign & supervise personnel with knowledge & ability for significant engagement responsibilities.
- Evaluate whether selection and application of accounting policies by entity may be indicative of fraudulent financial reporting.
- Incorporate element of unpredictability in selection of NTE of audit procedures.

Audit procedures responsive to assessed ROMM due to fraud at assertion level:

- Auditor shall design and perform further audit procedures.
- In doing so, auditor may change NTE of audit procedures to obtain more reliable audit evidence or to obtain additional corroborative information.

### Audit Procedures responsive to Risks related to Management Override of Controls

**Auditor shall design and perform audit procedures to:**

- Test appropriateness of journal entries recorded in general ledger and adjustments made in FS.
- Review accounting estimates for biases.
- For significant transactions that are outside the normal course of business, evaluate whether business rationale of transactions suggests that they have been entered to engage in fraudulent financial reporting.

## Impossibility to Continue the Performance of Audit

**As a result of misstatement resulting from fraud, auditor encounters exceptional circumstances that bring questions to auditor's ability to continue performing the audit, auditor shall:**

- **Determine** professional & legal responsibilities to report the person who made audit appointment or regulatory authorities **regarding fraud.**
- Consider to withdraw **from the engagement** if **withdrawal is** legally permitted.
- **If auditor withdraws:**
  - Discuss with **appropriate level of** management/TCWG regarding **auditor's** withdrawal & reasons **for withdrawal.**
  - **Determine** professional & legal requirement to report the person who made audit appointment or regulatory authorities **regarding auditor's withdrawal & reasons for withdrawal.**

## Management Representations

**Auditor shall obtain WR from management/TCWG that:**

- **They** acknowledge their responsibility **for design, implementation and maintenance of** internal control to prevent and detect fraud.
- **They have** disclosed **to auditor the** results of management's assessment of risk **of fraud.**
- **They have** disclosed **to auditor their knowledge of** fraud or suspected fraud **affecting the entity.**
- **They have** disclosed **to the auditor their knowledge of** any allegations **of fraud or suspected fraud communicated by employee, former employees, regulators or others.**

## Documentation

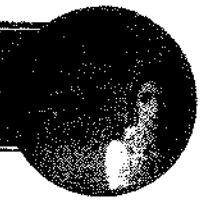
**Auditor's documentation of understanding of entity and assessment of ROMM shall include:**

- **Significant decisions reached during discussion among engagement team regarding susceptibility of entity's FS to material misstatement due to fraud.**
- **Identified and assessed ROMM due to fraud at FS level and at assertion level.**

**Auditor's documentation of responses to assessed ROMM shall include:**

- **Overall responses to assessed ROMM due to fraud at FS level and at assertion level and NTE of audit procedures.**
- **Results of audit procedures including those address the risk of management override of controls.**

# SA 250 – Consideration of Laws & Regulations in an Audit of Financial Statements



## Introduction

- This SA deals with auditor's responsibility to consider laws & regulations in performing audit of FS.
- Non-compliance means act of omission or commission by entity, either intentional or unintentional which are contrary to prevailing laws or regulations. It does not include personal misconduct (unrelated to business activities of entity) by management/TCWG or employees.

## Responsibility of Management for Compliance with Laws and Regulations

- Ensure that entity's operations are conducted as per provisions of laws and regulations.
- **For this, entity may implement following Policies and Procedures that assist in prevention and detection of non-compliance with laws and regulations:**
  - Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
  - Instituting and operating appropriate systems of internal control.
  - Developing, publicizing and following code of conduct.
  - Ensuring employees are properly trained and understand code of conduct.
  - Monitoring compliance with code of conduct.
  - Engaging legal advisors to assist in monitoring legal requirements.
  - Maintaining register of significant laws and regulations and record of complaints.

## Responsibility of Auditor in relation to Compliance with Laws & Regulations by the Entity

### (1) Inherent Limitations on Auditor's Ability

In case of laws and regulations, potential effects of inherent limitations on auditor's ability to detect material misstatements are greater due to following reasons:

- There are many laws and regulations that do not affect the FS and not captured by entity's information systems.
- Non-compliance may involve conduct designed to conceal it, such as collusion, forgery, or intentional misrepresentations made to auditor.
- Whether an act constitutes non-compliance is ultimately a matter for legal determination by a court of law.

### (2) Auditor's Responsibilities

**Responsibilities relating to compliance with those laws and regulations that have a direct effect on determination of material amounts and disclosures in FS** (Tax, Labour Laws etc.)

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- As part of obtaining understanding of entity & its environment, auditor shall obtain a general understanding of:
  - Legal and regulatory framework applicable to entity & industry in which entity operates.
  - How the entity is complying with that framework.
- Auditor shall obtain sufficient appropriate audit evidence regarding compliance with those laws and regulations that have direct and material effect on FS.

**Responsibilities relating to other laws and regulations that do not have direct effect on FS but their compliance is fundamental to operating aspects of business** (Employment of Child Labour, Environmental Regulations etc.)

- Auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.
- For other laws, auditor's responsibility is limited to identify non-compliance that may have a material effect on FS.
- Auditor shall perform following audit procedures to identify non-compliance that have material effect on FS:
  - Inquiring of management/TCWG, whether entity is in compliance with laws & regulations.
  - Inspecting correspondence with regulatory authorities.

- During audit, auditor shall remain alert to possibility that other audit procedures applied may bring instances of non-compliance to auditor's attention.
- Auditor shall obtain WR from management/TCWG that all known instances of non-compliance have been disclosed to auditor.

## Indications of Non-compliance with Laws & Regulations

**When auditor has information about following matters, it may be an indication of non-compliance with laws & regulations:**

- Investigation by regulatory organisations & government departments or payment of penalties.
- Payment for unspecified services to consultants or government employees.
- Sales commission or agent fees that appear excessive in relation to those ordinary paid by entity.
- Purchasing at prices significantly above or below market price.
- Unusual payment towards legal & retainership fees.
- Unusual transactions with companies registered in tax heavens.
- Payments for goods/services made other than to the country from which goods/services originated.
- Existence of information system which fails by design or accident to provide sufficient evidence.
- Adverse media comment.

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## Audit Procedures to be Followed when Non-compliance is Identified or Suspected

- If auditor has information about non-compliance, he shall obtain:
  - Understanding of nature of act and circumstances in which it has occurred; and
  - Further information to evaluate the possible effect on FS.
- If auditor suspects non-compliance, he shall discuss matter with management. If they do not provide sufficient information and effect of non-compliance may be material to FS, auditor shall consider to obtain legal advice.
- If sufficient information about suspected non-compliance cannot be obtained, auditor shall evaluate effect on auditor's opinion.
- Auditor shall document identified or suspected non-compliance with laws and regulations.

## Reporting Responsibility of Auditor for Non-compliance of Laws and Regulations in Audit of FS [Reporting of Identified or Suspected Non-compliance]

### Reporting Non-compliance to TCWG

- Auditor shall communicate TCWG with matters involving non-compliance that come to auditor's attention during audit, other than when the matters are clearly inconsequential.
- If non-compliance referred above is intentional & material, auditor shall communicate the matter to TCWG as soon as practicable.
- If auditor suspects that management/TCWG are involved in non-compliance, he shall communicate matter to next higher level of authority in entity such as audit committee or supervisory board. Where no such authority exists, auditor shall consider to obtain legal advice.

### Reporting Non-compliance in Auditor's Report

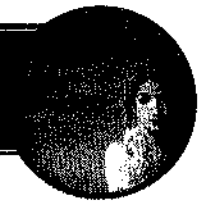
- If auditor concludes non-compliance has material effect but not reflected in FS, he shall express qualified or adverse opinion.
- If auditor is precluded by management/TCWG from obtaining audit evidence to evaluate whether non-compliance has occurred, he shall express qualified or disclaimer of opinion on basis of limitation of scope.

### Reporting Non-compliance to Regulatory & Enforcement Authorities

- Auditor shall determine whether he has responsibility to report non-compliance to parties outside entity.

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# SA 260 – Communication with Those Charged with Governance (TCWG)



## Introduction

- This SA deals with auditor's responsibility to communicate with TCWG in audit of FS.
- **TCWG** – Person with responsibility for overseeing the strategic direction of entity and obligations related to accountability of entity. TCWG may include management personnel.
- **Management** – Person with executive responsibility for conduct of entity's operations.
- **Form and Timing of communication** – If in auditor's judgment oral communication is not adequate, he shall communicate in writing with TCWG. Auditor shall communicate with TCWG on a timely basis.

## Significance of Communication with TCWG

An effective two-way communication is important in assisting:

- Auditor and TCWG in understanding matters related to audit and in developing constructive working relationship.
- Auditor in obtaining information relevant to the audit from TCWG.
- TCWG in fulfilling their responsibility to oversee financial reporting process.

## Matters to be Communicated by Auditor to TCWG

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| **Auditor's Responsibilities relating to FS Audit** | Auditor shall communicate responsibilities of auditor in relation to FS that:<br>▪ Auditor is responsible for forming & expressing an opinion on FS that have been prepared by the Management with the oversight of TCWG.<br>▪ Audit of FS does not relieve Management/TCWG of their responsibilities. |
| **Planned Scope & Timing of Audit** | Audit shall communicate with TCWG an overview of planned scope & timing of audit. |
| **Significant Findings from Audit** | Auditors shall communicate with TCWG:<br>▪ Auditor's views about significant qualitative aspects of entity's accounting practices, including accounting policies, accounting estimates & FS disclosures.<br>▪ Significant difficulties encountered during audit.<br>▪ Unless all TCWG are involved in managing entity:<br>➢ Significant matters arising from audit that are discussed with management<br>➢ Written representations the auditor is requesting.<br>▪ Circumstances that affect the form and content of auditor's report [going concern (SA 570), key audit matters (SA 701), modification of report (SA 705), emphasis of matter paragraph or other matter paragraph (SA 706), uncorrected material misstatement of other information (SA 720)] |

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| | ▪ Other matters arising from audit that in auditor's judgment are significant to oversight of financial reporting process. |

## Significant Difficulties Encountered during Audit

**Significant difficulties encountered during audit may include matters such as:**

- Significant delays by management or unwillingness to provide necessary information.
- Unreasonably brief time within which to complete the audit.
- Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- Unavailability of expected information.
- Restrictions imposed on auditor by management.
- Management's unwillingness to make its assessment of entity's ability to continue as going concern.

## Significant Matters that were Discussed or Subject to Correspondence with Management

**Significant matters that were discussed with management include matters such as:**

- Significant transactions occurred during the year.
- Business conditions affecting the entity, and business plans that may affect ROMM.
- Concerns about management consultation with other accountants on accounting/auditing matters.
- Discussions regarding initial or recurring appointment of auditor.
- Matters on which there was disagreement with management except initial differences of opinion.

## Additional Communication in case of Listed Entities regarding Independence

**In case of listed entities, auditor shall communicate with TCWG:**

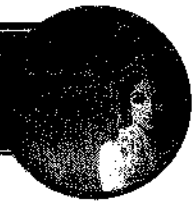
(i) Statement that engagement team & others in firm complied with relevant ethical requirements regarding independence.

(ii) All relationship & other matters between firm & entity that may affect independence. It includes total fees charged during the period for audit and non-audit services.

(iii) Related safeguards applied to eliminate identified risk to independence or reduce them to an acceptable level.

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# SA 265 – Communicating Deficiencies in Internal Control to TCWG and Management



## Introduction

- This SA deals with auditor's responsibility to communicate to TCWG and Management about deficiencies in internal control that the auditor has identified in audit of FS. This kind of communication is known as letter of weakness.
- Auditor shall identify deficiencies in internal control & determine whether they are significant deficiencies. He shall communicate in writing significant deficiencies on a timely basis to TCWG.
- **Deficiency in Internal Control** – When a control is designed, implemented or operated in a way that it is unable to prevent, detect & correct misstatement in FS on a timely basis or when it is missing.

## Significant Deficiency in Internal Control

- Significant deficiency in internal control means deficiency in internal control that is of sufficient importance in auditor's judgment to merit attention of TCWG.
- **Indicators of significant deficiencies in internal control**

(i) Evidence of ineffective aspects of control environment such as:
  (a) Indications that significant transactions are not appropriately scrutinised by TCWG.
  (b) Management's failure to implement action on deficiencies previously communicated.

(ii) Absence of risk assessment process within the entity.

(iii) Evidence of ineffective entity risk assessment process.

(iv) Evidence of ineffective response to identified significant risks.

(v) Misstatements detected by auditor's procedures that were not prevented, detected and corrected by entity's internal control.

(vi) Evidence of management's inability to oversee preparation of FS.

- **Matters to be considered in determining whether a deficiency in internal control constitutes a significant deficiency**

(i) Likelihood of deficiencies leading to material misstatements in FS in future.

(ii) Susceptibility to loss or fraud of related asset.

(iii) Subjectivity and complexity of determining estimated amounts.

(iv) FS amounts exposed to deficiencies.

(v) Volume of activity that occurred in account balance or class of transactions.

(vi) Importance of controls to financial reporting process
  - General monitoring controls.
  - Controls over prevention and detection of fraud.

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- Controls over selection and application of accounting policies.
- Controls over significant transactions with related parties.
- Controls over significant transactions outside the entity's normal course of business.

(vii) Cause and frequency of exceptions detected.

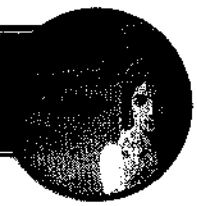
(viii) Interaction of deficiency with other deficiencies in internal control.

## Matters to be Communicated regarding Significant Deficiencies in Internal Control

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| **Matters to be Communicated** | ▪ Auditor shall include in written communication of significant deficiencies in internal control:<br>➢ Description of deficiencies & their potential effects.<br>➢ Sufficient information to enable management/TCWG to understand deficiencies.<br>▪ Auditor shall explain that:<br>➢ Purpose of audit is to express an opinion on FS.<br>➢ Audit includes consideration of internal control to design audit procedures but not for expressing an opinion on effectiveness of internal control.<br>➢ Matters reported are limited to those deficiencies that the auditor has identified during audit. |
| **Points to be Kept in Mind while Drafting Letter of Weakness** | Important points with regard to letter of weakness are as follows:<br>➢ The letter lists the area of weaknesses in system and offers suggestions for improvement.<br>➢ It should clearly indicate that it discusses only weaknesses which came to auditor's attention.<br>➢ This letter serves as valuable document for management for revising the system and its strict implementation.<br>➢ The letter may also serve to minimize liability resulting from weakness in internal control. |

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# SA 299 – Joint Audit of Financial Statements



## Introduction

- **This SA deals with auditor responsibilities in accepting appointment as Joint Auditors.**
- **Joint audit means** audit of FS of an entity by two or more auditors **(described as joint auditors).**
- **This SA does** not deal with relationship between principal auditor of entity and another auditor of component **(branches, subsidiary, joint venture, associates etc) included in FS of entity.**
- **Joint auditors shall obtain common engagement letter & common management representation letter.**

## Audit Planning and Allocation of Work

### Audit Planning

**Prior to commencement of audit, joint auditors shall** discuss and develop joint audit plan. **In developing joint audit plan, joint auditors shall:**

- **Identify** division of audit areas and common audit areas **among joint auditors that define scope of work of each joint auditor.**
- **Ascertain** reporting objectives **of engagement**
- **Directing engagement** team's efforts
- **Ascertain** NTE of resources **necessary to perform engagement.**

### Allocation/Division of Work

- **Joint auditors shall divide audit work among themselves** by mutual discussion.
- **Division of work would generally be in terms of audit of** specified areas or zones.
- **Division of work among joint auditors shall be** documented and communicated to the entity.
- **Work allocation document shall be** signed by all joint auditors.

## Responsibility & Coordination among Joint Auditors

- **Each joint auditor is** responsible only for work allocated to him, **whether or not he has made a separate report on work performed by him.**
- **All joint auditors shall be jointly and severally responsible for:**

(i) **Audit** work **which is** not divided **among joint auditors and is** carried out by all **of them.**

(ii) Decisions taken by all **joint auditors** in planning NTE **of audit procedures to be performed** for common areas. **(**Jointly responsible for appropriateness of planning **NTE. Proper** execution **of these audit procedures is** individual responsibility **of concerned joint auditor)**

(iii) Matters brought to notice **of joint auditors by any one of them and on which there is an** agreement **among joint auditors.**

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(iv) For presentation and disclosure of FS as per applicable FRF.

(v) For ensuring that audit report complies with requirements of relevant statute.

- Each joint auditor is entitled to assume that other joint auditors have carried out their work as per SA and therefore it is not necessary to review the work performed by other joint auditors.

## Reporting by Joint Auditors

- Before finalizing audit report, joint auditors shall discuss and communicate their respective conclusions with each other.
- Normally, joint auditors are able to arrive at an agreed report.
- However, if joint auditors are in disagreement with regard to any matter, each one of them should express their own opinion through a separate report.
- A joint auditor is not bound by views of majority of joint auditors regarding matters to be covered in report and should express his opinion in a separate report in case of a disagreement.
- Separate audit report shall also make reference to audit report issued by other joint auditors. Such reference shall be made under heading "Other Matter Paragraph" as per SA 706.

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# SA 300 – Planning an Audit of Financial Statement



## Introduction

- This SA deals with auditor's responsibility to plan audit of FS so that it will be performed in effective manner.
- Engagement partner and other members of engagement team shall be involved in planning the audit.
- Planning is not a discrete phase of an audit but rather a continual and iterative process.

## Factors while Establishing Overall Audit Strategy and Its Benefits

| Auditor shall establish overall audit strategy that sets the scope, timing and direction of audit, and that guides the development of audit plan. | |
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| **Factors** | ▪ Determination of characteristics of audit<br>▪ Reporting objectives<br>▪ Team's efforts<br>▪ Preliminary work<br>▪ NTE of resources |
| **Benefits** | ▪ Employment of qualitative resources<br>▪ Allocation of quantity of resources<br>▪ Timing of deployment of resources<br>▪ Management of resources |

## Contents and Nature of an Audit Plan and Change in Audit Plan

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| **Contents** | Auditor shall develop an audit plan that include a description of:<br>▪ NTE of planned risk assessment procedures as determined under SA 315.<br>▪ NTE of planned further audit procedures as determined under SA 330.<br>▪ Other planned audit procedures required to be carried out so that engagement complies with SAs. |
| **Matters** | Planning is not a discrete phase of an audit but rather a continual and iterative process.<br>Planning includes the need to consider matters such as:<br>▪ Obtaining general understanding of legal framework applicable to entity.<br>▪ Analytical procedures to be applied as risk assessment procedures.<br>▪ Performance of other risk assessment procedures.<br>▪ Determination of materiality.<br>▪ Involvement of experts. |

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| **Nature** | Nature and extent of planning vary according to:<br>▪ Size and complexity of auditee<br>▪ Past experience & expertise<br>▪ Change in circumstances |
| **Change** | Auditor may need to modify the audit plan due to factors such as:<br>▪ Result of unexpected events<br>▪ Changes in conditions<br>▪ Audit evidence obtained from results of audit procedures |

## Relationship between Overall Audit Strategy and Audit Plan

- Audit strategy provides guidelines for developing the audit plan.
- Audit strategy is prepared before the audit plan.
- Audit plan contains more details than overall audit strategy.
- Audit strategy and audit plan are inter-related because change in one result into change in other.

## Benefits / Advantages of Planning in Audit of FS

- Attention to important areas.
- Timely resolution of potential problems.
- Proper organisation and management of audit engagement.
- Proper selection of engagement team.
- Direction and supervision of engagement team.
- Easy coordination in work done by auditors of components and experts.

## Documentation of Overall Audit Strategy and Audit Plan

Auditor shall document:

(i) Overall audit strategy;

(ii) Audit plan; and

(iii) Any significant changes made during audit engagement in overall audit strategy or audit plan and reasons for such changes.

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## Audit Programme

Audit programme is prepared to allocate work to team members which may include list of procedures and instructions to be followed by member. It also estimates duration for completing an audit task.

| | |
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| **Formulating an Audit Programme** | In formulating an audit programme, matters which need to be considered are:<br>▪ Nature of business in which organisation is engaged.<br>▪ Overall plan prepared for audit.<br>▪ System of internal control and accounting procedures.<br>▪ Size of organisation and structure of its management.<br>▪ Information regarding organisation of business.<br>▪ Accounting policies followed by client. |
| **Circumstances where Audit Programme would have to be Suitably Altered** | ▪ If audit procedures were designed for certain volume of turnover and subsequently volume have substantially increased.<br>▪ During audit, it is discovered that internal control procedures were not as effective as assumed at the time audit programme was framed.<br>▪ If there is extraordinary increase in amount of book debts or stocks as compared to previous year.<br>▪ When a suspicion has aroused during audit or information is received that assets have been misappropriated. |

## Additional Considerations in Initial Audit Engagements

- For initial audit, auditor may need to expand planning activities because auditor does not have previous experience with entity.
- Auditor may consider following additional matters in establishing audit strategy and audit plan:
  - Arrangements to be made with predecessor auditor to review his working papers.
  - Any major issues discussed with management in connection with initial selection as auditor.
  - Audit procedures to obtain sufficient appropriate audit evidence regarding opening balances.
  - Other procedures required by firm's system of quality control for initial audit engagements.



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# SA 315 – Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and Its Environment

## Audit Risk and It's Components

| | |
|---|---|
| **Inherent Risk** | ▪ Inherent Risk is susceptibility of assertion about class of transaction, account balance and disclosure (CAD) towards misstatements.<br>▪ These are risks that arise from entity's objectives, nature of operations & industry, regulatory environment and its size and complexity. |
| **Control Risk** | ▪ It is the risk that entity's internal control system will not prevent, detect and correct material misstatement on a timely basis or such control will be missing.<br>▪ Some control risk will always exist because there are inherent limitations of any internal control system. |
| **Risk of Material Misstatement** | ▪ It is anticipated risk that material misstatement may exist in FS prior to audit.<br>▪ It has two components: Inherent Risk and Control Risk.<br>▪ ROMM = Inherent Risk x Control Risk |
| **Detection Risk** | ▪ It is the risk that auditor will not be able to detect a material misstatement that exists in an assertion.<br>▪ ROMM is inversely related with Detection Risk. (i.e., if ROMM is high, auditor will do more checking, that results in low detection risk) |
| **Audit Risk** | ▪ It is a risk that auditor will issue inappropriate opinion while FS are materially misstated. It has two components: ROMM and Detection Risk.<br>▪ Audit Risk = ROMM x Detection Risk<br>▪ Objective of auditor is to reduce audit risk to an acceptably low level. |

## Understanding of Entity & its Environment including Entity's Internal Control

| **Risk Assessment Procedures for understanding of entity & its environment including entity's internal control (for obtaining knowledge of business)** | |
|---|---|
| For Inherent Risk | Auditor shall obtain understanding of following by conducting inquiries, observation & analytical procedures:<br>▪ Relevant industry, regulatory & other external factors<br>▪ Nature of entity including its operations, type of investments, ownership & governance structure and way in which entity is financed.<br>▪ Entity's selection & application of accounting policies<br>▪ Entity's objectives & strategies & related business risks<br>▪ Measurement & review of entity's financial performance |

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| | |
|---|---|
| For Control Risk | Auditor is required to understand the entity's internal control by conducting inquiries & observation. |

## Assertions

| Assertions means representations by management embodied in FS about classes of transaction, account balance, presentation & disclosure. | |
|---|---|
| **Assertions about classes of transaction & events** | Occurrence, Completeness, Accuracy, Cut-off, Classification |
| **Assertions about account balance** | Existence, Completeness, Rights & Obligations, Valuation & Allocation |
| **Assertions about presentation & disclosure** | Occurrence, Right & Obligations, Completeness, Classification & Understandability, Accuracy & Valuation |

## Identifying & Assessing the Risk of Material Misstatement

- Auditor shall identify & assess ROMM at FS level and assertion level for classes of transactions, accounts balances & disclosures.
- <u>For this, auditor shall (considerations of auditor to assess ROMM)</u>:
  - Identify risks including relevant control relate to risks throughout the process of obtaining understanding of entity & its environment by considering classes of transactions, account balances & disclosures in FS.
  - Assess the identified risks & evaluate whether they relate more pervasively to FS and potentially effect many assertions.
  - Relate the identified risks to what can go wrong at assertion level.
  - Consider likelihood of misstatement including possibility of multiple misstatements & whether potential misstatement is of a magnitude that could result in material misstatement.

## Risks that require Special Audit Consideration [Significant Risks]

- As part of risk assessment, auditor shall determine whether any risks identified are significant risk.
- <u>**Factors to be considered to determine whether risks identified are significant risks or not**</u>:
  - Whether risk is a risk of fraud.
  - Whether risk is related to recent significant economic, accounting or other developments.
  - Complexity of transactions.
  - Whether risk involves significant transactions with related parties.
  - Whether risk involves significant transactions that are outside normal course of business.



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## Revision of Risk of Material Misstatement

- Obtaining understanding of entity and its environment, including entity's internal control is a continuous process of gathering, updating and analysing information throughout audit.
- During audit, information may come to auditor's attention that differs significantly from information on which risk assessment was based, auditor shall revise the inherent risk or control risk which lead to revision in ROMM and modify further planned audit procedures accordingly.

## IT Systems also pose Specific Risks to Entity's Internal Control

| Some Examples of IT Risks to Entity's Internal Control |
|---|
| ▪ Reliance on system/programs that are inaccurately processing data or processing inaccurate data. |
| ▪ Unauthorized access to data. |
| ▪ Possibility of IT personnel gaining extra access. |
| ▪ Unauthorized changes to data. |
| ▪ Unauthorized changes to systems or programs. |
| ▪ Failure to make changes to systems or programs. |
| ▪ Inappropriate manual intervention. |
| ▪ Potential loss of data or inability to access data. |

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# SA 320 – Materiality in Planning & Performing an Audit



## Basics

- This SA deals with auditor's responsibility to apply materiality in planning & performing audit of FS.
- Materiality is also applied by auditor in evaluating the effect of identified misstatements on audit and of uncorrected misstatements on FS (Covered in SA 450).

## Determining Materiality & Performance Materiality when Planning the Audit

| | |
|---|---|
| **Materiality for FS** | While establishing overall audit strategy, auditor shall determine materiality for FS as a whole. |
| **Materiality for Particular CAD** | If misstatement of lesser amounts is expected to influence economic decisions of users for any class of transaction, account balance and disclosure (CAD) than materiality for FS, auditor shall also determine materiality for those particular CAD. |
| **Performance Materiality** | Performance Materiality means amount set by auditor at less than materiality to reduce probability to low level that aggregate of uncorrected and undetected misstatements exceeds materiality for FS.<br>Auditor shall determine performance materiality for determining NTE of further audit procedures. |

## Revision of Materiality as the Audit Progress / Re-evaluation of Materiality Concept

- Auditor shall revise materiality on becoming aware of information during audit which cause auditor to determine a different amount initially.
- If auditor concludes lower materiality, auditor shall determine whether it is necessary to revise performance materiality & whether NTE of further audit procedures remain appropriate.

## Use of Benchmarks in Determining Materiality for the FS as a Whole

- Determining materiality involves professional judgment. A percentage is applied to a chosen benchmark as a starting point in determining materiality for FS as a whole.
- **Factors affecting identification of benchmark**
  - Elements of FS (Eg: assets, liabilities, equity, revenue, expenses).
  - Whether there are items on which attention of users are focused. (Eg: profit, revenue etc.).
  - Nature of entity (entity's life cycle & the industry) and economic environment.
  - Entity's ownership structure & way it is financed (Eg: if entity financed by debt, users put more emphasis on asset than on equity).
  - Relative volatility of benchmark.

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- In case of regular profits, auditor may consider profit before tax as benchmark. In case of losses, auditor may consider revenue as benchmark.
- Determining a percentage to be applied to a chosen benchmark also involves professional judgment. Percentage applied to profit before tax (5%-10%) will normally be higher than percentage applied to total revenue (0.5%-2%).

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# SA 330 – The Auditors Responses to Assessed Risks

## Basics

- This SA deals with auditor's responsibility to design and implement responses to ROMM identified and assessed by auditor as per SA 315.

## Further Audit Procedures

| | |
|---|---|
| **Test of Controls** | Audit procedure designed to evaluate operating effectiveness of controls in preventing, detecting and correcting, material misstatements. |
| **Substantive Procedures** | Audit procedure designed to detect material misstatements. Substantive procedures comprise:<br>(i) Tests of details of CAD<br>(ii) Substantive analytical procedures |

## Auditor Responses to Assessed ROMM

| **In designing the further audit procedures to be performed, auditor shall:** | |
|---|---|
| ▪ Consider reasons for assessment given to ROMM at assertion level for each CAD including:<br>➢ Likelihood of material misstatement due to particular characteristics of CAD (inherent risk).<br>➢ Whether the risk assessment takes into account relevant controls (control risk).<br>▪ Obtain more persuasive audit evidence the higher the auditor's assessment of risk. | |
| | |
| **Performance of Further Audit Procedures** | |
| **Test of Controls** | ▪ Auditor shall perform tests of controls to obtain audit evidence regarding operating effectiveness of relevant controls when auditor's assessment of ROMM at assertion level includes expectation that controls are operating effectively. (i.e. auditor intends to rely on operating effectiveness of controls)<br>▪ In performing tests of controls, auditor shall obtain more persuasive audit evidence the greater the reliance auditor places on effectiveness of a control. |
| **Substantive Procedures** | ▪ Irrespective of assessed ROMM, auditor shall perform substantive procedures for each material CAD.<br>▪ In case of low assessed ROMM, substantive procedures have to be performed due to following reasons:<br>(i) Auditor's assessment of risk is judgmental and so may not identify all ROMM.<br>(ii) There are inherent limitations of internal control. |

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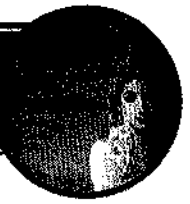
## Factors that may Warrant Re-test of Controls

- Changes may affect relevance of audit evidence obtain in previous audits. If there are no changes, auditor shall test the controls at least once in every third audit.
- Factors warrant re-test of controls/Factors that may decrease period for retesting a control are:

  - Deficient control environment.
  - Deficient monitoring of controls.
  - Significant manual element to relevant controls.
  - Personnel changes that significantly affect application of control.
  - Changing circumstances that indicate need for change in control.
  - Deficient general IT controls.

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# SA 402 – Audit Consideration Relating to an Entity using a Service Organisation



## Basics

- This SA deals with user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organisations.
- Some Important Definitions

| | |
|---|---|
| **User Entity** | An entity that uses a service organisation and whose FS are being audited. |
| **User Auditor** | An auditor who audits and reports on FS of a user entity. |
| **Service Organisation** | A third-party organisation that provides services to user entities. |
| **Service Auditor** | An auditor who provides assurance report on controls of service organisation at request of service organisation. |
| **Subservice Organisation** | A service organisation used by another service organisation to perform some of the services provided to user entities. |

- Services provided by a service organisation are relevant to the audit of user entity's FS when those services are part of user entity's information system relevant to financial reporting.

## Factors to be considered by Auditor in determining whether Services are relevant to Financial Reporting

**Service organisation's services are part of user entity's information system relevant to financial reporting if these services affect any of the following:**

(i) Classes of transactions in the user entity's operations that are significant to user entity's FS.

(ii) Financial reporting process used to prepare user entity's FS, including significant accounting estimates and disclosures.

(iii) Related accounting records either in electronic or manual form.

(iv) Procedures within both information technology (IT) and manual systems.

(v) How user entity's information system captures events and conditions, other than transactions, that are significant to FS.

## Obtaining Understanding of Services provided by Service Organisation

**(1) How to obtain understanding of Services provided by Service Organisation / Considerations regarding Nature and Extent of Activities undertaken by Service Organisation to Determine whether those Activities are relevant to Audit**

When obtaining understanding of user entity in SA 315, user auditor shall obtain understanding of how a user entity uses services of service organisation in user entity's operations including:

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- Nature of services provided by service organisation and significance of those services to user entity.
- Nature & materiality of transactions processed or account affected by service organisation.
- Degree of interaction between activities of service organisation & user entity.
- Nature of relationship between user entity & service organisation including contractual terms for activities undertaken by service organisation.

Information on nature of services provided by service organisation may be available from sources such as user manuals, technical manuals, contract or service level agreement between user entity and service organisation, internal auditors or regulatory authorities.

(2) **Obtaining understanding of controls at service organisation:**

(i) Obtaining Type 1 or Type 2 report, if available.

(ii) Contacting service organisation through user entity to obtain specific information.

(iii) Visiting service organisation and performing procedures that will provide necessary information about relevant controls.

(iv) Using another auditor to perform procedures at service organisation that will provide necessary information about relevant controls.

## Type 1 and Type 2 Report

| | |
|---|---|
| **Type 1 Report** | **Report on the Description and Design of Controls at a Service Organisation**<br>A report that comprises:<br>(i) Description prepared by management about service organisation's system, control objectives and related controls.<br>(ii) Report by service auditor that includes service auditor's opinion on description of service organisation's system, control objectives and related controls. |
| **Type 2 Report** | **Report on the Description, Design and Operating Effectiveness of Controls at a Service Organisation**<br>A report that comprises:<br>(i) Description prepared by management about service organisation's system, control objectives and related controls.<br>(ii) Report by service auditor that includes:<br>➢ Service auditor's opinion on description of service organisation's system, control objectives and related controls and<br>➢ Description of service auditor's tests of controls and results thereof. |

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## Aspects to be considered by User Auditor in using Type 1 or Type 2 Report as Audit Evidence that Controls at Service Organisation are Designed and Operating Effectively

In determining sufficiency and appropriateness of audit evidence provided by Type 1/Type 2 report, user auditor shall be satisfied as to:

- Service auditor's professional competence (except where he is CA) and independence from service organisation.
- Adequacy of standards under which Type 1/Type 2 report was issued.

User auditor shall determine whether service auditor's report provides sufficient appropriate audit evidence about controls by performing following:

- Evaluate whether Type 1/Type 2 report is for date or period appropriate for user auditor purpose.
- Evaluate adequacy of time period covered by tests of controls.
- Evaluating whether tests of controls performed are relevant to the assertions in user entity's FS.
- Determine whether complementary user entity controls are designed and operating effectively by user entity.

## Controls at Subservice Organisation

- If a service organisation uses a subservice organisation, service auditor's report may either include or exclude the subservice organisation's control.
- These 2 methods of reporting are known as Inclusive method & Carve out method.
- If Type 1 or Type 2 report excludes control at subservice organisation, user auditor shall require to apply requirements of SA 402 in respect of subservice organisation.

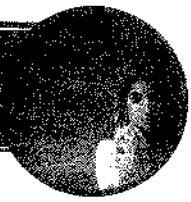
## Reporting by the User Auditor

- User auditor shall modify opinion in user auditor's report as per SA 705, if user auditor is unable to obtain sufficient appropriate audit evidence regarding services provided by service organisation.
- Reference of Work of Service Auditor in User Auditor's Report

| | |
|---|---|
| **Unmodified Opinion by User Auditor** | User auditor shall not refer work of service auditor in user auditor's report containing an unmodified opinion unless required by law or regulation. If reference required by law or regulation, user auditor report shall indicate that reference does not reduce his responsibility for that opinion. |
| **Modified Opinion by User Auditor** | User auditor can refer work of service auditor if service auditor work is relevant to modification. User auditor report shall indicate that reference does not reduce his responsibility for that opinion. |

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# SA 450 – Evaluation of Misstatements Identified During the Audit



## Basics

- This SA deals with auditor's responsibility to evaluate effect of identified misstatements on the audit and uncorrected misstatements on the FS.
- Misstatement is a difference between ACPD of reported FS Item & APCD required for item as per applicable FRF. It arises from error or fraud.

## Types and Sources/Examples of Misstatements

| Types of Misstatements |
|---|
| ▪ Factual Misstatements: Misstatements about which there is no doubt.<br>▪ Judgmental Misstatements: Differences arising from judgments of management regarding AE that auditor considers unreasonable or accounting policies that auditor considers inappropriate.<br>▪ Projected Misstatements: Auditor's best estimate of misstatements in population during sampling. |

| Sources/Examples of Misstatements | |
|---|---|
| Arising from other than Fraud | ▪ Inaccuracy in gathering or processing data from which FS are prepared.<br>▪ Omission of amount or disclosure.<br>▪ Incorrect accounting estimate arising from misinterpretation of facts.<br>▪ Judgments of management about accounting estimates or accounting policies which auditor considers inappropriate. |
| Arising from Fraud | Given in SA 240 |

## Accumulation, Communication and Correction of Identified Misstatements

| | |
|---|---|
| Accumulation | Auditor shall accumulate misstatements identified during audit other than those that are clearly trivial (very small or inconsequential). |
| Communication | Auditor shall communicate on a timely basis all misstatements accumulated during audit with management. |
| Correction | Auditor shall request management to correct those misstatements. |

## Impact of Uncorrected Misstatements identified during Audit & Auditor's Responses to Them [Evaluating Effect of Uncorrected Misstatements]

- Uncorrected Misstatements - Misstatements that auditor has accumulated during audit and that have not been corrected.

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- Before evaluating impact of uncorrected misstatements, auditor shall reassess materiality determined in SA 320 to confirm whether it remains appropriate in context of entity's actual financial results.
- Auditor shall determine whether uncorrected misstatements are material (individually or aggregate). For this, auditor shall consider:
  - Size & Nature of misstatement for CAD & FS.
  - Effect of uncorrected misstatement related to prior periods on CAD & FS.
- Auditor shall communicate with TCWG uncorrected misstatement & their effect on auditor's opinion. Auditor shall request that uncorrected misstatements should be corrected.
- As per TCWG, if effect of such uncorrected misstatements are immaterial, auditor shall request WR from TCWG.
- If management refuses to adjust financial information & auditor is not able to conclude whether aggregate of uncorrected misstatement is not material, auditor shall report accordingly (express qualified or adverse opinion).

## Documentation

- Amount below which misstatements would be regarded as clearly trivial.
- All misstatements accumulated during audit and whether they have been corrected.
- Auditor's conclusion whether uncorrected misstatements are material & basis for that conclusion.

# SA 500 – Audit Evidence



## Basics

- This SA explains what constitutes audit evidence in audit of FS, and deals with auditor's responsibility to design and perform procedures to obtain sufficient appropriate audit evidence.
- Audit Evidence means information used by auditor in arriving at conclusions to form auditor's opinion. It includes both financial information and other information.

## Audit Procedures to obtain Audit Evidence

| Risk Assessment Procedures | |
|---|---|
| Audit procedure to identify ROMM (Given in SA 315) | |
| **Further Audit Procedures** | |
| **Test of Controls** | Audit procedure designed to evaluate operating effectiveness of controls in preventing, detecting and correcting, material misstatements. |
| **Substantive Procedures** | Audit procedure designed to detect material misstatements. Substantive procedures comprise:<br>(i) Tests of details of CAD<br>(ii) Substantive analytical procedures |

## Methods to obtain Audit Evidence in Performing above Procedures

| | |
|---|---|
| **Inquiry** | ➢ Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within or outside the entity.<br>➢ Inquiries may range from formal written inquiries to informal oral inquiries.<br>➢ Responses to inquiries may provide corroborative audit evidence.<br>➢ Auditor may obtain WR to confirm responses to oral inquiries. |
| **Observation** | Observation consists of looking at a process being performed by others. |
| **Inspection** | Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or physical examination of asset. |
| **Recalculation** | Recalculation consists of checking arithmetical accuracy of documents or records. |
| **Re-performance** | It involves the auditor's independent execution of procedures or controls. |
| **External Confirmation** | External confirmation represents audit evidence obtained by auditor as a direct written response to the auditor from a third party (confirming party). |
| **Analytical Procedure** | Analytical procedures consist of evaluations of financial information by study of plausible relationships among both financial and non-financial data. |



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## Selecting Items for Testing to Obtain Audit Evidence

| ▪ Selecting all items (100% examination) | ▪ Selecting specific items | ▪ Audit sampling |
|---|---|---|

## Using the Work of Management Expert as Audit Evidence

**(1) Management Expert**

An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by entity to assist entity in preparing FS. Entity may employ or engage experts in other fields (such as actuarial calculations, valuations etc.) to obtain needed expertise to prepare FS.

**(2) Evaluating / Using the Work of Management Expert**

- When information to be used as Audit evidence is prepared using work of management expert, auditor shall:
  - (i) Evaluate the competence, capability & objectivity of that expert.
  - (ii) Obtain understanding of work of that expert.
  - (iii) Evaluate the appropriateness of expert's work as audit evidence.
- Auditor may obtain information regarding competence, capability and objectivity from variety of sources such as:
  - ➢ Personal experience with previous work of that expert
  - ➢ Discussion with that expert
  - ➢ Knowledge of expert qualification
  - ➢ Published paper or book written by that expert
- Auditor may also consider following while evaluating appropriateness of management expert work as audit evidence:
  - ➢ Relevance & reasonableness of expert findings or conclusion and their consistency with other audit evidence.
  - ➢ If expert work involves use of significant assumption & methods, relevance & reasonableness of those assumption & methods.
  - ➢ If expert work involves use of source data, relevance & completeness of source data.

**(3) Threats to Management Expert's Objectivity**

- Many circumstances may threaten management expert's objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats and intimidation threats. Safeguards may reduce such threats but cannot eliminate all threats.
- Auditor shall discuss with management and that expert any interests and relationships that may create threats to expert's objectivity and any applicable safeguards.

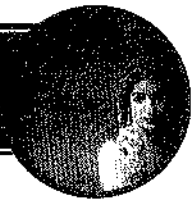
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(4) **Matters which may Affect the Nature, Timing and Extent of Audit Procedure adopted by Auditor in case of Management's Expert**

| | |
|---|---|
| (i) | Nature and complexity of matter. |
| (ii) | ROMM in the matter. |
| (iii) | Availability of alternative sources of audit evidence. |
| (iv) | Whether management's expert is employed by entity or engaged by it. |
| (v) | Whether management's expert is subject to technical performance standards. |
| (vi) | Auditor's knowledge and experience of management's expert's field of expertise. |
| (vii) | Auditor's previous experience of the work of that expert. |

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# SA 501 – Audit Evidence: Specific Consideration For Selected Items



## Basics

- This SA deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence with respect to inventory, litigation and claims, and segment information in audit of FS.

## Inventory

**(1) When inventory is material to FS, auditor shall obtain sufficient appropriate audit evidence regarding existence and condition of inventory by:**

- Attendance at physical inventory counting, if practical and:
  - (i) Evaluate management instructions and procedure for recording & controlling results of physical counting.
  - (ii) Observe management counting procedure
  - (iii) Inspect Inventory (for identifying obsolete, damaged or ageing inventory)
  - (iv) Perform Test Counts
- Performing audit procedures over entity's final inventory record to determine whether they accurately reflect actual inventory count results.

**(2) If physical inventory counting is conducted at a date other than date of FS**

In addition to above, auditor shall also perform audit procedures to obtain audit evidence whether change in inventory between count date and date of FS are properly recorded.

Auditor shall also consider following matters:

(i) Whether perpetual inventory records are properly adjusted.

(ii) Reliability of entity's perpetual inventory records.

(iii) Reasons for significant difference between physical count & perpetual inventory records.

**(3) If auditor is unable to present at physical inventory count on the date planned due to unforeseen circumstances**

Auditor should make or observe some physical counts on alternative date and perform audit procedures on intervening transactions.

**(4) When attendance at physical inventory counting is impracticable**

- If attendance at physical inventory counting is not practicable due to factors such as nature & location of inventory that pose threats to safety of auditor (general inconvenience not sufficient), then auditor shall perform alternative audit procedures.
- Example of alternative audit procedures: Inspection of documentation of subsequent sale of specific inventory items acquired or purchased prior to physical inventory counting.

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- If not possible to obtain sufficient appropriate audit evidence regarding existence and condition of inventory by performing alternative audit procedures, then auditor shall modify report as per SA 705 as a result of scope limitation.

**(5) Inventory held by third party**

When inventory under the custody and control of a third party is material to FS, auditor shall:

- Request confirmation from third party regarding quantities & condition of inventory.
- Perform inspection or other audit procedures appropriate in the circumstances.

If information is obtained that raises doubt about integrity and objectivity of third party, auditor may perform other audit procedures. Examples of other audit procedures include:

- Attending third party's physical counting of inventory, if practicable.
- Obtaining another auditor's report for ensuring that inventory is properly counted and safeguarded.
- Inspecting documentation regarding inventory held by third parties.

## Litigation and Claims

- Auditor shall perform following audit procedures to identify litigations & claims which may give rise to ROMM:
  - Inquiry from management including in-house legal counsel.
  - Reviewing minutes of meetings of TCWG.
  - Reviewing legal expense accounts.
- Communication with entity's external legal counsel
  - When audit procedures performed indicate that material litigation or claims may exist, auditor shall seek direct communication with entity's external legal counsel.
  - Auditor shall do so through a letter of inquiry prepared by management and sent by the auditor, requesting entity's external legal counsel to communicate directly with auditor.
  - Auditor may ask for list of litigation & claims and may seek meeting with external legal counsel.
  - If auditor is unable to communicate with external legal counsel, modify report as per SA 705.
- Obtain WR that all known litigation & claims have been disclosed to auditor and appropriately accounted as per FRF.

## Segment Information

**Auditor shall obtain sufficient appropriate audit evidence regarding presentation and disclosure of segment information as per FRF by:**

- Obtaining understanding of methods use by management in determining segment information. Example of matters that may be relevant when obtaining such understanding include:



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- Sales between segments, and elimination of inter-segment amounts.
- Comparisons with budgets and other expected results.
- Allocation of assets and costs among segments.
- Consistency with prior periods and disclosures with respect to inconsistencies.

- Performing analytical or other audit procedures.

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# SA 505 – External Confirmation

## Basics

- This SA deals with auditor's use of external confirmation procedures to obtain audit evidence.
- Some Important Definitions

| | |
|---|---|
| **External Confirmation** | Audit evidence obtained as a direct written response to the auditor from a third party (confirming party). |
| **Positive Confirmation Request** | A request that the confirming party respond directly to auditor indicating whether confirming party agrees or disagrees with information in the request or providing the requested information. |
| **Negative Confirmation Request** | A request that the confirming party respond directly to auditor only if confirming party disagrees with information provided in the request. |
| **Exception** | Response that indicates a difference between information requested to be confirmed and information provided by confirming party. |

## Situations where External Confirmations can be Used

| | |
|---|---|
| Bank Balance from bankers | Inventories held by third parties |
| A/c receivable balances | Title deeds held by third parties |
| A/c payable balances | Loan from lenders |

## External Confirmation Procedures

**(1) Procedure**

- Determining the information to be confirmed or requested
- Selecting appropriate confirming party
- Designing confirmation requests including determining that requests are properly addressed.
- Send request & follow up.

**(2) Factors to be Considered while designing Confirmation Requests**

- Assertions being addressed.
- Specific identified ROMM including fraud risk.
- Layout & presentation of confirmation request.
- Prior experience on audit or similar engagements.
- Method of communication (paper/electronic).
- Management authorization to confirming party to respond to auditor.

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(3) **Factors that may assist auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures**

- Confirming party's knowledge of subject matter.
- ability or willingness of confirming party to respond.
- objectivity of confirming party (if confirming party is related, responses may be less reliable).

## Management Refusal to Allow the Auditor to Send a Confirmation Request

| **If management refuses to allow the auditor to send a confirmation request or If management request not to seek confirmation due to some reasons, auditor shall:** |
|---|
| (i) Inquire regarding management reasons for refusal & seek audit evidence for their validity. |
| (ii) Evaluate implication of refusal on auditor's assessment of ROMM including risk of fraud & NTE of other audit procedures. |
| (iii) Perform alternative audit procedures. |
| (iv) If auditor concludes management refusal as unreasonable or auditor is unable to obtain reliable audit evidence from alternative audit procedures, auditor shall communicate with TCWG and also determine implications for audit & his opinion. |

## Results of External Confirmation Procedures

| | |
|---|---|
| **Non-responses** | Auditor shall perform alternative audit procedures in case of non-responses/no confirmation. |
| **Exception** | Auditor shall investigate exception to determine whether they are indicative of misstatements. |
| **Positive Confirmations** | Effects of using positive external confirmation request<br>➢ Response to a positive confirmation request can provide reliable audit evidence.<br>➢ There is risk that confirming party may reply without verifying that information is correct. Auditor may reduce this risk by using positive confirmation requests that do not state amount and ask confirming party to fill amount or other information.<br>➢ However, use of blank confirmation request may result in lower response rates because additional effort is required of the confirming parties. |
| **Negative Confirmations** | ▪ Negative confirmations provide less persuasive audit evidence than positive confirmations.<br>▪ Auditor shall not use it as a sole audit procedure unless:<br>(i) Auditor has assessed ROMM as low & obtain sufficient appropriate audit evidence regarding operating effectiveness of controls. |

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| | (ii) Population of items comprises large number of small items.<br>(iii) Very low exception rate is expected.<br>(iv) Auditor is not aware of conditions that cause recipient to disregard such request.<br>▪ Failure to receive response to a negative confirmation request does not indicate anything clearly. Confirming parties may be more likely to respond if information in request is not in their favor and less likely to respond otherwise. |
| **Reliability of Responses to Confirmation Request** | ▪ If auditor identifies factors which gives doubts about reliability of responses, he shall obtain further audit evidence to resolve these doubts.<br>▪ Factors that may indicate doubts about reliability of response:<br>➢ Received by auditor indirectly.<br>➢ Appeared not to come from intended confirming party.<br>▪ If auditor determines that response is not reliable, auditor shall evaluate implications on ROMM including risk of fraud & NTE of other audit procedures. |

## Examples of Alternative Audit Procedures

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| **For accounts receivable balances** | Examining subsequent cash receipts and sales near the period end. |
| **For accounts payable balances** | Examining subsequent cash disbursements or correspondence from third parties. |

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# SA 510 – Initial Audit Engagement: Opening Balances



## Basics

- This SA deals with auditor's responsibilities relating to opening balances when conducting an initial audit engagement.
- Initial audit engagement is an engagement in which either:
  - FS for the prior period were not audited or
  - FS for the prior period were audited by a predecessor auditor.

## Objective

In conducting initial audit engagement, auditor objective is to obtain audit evidence about OB whether:

(i) Opening Balances contains misstatement that materially affect current period FS.

(ii) Appropriate accounting polices reflected in opening balances, consistently applied in current period FS, or changes thereto are properly accounted, presented & disclosed as per FRF.

## Audit Procedures regarding Opening Balances

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| **General Audit Procedures** | Auditor shall obtain sufficient appropriate audit evidence with respect to opening balances by:<br>(i) Determining prior period closing balance correctly b/f to current period or any adjustment disclosed as prior period items in current year P&L.<br>(ii) Determining opening balances reflect application of appropriate accounting policies.<br>(iii) Evaluating audit procedures performed in current period or performing specific audit procedures to obtain evidence regarding opening balances. |
| **If Prior Period FS Audited by a Predecessor Auditor** | ➢ Perusing copies of audited FS. Current auditor can place reliance on closing balances contained in preceding period audited FS except if possibility of misstatements in opening balances is indicated.<br>➢ Where prior period report is modified, ascertain impact on current period. |
| **If FS Audit is conducted first time** | Auditor can obtain WR regarding opening balances. |
| **Specific Audit Procedures** | Specific audit procedures to obtain evidence regarding opening balances<br>➢ For inventory, reconcile current physical inventory count with opening inventory and perform audit procedures on valuation of opening inventory.<br>➢ For current assets & liabilities, audit evidence can be obtained as part of current period audit procedures. |

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| | ➢ For other assets & liabilities, examine records and get confirmation from third parties for obtaining audit evidence. |
| **Communication of Misstatements** | If auditor obtains audit evidence that opening balances contains misstatement which exist in current period FS, then he shall communicate the misstatements to management/TCWG. |

## Audit Conclusion & Reporting

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| **Opening Balances** | ▪ If auditor is unable to obtain sufficient appropriate audit evidence regarding opening balances, auditor shall express qualified or disclaimer of opinion as per SA 705.<br>▪ If auditor concludes that opening balances contains misstatement that materially affect current period FS but not properly accounted, presented & disclosed auditor shall express qualified or adverse opinion as per SA 705. |
| **Accounting Policies** | ▪ If auditor concludes that accounting polices reflected in opening balances not consistently applied in current period FS, or changes thereto not properly accounted, presented & disclosed as per FRF, auditor shall express qualified or adverse opinion as per SA 705. |

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# SA 520 – Analytical Procedure

## Basics

- This SA deals with auditor's use of analytical procedures as substantive procedures, that assist the auditor when forming an overall conclusion on FS.
- Analytical Procedure means evaluation of financial information through analysis of plausible relationship among both financial & non-financial data. It also encompass investigation of identified fluctuations that are inconsistent with other relevant information.

## Analytical Procedure used as Substantive Test

### Consideration to be kept while Performing Analytical Procedure

When designing & performing substantive analytical procedure, auditor shall:

(i) Determine suitability of SAP for given assertions by taking assessed ROMM.

(ii) Evaluate reliability of data from which auditor's expectation of recorded amount is developed.

(iii) Develop expectation of recorded amount and evaluate whether expectation is sufficiently precise to identify a misstatement.

(iv) Determine difference of recorded amount from expected values that is acceptable without further investigation.

### Following are relevant for determining whether data is reliable for designing SAP

- Source of information available
- Comparability of information available
- Nature and relevance of information available
- Controls over preparation of information to ensure its completeness, accuracy & validity

### Investigating Results of Analytical Procedures

If analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, auditor shall investigate such differences by:

- Inquiring of management and obtaining appropriate audit evidence.
- Performing other audit procedures as necessary.

### Use of Analytical Procedure in respect of Payroll Expenses and Room Rentals

- **In case of payroll cost** – When entity has known number of employees at fixed rate of pay, auditor can use this data to calculate total payroll cost, reducing need to perform test of details.
- **In case of room rental income** – Prediction of total rental income by taking number of rooms, room and vacancy rates can provide persuasive evidence, reducing need to perform test of details.

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# SA 530 – Audit Sampling

## Basics

- This SA applies when auditor has decided to use audit sampling in performing audit procedures.
- Some Important Definitions

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| **Audit Sampling** | Application of audit procedure to less than 100% of items within a population such that all sampling units have a chance of selection. It provides auditor to draw reasonable conclusion. |
| **Population** | Entire set of data from which a sample is selected. |
| **Sample Size** | Number of items or data that need to be selected and examined from population. |

## Sampling Risk / Risk Factors in Sampling Techniques

Sampling Risk is the risk that auditor's conclusion based on a sample may be different from the conclusion if entire population were subjected to same audit procedure.

**It leads to two types of erroneous conclusions:**

(i) In case of test of controls, that controls are more effective than they actually are, or in case of test of details, that a material misstatement does not exist when in fact it does.

Auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and leads to an inappropriate audit opinion.

(ii) In case of test of controls, that controls are less effective than they actually are, or in case of test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it leads to additional work to establish that initial conclusions were incorrect.

## Sample Size and Selection of Items for Testing

- Auditor shall determine sample size sufficient to reduce sampling risk to an acceptably low level.
- Higher the auditor's assessment of ROMM, larger the sample size needs to be.
- Auditor shall select sample items so that sample can be expected to be representative of population. This requires that all items in the population have an opportunity of being selected.

## Principal Methods of Selection of Samples / Collecting Samples

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| **Random Sampling** | This method is applied through random number generators. For example - random number tables. |



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| **Systematic Sampling Or Interval Sampling** | In this method, number of sampling units in the population is divided by sample size to give a sampling interval. |
| **Monetary Unit Sampling** | This method is a type of value-weighted selection in which sample size, selection and evaluation results in monetary amounts. |
| **Haphazard Sampling** | In this method, auditor selects the sample without following a structured technique. |
| **Block Sampling** | This method involves selection of block(s) of contiguous items within population. Block selection cannot ordinarily used in audit sampling. |

## Stratification

Stratification is the process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics.

**Uses of Stratification**

- Allows sample size to be reduced without increasing sampling risk. Audit efficiency may improve.
- Allows greater audit effort to be directed to the larger value items.
- If a class of transactions or account balance has been divided into strata, misstatement is projected for each stratum separately.

## Performing Audit Procedures

- Auditor shall perform appropriate audit procedure on each item selected.
- If audit procedure is not applicable on selected item, apply procedure on replacement item.
- If auditor is unable to apply audit procedure, treat that item as deviation from control in case of tests of controls, or misstatement in case of tests of details.

## Evaluating Results of Audit Sampling

| | |
|---|---|
| Auditor shall evaluate: | ➢ Results of sample.<br>➢ Whether use of audit sampling provided a reasonable basis for conclusions about population that has been tested. |

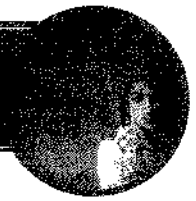
If auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, auditor may:

(i) Request management to investigate identified misstatement & to make necessary adjustment.

(ii) Tailor NTE of those further audit procedures to achieve required assurance. For example, in case of tests of controls, auditor might extend sample size or test alternative control.

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# SA 540 – Auditing Accounting Estimate Including Fair Value Accounting Estimate & Related Disclosures



## Basics

- This SA deals with auditor's responsibilities regarding accounting estimates, including fair value accounting estimates (AE), and related disclosures in audit of FS.
- Some FS items cannot be measured precisely, but can only be estimated. Such items are referred as AE. AE means approximation of a monetary amount in absence of precise means of measurement.

## Kinds of Accounting Estimates

| Two Kinds of Estimates are involved in Preparing & Presenting FS | |
|---|---|
| **Fair value AE [FMV Based]** | ➢ Complex Financial instruments which are not traded in an active and open market<br>➢ Share based payments<br>➢ Certain assets acquired in business combination including goodwill<br>➢ Transaction involving non-monetary exchange of assets between parties<br>➢ Estimate of FMV of inventory |
| **Other AE** | ➢ Allowance for doubtful accounts<br>➢ Warranty obligations<br>➢ Depreciation method or asset useful life<br>➢ Provision for gratuity<br>➢ Financial obligations/cost arising from litigation settlement & judgments |

## Nature of Accounting Estimates

| Some AE involve low estimation uncertainty and may give rise to lower ROMM, for example: |
|---|
| ➢ AE arising in entities that engage in business activities that are not complex. |
| ➢ AE that are frequently made and updated because they relate to routine transactions. |
| ➢ AE derived from data that is readily available. |
| ➢ Fair value AE where measurement method prescribed by FRF is simple and applied easily. |
| ➢ Fair value AE where measurement model is well-known or generally accepted. |
| **Some AE involve high estimation uncertainty, if based on significant assumptions, for example:** |
| ➢ AE that are highly dependent upon judgment (judgment about outcome of pending litigation). |
| ➢ AE that are not calculated using recognised measurement techniques. |
| ➢ AE where auditor review indicates substantial difference between original AE and actual outcome. |
| ➢ Fair value AE for which a highly specialised model is used or there are no observable inputs. |

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## Risk Assessment Procedures to assess ROMM in relation to Accounting Estimates / How to Minimize ROMM in relation to Accounting Estimates

(1) **Auditors shall obtain an understanding of the following in order to provide a basis for identification & assessment of ROMM relating to AE:**

(i) Requirements of FRF relevant to AE, including related disclosures.

(ii) How management identifies those transactions that may give rise to need for AE to be disclosed in FS. In obtaining this understanding, auditor shall make inquires of management about circumstances that may give rise to new or need to revise existing AE.

(iii) Estimation making process adopted by management, including:

- Method including model used in making AE
- Relevant controls
- Whether management has used an expert
- Assumptions
- Whether there has been a change from prior period in methods for making AE and
- Whether management has assessed the effect of estimation uncertainty

(2) **Inquiries of management about change in circumstances may include inquiries about whether:**

- Entity has engaged in new types of transactions.
- Terms of transactions have changed.
- Accounting policies relating to AE have changed.
- Regulatory or other changes outside the control of management have occurred.
- New conditions or events have occurred.

(3) **Reviewing Outcome of AE included in Prior Period**

- Auditor shall review outcome of AE included in prior period FS and their subsequent re-estimation for current period.
- Outcome of AE will often differ from AE recognised in prior period FS. To identify reasons for such differences, auditor may obtain:
  - Information regarding effectiveness of management's prior period estimation process.
  - Audit evidence that is pertinent to re-estimation of prior period AE in current period.
  - Audit evidence of matters that may be required to be disclosed in FS.
- Review of prior period AE may also assist auditor in identifying circumstances that increase the susceptibility of possible management bias.
- However, review is not intended to question judgments made in prior periods on basis of information available at that time.

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## Responses to Assessed ROMM in relation to Accounting Estimates

### Dealing with assessed ROMM in relation to AE

Based on assessed ROMM, auditor shall determine:

- Whether management has appropriately applied requirements of FRF relevant to AE and
- Whether methods for making AE are appropriate and have been applied consistently.

In responding to assessed ROMM, auditor shall undertake following:

- Determine whether events occurring upto date of auditor's report provide audit evidence regarding AE.
- Test how management made the AE and the data on which it is based. In doing so, auditor shall evaluate whether:
  - Method of measurement used is appropriate, and
  - Assumptions used by management are reasonable.
- Test operating effectiveness of controls over how management made the AE, together with appropriate substantive procedures.
- Develop a range to evaluate management's point estimate.

### Further Substantive Procedures to Respond to Significant Risks / Evaluation of AE which Involves Significant Risk

Auditor shall evaluate the following:

(i) How management has considered alternative assumptions or outcomes.

(ii) Whether assumptions used by management are reasonable.

(iii) With respect to reasonableness of assumptions, management's intent and ability to carry out specific courses of action.

(iv) If management has not addressed the effects of estimation uncertainty, auditor shall develop a range to evaluate reasonableness of AE.

## Disclosures Related to Accounting Estimates

- Auditor shall obtain sufficient appropriate audit evidence about whether disclosures in FS related to AE are as per FRF.
- Disclosures may include:
  - Assumptions used.
  - Method of estimation used, including any applicable model.
  - Basis for selection of method of estimation.
  - Any changes in method of estimation from prior period.
  - Sources and implications of estimation uncertainty.

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- For AE that give rise to significant risks, auditor shall also evaluate adequacy of disclosure of their estimation uncertainty in FS.

## Written Representations about Accounting Estimates

Auditor shall obtain WR from management/TCWG whether they believe significant assumptions used in making AE are reasonable.

**WR about AE recognised or disclosed in FS may include representations:**

- About appropriateness of measurement processes, including related assumptions and models, used by management in determining AE.
- That the assumptions appropriately reflect management's intent and ability to carry out specific courses of action.
- That disclosure related to AE are complete and appropriate as per applicable FRF.
- That no subsequent event requires adjustment to AE and disclosures included in FS.

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# SA 550 – Related Parties



## Basics

- This SA deals with auditor's responsibilities regarding related party relationships and transactions when performing audit of FS.
- Related Party - A party that is either:

(i) A related party as defined in FRF or

(ii) Where FRF establish minimum or no related party requirements:

(a) Person or other entity that has control or significant influence over reporting entity.

(b) Another entity over which reporting entity has control or significant influence.

(c) Another entity that is under common control with reporting entity through common controlling ownership, close family members, or common key management.

However, parties under common control by a state (national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

## Understanding the Entity's Related Party Relationships and Transactions

### Inquiry of Management

Auditor shall inquire of management regarding:

- Identity of entity's related parties, including changes from prior period.
- Nature of relationships between entity and these related parties.
- Whether entity entered into any transactions with these related parties during the period.

### Discussion with Engagement Team

Matters that may be addressed in the discussion among engagement team include:

(i) Nature and extent of entity's relationships and transactions with related parties.

(ii) Emphasis on importance of maintaining professional skepticism throughout.

(iii) Records/documents that may indicate existence of related party relationship or transactions.

(iv) Circumstances that may indicate existence of related party relationships or transactions that management has not identified or disclosed to auditor.

(v) Discussion may include consideration of how related party may involve in fraud. For example:

- how entities controlled by management may be used to facilitate earnings management (fraudulent financial reporting).
- how transactions between entity and known business partner of management may be arranged to facilitate misappropriation of entity's assets.

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## Maintaining Alertness for Related Party Information when reviewing Records or Documents (Verification of Existence of Related Parties for the purpose of Reporting)

During audit, auditor shall remain alert when inspecting records or documents for information that indicate existence of related party relationship or transactions that management has not previously identified or disclosed to auditor. For this purpose, auditor shall inspect the following:

(i) Bank, legal & third-party confirmation obtained by audit procedures.

(ii) Minutes of meetings of shareholders & TCWG.

(iii) Such other records or documents as auditor considers necessary.

| **Examples to Verify Existence of Related Parties / Possible Source of Related Party Information / Records or Documents that may be helpful in gathering Information about Related Party Relationships and Transactions / Other Records or Documents that the Auditor may Inspect** |
|---|
| ➢ Entity Income Tax Returns |
| ➢ Shareholder register to identify principal shareholders |
| ➢ Record of entity investment & pension plans |
| ➢ Life insurance policies acquired by entity |
| ➢ Significant contracts re-negotiated by entity |
| ➢ Information supplied by entity to regulatory authority |
| ➢ Significant contracts and agreements not in ordinary course of business |

## Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions

If auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to the auditor, auditor shall:

- Communicate relevant information to other members of engagement team.
- Request management to identify all transactions with newly identified related parties.
- Inquire why entity's controls failed to enable identification or disclosure of related party relationships or transactions.
- Perform appropriate substantive audit procedures for such related parties or transactions.
- If non-disclosure by management appears intentional (and therefore indicative of fraud), evaluate implications for audit.

## Identified Significant Related Party Transaction outside Entity Normal Course of Business

| **Examples of Transactions outside the Entity's Normal Course of Business** |
|---|
| ➢ Complex equity transactions, such as corporate restructurings or acquisitions. |
| ➢ Transactions with offshore entities in jurisdictions with weak corporate laws. |



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- Leasing of premises or rendering of management services by the entity without consideration.
- Sales transactions with unusually large discounts or returns.
- Transactions with circular arrangements, for example, sales with a commitment to repurchase.

**Dealing with Biased Transactions**

For identified significant related party transactions outside normal course of business, auditor shall:

(i) Inspect the underlying contracts or agreements and evaluate whether:

- Business rationale of transactions suggests that they may be entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.
- Terms of transactions are consistent with management explanation.
- Transactions have been appropriately accounted & disclosed as per FRF.

(ii) Obtain audit evidence that the transactions have been appropriately authorised and approved.

## Related Party Disclosures

- Auditor shall ensure compliance of applicable FRF (Ind AS 24/AS 18 - Related Party Disclosures).
- Auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted and disclosed as per FRF.

## Written Representations about Related Parties

**Auditor shall obtain WR from management/TCWG that:**

- They have disclosed to auditor all known related party relationships and transactions.
- They have appropriately accounted and disclosed such relationships and transactions as per FRF.

## Communication of Significant Related Party Matters with TCWG

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| **Communication of Significant Matters** | Unless all TCWG are involved in managing the entity, auditor shall communicate with TCWG significant matters arising during audit about entity's related parties. This helps the auditor to establish common understanding with TCWG of the nature and resolution of these matters. |
| **Examples of Significant Matters** | Examples of significant related party matters include:<br>➢ Non-disclosure by management of significant related party transactions.<br>➢ Identification of related party transactions that have not authorised & approved.<br>➢ Disagreement with management regarding accounting and disclosure of significant related party transactions as per FRF.<br>➢ Non-compliance with laws prohibiting specific types of related party transactions.<br>➢ Difficulties in identifying the party that ultimately controls the entity. |

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# SA 560 - Subsequent Events

## Basics

- This SA deals with auditor's responsibilities relating to subsequent events in audit of FS.
- FS may be affected by certain events that occur after the date of FS. Two types of event as per AS 4/Ind AS 10 are:

(i) Those that provide evidence of conditions that existed at FS date (Adjusting). AS 4/ Ind AS 10 requires adjustments to assets and liabilities for adjusting events.

(ii) Those that provide evidence of conditions that arose after FS date (Non-adjusting). AS 4/Ind AS 10 requires disclosure of non-adjusting events.

- **Subsequent Events**

Events occurring between date of FS and date of auditor's report.

and

Facts that become known to auditor after date of auditor's report.

- Auditor should consider the effect of subsequent events on FS and on auditor's report.

## Events occurring Between Date of FS and Date of Auditor's Report

### (1) Audit Procedures

- Auditor shall perform audit procedures to obtain sufficient appropriate audit evidence that all subsequent events that require adjustment or disclosure in FS have been identified.
- Auditor shall perform procedures so that they covered period from data of FS to auditor's report which shall include the following:
  - (i) Obtaining understanding of any procedures established by management to ensure subsequent events are identified.
  - (ii) Inquiring of management/TCWG whether any subsequent events have occurred that affect the FS.
  - (iii) Reading minutes of meetings of entity's owners, management/TCWG held after date of FS and inquire about matters discussed at meeting for which minutes not available.
  - (iv) Reading entity's latest subsequent interim FS.
- When as a result of procedures performed above, auditor identifies events that require adjustment or disclosure in FS, auditor shall determine whether each such event is appropriately reflected in FS.
- Auditor shall obtain WR from management/TCWG that all subsequent events for which FRF requires adjustment or disclosure are adjusted or disclosed.

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(2) Specific Inquiries to Evaluate Subsequent Events

In inquiring of management/TCWG as to whether any subsequent events have occurred that might affect the FS, auditor may make specific inquiries about following matters:

(i) Whether new commitments, borrowings or guarantees have been entered into.
(ii) Whether sales or acquisitions of assets have occurred or planned.
(iii) Whether there have been increase in capital or issuance of debt instruments.
(iv) Whether any assets have been appropriated by government or destroyed.
(v) Whether there have been any developments regarding contingencies.
(vi) Whether any events are relevant to measurement of estimates or provisions made in FS.
(vii) Whether any events are relevant to recoverability of assets.

## Facts which become Known to the Auditor after the Date of Auditor's Report

**Facts which become known to the Auditor after the Date of Auditor's Report but before Date of FS are Issued**

- Auditor has no obligation to perform any audit procedures regarding FS after date of auditor's report.
- But, if a fact becomes known to auditor that may have caused the auditor to amend auditor's report, auditor shall:
  (i) Discuss the matter with management/TCWG.
  (ii) Determine whether FS need amendment.
  (iii) Inquire how management address the matter in FS.
- If management/TCWG amends the FS, auditor shall:
  - Carry out audit procedures on amendment.
  - Provide a new/amended auditor's report on amended FS with EOM/OM para. However, new auditor's report shall not be dated earlier than the date of approval of amended FS.
- If management/TCWG does not amend the FS
  - If audit report not yet provided to management/TCWG, modify opinion.
  - In other case, auditor shall take appropriate action to prevent reliance on auditor's report.

**Facts which become known to the Auditor after FS have been Issued**

Auditor shall perform same procedure as above. (except modification of opinion, since report is already issued)

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# SA 570 – Going Concern

## Basics

- This SA deals with auditor's responsibilities in audit of FS relating to going concern and implications on auditor's report.
- Under going concern basis of accounting (assumption), FS are prepared on the assumption that entity is a going concern and will continue its operations for foreseeable future.
- It is the responsibility of management to make assessment of entity's ability to continue as going concern (atleast 12 months from FS date) and to make appropriate disclosures regarding going concern in FS.

## Responsibilities / Objectives of Auditor regarding Going Concern

- Evaluate management's assessment of entity's ability to continue as a going concern.
- Obtain sufficient appropriate audit evidence regarding appropriateness of management use of going concern assumption in preparation & presentation of FS.
- Conclude whether material uncertainty exist that cast significant doubt on entity's ability to continue as going concern.

## Events or Conditions that may Cast Significant Doubt on Entity's Ability to Continue as Going Concern

| **Examples of events or conditions that may cast significant doubt about on entity's ability to continue as going concern / Evaluating Going Concern Assumption / Indications to be examined:** | |
|---|---|
| **Financial Indications** | ▪ Negative operating cash flows indicated by FS<br>▪ Adverse key financial ratios<br>▪ Substantial operating losses or significant deterioration in assets value<br>▪ Net liability or Net current liability position<br>▪ Inability to pay creditors on due dates<br>▪ Indication of withdrawal of financial support by creditors<br>▪ Change from credit to cash-on-delivery transactions with suppliers<br>▪ Inability to comply with terms of loan agreements<br>▪ Inability to obtain financing for new product |
| **Operating Indications** | ▪ Management intention to liquidate the entity or to cease operations<br>▪ Loss of key management without replacement<br>▪ Loss of major market, key customer or principal suppliers |



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| | ▪ Labour difficulties<br>▪ Shortage of important supplies<br>▪ Emergence of a highly successful competitor |
| **Other Indications** | ▪ Non-compliance with capital or other statutory requirements<br>▪ Pending legal or regulatory proceedings against entity result in claims that entity is unable to satisfy<br>▪ Changes in law or regulation expected to adversely affect the entity<br>▪ Uninsured or under insured catastrophe when they occur |

## Risk Assessment Procedure for Going Concern

Auditor shall consider whether events or conditions exist that may cast significant doubt on entity's ability to continue as a going concern. In doing so, auditor shall determine whether management has already performed assessment of entity's ability to continue as a going concern.

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| **If such assessment has been performed** | Auditor shall discuss assessment with management and determine whether management has identified events or conditions that may cast significant doubt on entity's ability to continue as going concern and management's plans to address them. |
| **If such assessment has not yet been performed** | Auditor shall discuss with management the basis for use of going concern assumption and inquire management whether events or conditions exist that may cast significant doubt on entity's ability to continue as going concern. |

Auditor shall remain alert throughout the audit for events or conditions that may cast significant doubt on entity's ability to continue as going concern.

## Additional Audit Procedures when Events or Conditions are Identified

**Additional Audit Procedures to Determine whether Material Uncertainty Exists or Not**

Auditor shall obtain sufficient appropriate audit evidence to determine whether material uncertainty exists through performing additional audit procedure. This include:

- Where management has not performed assessment for going concern, request management to make assessment.
- Evaluate management plans for future actions in relation to its going concern assessment, whether outcome of these plans is likely to improve the situation.
- Where entity has prepared a cash flow forecast, evaluate reliability of data to prepare forecast and determine whether there is adequate support for assumptions underlying the forecast.
- Consider whether any additional facts or information available.
- Requesting WR from management/TCWG regarding future plans & feasibility of these plans.



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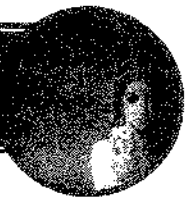
| | |
|---|---|
| **If No Material Uncertainty Exists** | <u>If auditor concludes that no material uncertainty exists, auditor shall</u>:<br>➢ Evaluate whether as per requirements of FRF, FS provide adequate disclosures about these events or conditions. |
| **If Material Uncertainty Exists** | <u>If auditor concludes that use of going concern assumption is appropriate but material uncertainty exists, auditor shall determine whether FS</u><br>➢ Adequately describe principal events or conditions that cast significant doubt on entity's ability to continue as going concern and management plans to deal with these events or conditions.<br>➢ Disclose clearly that there is a material uncertainty that cast significant doubt on entity's ability to continue as going concern. |

## Audit Reporting

| **When use of Going Concern Assumption is Appropriate but Material Uncertainty Exists** | |
|---|---|
| **If adequate disclosure is made in FS** | If adequate disclosure about material uncertainty is made in FS, auditor shall express an unmodified opinion and auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:<br>(i) Draw attention to the note in the FS that discloses the matters and<br>(ii) State that these events or conditions indicate that material uncertainty exists that cast significant doubt on entity's ability to continue as going concern and auditor's opinion is not modified in respect of the matter. |
| **If adequate disclosure not made in FS** | If adequate disclosure of a material uncertainty is not made in FS, auditor shall:<br>(i) Express a qualified or adverse opinion as per SA 705 and<br>(ii) In the Basis for Qualified (Adverse) Opinion section of auditor's report, state that material uncertainty exists that may cast significant doubt on entity's ability to continue as going concern & FS do not adequately disclose this matter. |
| **When use of Going Concern Basis of Accounting is Inappropriate** | |
| If FS have been prepared using going concern basis of accounting but in auditor's judgment, management's use of going concern basis of accounting in FS is inappropriate, auditor shall express an adverse opinion, whether or not FS include disclosure of inappropriateness of management's use of going concern basis of accounting. | |
| **Management Unwilling to Make Its Assessment** | |
| Even after requested by auditor, if management is unwilling to make its assessment, auditor shall express disclaimer of opinion. | |

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# SA 580 – Written Representations



## Basics

- This SA deals with auditor's responsibility to obtain WR from management/TCWG.
- Meaning of WR and From whom WR is Requested

| | |
|---|---|
| **Meaning of WR** | A written statement by management/TCWG provided to auditor to confirm certain matters or to support other audit evidence. WR do not include FS, assertions therein, or supporting books & records. |
| **From whom WR is Requested** | Auditor shall request WR from management/TCWG with appropriate responsibilities for FS and knowledge of the matters concerned. WR may therefore be requested from entity's CFO, CEO or other equivalent persons. |

- Objectives of Auditor
  - To obtain WR from management/TCWG that they fulfill their responsibility for preparation of FS and completeness of information provided to the auditor.
  - To support other audit evidence by means of WR.
  - To respond appropriately to WR provided by management/TCWG. Also respond if management/TCWG do not provide WR requested by auditor.

## Written Representation as Audit Evidence

- Audit Evidence is all information used by auditor in arriving at conclusions on which audit opinion is based. WR are necessary information that auditor requires for FS audit. So, WR are audit evidence.
- Although WR provide necessary evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matter with which they deal.
- WR cannot be a substitute for other audit evidence that the auditor could expect to be available.

## Date of and Period Covered by Written Representation

| | |
|---|---|
| **Date** | Since auditor is concerned with events occurring upto date of auditor's report, date of WR shall be as near as practicable to but not after date of auditor's report. |
| **Period** | WR shall be for all FS & period referred in auditor's report.<br>If current management assert that they are not in a position to provide some or all WR because they were not present during all periods referred in auditor's report, it does not diminish their responsibilities for FS. Accordingly, requirement for auditor to request WR from them that cover whole period still applies. |
| **Form** | WR shall be in the form of a representation letter addressed to the auditor. |

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## Doubt as to the Reliability of Written Representation / Extent of Reliance on WR

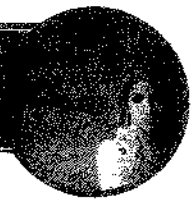
- If auditor has concerns about competence, integrity, ethical values or diligence of management/TCWG, he shall determine the effect of such concerns on reliability of WR.
- If WR are inconsistent with other audit evidence, auditor shall perform audit procedures to resolve the matter.
- If auditor concludes that WR are not reliable, auditor shall take appropriate actions including determining the possible effect on opinion in auditor's report as per SA 705.

## Requested Written Representation not provided by Management/TCWG

| If Management/TCWG does not provide the Requested WR, Auditor shall: |
|---|
| ▪ Discuss matter with management/TCWG.<br>▪ Re-evaluate integrity of management/TCWG and evaluate the effect that this may have on reliability of representations & audit evidence in general.<br>▪ Take appropriate actions including determining the possible effect on opinion in auditor's report as per SA 705. |

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# SA 600 – Using the Work of Another Auditor



## Basics

- This SA applied in situations where an auditor (principal auditor), reporting on FS of an entity, uses the work of another auditor (other/component auditor) with respect to FS of one or more components included in FS of entity. This SA also discusses principal auditor's responsibility regarding his use of work of other auditor.
- This SA does not deal with Joint Audit (SA 299) and Immaterial Component.
- 'Component' means a branch, subsidiary, associated enterprises, joint venture or other entity whose financial information is included in FS audited by principal auditor.

## Factors to be Considered while Accepting the Position of Principal Auditor

**Auditor shall consider following factors while accepting position as principal auditor:**

(i) Materiality of portion of financial information which principal auditor audits.

(ii) Principal auditor's degree of knowledge regarding business of components.

(iii) ROMM in financial information of components audited by other auditor.

(iv) Performance of additional procedures regarding components audited by other auditor resulting in the principal auditor having significant participation in such audit.

## Audit Procedures to be performed by Principal Auditor

- Principal auditor would normally entitled to rely on work of other auditor. Principal auditor has the right to visit and examine records of component.
- Principal auditor should consider professional competence of other auditor if other auditor is not a member of ICAI.
- Principal auditor should perform following additional procedures to obtain sufficient appropriate audit evidence that the work of other auditor is adequate for principal auditor's purposes:

  (i) Advise other auditor of the use that is to be made of other auditor's work and make sufficient arrangements for co-ordination.

  - There should be sufficient liaison between principal auditor and other auditor.
  - Principal auditor may require other auditor to answer a detailed questionnaire regarding some matters. Other auditor should response to such questionnaire on timely basis.
  - Principal auditor may ask for summary of audit procedures and findings of other auditor.

  (ii) Inform the other auditor about matters requiring special consideration and time-table for completion of audit.



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(iii) Advise other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

**Note:** Principal auditor has no right for asking to share working papers of other auditor. It is the discretion of other auditor to provide his working papers to principal auditor because they are property of other auditor.

## Division of Responsibility

- Principal auditor is not responsible for work entrusted to other auditors except in circumstances which should have aroused his suspicion about reliability of work performed by other auditors.
- Principal auditor should clearly specify in his report (in Other Matter Paragraph) about division of responsibility by indicating all components audited by other auditors.

## Audit Reporting

**Principal auditor should express a modified (qualified or disclaimer) opinion if:**

- Principal auditor concludes that the work of other auditor cannot be used.
- Principal auditor has not been able to perform sufficient additional procedures regarding component audited by other auditor.

## Documentation by Principal Auditor regarding Component Audited by Other Auditor

- Principal Auditor shall document in his working papers procedures performed and conclusions reached regarding components audited by other auditors.
- He shall document results of discussions with other auditor & review of other auditor procedures.
- If other auditor's report is modified, principal auditor should also document how he has dealt with qualifications or adverse remarks contained in other auditor's report in framing his own report.



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# SA 610 – Using the Work of Internal Auditors



## Basics

- This SA deals with external auditor responsibilities if using work of internal auditors. This includes:
  - (i) Using the work of internal audit function in obtaining audit evidence and
  - (ii) Using internal auditors to provide direct assistance under direction, supervision and review of external auditor.
- External auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by using the work of internal auditors.

## Using the Work of Internal Audit Function

### Evaluating the Work of Internal Audit Function / Rely on Work of Internal Auditor

- While determining whether work of internal auditors can be used, external auditor shall evaluate:
  - Extent to which internal audit function organizational status and relevant policies & procedures support objectivity of internal auditors.
  - Level of competence of internal audit function.
  - Whether internal audit function applies systematic & disciplined approach.

- Further external Auditor shall not use work of internal Audit function if determines that:
  - Function organizational status and relevant policies & procedures do not adequately support objectivity of internal auditors.
  - Function lacks sufficient competence.
  - Function does not apply systematic & disciplined approach.

**Note**

In case of higher assessed ROMM of particular CAD which requires more judgment in planning and performing procedures, external auditor will need to perform more procedures directly and make less use of work of internal audit function.

### Work of Internal Audit Function that can be used by External Auditor

Work of internal audit function that can be used by external auditor include the following:

- Testing of operating effectiveness of controls.
- Substantive procedures involving limited judgment.
- Observations of inventory counts.
- Testing of compliance with regulatory requirements.
- Audit or review of insignificant components of group.

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**Procedure for Using the Work of Internal Audit Function**

- If external auditor plans to use the work of internal audit function, he shall discuss the planned use of its work with the function.
- External auditor shall read the reports of internal audit function relating to work of function that the external auditor plans to use.
- External auditor shall perform sufficient procedures to determine adequacy of internal audit function including whether sufficient appropriate evidence had been obtained by function.
- External auditor shall also evaluate whether external auditor's conclusions regarding internal audit function is appropriate.

## Using Internal Auditors to provide Direct Assistance

**Obtain Written Agreement from Entity and Internal Auditors**

Prior to using internal auditors to provide direct assistance, external auditor shall:

- Obtain written agreement from entity that internal auditors will follow external auditor's instructions and entity will not intervene in such work.
- Obtain written agreement from internal auditors that they will keep confidential specific matters as instructed by external auditor.

**Factors for determining Nature and Extent of Work that can be Assigned to Internal Auditors**

In determining nature and extent of work that may be assigned to internal auditors, external auditor shall consider following factors:

(i) Amount of judgment involved in planning and performing audit procedures.

(ii) Assessed ROMM.

(iii) External auditor's evaluation of existence of threats to objectivity and competence of internal auditors. It includes inquiry of internal auditors regarding interests and relationships that may create threat to their objectivity.

Factors for Evaluating Existence of Threats to Objectivity of Internal Auditor

- Extent to which internal audit function organizational status and relevant policies & procedures support objectivity of internal auditors.
- Family and personal relationships with individual working in entity.
- Association with division or department in entity to which the work relates.
- Significant financial interests in entity other than remuneration consistent with other employees.

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**Circumstances where Internal Auditors cannot be used to provide Direct Assistance**

External auditor shall not use internal auditors to provide direct assistance to perform procedures that:

- Involve making significant judgments.

  Significant judgments include the following:
  - Assessing ROMM.
  - Evaluating sufficiency of tests performed.
  - Evaluating appropriateness of management's use of going concern assumption.
  - Evaluating significant accounting estimates.
  - Evaluating adequacy of disclosures in FS.

- Relate to higher assessed ROMM which requires more than limited judgment.
- Relate to work in which internal auditor involved and already reported to management/TCWG.
- Relate to decisions external auditor makes regarding internal audit function as per this SA.

**Audit Documentation if External Auditor uses Internal Auditors to provide Direct Assistance**

If external auditor uses internal auditors to provide direct assistance on audit, external auditor shall include following in audit documentation:

- Written agreement obtained from entity and internal auditors.
- Evaluation of existence of threats to objectivity and competence of internal auditors.
- Basis for decision regarding nature and extent of work performed by internal auditors.
- Working papers prepared by internal auditors who provided direct assistance.
- Who reviewed the work performed and the date and extent of that review.

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# SA 620 – Using the Work of an Auditor's Expert



## Basics

- This SA deals with auditor's responsibilities regarding the use of auditor's expert to assist the auditor in obtaining sufficient appropriate audit evidence.
- This SA is not applicable when auditor uses the work of management expert (SA 500).
- **Auditor's Expert** – An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by auditor to assist the auditor in obtaining audit evidence. An auditor's expert may be either an auditor's internal expert or external expert.
- Auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by using the work of auditor's expert.

## Types of Reports / Opinions that Auditor can Obtain from Expert

**Auditor can obtain following types of reports, opinions or statements of expert for purpose of Audit evidence/Expertise in a field other than accounting or auditing may include expertise in:**

- Valuation of complex financial instruments, land & building, plant & machinery, intangible assets, jewellery, asset acquired in business combinations, impaired assets etc.
- Actuarial calculation of liabilities associated with insurance contracts or employee benefit plans.
- Valuation of environmental liabilities and site clean-up costs.
- Interpretation of contracts, laws & regulations.
- Analysis of complex or unusual tax compliance issues.

## Considerations When Deciding Whether to Use an Auditor's Expert

- Nature, significance and complexity of matter.
- ROMM in the matter.
- Availability of alternative sources of audit evidence.
- Whether management has used a management's expert in preparing FS.

  <u>If so, auditor decision on whether to use auditor expert may also influenced by following factors</u>:
  - Nature, scope and objectives of management's expert's work.
  - Whether management's expert is employed by entity or engaged by it.
  - Whether management's expert is subject to technical performance standards.
  - Management's expert competence and capabilities.
  - Extent to which management can exercise control or influence over management's expert work.

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## Evaluating Competence, Capabilities and Objectivity of Auditor's Expert

### Evaluating Competence and Capabilities of Auditor's Expert

Same as SA 500 [Management Expert]

### Evaluating Objectivity of Auditor's External Expert

- Inquiry of entity about any known interests or relationships with auditor's external expert that may affect objectivity.
- Discuss with that expert any applicable safeguard and evaluate whether safeguards are adequate to reduce threats to an acceptable level. Interests and relationships that may be relevant to discuss with auditor's expert include:
  - Financial interests
  - Business and personal relationships
  - Provision of other services by expert

## Agreement with the Auditor's Expert

### Factors suggesting need for Detailed & Written Agreement between Auditor and Auditor Expert

- Auditor's expert will have access to sensitive or confidential entity information.
- Matter to which the auditor's expert's work relates is highly complex.
- Auditor has not previously used work performed by that expert.
- Greater the extent of auditor's expert's work and its significance in audit.

### Contents of Agreement

Auditor shall agree on following matters with auditor's expert:

- Nature and scope of that expert's work.
- Respective roles and responsibilities of auditor and that expert.
- Nature of communication between auditor and that expert including form of report to be provided by that expert.
- Need for auditor's expert to observe confidentiality requirements.

## Evaluating Adequacy of Auditor's Expert Work / Extent of Rely on Auditor's Expert Work

(1) **Auditor shall evaluate adequacy of auditor's expert work for auditor's purposes, including:**

- Relevance & reasonableness of expert findings or conclusions and their consistency with other audit evidence.
- If expert work involves use of significant assumption & methods, relevance & reasonableness of those assumptions & methods.
- If expert work involves use of source data, relevance & completeness of source data.



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**(2) Evaluating Relevance & Reasonableness of Assumptions/Methods and Source Data use by Auditor's Expert**

- Assumptions & Methods

  Factors relevant to auditor's evaluation of assumptions & methods include whether they are:
  - Generally accepted within auditor's expert's field.
  - Consistent with requirements of applicable FRF.
  - Consistent with management, and if not, reason and effect of differences.
  - Dependent on use of specialised models.
- Source Data

  Following procedures may be used to test that data:
  - Verifying origin of data, including obtaining understanding & testing internal controls over data.
  - Reviewing data for completeness and internal consistency.

**(3) Specific Procedure to Evaluate Adequacy of Auditor's Expert Work**

- Inquiries of auditor's expert.
- Reviewing auditor's expert working papers and reports.
- Corroborative procedure such as:
  - Observing auditor's expert work.
  - Confirming relevant matters with third parties.
  - Re performing calculations.
- Discussing expert report with management.
- Discussions with another expert with relevant expertise when findings of auditor's expert are not consistent with other audit evidence.

**(4) If Work of Auditor's Expert is Not Adequate for Auditor's Purposes**

- If auditor determines that work of expert is not adequate for auditor's purposes, he shall:
  (i) Agree with that expert on further work to be performed by that expert or
  (ii) Perform further audit procedures appropriate to the circumstances.
- If auditor concludes that work of auditor's expert is not adequate for auditor's purposes and auditor cannot resolve the matter through additional audit procedures, auditor shall express a modified opinion in auditor's report.

**(5) Nature, Timing and Extent of Audit Procedures**

- Matters which may affect NTE of audit procedure adopted by auditor for auditor expert:
  - Nature of matter.
  - ROMM in the matter.

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- Auditor's previous experience of the work of that expert.
- Significance of that expert's work in audit.
- Whether expert is subject to auditor's firm quality control policies and procedures.

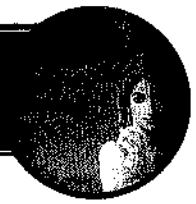
- Following factors may suggest the need for more extensive procedures:
  - Work of auditor's expert relates to significant matter that involves complex judgments.
  - Auditor has not previously used the work of auditor's expert.
  - Work of auditor's expert is integral to audit.
  - Expert is an auditor's external expert and is not subject to firm quality control policies and procedures.

## Reference to The Auditor's Expert in Auditor's Report

| Reference of Work of Auditor's Expert in Auditor's Report | |
|---|---|
| **Unmodified Opinion by Auditor** | Auditor shall not refer work of expert in auditor's report containing an unmodified opinion unless required by law or regulation. If reference is required by law or regulation, auditor shall indicate in his report that such reference does not reduce his responsibility for that opinion. |
| **Modified Opinion by Auditor** | Auditor can refer work of expert if expert work is relevant to understanding of modification. Auditor shall indicate in his report that such reference does not reduce his responsibility for that opinion. |

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# SA 700 – Forming an Opinion and Reporting on Financial Statements



## Basics

- This SA deals with auditor's responsibility to form an opinion on FS. It also deals with form and content of auditor's report issued as a result of audit of FS.
- As per this SA, objectives of auditor is to form an opinion on FS and to express clearly that opinion through a written report.
- Types of Financial Statement (FS) and Financial Reporting Framework (FRF)

| | | |
|---|---|---|
| **Types of FS** | **General Purpose FS** | FS prepared as per general purpose framework. |
| | **Special Purpose FS** | FS prepared as per special purpose framework. (SA 800) |
| **Types of Framework** | **General Purpose Framework** | FRF designed to meet common financial information needs of wide range of users is known as "general purpose framework." |
| | **Special Purpose Framework** | FRF designed to meet financial information needs of specific users is known as "special purpose framework." |

- Auditor shall form an opinion whether FS are prepared as per applicable FRF. To form that opinion, he shall obtain reasonable assurance whether FS as a whole are free from material misstatement.

## Form of Opinion

| | |
|---|---|
| **Unmodified Opinion** | Auditor shall express an unmodified opinion when he concludes that FS are prepared as per FRF. |
| **Modified Opinion** | Auditor shall modify the opinion in auditor's report as per SA 705, If auditor:<br>(i) Concludes that FS as a whole are not free from material misstatement or<br>(ii) Unable to obtain sufficient appropriate audit evidence to conclude that FS as a whole are free from material misstatement. |

## Basic Elements of Auditor's Report

| **Auditor's report includes following basic elements:** |
|---|
| ▪ **Title:** That clearly indicates that it is the report of an independent auditor. |
| ▪ **Addressee:** Auditor's report shall be addressed as required by circumstances of engagement.<br>Example - Members of Company (general purpose FS) and BOD (special purpose FS). |
| ▪ **Auditor's Opinion:** First section of auditor's report shall include auditor's opinion under the heading "Opinion." The opinion section of auditor's report shall also:<br>➢ Identify entity whose FS have been audited.<br>➢ State that FS have been audited. |

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- Identify title of each statement comprising the FS.
- Refer to notes and summary of significant accounting policies.
- Specify date or period covered by each FS.

- **Basis for Opinion:** Auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:
  - States that audit was conducted as per SAs.
  - Refers to section of auditor's report that describes auditor's responsibilities under the SAs.
  - Includes a statement that auditor is independent of entity as per ethical requirements. Statement shall refer to Code of Ethics issued by ICAI.
  - States whether auditor has obtained sufficient and appropriate audit evidence to provide a basis for auditor's opinion.
- **Going Concern:** Auditor shall report as per SA 570.
- **Key Audit Matters:** Auditor shall communicate key audit matters in auditor report as per SA 701.
- **Other Information:** Auditor shall report as per SA 720.
- **Responsibilities for the FS:** Auditor's report shall include a section with heading "Responsibilities of Management for the FS." This section shall describe management's responsibility for:
  - Preparing FS as per FRF and for such internal control as management determines is necessary to enable preparation of FS that are free from material misstatement.
  - Assessing entity's ability to continue as going concern and whether use of going concern assumption is appropriate.
- **Auditor's Responsibilities for the Audit of FS:** This section of auditor's report shall state:
  - Objective is to obtain reasonable assurance whether FS are free from material misstatement.
  - Auditor's responsibilities as per other SAs.

  Example: Identify & assess ROMM, Communicate significant deficiencies in internal control to TCWG, Evaluate appropriateness of going concern assumption etc.

  Location of Description of Auditor's Responsibilities
  - Within body of auditor's report.
  - In appendix to auditor's report (include reference to appendix location).
  - On website of appropriate authority if law permit to do so (include reference to such location).
- **Other Reporting Responsibilities** (Section 143(3) of Companies Act, CARO etc.)
- **Signature of Auditor** [along with Membership No., Firm Registration No. and UDIN]
- **Place of Signature:** City where the audit report is signed.
- **Date of Auditor's Report:** Shall be dated not earlier than date on which auditor has obtained sufficient appropriate audit evidence.

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## Auditor's Report for Audits Conducted as per Both Standards on Auditing Issued by ICAI and International Standards on Auditing

In addition to SA issued by ICAI, auditor may be required to conduct audit as per International SA/Other Standards. If this is the case, auditor's report may refer to SA in addition to International Standards on Auditing, but the auditor shall do so only if:

- There is no conflict between requirements in ISAs and SAs that would lead the auditor to form a different opinion, and
- Auditor's report includes all elements discussed above when the auditor uses wording specified by SA.

When auditor's report refers to both ISAs or SA issued by ICAI, auditor's report shall clearly identify the jurisdiction of other auditing standards.

## Supplementary Information Presented with the Financial Statements

If supplementary information that is not required by FRF is presented with audited FS, auditor shall evaluate whether supplementary information is an integral part of FS.

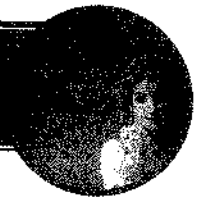
| | |
|---|---|
| **Integral Part** | When it is an integral part of FS, supplementary information shall be covered by auditor's opinion. |
| **Not Integral Part** | If it is not an integral part of FS, auditor shall evaluate whether such supplementary information is presented in a way that clearly differentiates it from audited FS. If not, auditor shall ask management to change presentation of unaudited supplementary information. If management refuses, auditor shall identify unaudited supplementary information and explain in auditor's report that such supplementary information is not audited. |

Examples of Supplementary Information

- Additional disclosures given not required by FRF.
- Additional/Summary Profit & Loss A/c of specific items annexed.
- Average revenue statement attached.

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# SA 701 – Communicating Key Audit Matters in the Independent Auditor's Report



## Basics

- This SA deals with auditor's responsibility to communicate key audit matters in auditor's report. This SA mandatory applies to audit of FS of listed entities.
- **Key audit matters** - Those matters that, in the auditor's professional judgment, were of most significance in the audit of FS of current period. Key audit matters are selected from matters communicated with TCWG.
- Purpose of communicating key audit matters

  - Enhance communicative value of auditor's report.
  - Provide additional information to intended users of FS about most significant matters.

- Communicating key audit matters in the auditor's report is not:

  - A substitute for disclosures in FS that applicable FRF requires.
  - A substitute for auditor expressing modified opinion as per SA 705.
  - A substitute for reporting as per SA 570 when material uncertainty exists relating to events or conditions that may cast significant doubt on entity's ability to continue as going concern.
  - A separate opinion on individual matters.

## Determining Key Audit Matters

- Auditor shall determine key audit matters from the matters communicated with TCWG. In making this determination, auditor shall take into account the following:

  (i) Areas of higher assessed ROMM or significant risks as per SA 315.

  (ii) Significant auditor judgments relating to areas in FS that involved significant management judgment including accounting estimates that have high estimation uncertainty.

  (iii) Effect on audit of significant events or transactions occurred during the period.

  Examples of key audit matters - Matters relating to revenue recognition, Assessment of Impairment, Valuation of financial instruments, Provision for losses and contingencies etc.

- Auditor shall determine which of the matters determined above were of most significance in audit of FS of current period and therefore are key audit matters.
- Matters that do not link with matters disclosed in FS can also be considered as a key audit matter if it required significant attention of auditor which had an impact on its audit.

  Example - Implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention if such change had significant effect on auditor's overall audit strategy.



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## Communicating Key Audit Matters to TCWG

- Auditor shall communicate key audit matters with TCWG on a timely basis. Appropriate timing for communications about key audit matters will vary with circumstances of engagement.
- Communication of key audit matters with TCWG enables them to be made aware of such matters that auditor intends to communicate in auditor's report.
- It provides opportunity to TWCG to understand basis for auditor's decisions about such matters.
- It also enables TCWG to consider whether new or enhanced disclosures may be useful.

## Communicating Key Audit Matters in Auditor's Report

| | |
|---|---|
| **Heading** | Auditor shall describe each key audit matter in a separate section of auditor's report under the heading "Key Audit Matters". |
| **Introductory Language** | Introductory language in this section of auditor's report shall state that:<br>(i) Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of FS of current period.<br>(ii) These matters were addressed in context of audit of FS as a whole and auditor does not provide a separate opinion on these matters. |
| **Description** | Description of each key audit matter shall address:<br>(i) Why the matter was considered to be most significance in audit and therefore determined to be a key audit matter.<br>(ii) How the matter was addressed in audit. |
| **No Communication of Key Audit Matter** | ▪ Auditor shall describe each key audit matter in auditor's report unless:<br>(i) Law or regulation precludes public disclosure about the matter or<br>(ii) In extremely rare circumstances, auditor determines that matter should not be communicated in auditor's report because adverse consequences of doing so would reasonably be expected to outweigh public interest benefits of such communication. This shall not apply if entity has publicly disclosed information about the matter.<br>▪ Auditor shall not communicate a matter as key audit matter when auditor would be required to modify the opinion as per SA 705 as a result of matter.<br>▪ SA 705 also prohibits auditor from communicating key audit matters when auditor disclaims an opinion on FS. |
| **If Auditor determined No Key Audit Matters** | In case of listed entities, if auditor has determined that there are no key audit matters to communicate, he shall mention following under Key Audit Matter section: "We have determined that there are no key audit matters to communicate in our report". |

# SA 705 – Modifications to Opinion in Independent Auditor's Report



## Basics

- This SA deals with auditor's responsibility to issue an appropriate report if auditor concludes that a modification to auditor's opinion on FS is necessary.
- Auditor shall modify the opinion in auditor's report when:
  - (i) Auditor concludes that FS as a whole are not free from material misstatement or
  - (ii) Auditor is unable to obtain sufficient appropriate audit evidence to conclude that FS as a whole are free from material misstatement.

## Modification to the Auditor's Opinion

**(1) Decision regarding which type of modified opinion is appropriate depends upon:**

(i) Nature of matter giving rise to the modification and

(ii) Auditor's judgment about pervasiveness of effects of matter on the FS.

**What is Pervasive?**

Pervasive effects of misstatement on FS are those that in auditor's judgment:

- Are not confined to specific accounts or items of FS, or
- If confined, represent substantial proportion of FS, or
- Disclosures that are fundamental to users understanding of FS are not given.

**(2) Types of Modifications/Modified Opinion**

| | |
|---|---|
| **Qualified Opinion** | • Auditor shall express a qualified opinion when he obtained sufficient appropriate audit evidence, concludes that misstatements are material but not pervasive to FS, or<br>• Auditor is unable to obtain sufficient appropriate audit evidence, but he concludes that possible effects of undetected misstatements on FS could be material but not pervasive. |
| **Adverse Opinion** | Auditor shall express an adverse opinion when he obtained sufficient appropriate audit evidence, concludes that misstatements are both material and pervasive to FS. |
| **Disclaimer of Opinion** | Auditor shall disclaim an opinion when he is unable to obtain sufficient appropriate audit evidence, and he concludes that possible effects of undetected misstatements on FS could be both material and pervasive. |

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### (3) Examples of Situations in which Modified Opinion is Expressed

| Situation | Opinion |
|---|---|
| Material misstatement in foreign travel expense, provision for gratuity etc. | Qualified |
| Inadequate disclosure of material uncertainty related to going concern | Qualified |
| Unable to verify loans & advances (not substantial proportion) due to unavailability of loan agreement | Qualified |
| Non-consolidation of subsidiary or CFS not prepared even after applicability | Adverse |
| Non-disclosure of material uncertainty related to going concern | Adverse |
| Unable to obtain audit evidence about investment that represents substantial proportion of entity's net assets | Disclaimer |

## Inability to Obtain Sufficient Appropriate Audit Evidence

### (1) Nature of Inability to Obtain Sufficient Appropriate Audit Evidence

Auditor's inability to obtain sufficient appropriate audit evidence (also referred as limitation on scope of audit) may arise from:

- Circumstances beyond the control of entity (accounting records destroyed or seized)
- Circumstances relating to nature or timing of auditor's work (timing of appointment)
- Limitations imposed by management (management prevents the auditor)

### (2) Consequence of Inability to obtain Sufficient Appropriate Audit Evidence due to Management imposed Limitation after Auditor has Accepted the Engagement

| | |
|---|---|
| **Request Management** | If, after accepting the engagement, auditor becomes aware that management has imposed a limitation on scope of audit, auditor shall request management to remove the limitation. |
| **Perform Alternative Procedures** | If management refuses, auditor shall communicate matter to TCWG and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence. |
| **Unable to obtain Sufficient Appropriate Audit Evidence** | • If auditor concludes that possible effects of undetected misstatements on FS could be material but not pervasive, he shall qualify the opinion.<br>• If auditor concludes that possible effects of undetected misstatements on FS could be both material and pervasive, he shall:<br>➢ Withdraw from audit, if possible under applicable law or regulation<br>➢ If withdrawal from audit before issuing auditor's report is not possible, disclaim an opinion on FS. |

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(3) **Where Auditor's Withdrawal is not Permitted Without Issuing Audit/Review Report**

As per SEBI directive (in case of listed companies), if auditor proposes to resign:

- Within 45 days from end of any quarter, then auditor shall issue audit/limited review report for such quarter before resignation.
- After 45 days from end any of quarter, then auditor shall issue audit/limited review report for such quarter as well as next quarter.
- If limited review report has been issued for all three quarters, then auditor shall issue audit report for full year before resigning from engagement.

ICAI announcement on Resignation of Auditor (in case of unlisted companies)

Auditor of unlisted company shall not mention "professional pre-occupation" as a reason for resignation. He shall mention resignation reasons clearly in resignation letter issued to the Company.

## Other Considerations regarding Disclaimer of Opinion

| | |
|---|---|
| **Non Inclusion of Elements in Auditor's Report** | When auditor disclaims an opinion on FS, report shall not include following elements:<br>(i) Reference to report section where auditor's responsibilities are described.<br>(ii) Statement about whether SAAE is obtained.<br>When auditor disclaims an opinion on FS, report shall also not include Key Audit Matter section. |
| **Description of Auditor's Responsibilities** | Description of Auditor's Responsibilities when Auditor Disclaims an Opinion on FS<br>(i) Statement that auditor's responsibility is to conduct audit as per SA and to issue report.<br>(ii) Statement that because of matters described in Basis for Disclaimer of Opinion section, auditor was not able to obtain SAAE.<br>(iii) Statement about auditor independence and other ethical responsibilities. |

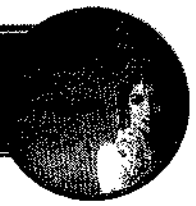
## Communication with TCWG regarding Modification

When auditor expects to modify opinion in auditor's report, he shall communicate with TCWG:

- Circumstances that led to expected modification.
- Wording of modification.

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# SA 706 – Emphasis of Matter Paragraphs & Other Matter Paragraphs in Independent Auditor's Report



## Basics

This SA deals with additional communication in auditor's report when auditor wants to draw users' attention to:

(i) Matter presented or disclosed in FS that are fundamental to users understanding of FS, or

(ii) Matter other than those presented or disclosed in FS that are relevant to users' understanding of audit or auditor's report.

## Emphasis of Matter [EOM] Paragraph

| | |
|---|---|
| **Meaning** | A paragraph included in auditor report that refers to matter presented or disclosed in FS that, in auditor's judgment is fundamental to users understanding of FS. |
| **Examples of Circumstance for giving EOM Para** | ▪ Circumstances where specific requirement for auditor to include EOM paragraph:<br>➢ When a FRF prescribed by law or regulation is unacceptable.<br>➢ To alert users that FS are prepared as per special purpose framework.<br>➢ When facts become known to auditor after date of auditor's report and auditor provides a new or amended auditor's report (i.e., subsequent events).<br>▪ Circumstances where auditor may consider it necessary to include EOM paragraph:<br>➢ Uncertainty relating to future outcome of litigation or regulatory action.<br>➢ Significant subsequent event that occurs between date of FS & auditor's report.<br>➢ Early application of new Accounting Standard that has material effect on FS.<br>➢ Major catastrophe that has significant effect on entity's financial position. |
| **Condition** | Auditor shall include EOM paragraph in auditor's report provided:<br>➢ Auditor is not required to modify opinion as per SA 705 as a result of matter.<br>➢ Matter has not been determined to be a key audit matter as per SA 701. |

## Other Matter [OM] Paragraph

| | |
|---|---|
| **Meaning** | A paragraph included in auditor report that refers to matter other than those presented or disclosed in FS that, in auditor's judgment is relevant to users understanding of audit or auditor's report. |
| **Examples of Circumstance for giving OM Para** | ➢ In separate audit report given by joint auditor by making reference to audit report issued by other joint auditors.<br>➢ In principal auditor report by indicating all components audited by other auditors.<br>➢ In case where FS of prior period not audited or audited by predecessor auditor. |

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# SA 710 – Comparative Information: Corresponding Figures and Comparative Financial Statements

## Basics

- This SA deals with auditor's responsibilities regarding comparative information in audit of FS.
- Some Important Definitions

| | |
|---|---|
| **Comparative Information** | Amounts and disclosures for prior period included in FS as per applicable FRF. |
| **Corresponding Figures** | Comparative information where amounts and other disclosures for prior period are included as part of current period FS, and are intended to be read in relation to current period figures. These are not presented as complete FS but are an integral part of current period FS. |
| **Comparative FS** | Comparative information where amounts and other disclosures for prior period are included for comparison with FS of current period. |

## Procedures or Responsibilities of Auditor regarding Comparative Information

- Auditor shall determine whether FS include comparative information as per FRF & is appropriately classified. For this, auditor shall evaluate whether:
  - (i) Comparative information agrees with amount & other disclosure presented in prior period.
  - (ii) Accounting policies reflected in comparative information are consistent with those applied in current period, or if there is any change in accounting policy, whether those changes have been properly accounted, disclosed & presented.
- If auditor becomes aware of possible misstatement in comparative information, auditor shall perform such additional audit procedures to determine whether a material misstatement exists.
- As per SA 580, auditor shall obtain WR for all period. Auditor shall also obtain specific WR regarding any prior period item that is separately disclosed in current year P&L.

## Audit Reporting regarding Comparative Information

| Reporting Requirement of Comparative Information for Current Period FS | |
|---|---|
| **Audit Report for Prior Period is Modified** | When auditor's report on prior period included a modified opinion and the matter which gave rise to modified opinion is resolved, accounted or disclosed as per FRF, auditor's opinion on current period need not refer to previous modification.<br>If matter is unresolved, auditor shall modify opinion on current period FS. Also in the Basis for Modification paragraph, auditor shall either: |



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| | |
|---|---|
| | ▪ Refer to both current period figures and corresponding figures, when the effects of matter on current period's figures are material, or<br>▪ In other cases, explain opinion has been modified because of the effects of unresolved matter on comparability of current period's figures and corresponding figures. |
| **Prior Period FS were Not Audited** | Auditor shall state in Other Matter paragraph that comparative information is unaudited. |
| **Prior Period FS Audited by a Predecessor Auditor** | Auditor shall state in Other Matter paragraph:<br>▪ FS of prior period were audited by predecessor auditor.<br>▪ Type of opinion expressed by predecessor auditor and reasons of modified opinion, and<br>▪ Date of that report. |

| **Audit Reporting Differences between Corresponding Figures and Comparative FS** | |
|---|---|
| **For Corresponding Figures** | Auditor's opinion on FS refers to current period only.<br>Auditor's opinion on current period FS shall not refer to corresponding figures except above circumstances. |
| **For Comparative FS** | Auditor's opinion refers to each period for which FS are presented. |

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# SA 720 – Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements



## Basics

- This SA deals with auditor's responsibilities relating to other information, whether financial or non-financial information (other than FS and auditor's report), included in entity's annual report.
- Auditor's opinion on FS does not cover other information This SA requires auditor to read and consider other information for any materially inconsistency with FS.

## Obtaining, Reading and Considering the Other Information

| | |
|---|---|
| **Obtaining Other Information** | Auditor shall:<br>▪ Determine, through discussion with management, which document comprises annual report and timing of issuance of such document.<br>▪ Make appropriate arrangements with management to obtain final version of document prior to date of auditor's report (if possible).<br>▪ If document determined above will not be available upto date of auditor's report, request management to provide WR that final version of document will be provided to auditor prior to its issuance by the entity. |
| **Reading and Considering Other Information** | Auditor shall read the other information and consider:<br>▪ Whether there is material inconsistency between other information and FS.<br>▪ Whether there is material inconsistency between other information and auditor's knowledge obtained in audit. |

## Responding when auditor concludes that Material Misstatement exist in Other Information

If auditor concludes that a material misstatement exists in other information, auditor shall request management to correct the other information. If management:

(i) Agrees to make correction, auditor shall determine that correction has been made; or

(ii) Refuses to make correction, auditor shall communicate matter with TCWG and request that correction be made.

If auditor concludes that a material misstatement exists in other information obtained prior to date of auditor's report, and other information is not corrected after communicating with TCWG, he shall:

(i) Considering implications for auditor's report and communicating with TCWG about how auditor plans to address material misstatement in auditor's report.

(ii) Withdrawing from engagement, where withdrawal is possible under applicable law or regulation.

If auditor concludes that a material misstatement exists in other information obtained after the date of auditor's report, auditor shall:

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(i) If other information is corrected, perform necessary procedures.

(ii) If other information is not corrected after communicating with TCWG, take appropriate action to brought uncorrected material misstatement to users attention.

## Reporting of Other Information

Auditor's report shall include a separate section with heading "Other Information". This include:

- Statement that management is responsible for other information.
- Description of auditor's responsibilities relating to reading and considering other information.
- Statement that auditor's opinion on FS does not cover other information.
- When other information has been obtained prior to date of auditor's report, either:
  - Statement that auditor has nothing to report, or
  - If auditor concluded that there is uncorrected material misstatement of other information, statement that describes uncorrected material misstatement of other information.

## Examples of Other Information

Other information means financial or non-financial information (other than FS and auditor's report thereon) included in entity's annual report.

**Examples of Amounts or Other Items that may be Included in the Other Information**

**Amounts**

(i) Summary of key financial results, such as net income, EPS, dividends, sales and purchases.

(ii) Selected operating data, such as sales by geographical segment or product line.

(iii) Special item such as litigation provisions and restructuring expenses.

(iv) Liquidity and capital resource information, such as cash, cash equivalents, and debt.

(v) Capital expenditures by segment or division.

(vi) Amounts involved in guarantees, contractual obligations and off-balance sheet arrangements.

(vii) Financial measures or ratios, such as gross margin, current ratio and debt ratio.

**Other Items**

(i) Explanations of critical accounting estimates and related assumptions.

(ii) Identification of related parties and descriptions of transactions with them.

(iii) Approach to manage foreign exchange risks through use of financial instruments.

(iv) Descriptions of guarantees, contractual obligations and off-balance sheet arrangements.

(v) Descriptions of changes in legal or regulatory requirements, such as new tax regulations.

(vi) Overview of strategy.

(vii) Descriptions of trends in market prices of key commodities or raw materials.

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# SA 800 – Special Considerations: Audits of Financial Statements Prepared as per Special Purpose Frameworks



## Basics

- SAs in 100-700 series apply to audit of FS. This SA deals with special considerations in application of those SAs to audit of FS prepared as per special purpose framework.
- Special purpose framework is different from general purpose framework. FRF designed to meet financial information needs of specific users is known as "special purpose framework."
- Examples of special purpose frameworks are:

| |
|---|
| Cash basis of accounting and cash flow information prepare for creditors. |
| Financial reporting provisions established by regulator to meet requirements of that regulator. |
| Financial reporting provisions of contract such as loan agreement or project grant. |

## Considerations in Accepting Such Audit

- SA 210 requires auditor to determine acceptability of FRF applied in preparation of FS. In case of special purpose FS, financial information needs of intended users are key factor in determining the acceptability of FRF applied in preparation of FS.
- In audit of special purpose FS, auditor shall obtain understanding of purpose for which FS are prepared and intended users.

## Considerations in Planning and Performing Such Audit

While planning and performing audit, auditor should consider following factors:

- Compliance of all SAs relevant to audit and ethical requirements including independence.
- Application of some SAs in audit of special purpose FS may require special consideration. For example, in SA 320, judgments are based on financial information needs of intended users.
- In case of special purpose FS, management may agree with intended users on a threshold below which misstatements identified will not be corrected. This does not relieve the auditor from requirement to determine materiality as per SA 320.
- SA 260 requires auditor to communicate with TCWG. TCWG responsible for oversight of preparation of special purpose FS may not be same as general purpose FS.

## Forming an Opinion and Reporting Considerations in such Audit

When forming an opinion and reporting on special purpose FS, auditor shall apply requirements in SA 700. SA 700 requires auditor to evaluate whether FS adequately describe applicable FRF. Auditor's report shall also describe purpose for which FS are prepared and intended users.

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| | |
|---|---|
| **Alerting Readers** (Mandatory) | Special purpose FS may be used for other purposes. For example, a regulator may require certain entities to place special purpose FS on public record. To avoid misunderstandings, auditor shall alert users of auditor's report that FS are prepared as per special purpose framework and may not be suitable for another purpose in EOM Paragraph. |
| **Restriction on Distribution or Use** | Auditor may indicate that auditor's report is intended only for specific users. This may be achieved by restricting distribution or use of auditor's report. In this case, paragraph alerting the readers may be expanded to include these other matters and the heading modified accordingly. |

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# SA 805 – Special Considerations: Audits of Single FS and Specific Elements, Accounts or Items of a FS



## Basics

- SAs in 100-700 series apply to audit of FS. This SA deals with special considerations in application of those SAs to audit of single FS or specific element/account/item of FS. These may be prepared as per general or special purpose framework. If prepared as per special purpose framework, SA 800 also applies.
- A single FS is different from complete set of FS. For example, cash flow statement is a single FS.
- Examples of specific elements/accounts/items of FS are:
  - Trade receivable, cash/bank balances, allowance for doubtful debts, inventory, recorded value of identified intangible assets etc
  - Schedule of externally managed assets and income of private pension plan
  - Schedule of tangible assets
  - Schedule of disbursements in relation to lease property

## Considerations in Accepting Such Audit

- In such engagement, auditor shall comply with all SAs relevant to audit even if auditor is also engaged to audit complete set of FS.
- If auditor not engaged to audit complete set of FS, auditor shall determine whether such engagement as per SAs is practicable.
- It may not be practicable because auditor often does not have same understanding of entity and its environment, including internal control, as an auditor who also audits complete set of FS. Auditor may need further evidence to corroborate audit evidence acquired from accounting records.
- If auditor concludes that such engagement may not be practicable, auditor may discuss with management whether another type of engagement might be more practicable.

## Considerations in Planning and Performing Such Audit

- Auditor shall adapt all SAs as necessary in engagement. Even when auditing specific element of FS, SAs such as SA 240, SA 550 and SA 570 are relevant.
- When auditing single FS or specific element, auditor may use audit evidence obtained as part of audit of complete set of FS.
- Materiality determined for single FS or specific element may be lower than materiality determined for complete set of FS, this will affect NTE of audit procedures.
- SA 260 requires auditor to communicate with TCWG. TCWG responsible for oversight of preparation of single FS or element may not be same as complete set of FS.

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## Forming an Opinion and Reporting Considerations

| | |
|---|---|
| **Separate Opinion** | If auditor undertakes engagement to report on single FS or specific element alongwith engagement to audit complete set of FS, auditor shall express separate opinion for each engagement. |
| **Published Together** | Audited single FS or specific element may be published together with audited complete set of FS, If presentation of single FS or specific element differentiate it sufficiently from complete set of FS. |
| **Relevance of Matter Included in Auditor's Report on Complete Set of FS** | Auditor shall consider the implications whether a matter [Going Concern, Key Audit Matter, Modified Opinion, EOM/OM, Other Information] included in auditor's report on complete set of FS is relevant for engagement to report on single FS or specific element of FS.<br>Factors that may be relevant in considering those implications include:<br>▪ Nature of matter being described in auditor's report on complete set of FS and extent to which it relates to single FS or specific element of FS.<br>▪ Pervasiveness of matter described in auditor's report on complete set of FS.<br>▪ Nature and extent of difference between applicable FRFs.<br>▪ Extent of difference between period covered by complete set of FS compared to period of single FS or element of FS.<br>▪ Time elapsed since the date of auditor's report on complete set of FS. |
| **Auditor's Report on Complete Set of FS Contains Modified Opinion** | ▪ If auditor expressed qualified opinion on complete set of FS, auditor shall determine effect of this on auditor's report on single FS or specific element. If deemed appropriate, auditor shall modify (qualify) opinion in auditor's report on single FS or specific element.<br>▪ If auditor expressed adverse or disclaimer of opinion on complete set of FS but auditor wants to express unmodified opinion on specific element of FS, auditor shall do so only if:<br>(i) Not prohibited by law or regulation;<br>(ii) That opinion is expressed in auditor report that is not published together with auditor's report containing adverse or disclaimer of opinion; and<br>(iii) Specific element not constitute major portion of complete set of FS.<br>▪ If auditor expressed adverse or disclaimer of opinion on complete set of FS, auditor shall not express unmodified opinion on single FS. This is because a single FS is deemed to constitute major portion. |

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# SA 810 – Engagements to Report on Summary Financial Statements

## Basics

- This SA deals with auditor's responsibilities when undertaking engagement to report on summary FS derived from FS audited as per SAs ordinarily by same auditor.
- Summary FS contains less detail than FS but provides structured representation consistent with that provided by FS.

## Engagement Acceptance

Auditor shall ordinarily accept engagement to report on summary FS only when auditor has been engaged to conduct audit of FS from which summary FS are derived.

**Before accepting engagement to report on summary FS, auditor shall:**

| | |
|---|---|
| **Applied Criteria** | Determine whether applied criteria are acceptable<br>▪ It refers to criteria applied by management in preparation of summary FS.<br>▪ Factors affecting determination of acceptability of applied criteria:<br>➢ Nature of entity<br>➢ Purpose of summary FS<br>➢ Information needs of intended users of summary FS<br>➢ Whether applied criteria will result in summary FS that are not misleading<br>▪ Criteria may also be established by recognised organisation or by law or regulation. In such case, auditor may presume that such criteria are acceptable. |
| **Management Responsibility** | Obtain agreement from management that it acknowledges its responsibility:<br>▪ For preparation of summary FS as per applied criteria.<br>▪ To make audited FS available to intended users of summary FS without difficulty.<br>Auditor's evaluation whether audited FS are available to intended users of summary FS without undue difficulty is affected by factors such as whether:<br>➢ Summary FS describe clearly from whom or where audited FS are available.<br>➢ Audited FS are on public record.<br>➢ Management has established a process by which intended users of summary FS can obtain ready access to audited FS.<br>▪ To include auditor report on summary FS in any document containing summary FS. |

If auditor concludes that applied criteria are unacceptable or unable to obtain agreement from management, he shall not accept such engagement.

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## Nature of Procedures to be Performed by Auditor

Auditor shall perform following procedures as the basis for auditor's opinion on summary FS:

(i) Evaluate whether summary FS adequately disclose their summarised nature and identify audited FS. (for example, be provided by a title such as "Summary/Abridged FS prepared/derived from Audited FS for year ended March 31, 20XX")

(ii) Evaluate whether audited FS are available to users of summary FS without difficulty.

(iii) When summary FS are not accompanied by audited FS, evaluate whether they clearly describe from whom or where audited FS are available.

(iv) Evaluate whether summary FS are prepared as per applied criteria.

(v) Evaluate whether summary FS adequately disclose applied criteria.

(vi) Compare summary FS with related information in audited FS to determine whether summary FS agree with related information in audited FS.

(vii) Evaluate whether summary FS contain necessary information and not misleading.

## Events Subsequent to Date of Auditor's Report on Audited Financial Statements

When auditor reports on summary FS after completion of audit of FS, auditor is not required to report on effect of subsequent events occurred after date of auditor's report on audited FS since summary FS are derived from audited FS.

## Auditor's Opinion on Summary FS / Form of Opinion

| | |
|---|---|
| **Unmodified Opinion** | If auditor concluded that an unmodified opinion on summary FS is appropriate, auditor's opinion shall use one of the following phrases (form of opinion):<br>▪ Summary FS are consistent (in all material aspects) with audited FS as per applied criteria.<br>or<br>▪ Summary FS are a fair summary of audited FS as per applied criteria. |
| **Modified Opinion** | If summary FS are not consistent (in all material aspects) or not a fair summary of audited FS as per applied criteria and management does not make necessary changes, auditor shall express adverse opinion on summary FS. |

**Note:**

(i) Auditor shall agree with management on form of opinion to be expressed on summary FS.

(ii) If law or regulation prescribes different wording of opinion on summary FS, auditor shall:

- Apply necessary procedures to enable auditor to express prescribed opinion.
- Evaluate whether users might misunderstand auditor's opinion on summary FS. If so, whether additional explanation in auditor's report on summary FS can mitigate misunderstanding.



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## Reference in Auditor's Report on Summary FS about Matters Included in Auditor's Report on Audited FS

| Going Concern/Key Audit Matter/EOM/OM/Other Info. in Auditor's Report on Audited FS | |
|---|---|
| In that case, auditor's report on summary FS shall also contain following:<br>(i) State that auditor's report on audited FS contains Material Uncertainty Related to Going Concern section, Key Audit Matter section, EOM/OM para and statement of uncorrected material misstatement of other information.<br>(ii) Describe the matter referred above and effect thereof on summary FS. | |
| **In case of Modifed Opinion in Auditor's Report on Audited FS** | |
| **Qualified Opinion in Auditor's Report on Audited FS** | Auditor's report on summary FS shall also contain following:<br>(i) State that auditor's report on audited FS contains qualified opinion.<br>(ii) Describe basis for qualified opinion on audited FS and effect thereof on summary FS. |
| **Adverse/Disclaimer of Opinion in Auditor's Report on Audited FS** | Auditor's report on summary FS shall additionally:<br>(i) State that auditor's report on audited FS contains adverse/disclaimer.<br>(ii) Describe basis for adverse/disclaimer.<br>(iii) State that due to such opinion, it is inappropriate to express opinion on summary FS. |

## Basic Elements of Auditor's Report on Summary FS

| Auditor's report on summary FS shall include following elements: |
|---|
| ▪ Title |
| ▪ Addressee |
| ▪ Introductory Paragraph<br>➢ Identifies summary FS including title and identifies audited FS.<br>➢ If date of auditor's report on summary FS is later than audited FS, state that summary FS do not reflect effect of subsequent events occurred after date of auditor's report on audited FS.<br>➢ Statement that reading summary FS is not a substitute for reading audited FS. |
| ▪ Management Responsibility |
| ▪ Auditor Responsibility<br>Statement that auditor is responsible for expressing opinion on summary FS which was conducted as per SA 810. |
| ▪ Reference about matters included in auditor's report on audited FS |
| ▪ Auditor's Opinion (including EOM/OM paragraph, if any) |



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- Date of report

  Report shall be dated not earlier than date on which auditor has obtained sufficient appropriate audit evidence AND not earlier than date of auditor's report on audited FS.

- Auditor's signature
- Place of signature

## Auditor Association/Reference

**Auditor Reference in Document containing Audited Summary FS without Auditor's Report**

- If entity plans to state that auditor has reported on summary FS in document containing summary FS without auditor's report, auditor shall request management to include auditor's report.
- If management does not do so, auditor shall take actions to prevent management from inappropriately associating auditor with summary FS in that document.

**Auditor Reference in Document containing Unaudited Summary FS**

- Auditor may be engaged to report on FS of entity but not on summary FS. In this case, if entity plans to make a statement in a document that refers to auditor, auditor shall be satisfied that:
  (a) Reference to auditor is made only for auditor's report on audited FS; and
  (b) Statement does not give impression that auditor has reported on summary FS.
- If (a) or (b) are not met, auditor shall request management to change statement or not refer auditor in document. If management does not do so, auditor shall take actions to prevent management from inappropriately referring the auditor.

## Other Considerations

- Unaudited Supplementary Information Presented with Summary FS

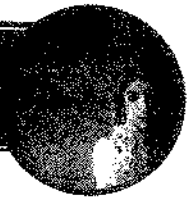
  Same as SA 700
- Comparatives
  - If audited FS contain comparatives but summary FS do not, auditor shall determine whether such omission is reasonable.
  - Auditor shall determine effect of unreasonable omission on auditor's report on summary FS.
- Other Information in Documents containing Summary FS

  Responding when material inconsistency exist in other information: Same as SA 720
- Restriction on Distribution or Use or Alerting Readers to the Basis of Accounting

  Same as SA 800

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# RISK ASSESSMENT & INTERNAL CONTROL



## Audit Risk and It's Components

| | |
|---|---|
| **Inherent Risk** | ▪ Inherent Risk is susceptibility of assertion about class of transaction, account balance and disclosure (CAD) towards misstatements.<br>▪ These are risks that arise from entity's objectives, nature of operations & industry, regulatory environment and its size and complexity. |
| **Control Risk** | ▪ It is the risk that entity's internal control system will not prevent, detect and correct material misstatement on a timely basis or such control will be missing.<br>▪ Some control risk will always exist because there are inherent limitations of any internal control system. |
| **Risk of Material Misstatement** | ▪ It is anticipated risk that material misstatement may exist in FS prior to audit.<br>▪ It has two components: Inherent Risk and Control Risk.<br>▪ ROMM = Inherent Risk x Control Risk |
| **Detection Risk** | ▪ It is the risk that auditor will not be able to detect a material misstatement.<br>▪ ROMM is inversely related with Detection Risk. |
| **Audit Risk** | ▪ It is a risk that auditor will issue inappropriate opinion while FS are materially misstated. It has two components: ROMM and Detection Risk.<br>▪ Audit Risk = ROMM x Detection Risk<br>▪ Objective of auditor is to reduce audit risk to an acceptably low level. |

## Steps for Risk Identification

- Determine likelihood of occurrence of assessed risk.
- Assess significance of assessed risk and impact of its occurrence.
- Identify degree of significant risks that require separate attention by auditor.
- Document assertions that are effected.
- Consider nature of internal control system in place and its effectiveness in mitigating risks.
- Enquire and document management's response.

## Risk-Based Audit (RBA) Approach

(1) **Meaning of RBA Approach**

RBA is an approach to audit that analyzes audit risks, sets materiality thresholds based on analysis and develops audit programmes that allocate larger resources to high-risk areas. In RBA, auditor does not need to perform audit procedures on all areas of audit.



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## (2) General Steps and Phases in Conduct of RBA

| | |
|---|---|
| **Risk Assessment** | Risk assessment phase involves following steps:<br>➢ Planning overall engagement<br>➢ Performing procedures to understand business and identify inherent and control risks<br>➢ Assessing ROMM in FS<br>➢ Identifying significant risks that require special consideration<br>➢ Communicating any material weakness in internal control to TCWG |
| **Risk Response** | Performing audit procedures that respond to assessed risks and reduce ROMM to low level. |
| **Reporting** | Issuing appropriate audit report based on audit findings. |

# Internal Control System

## (1) Meaning of Internal Control System

It means all policies and procedures (internal controls) adopted by management for efficient conduct of business, safeguarding of assets, prevention & detection of fraud/error, accuracy & completeness of accounting records and timely preparation of reliable financial information.

## (2) Objectives of Internal Control System

| | |
|---|---|
| **Objectives of Internal Control** | ▪ Transactions are executed through management authorization.<br>▪ All transactions are recorded in appropriate manner.<br>▪ Assets and records are safeguarded from unauthorized access or use.<br>▪ Assets are verified regularly and action is taken regarding discrepancies. |
| **Basic Accounting Control Objective** | Whether all transactions are:<br>▪ Recorded<br>▪ Real<br>▪ Properly valued<br>▪ Recorded timely<br>▪ Properly posted<br>▪ Properly classified and disclosed |

## (3) Inherent Limitations of Internal Control System

- Management's consideration that cost of internal control does not exceed expected benefits.
- Potential for human error due to carelessness, distraction and judgment mistakes.
- Possibility of circumvention of internal controls through collusion with employees etc.
- Possibility that person responsible for exercising control could abuse that responsibility.
- Manipulations by management with respect to judgments required in preparation of FS.

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## Structure of Internal Control

| Manual Elements and Automated Elements in Internal Control |
|---|
| Entity's system of internal control contains both manual elements and automated elements. Circumstances in which manual elements in internal control may be more suitable:<br>➢ Large, unusual or non-recurring transactions.<br>➢ Circumstances where errors are difficult to define or predict.<br>➢ In changing circumstances that require response outside scope of existing automated control.<br>➢ In monitoring effectiveness of automated controls. |
| **Policies and Procedures** |
| To achieve objectives of internal control, it is necessary to establish adequate control policies and procedures. Most of these policies and procedures cover:<br>▪ Segregation of duties: Following functions are segregated - Authorization of transactions, Execution of transactions, Physical custody of assets and Maintenance of records & documents.<br>▪ Authorization of Transaction<br>▪ Adequacy of Records and Documents: Same as objectives of internal control.<br>▪ Accountability and Safeguarding of Assets<br>▪ Independent Checks |

## Components of Internal Controls

| There are Five Components of Internal Control Framework | |
|---|---|
| **Control Environment** | Control environment encompasses following elements:<br>▪ Communication and enforcement of integrity and ethical values<br>▪ Commitment to competence<br>▪ Human resource policies and practices<br>▪ Participation by TCWG<br>▪ Organisational structure<br>▪ Assignment of authority and responsibility |
| **Entity's Risk Assessment Process** | Entity's risk assessment process includes how management identifies business risks relevant to preparation of financial statements.<br>**Risks can arise or change due to following circumstances:**<br>▪ Changes in operating environment: Changes in regulatory or operating environment can result in changes in different risks.<br>▪ New personnel: They may have different understanding of internal control.<br>▪ New or revamped information systems: Rapid changes in information systems can change the risk relating to internal control. |

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| | ▪ New technology: Incorporating new technologies may change the risk of controls.<br>▪ Rapid growth of operations: Rapid expansion increases risk of controls breakdown.<br>▪ New business models, products or activities: These may introduce new risks.<br>▪ Corporate restructurings: Restructurings may change the risk of controls.<br>▪ Expanded foreign operations: Expansion or acquisition of foreign operations carries new and unique risks that may affect internal control.<br>▪ New accounting pronouncements: Adoption of new accounting principles may affect risks in preparing financial statements. |
| **Control Activities** | Control activities may be categorised as policies and procedures relate to following:<br>▪ Performance reviews: It include reviews and analyses of actual performance versus budgets, forecasts and prior period performance.<br>▪ Information processing: It includes application controls and general IT controls.<br>▪ Physical controls: Controls that encompass physical security of assets etc.<br>▪ Segregation of duties: Assigning responsibilities to different people. |
| **Information & Communication** | Information System consists of infrastructure (physical and hardware components), software, people, procedures and data.<br>Communication involves providing understanding of roles and responsibilities pertaining to internal control.<br>Information system relevant to financial reporting objectives encompasses methods & records that:<br>▪ Identify and record all valid transactions.<br>▪ Describe transactions in detail on a timely basis.<br>▪ Measure value of transactions in a manner that permits proper recording in FS.<br>▪ Present transactions and related disclosures properly in FS. |
| **Monitoring** | Monitoring of controls include considering whether they are operating as intended. |

## Internal Check System and Internal Audit

### (1) Internal Check System

It implies organization of overall system of book-keeping and arrangement of staff duties such that no one person can carry through a transaction and record every aspect thereof.

| Objectives of Internal Check System |
|---|
| ▪ To minimize possibility of commission of errors and fraud by any staff. |
| ▪ To detect error and frauds with ease. |
| ▪ To increase efficiency of staff. |
| ▪ To locate responsibility area where actual fraud and error occurs. |



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- To protect integrity of business.
- To prevent misappropriation of cash and falsification of accounts.

**Considerations on which Effectiveness of Internal Check System Depends**

- Division of Work: Segregation of work should be made so that work flow is not interrupted.
- Clarity of Responsibility: Responsibility of different persons should be properly identified.
- Standardization: Accounting process should be standardized by creating suitable policies.
- Appraisal: Periodic review should be made of the chain of operations and workflow.

**General Condition pertaining to Internal Check System**

- No single person should have complete control over important aspect of business operation.
- Staff duties should be rotated from time to time.
- Every member of staff should be encouraged to go on leave at least once a year.
- Persons having physical custody of assets must not be permitted to access books.
- There should exist an accounting control for each class of assets.
- Mechanical devices should be used to prevent loss or misappropriation of cash.
- Budgetary control should be exercised and wide deviations should be reconciled.
- For inventory taking at the close of year, trading activities should be suspended (if possible).
- Financial and administrative powers should be distributed judiciously among officers.
- Procedures should be laid down for periodical verification of accounting records.

**(2) Internal Audit**

Internal audit involves continuous and critical appraisal of functioning of entity with a view to suggest improvements and add value to strengthen overall governance mechanism of entity including its internal control system.

Internal audit also involves evaluation of internal control to provide assurance to management regarding design, implementation and operating effectiveness of control. Scope of internal audit is determined by management.

## Assessment and Evaluation of Internal Control

**Well-defined set of Standard Operating Procedures (SOP) in Assessment & Evaluation of Control**

- Enterprise Risk Management - Robust process to identify & mitigate risks across enterprise.
- Segregation of Job Responsibilities - Multiple activities should not concentrated on one individual.
- Job Rotation in Sensitive Areas - Job rotation is regularly followed to avoid controls degeneration.
- Delegation of Financial Powers Document - Clearly defined document on delegation of powers.
- IT based Controls - Embed controls through system instead of human dependent.

@finalnotes

## Techniques of Evaluation of Internal Control

| | |
|---|---|
| **Questionnaire** | ▪ It is a set of questions framed in organised manner about each functional area. It is intended to be filled by entity executives who are in charge of various areas.<br>▪ Basic assumption about elements of good control in Standardized Internal Control Questionnaire:<br>➢ Organisation permits extensive division of duties and responsibilities.<br>➢ Employees of accounting function are not assigned any custodial function.<br>➢ No single person has responsibility of completing a transaction all by himself.<br>➢ Work performed by each one is expected to come under review of another.<br>➢ There should be evidence to identify person who has done the work.<br>➢ There is proper documentation and recording of transactions. |
| **Check List** | It is a series of instructions or questions on internal control which the auditor must follow or answer. A check list is a reminder to the auditor about matters to be checked for testing internal control system. |
| **Flow Chart** | ▪ It is a graphic presentation of internal controls in organisation and is normally drawn up to show controls in each department. It provides most concise way for reviewing internal controls. It gives a bird's eye view of system.<br>▪ A properly drawn up flow chart can provide a neat visual picture of whole activities of department. More specifically it can show:<br>➢ at what point a document is raised internally or received from external sources;<br>➢ number of copies in which a document is raised or received;<br>➢ distribution of documents to various department;<br>➢ checking authorisation and matching;<br>➢ filing of documents; and<br>➢ final disposal by sending out or destruction. |

## International Internal Control Frameworks

| |
|---|
| **Internal Control - Integrated Framework issued by Committee of the Sponsoring Organisations of the Treadway Commission** (COSO Framework) |
| **Guidance on Assessing Control published by the Canadian Institute of Chartered Accountants** (CoCo) |
| **Control Objectives for Information and Related Technology** (COBIT) |
| **Internal Control: Guidance for Directors on the Combined Code, published by Institute of Chartered Accountants in England & Wales** (Turnbull Report) |
| Sarbanes-Oxley **Section 404** |



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## COSO Framework

- It was introduced in 1992 as guidance on how to establish better controls so companies can achieve their objectives.
- Five Components of COSO are:
  (i) Control Environment
  (ii) Risk Assessment
  (iii) Control Activities
  (iv) Information and Communication
  (v) Monitoring
- Framework lists three categories of objectives:
  (i) Operations Objectives - related to effectiveness and efficiency of entity's operations.
  (ii) Compliance Objectives - related to entity's compliance with applicable laws and regulations.
  (iii) Reporting Objectives - related to financial and non-financial reporting to stakeholders.

## CoCo Framework

This framework was developed by Canadian Institute of Chartered Accountants. It includes 20 criteria for effective control in four areas of organization - purpose, commitment, capability, and monitoring & learning.

## COBIT Framework

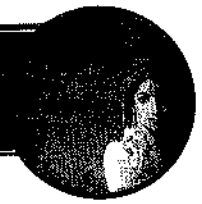
It is a framework created by ISACA (Information Systems Audit and Control Association) for IT governance and management. COBIT has 34 high-level processes that cover 210 control objectives categorized in four domains: planning and organization, acquisition and implementation, delivery and support, and monitoring and evaluation.

## Sarbanes-Oxley Section 404

Section 404 of Sarbanes-Oxley Act mandates that all publicly-traded companies must establish internal controls for financial reporting and must document, test and maintain those controls to ensure their effectiveness.

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# REPORTING



## Classification of Financial Reporting Framework for Purpose of Reporting

| | Fair Presentation Framework | Compliance Framework |
|---|---|---|
| **Requirement / Meaning** | It requires compliance with requirements of FRF and acknowledges that to achieve fair presentation of FS, management may provide disclosures beyond those specifically required by FRF. | It requires compliance with requirements of FRF. |
| **Reporting Phrase** | FS give a true and fair view/present fairly as per applicable FRF. | FS prepared in all material respects as per applicable FRF. |

## Framing of Audit Report as per SA 700 & SA 705

| **Opinion Paragraph of Audit Report [Extract] (Fair Presentation Framework)** | |
|---|---|
| **Unmodified Opinion** | In our opinion and to the best of our information and according to explanations given to us, FS give a true and fair view in conformity with accounting principles generally accepted in India, of state of affairs of entity as at March 31, 20XX, and profit/loss and its cash flows for the year ended on that date. |
| **Qualified Opinion** | In our opinion and to the best of our information and according to explanations given to us, except for the effects of matter described in Basis for Qualified Opinion section of our report, FS give a true and fair view in conformity with accounting principles generally accepted in India, of state of affairs of entity as at March 31, 20XX, and profit/loss and its cash flows for the year ended on that date. |
| **Adverse Opinion** | In our opinion and to the best of our information and according to explanations given to us, because of omission of information / significance of matter mentioned in Basis for Adverse Opinion section of our report, FS do not give a true and fair view in conformity with accounting principles generally accepted in India of financial position of entity as at March 31, 20XX, and profit/loss and its cash flows for the year ended on that date. |
| **Disclaimer of Opinion** | We have engaged to audit the FS of XYZ Ltd. We do not express an opinion on FS of entity. Because of significance of matters described in Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for audit opinion on these FS. |

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| Basis for Opinion Paragraph of Audit Report |
|---|
| When auditor modifies (Qualification/Adverse/Disclaimer) the opinion on FS, auditor shall:<br>➢ Amend the heading "Basis for Opinion" to "Basis for Qualified Opinion," "Basis for Adverse Opinion", or "Basis for Disclaimer of Opinion"; and<br>➢ Within this section, include description of matter giving rise to modification. |

| Emphasis of Matter and Other Matter Paragraph in Audit Report | |
|---|---|
| Emphasis of Matter | We draw attention to Note X of FS. Our opinion is not modified in respect of this matter. |
| Other Matter | Relevant Matter. Our opinion is not modified in respect of this matter. |

| Going Concern Paragraph in Audit Report [Material Uncertainty Related to Going Concern] |
|---|
| We draw attention to Note X of FS. As stated in Note X, this event or condition indicate that material uncertainty exists that may cast significant doubt on company's ability to continue as going concern. Our opinion is not modified in respect of this matter. |

## Duties of Auditors as per Companies Act, 2013 / Other Reporting Responsibilities

| Section | Duty of Auditor |
|---|---|
| 143(1) | **Duty to Inquire on Certain Matters**<br>(a) whether loans and advances made by company on basis of security have been properly secured and whether terms on which they have been made are prejudicial to interests of company or its members;<br>(b) whether transactions of company which are represented merely by book entries are prejudicial to interests of company;<br>(c) where company not being an investment company or a banking company, whether so much of assets of company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by company;<br>(d) whether loans and advances made by company have been shown as deposits;<br>(e) whether personal expenses have been charged to revenue account;<br>(f) where it is stated in books and documents of company that any shares have been allotted for cash, whether cash has actually been received for such allotment, and if no cash has actually been so received, whether position as stated in account books and balance sheet is correct, regular and not misleading.<br>**Note:** Auditor is not required to report on above matters unless he finds answer to any of these matters in adverse. |

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| 143(3) | **Duty to Report**<br>Auditor's report shall state:<br>(a) Whether he has obtained all information and explanations which were necessary for audit and if not, details thereof and effect of such information on FS.<br>(b) Whether proper books of account have been kept by company and proper returns adequate for audit have been received from branches not visited by him.<br>(c) Whether report on accounts of branch office of company audited by other person has been sent to him and manner in which he has dealt with it in preparing his report.<br>(d) Whether company's balance sheet and P&L are in agreement with books and returns.<br>(e) Whether FS comply with accounting standards.<br>(f) Observations or comments of auditors on financial transactions or matters which have any adverse effect on functioning of company.<br>(g) Whether any director is disqualified from being appointed as a director u/s 164(2).<br>(h) Any qualification, reservation or adverse remark relating to accounts maintenance.<br>(i) Whether company has adequate internal financial controls with reference to FS and operating effectiveness of such controls.<br>[Point (i) is not applicable to one person company and private company having turnover less than ₹ 50 crores plus aggregate borrowings less than ₹ 25 crores at any time during the year]<br>(j) Such other matters as may be prescribed. Auditor's report shall also include their views and comments on following other matters:<br>➢ Whether company has disclosed impact of pending litigations in FS.<br>➢ Whether company has made provision for material foreseeable loss on contracts.<br>➢ Whether there has been any delay in transferring amounts to Investor Education and Protection Fund by company.<br>➢ Whether dividend declared or paid by company is in compliance with section 123.<br>➢ Whether company has used such accounting software for maintaining its books which has feature of recording audit trail and same is operated throughout year. |
| 143(12) | **Duty to Report on Frauds**<br>• Reporting to Central Government<br>If auditor of a company has reason to believe that offence of fraud involving ₹ 1 crore or above has been committed in company by its officers or employees, auditor shall report the matter to Central Government within following time and manner:<br>➢ Auditor shall report matter to Board or Audit Committee within 2 days of his knowledge of fraud, seeking their reply within 45 days.<br>➢ On receipt of such reply, auditor shall forward his report and reply of Board or Audit Committee to Central Government within 15 days from receipt of such reply. |

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| | ➢ In case auditor fails to get any reply, he shall forward his report to Central Government along with a note that he has not received any reply.<br>➢ Report shall be sent to Secretary, MCA in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by e-mail.<br>➢ Report shall be on letter-head of auditor containing postal address, e-mail address and mobile number and be signed by auditor with his seal and Membership Number.<br>➢ Report shall be in Form ADT-4.<br>▪ <u>Reporting to Audit Committee or Board</u><br>➢ In case of fraud involving less than ₹ 1 crore, auditor shall report the matter to Audit Committee or Board within 2 days of his knowledge of fraud specifying nature of fraud with description, amount involved and parties involved.<br>➢ Company shall disclose details about such frauds in Board report.<br>▪ <u>Other Points</u><br>➢ Provisions regarding fraud reporting also apply to cost auditor & secretarial auditor.<br>➢ In case of non-compliance with section 143(12), auditor shall be liable to a penalty of ₹ 5 lacs in case of listed company and ₹ 1 lac in case of any other company. |
| **143(11)** | **<u>Duty to Report on Any Other Matter Specified by Central Government</u>**<br>Central Government, after consultation with National Financial Reporting Authority has issued CARO (Companies Auditor's Report Order), 2020. Auditor's report shall also include statement on matters specified in CARO, 2020. |

## Reporting Under CARO, 2020

### Applicability of CARO

CARO applies to every company including foreign company. However, following companies are exempt from applicability of CARO:

- Banking company
- Insurance company
- Company licensed to operate u/s 8 of Companies Act (NPO)
- One person company and small company
- Private company (not being subsidiary or holding of public company) having:
  - ➢ Paid up capital plus reserves and surplus upto ₹ 1 crore as on balance sheet date;
  - ➢ Borrowings upto ₹ 1 crore from bank or financial institution at any time during year; and
  - ➢ Revenue (including from discontinuing operations) upto ₹ 10 crore during year as per FS.

**<u>Note</u>:** CARO shall not apply to auditor's report on CFS except clause (xxi).

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**Auditor's Report of a Company to which CARO Applies shall include Statement on Following:**

<table>
<tr><th>Clause</th><th>Matters to be included in Auditor's Report</th></tr>
<tr><td>(i) PPE (including Right of Use Assets) and Intangible Assets</td><td>
(a) Whether company is maintaining proper records showing full particulars, including quantitative details and situation of PPE and whether company is maintaining proper records showing full particulars of intangible assets.<br>
(b) Whether PPE have been physically verified by management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether same have been properly dealt with in books.<br>
(c) Whether title deeds of all immovable properties disclosed in FS are held in name of company, if not, provide details thereof in format below:
<table>
<tr><th>Description of property</th><th>Gross carrying value</th><th>Held in name of</th><th>Whether promoter, director or their relative or employee</th><th>Period held - indicate range</th><th>Reason for not being held in name of company</th></tr>
</table>
(d) Whether company has revalued its PPE or intangible assets during the year and, if so, whether revaluation is based on valuation by registered valuer; specify amount of change, if aggregate change is 10% or more of net carrying value of each class of PPE or intangible assets.<br>
(e) Whether any proceeding is initiated or pending against company for holding any benami property under Benami Transactions (Prohibition) Act 1988, if so, whether company has appropriately disclosed details in its FS.
</td></tr>
<tr><td>(ii) Inventory</td><td>
(a) Whether physical verification of inventory has been conducted at reasonable intervals (atleast once in a year) by management and whether coverage & procedure of such verification by management is appropriate; whether any discrepancies of 10% or more in aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in books.<br>
(b) Whether during any time in year, company has been sanctioned aggregate working capital limits in excess of ₹ 5 crores from banks or financial institutions on security of current assets; whether quarterly returns or statements filed by company are in agreement with books of company, if not, give details.
</td></tr>
<tr><td>(iii) Loans, Investment, Guarantees, Securities</td><td>
Whether during the year company has made investments, provided any guarantee or security or granted any loans or advances in nature of secured or unsecured loans, to companies, firms, LLP or any other parties, [sub-clause (a) and (e) is not applicable to company whose principal business is to give loans] if so:<br>
(a) Whether company has provided loans or provided advances in nature of loans, or stood guarantee, or provided security to any other entity, if so, indicate-<br>
➢ aggregate amount & balance outstanding at balance sheet date of such loans or advances & guarantees or security to subsidiaries, joint ventures & associates;
</td></tr>
</table>



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| | |
|---|---|
| | ➢ aggregate amount and balance outstanding at balance sheet date of such loans or advances and guarantees or security to other parties;<br>(b) Whether investments made, guarantees provided, and terms and conditions of grant of all loans & advances are not prejudicial to company's interest;<br>(c) In respect of loans and advances, whether schedule of principal repayment and interest payment has been stipulated and whether repayments are regular;<br>(d) If amount is overdue, state total amount overdue for more than 90 days, and whether reasonable steps have been taken by company for recovery;<br>(e) Whether any loan or advance which has fallen due during year, has been renewed or extended or settled by fresh loans, if so, specify aggregate amount of such dues renewed or extended or settled by fresh loans and percentage of aggregate to total loans or advances;<br>(f) Whether company has granted any loans or advances either repayable on demand or without specifying any terms or period of repayment, if so, specify aggregate amount, percentage to total loans granted, aggregate amount of loans granted to promoters, related parties as defined Companies Act, 2013. |
| **(iv) Sec 185, 186** | In respect of loans, investments, guarantees, and security, whether provisions of sections 185 and 186 of Companies Act have been complied with, if not, provide details. |
| **(v) Deposits** | In respect of deposits accepted by company or amounts which are deemed to be deposits, whether directives issued by RBI and provisions of sections 73 to 76 of Companies Act have been complied with, if not, nature of such contraventions be stated; if an order has been passed by Company Law Board or NCLT or RBI or any court or any other tribunal, whether same has been complied with or not. |
| **(vi) Cost Record** | Whether maintenance of cost records has been specified by Central Government u/s 148 of Companies Act and whether such records have been so made and maintained. |
| **(vii) Statutory Dues** | (a) Whether company is regular in depositing undisputed statutory dues including GST, provident fund, employees' state insurance, income-tax, sales-tax, service tax, customs duty, excise duty, VAT, cess and any other statutory dues to appropriate authorities and if not, extent of arrears of outstanding statutory dues as on last day of financial year concerned for more than 6 months from due date, shall be indicated.<br>(b) Where statutory dues have not been deposited due to any dispute, then amounts involved and forum where dispute is pending shall be mentioned (mere representation to concerned department shall not be treated as a dispute). |
| **(viii) Income Disclosure** | Whether any transactions not recorded in books have been surrendered or disclosed as income in tax assessments under Income Tax Act 1961, if so, whether previously unrecorded income has been properly recorded in books during the year; |

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<table>
<tr><td>(ix) Loan Repayment</td><td>(a) Whether company has defaulted in repayment of loans or other borrowings or in payment of interest to any lender, if yes, period and amount of default to be reported as per format below:
<table>
<tr><th>Nature of borrowing, including debt securities</th><th>Name of lender</th><th>Amount not paid on due date</th><th>Whether principal or interest</th><th>No. of days delay or unpaid</th><th>Remarks, if any</th></tr>
</table>
(b) Whether company is declared wilful defaulter by any bank or financial institution.<br>(c) Whether term loans were applied for purpose for which loans were obtained; if not, amount of loan so diverted and purpose for which it is used may be reported.<br>(d) Whether funds raised on short term basis have been utilised for long term purposes, if yes, nature and amount to be indicated.<br>(e) Whether company has taken any funds from any entity or person to meet obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and amount in each case.<br>(f) Whether company has raised loans during the year on pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if company has defaulted in repayment of such loans raised.</td></tr>
<tr><td>(x) IPO/FPO and Other Allotments</td><td>(a) Whether moneys raised by way of initial public offer or further public offer were applied for purposes for which those are raised, if not, details together with delays or default and subsequent rectification, if any, be reported.<br>(b) Whether company has made any preferential allotment or private placement of shares or convertible debentures and if so, whether requirements of section 42 and 62 of Companies Act, 2013 have been complied with and funds raised have been used for purposes for which funds were raised, if not, provide details of amount involved and nature of non-compliance.</td></tr>
<tr><td>(xi) Fraud</td><td>(a) Whether any fraud by company or any fraud on company has been noticed or reported during the year, if yes, nature and amount involved is to be indicated;<br>(b) Whether any report u/s 143(12) of Companies Act has been filed by auditors in Form ADT-4 with Central Government.<br>(c) Whether auditor has considered whistle-blower complaints received by company.</td></tr>
<tr><td>(xii) Nidhi Company</td><td>(a) Whether Nidhi Company has complied with Net Owned Funds to Deposits in ratio of 1:20 to meet out liability;<br>(b) Whether Nidhi Company is maintaining 10% unencumbered term deposits as specified in Nidhi Rules to meet out liability.<br>(c) Whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, details thereof.</td></tr>
<tr><td>(xiii)</td><td>Whether all transactions with related parties are in compliance with section 177 and</td></tr>
</table>

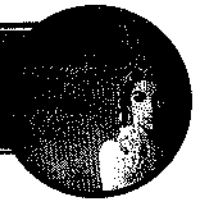


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| | |
|---|---|
| **Related Parties** | 188 of Companies Act and details have been disclosed in FS as per applicable accounting standards. |
| **(xiv) Internal Audit** | (a) Whether company has internal audit system commensurate with size and nature of its business.<br>(b) Whether reports of Internal Auditors were considered by statutory auditor. |
| **(xv) Non-cash Transaction** | Whether company has entered into any non-cash transactions with directors or persons connected with him and if so, whether provisions of section 192 of Companies Act have been complied with. |
| **(xvi) NBFC** | (a) Whether company is required to be registered under section 45-IA of RBI Act, 1934 and if so, whether registration has been obtained.<br>(b) Whether company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from RBI.<br>(c) Whether company is a Core Investment Company (CIC) as defined in regulations of RBI, if so, whether it continues to fulfil criteria of CIC, and in case company is an exempted or unregistered CIC, whether it continues to fulfil such criteria.<br>(d) Whether Group has more than one CIC as part of Group, if yes, indicate number of CICs which are part of Group. |
| **(xvii) Cash Losses** | Whether company has incurred cash losses in financial year and in immediately preceding financial year, if so, state amount of cash losses. |
| **(xviii) Resignation of Auditor** | Whether there has been any resignation of statutory auditors during the year, if so, whether auditor has taken into consideration issues, objections or concerns raised by outgoing auditors. |
| **(xix) Going Concern** | On basis of financial ratios, ageing and expected date of realisation of financial assets and payment of financial liabilities, auditor's knowledge of management plans, whether auditor is of opinion that no material uncertainty exists as on date of audit report that company is capable of meeting its liabilities existing at balance sheet date as and when they fall due within one year from balance sheet date. |
| **(xx) CSR** | (a) Whether, in respect of other than ongoing projects, company has transferred unspent amount to a Fund specified in Schedule VII to Companies Act within 6 months of expiry of financial year in compliance with section 135(5) of said Act.<br>(b) Whether any amount remaining unspent u/s 135(5) pursuant to ongoing project, has been transferred to special account in compliance with section 135(6). |
| **(xxi) CFS** | Whether there have been any qualifications or adverse remarks by respective auditors in CARO reports of companies included in CFS, if yes, indicate details of companies and paragraph numbers of CARO report containing qualifications or adverse remarks. |

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# REVIEW OF FINANCIAL INFORMATION



## Introduction

- "Review" is a limited assurance engagement. It provides lower level of assurance than audit. It involves fewer procedures on basis of which limited conclusions can be drawn up.
- **Audit Vs. Review**

| Audit | Review |
|---|---|
| It is a type of reasonable assurance engagement providing reasonable level of assurance. | It is a type of limited assurance engagement providing lower level of assurance than audit. |
| It performs extensive procedures including tests of controls and substantive procedures. | It performs fewer procedures primarily focusing on inquiry and analytical procedures. |
| It draws reasonable conclusions on the basis of sufficient appropriate evidence. | It draws limited conclusions on the basis of sufficient appropriate evidence. |
| It provides an assurance opinion. Language of assurance opinion is positively worded. | It provides an assurance conclusion. Language of assurance conclusion is negatively worded. |

- Following SRE have been issued:

| |
|---|
| SRE 2400 - Engagements to Review Historical Financial Statements |
| SRE 2410 - Review of Interim Financial Information Performed by Independent Auditor of Entity |

## SRE 2400 - Engagements to Review Historical Financial Statements

### Basics

- This SRE deals with practitioner's responsibilities performing a review of FS when he is not auditor of entity's FS.
- His objective in review is to obtain limited assurance by performing inquiry & analytical procedures.

### Accepting Review Engagement and Agreeing on Terms of Engagement

**(1) Factors affecting Acceptance of Review Engagements**

| **Practitioner shall not accept a review engagement if:** | |
|---|---|
| ▪ Practitioner is satisfied: | That there is no rational purpose for engagement. For example: law or regulation requires FS to be audited. |
| | That review engagement is not appropriate in circumstances. He may recommend another type of engagement. |

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|---|
| ▪ Practitioner has reason to believe that ethical requirements (including independence) will not be satisfied. |
| ▪ Practitioner's preliminary understanding indicates that information needed to perform review engagement is likely to be unavailable or unreliable. |
| ▪ Practitioner has cause to doubt management's integrity. |
| ▪ Management/TCWG impose limitation on scope of practitioner's work such that practitioner believes that limitation will result in disclaiming a conclusion on FS. |

**(2) Preconditions for Accepting a Review Engagement**

- Determine whether FRF applied in preparation of FS is acceptable.
- Obtain agreement from management that it acknowledges its responsibility for:
  - (i) Preparation & presentation of FS as per FRF.
  - (ii) Design, implementation and maintenance of internal control to enable preparation of FS that are free from material misstatement.
  - (iii) Provide the practitioner:

| | | |
|---|---|---|
| All information relevant to preparation & presentation of FS. | Any additional information, that practitioner requests from management/TCWG. | Unrestricted access to those within entity from whom practitioner can obtain evidence. |

**(3) Agreeing on Terms of Engagement**

Practitioner shall agree terms of review engagement with management/TCWG prior to performing engagement. Agreed terms of engagement shall be recorded in engagement letter.

**(4) Practitioner not Satisfied from any Precondition**

After accepting engagement, if practitioner is not satisfied from any preconditions, he shall discuss the matter with management/TCWG and determine:

- Whether matter can be resolved.
- Whether it is appropriate to continue with engagement.
- Whether and how to communicate the matter in practitioner's report.

## Performing Review Engagement

**Overview of Performing Review Engagement after its Acceptance**

(1) Obtain understanding of entity & applicable FRF to identify areas of material misstatements.

(2) Determine materiality for FS as a whole.

(3) Design and perform "Inquiry" and "Analytical procedures"

In review, practitioner mainly focuses on inquiry & analytical procedures for obtaining evidence.



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| Why "Inquiry" is important in Review? | ▪ In a review, inquiry includes seeking information from management and other persons within the entity as practitioner considers appropriate.<br>▪ Evidence obtained through inquiry is principal source of evidence about management intent. Management's stated reasons for choosing particular action may provide relevant information to corroborate evidence obtained.<br>▪ Performing inquiry procedures also assists practitioner in obtaining understanding of entity and its environment and to identify areas where material misstatements are likely to arise in FS. |
| Why "Analytical procedures" are important in Review? | Performing analytical procedures assists the practitioner in:<br>▪ Identifying inconsistencies from expected trends or values in FS.<br>▪ Obtaining understanding of entity and its environment and to identify areas where material misstatements are likely to arise in FS.<br>▪ Providing corroborative evidence for inquiries already performed.<br>▪ Serving as additional procedures when practitioner becomes aware of matters that cause him to believe that FS may be materially misstated. |

**(4) Perform procedures to address specific circumstances**

| | |
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| **Fraud and non-compliance** | If there is indication that fraud or non-compliance with laws or regulations has occurred, practitioner shall communicate this to TCWG and determine whether there is any responsibility to report to a party outside the entity. |
| **Related parties** | During review, practitioner shall remain alert for information that may indicate existence of related party relationships or transactions that management has not previously identified or disclosed to practitioner. |
| **Subsequent events** | ▪ If practitioner becomes aware of events occurring between date of FS and date of report that require adjustment/disclosure, he shall request management for adjustment/disclosure.<br>▪ Subsequent Event (after date of review report): Same as SA 560 |
| **Going concern** | If practitioner becomes aware of events or conditions that may cast significant doubt about entity's ability to continue as going concern, he shall:<br>▪ Inquire management about plans for future actions and their feasibility.<br>▪ Evaluate results of inquiries to consider whether management responses provide sufficient basis to:<br>➢ Continue to present FS on going concern basis, or<br>➢ Conclude whether FS are materially misstated regarding going concern. |
| **Using work of others** | In performing review, it may be necessary for practitioner to use work performed by other practitioners or expert. If practitioner uses work performed by others, he shall take appropriate steps to be satisfied that work performed is adequate for his purposes. |

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(5) **Perform additional procedures on becoming aware that FS may be materially misstated**

If practitioner becomes aware of matters that cause FS to be materially misstated, he shall design and perform additional procedures to enable him to:

- Conclude that matter is not likely to cause FS as a whole to be materially misstated or
- Determine that matter causes FS as a whole to be materially misstated.

Additional procedures focus on obtaining evidence to enable practitioner to form conclusion on matters that cause FS to be materially misstated. Procedures may be:

- Additional inquiry or analytical procedures in greater detail or focused on affected items.
- Other types of procedures such as test of details or external confirmations.

(6) **Evaluating evidence obtained from procedures performed**

- Practitioner shall evaluate whether sufficient appropriate evidence has been obtained from procedures performed.
- If practitioner considers that evidence obtained is not sufficient and appropriate to form conclusion on FS, he may:
  - Extend the work performed or
  - Perform other procedures necessary in circumstances.

## Written Representations

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|---|---|
| **Practitioner shall request to provide WR that:** | ▪ Management has fulfilled its responsibility for preparation of FS as per FRF and has provided practitioner with all information and access.<br>▪ All transactions have been recorded in FS. |
| | |
| **Practitioner shall also request WR that management has disclosed to practitioner:** | ▪ Significant facts relating to any frauds or suspected frauds<br>▪ Non-compliance with laws and regulations<br>▪ All related party relationships and transactions<br>▪ Subsequent events requiring adjustment/disclosure have adjusted/disclosed<br>▪ All information relevant to use of going concern assumption |
| | |
| **If management does not provide the requested WR, practitioner shall:** | ▪ Discuss matter with management.<br>▪ Re-evaluate integrity of management.<br>▪ Take appropriate actions including determining the possible effect on conclusion in practitioner's report as per this SRE. |

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## Practitioner's Conclusion on Financial Statements

**(1) Unmodified Conclusion**

Practitioner shall express an unmodified conclusion in practitioner's report when he has obtained limited assurance to conclude that nothing has come to his attention that FS are not prepared/not give a true & fair view as per applicable FRF.

**(2) Modified Conclusion**

| | |
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| **Qualified Conclusion** | ▪ Practitioner shall express a qualified conclusion when he obtained sufficient appropriate evidence, concludes that misstatements are material but not pervasive to FS, or<br>▪ Practitioner is unable to obtain sufficient appropriate evidence, but he concludes that possible effects of undetected misstatements on FS could be material but not pervasive. |
| **Adverse Conclusion** | Practitioner shall express an adverse conclusion when he obtained sufficient appropriate evidence, concludes that misstatements are both material and pervasive to FS. |
| **Disclaimer of Conclusion** | Practitioner shall disclaim a conclusion when he is unable to obtain sufficient appropriate evidence, and he concludes that possible effects of undetected misstatements on FS could be both material and pervasive. |

**(3) Withdraw from the Engagement**

Same as SA 705

**(4) Phrases used in Framing of Conclusion Para of Review Report (Fair Presentation Framework)**

| | |
|---|---|
| **Unmodified Conclusion** | Based on our review, nothing has come to our attention that causes us to believe that FS do not give a true and fair view/not present fairly as per applicable FRF. |
| **Qualified Conclusion** | Based on our review, except for the effects of matter described in Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that FS do not give a true and fair view/not present fairly as per applicable FRF. |
| **Adverse Conclusion** | Based on our review, due to significance of matter described in Basis for Adverse Conclusion paragraph, FS do not give a true and fair view/not present fairly as per applicable FRF. |
| **Disclaimer of Conclusion** | We do not express a conclusion on FS. Due to significance of matter described in Basis for Disclaimer of Conclusion paragraph, we are unable to obtain sufficient appropriate evidence to form a conclusion on FS. |

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## The Practitioner's Review Report

| Practitioner's report shall be in writing and shall contain following elements: |
|---|
| ▪ Title |
| ▪ Addressee |
| ▪ Introductory paragraph |
| ▪ Description of responsibility of management |
| ▪ Description of practitioner's responsibility |
| ▪ Description of review of FS and its limitations<br>➢ Review engagement under this SRE is a limited assurance engagement.<br>➢ Practitioner performs procedures primarily consisting of inquiries and analytical procedures.<br>➢ Procedures performed in review are substantially less than those performed in audit and accordingly practitioner does not express an audit opinion on FS. |
| ▪ Paragraph under heading "Conclusion" that contains practitioner's conclusion on FS |
| ▪ When practitioner's conclusion on FS is modified, paragraph under appropriate heading (basis for modified conclusion) that contains description of matters giving rise to modification<br>▪ Matters to be included in "basis for modified conclusion" paragraph:<br>➢ Describe & quantify financial effect of misstatements if they relate to specific amount in FS<br>➢ Explain how disclosures are misstated if misstatement relates to disclosures<br>➢ Describe nature of omitted information if misstatement relates to non-disclosure |
| ▪ EOM/OM paragraph, if any: Same as SA 706 |
| ▪ Practitioner's signature |
| ▪ Place of signature |
| ▪ Date of report |

## Documentation

Practitioner shall document following aspects of engagement in a timely manner:

- NTE of procedures performed to comply with this SRE and applicable legal requirements.

  While documenting NTE of procedures performed, practitioner shall record:
  - Who performed the work and date such work was completed.
  - Who reviewed the work performed and period and extent of review.
- Results obtained from procedures, and practitioner conclusions formed on basis of those results.
- Significant matters arising during engagement, practitioner conclusions and significant judgments made in reaching those conclusions.

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# SRE 2410 - Review of Interim Financial Information Performed by Independent Auditor of Entity

## Basics

- SRE 2410 deals with auditor's professional responsibilities when auditor undertakes an engagement to review interim financial information of an audit client.
- Interim financial information is financial information prepared and presented as per applicable FRF and comprises a complete or condensed set of FS for shorter period than entity's financial year.
- Objectives

  - Objective of such engagement is to enable auditor to express a conclusion on basis of review.
  - Auditor performs inquiry, analytical and other review procedures to obtain limited assurance.
  - Objective of review differs significantly from audit conducted as per SA.
  - Review is not designed to obtain reasonable assurance that interim financial information is free from material misstatement. Review does not provide all evidence that is required in an audit.

## Updating Understanding of Entity and its Environment including its Internal Control

**Procedures performed by auditor to update understanding of entity and its environment, including its internal control include following:**

- Reading documentation of preceding year audit and prior interim period reviews to identify matters that may affect current period interim financial information.
- Reading most recent prior period interim financial information.
- Considering any significant risks identified in prior year FS audit.
- Considering results of any internal audit performed and subsequent actions taken by management.
- Inquiring of management about changes in entity's business activities.
- Inquiring of management about any significant changes in internal control.
- Inquiring of management about process by which interim financial information has been prepared.
- Considering materiality with reference to applicable FRF.

## Inquiries, Analytical and other Review Procedures

**Auditor shall perform following procedures for review of FS:**

(i) Inquiring of management responsible for financial and accounting matters about following:

- Whether interim financial information has been prepared as per applicable FRF.
- Whether there have been any changes in accounting principles.
- Whether interim financial information contains any known uncorrected misstatements.



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| * Knowledge of any fraud or any non-compliance with laws and regulations that have a material effect on interim financial information. |
| * Significant changes in commitments, contractual obligations and contingent liabilities. |
| * Significant transactions occurring in last several days of interim period. |
| * Significant assumptions relevant to fair value measurement or disclosures. |
| * Whether related party transactions have been appropriately accounted and disclosed. |
| * Whether management has identified all events upto date of review report that may require adjustment/disclosure in interim financial information. |
| * Management assessment of entity's ability to continue as going concern. [Same as SRE 2400] |

(ii) Applying analytical procedures to identify relationships and items that appear unusual.

(iii) Reading minutes of meetings of shareholders and TCWG to identify matters that may affect interim financial information, and inquiring about matters for which minutes are not available.

(iv) Considering effect of matters giving rise to modification at the time of previous audit or reviews.

(v) Communicating with other auditors who are performing review of entity's significant components.

(vi) Reading interim financial information, and considering whether anything causes auditor to believe that interim financial information is not prepared as per applicable FRF.

## Management Representations

**Auditor should obtain WR from management that:**

- Interim financial information is prepared as per applicable FRF.
- It acknowledges its responsibility for design and implementation of internal control.
- It has disclosed to auditor all known significant facts relating to any frauds.
- It has disclosed to auditor all known non-compliance with laws and regulations.
- It has disclosed to auditor all subsequent events.

## Communication

| | | |
|---|---|---|
| When a matter causes auditor to believe that it is necessary to make material adjustment in interim financial information so that it is prepraed as per applicable FRF, he shall communicate this matter to management. If management do not respond appropriately, auditor should inform TCWG. | | |
| If TCWG do not respond within reasonable period, auditor shall consider: | | |
| Whether to modify report. | or | Possibility of withdrawing from review engagement.<br>and<br>Possibility of resigning from appointment to audit annual FS. |



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## Other Considerations

**(1) Departure from Applicable FRF**

If matters cause auditor to believe that interim financial information is materially affected by departure from applicable FRF and management does not correct interim financial information, auditor shall modify (qualified or adverse conclusion) review report.

**(2) Limitation on Scope**

| | |
|---|---|
| **Imposed by Management** | Auditor shall not accept an engagement to review interim financial information if there is a limitation on scope of auditor's review imposed by management.<br>If management imposes limitation on scope after accepting engagement, auditor shall request to remove that limitation. If management/TCWG refuses, auditor is unable to express a conclusion. So, auditor shall consider possibility to withdraw from review engagement and audit.<br>Auditor shall also consider legal and regulatory responsibilities whether there is a requirement to issue report before withdraw. If there is such requirement (mandatory in listed entity), auditor shall give disclaimer of conclusion in report. |
| **Other Case** | Limitation on scope may occur due to circumstances other than imposed by management. If limitation is confined to matters that are material but not pervasive, then auditor modifies review report by qualifying the conclusion. |

**(3) Going Concern and Significant Uncertainties**

If as a result of inquiries or other review procedures, material uncertainty relating to event or condition comes to auditor's attention that may cast significant doubt on entity's ability to continue as going concern, and adequate disclosure is made in interim financial information, auditor shall modify review report by adding EOM paragraph.

If material uncertainty that casts significant doubt about entity's ability to continue as going concern is not adequately disclosed in interim financial information, auditor shall express a qualified or adverse conclusion.

**(4) Auditor's Responsibility for Accompanying Information**

Auditor should read other information that accompanies interim financial information to consider whether such information is materially inconsistent with interim financial information.

If auditor identifies material inconsistency, auditor shall consider whether interim financial information or the other information needs to be amended.

If amendment is necessary in interim financial information and management refuses to make such amendment, auditor considers the implications for review report.

If amendment is necessary in other information and management refuses to make amendment, auditor considers to include additional paragraph in review report describing material inconsistency, or withholding issuance of review report or withdrawing from engagement.



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**(5) Auditor Association**

If any document containing interim financial information indicates that such information is reviewed by entity's auditor, review report will also be included in document. If management has not included review report, auditor should take legal advice for determining appropriate action.

If auditor has issued a modified review report and management issues interim financial information without including modified review report, auditor should take legal advice for determining appropriate action and possibility of resigning from appointment to audit annual FS.

## The Auditor's Review Report

| Auditor shall issue a written report that contains following: |
|---|
| ▪ Title |
| ▪ Addressee (Board of Directors) |
| ▪ Identification of interim financial information reviewed and date and period covered |
| ▪ Statement that management is responsible for preparation and presentation of interim financial information as per applicable FRF |
| ▪ Statement that auditor is responsible for expressing a conclusion on interim financial information |
| ▪ Statement that review of interim financial information was conducted as per SRE 2410 |
| ▪ Statement that review is substantially less in scope than audit conducted as per SA |
| ▪ Conclusion as to whether anything causes auditor to believe that interim financial information is not prepared or does not give true & fair view as per applicable FRF |
| ▪ EOM/OM paragraph, if any |
| ▪ Auditor's signature |
| ▪ Place of signature |
| ▪ Date of report |

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# PROSPECTIVE FINANCIAL INFORMATION & OTHER ASSURANCE SERVICES



## Introduction

- Assurance engagement may relate to examination of subject matters other than examination of historical FS. For example, it may relate to prospective financial information or to providing assurance regarding non-financial matters like design and operation of internal control in entity.
- Level of assurance provided by Standards on Assurance Engagements is moderate or reasonable.
- Following SAE have been issued:

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| SAE 3400 - The Examination of Prospective Financial Information |
| SAE 3402 - Assurance Reports on Controls at a Service Organisation |
| SAE 3420 - Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus |

## SAE 3400 - The Examination of Prospective Financial Information

### Basics

- This SAE provides guidance on engagements to examine Prospective Financial Information (PFI) including examination procedures for best-estimate and hypothetical assumptions.
- Examination of PFI need not necessarily performed by statutory auditor of entity.
- Meaning of certain terms

| | |
|---|---|
| **PFI** | PFI is financial information based on assumptions about events that may occur in future & possible actions by entity. PFI can be in the form of forecast or projection. |
| **Forecast** | Forecast means PFI prepared on basis of assumptions about future events and actions which management expects to take place (best-estimate). |
| **Projection** | Projection means PFI prepared on basis of:<br>▪ Hypothetical assumptions about future events and management actions which are not necessarily expected to take place (when entities are in start-up phase), or<br>▪ Mixture of best-estimate and hypothetical assumptions. |

- Management is responsible for preparation and presentation of PFI including identification and disclosure of source of information, basis of forecast and underlying assumptions.
- Can Professional Accountants be associated with Prospective Financial Information?

▪ Clause 3 of Second Schedule to Chartered Accountants Act, 1949 states that that a CA in practice shall be deemed to be guilty of professional misconduct, if he permits his name or



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name of his firm to be used in connection with estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for accuracy of forecast.

- Above clause does not preclude CA from associating his name with PFI. CA can participate in preparation of forecasts and can review them, provided he indicates clearly in his report sources of information, basis of forecasts and major assumptions made in arriving at forecasts and he does not vouch for accuracy of forecasts. Same also applies to projections.
- Nature of Assurance Regarding PFI

  PFI relates to events that have not yet occurred and might not occur. Therefore, opinion as to whether results shown in PFI will be achieved cannot be expressed.

## Precautions to be taken by Auditor Before Accepting such an Engagement

**Auditor shall consider following before accepting engagement to examine PFI:**

| | | |
|---|---|---|
| Intended use of information | Nature of assumptions whether they are best estimates or hypothetical | Period covered by information |
| Whether information will be for general or limited distribution | | Elements to be included in information |

Auditor shall not accept or withdraw from engagement when assumptions are clearly unrealistic or when he believes that PFI will be inappropriate for intended use.

To formalize terms of engagement, terms should be agreed with client by sending engagement letter.

## Duties of Auditor who is Examining the PFI

Auditor should obtain sufficient appropriate evidence as to whether:

- PFI is properly prepared on basis of assumptions.
- Management best-estimate assumptions are reasonable & also consistent in case of hypothetical.
- PFI is properly presented and all material assumptions are adequately disclosed.
- PFI is prepared on consistent basis with historical FS.

## Examination Procedures, Presentation and Disclosure

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|---|---|
| **Examination Procedures** | **Following matters shall be consider in determining NTE of examination procedures:**<br>▪ Knowledge obtained during any previous engagements.<br>▪ Management's competence regarding preparation of PFI.<br>▪ Engagement team's experience with business and industry in which entity operates.<br>▪ Sources of information considered by management to support assumptions.<br>▪ Stability of entity's business.<br>▪ Extent to which PFI is affected by management judgment.<br>▪ Likelihood of material misstatement. |



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| **Presentation & Disclosure** | **When assessing presentation and disclosure of PFI and underlying assumptions, it needs to be considered whether:**<br>▪ Presentation of PFI is informative and not misleading.<br>▪ Assumptions are adequately disclosed in notes to PFI (best estimates/hypothetical)<br>▪ Date as of which PFI was prepared is disclosed.<br>▪ Accounting policies are clearly disclosed in notes to PFI.<br>▪ If there is change in accounting policy from that disclosed in recent historical FS, whether reason for change and effect of such change on PFI is adequately disclosed.<br>▪ Basis of establishing points in a range is clearly indicated and range is not selected in biased manner when results shown in PFI are expressed in range. |

## Modified Opinions on PFI

- If assumptions do not provide reasonable basis for PFI, adverse opinion shall be given or withdrawal from engagement shall be made.
- If presentation and disclosure of PFI is not adequate, qualified or adverse opinion shall be given or withdrawal from engagement shall be made.
- If there is a scope limitation, disclaimer of opinion shall be given or withdrawal from engagement shall be made.

## Report on Examination of PFI

| Report for examination of PFI shall contain following: |
|---|
| ▪ Title |
| ▪ Addressee |
| ▪ Identification of PFI |
| ▪ Reference to SAE applicable to examination of PFI |
| ▪ Statement that management is responsible for preparation of PFI including assumptions |
| ▪ Reference to intended use, restricted distribution & inappropriateness of PFI for other purposes |
| ▪ Opinion as to whether PFI is properly prepared on basis of assumptions. (negatively worded to suggest whether assumptions provide a reasonable basis for PFI) |
| ▪ Appropriate caveats concerning achievability of results indicated by PFI |
| ▪ Signature |
| ▪ Place of signature |
| ▪ Date of report (date on which procedures have been completed) |

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# SAE 3402 - Assurance Reports on Controls at a Service Organisation

## Basics

- SAE 3402 deals with assurance engagements undertaken by CA in practice to provide a report on internal controls at a service organization for use by user entities and their auditors.
- It complements SA 402, in that reports prepared as per this SAE are capable of providing appropriate evidence under SA 402.
- Why controls of a service organization are important to a user entity's internal controls relating to financial reporting?

Such controls may pertain to assertions about presentation and disclosure relating to CAD or may pertain to evidence that user auditor uses in applying audit procedures.

**Example**

A company has outsourced its payroll processing functions to a service organization. The service organization is responsible for accurate preparation of payrolls and timely remittance of dues to government on behalf of company. Payroll processing service organization's controls related to timely remittance of payroll deductions to government may be relevant to company (user entity) as late remittances could result in interest and penalties resulting in liabilities for user entity.

## Objectives of Service Auditor as per SAE 3402

| | |
|---|---|
| **To obtain assurance about:** | ▪ Service organization's description of its system fairly presents the system as designed and implemented throughout specified period/specified date.<br>▪ Controls related to control objectives stated in service organization's description of its system were suitably designed throughout specified period/specified date.<br>▪ Where included in scope, controls operated effectively to provide reasonable assurance that control objectives were achieved throughout specified period. |
| To report on above matters as per service auditor's findings. | |

## Type 1 and Type 2 Report

| | |
|---|---|
| **Type 1** | Report on Description and Design of Controls at Service Organisation on specified date. |
| **Type 2** | Report on Description, Design and Operating Effectiveness of Controls at Service Organisation throughout specified period. |

**Report Comprises**

- Service organization's description of its system
- Written assertion by service organization (about point given in objectives)
- Service auditor report that conveys reasonable assurance (about point given in objectives)



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## How such an Engagement is Proceeded with?

**Service Auditor ordinarily performs following procedures:**

(i) Compliance with ethical requirements including independence
(ii) Acceptance and changes in terms of engagement
(iii) Determination of management and TCWG and communication with them
(iv) Determination of materiality
(v) Obtaining understanding of service organization's description of system and evaluate whether description is fairly presented
(vi) Obtaining evidence regarding description and design of controls
(vii) Obtaining evidence regarding operating effectiveness of controls (in case of type 2 report) by testing necessary controls
(viii) Understanding internal audit function to determine whether internal auditor work can be used
(ix) Asking for written representations

## Written Representations

**Service Auditor shall request service organization to provide WR that:**

- Reaffirm the assertion accompanying description of system.
- It has provided service auditor with all relevant information and access.
- It has disclosed following to service auditor if they aware:
  - Fraud or Non-compliance with laws and regulations attributable to service organization that may affect user entities.
  - Design deficiencies in controls.
  - Instances where controls have not operated as described.
  - Any subsequent events that could have significant effect on service auditor's report.

## Modified Opinions on Controls at Service Organisation

**If service auditor concludes that:**

| (i) | (ii) | (iii) | (iv) |
|---|---|---|---|
| Service organization description does not fairly present the system as designed and implemented | Controls related to control objectives were not suitably designed | In case of type 2 report, controls tested did not operate effectively | he is unable to obtain sufficient appropriate evidence |

In above cases, opinion shall be modified and report shall contain a clear description of reasons for modification.



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## The Service Auditor's Report

| Service Auditor's assurance report shall include following basic elements: |
|---|
| ▪ Title that clearly indicates the report is an independent service auditor's assurance report |
| ▪ Addressee |
| ▪ Identification of service organization's description of its system |
| ▪ Statement that report is intended only for user entities and their auditors |
| ▪ Statement that service organization is responsible for:<br>(i) Preparing description of its system<br>(ii) Providing services covered by service organization's description of its system;<br>(iii) Stating control objectives and<br>(iv) Designing and implementing controls to achieve control objectives |
| ▪ Statement that service auditor's responsibility is to express opinion on service organization's description, design and operating effectiveness (for type 2 report) of controls |
| ▪ Statement that engagement was performed as per SAE 3402 |
| ▪ Summary of service auditor's procedures to obtain reasonable assurance and in case of type 1 report, statement that service auditor has not performed any procedures regarding operating effectiveness of controls and therefore no opinion is expressed thereon |
| ▪ Statement of limitations of controls |
| ▪ Service auditor's opinion expressed in positive form (points given in objectives) |
| ▪ Additional Matters requiring reporting in Type 2 Report<br>➢ In case of type 2 report, service auditor's assurance report shall include a separate section after opinion that describes tests of controls that were performed and results of those tests.<br>➢ In describing tests of controls, service auditor shall clearly state which controls were tested and indicate nature of tests in detail.<br>➢ If deviations identified, service auditor shall include number and nature of deviations noted. |
| ▪ Signature |
| ▪ Place of signature |
| ▪ Date of report |

## Documentation

- NTE of procedures performed to comply with this SAE and applicable legal requirements.
- Results of procedures performed and evidence obtained.
- Significant matters, conclusions and significant judgments made in reaching those conclusions.

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# SAE 3420 - Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

## Basics

- SA 3420 deals with assurance engagements undertaken by practitioner to report on compilation of pro forma financial information (PFFI) included in a prospectus. It applies where such reporting is required by securities law or regulation in the jurisdiction in which prospectus is to be issued.
- Meaning and Significance of PFFI
  - PFFI refers to financial information shown with adjustments to illustrate impact of transaction on unadjusted financial information as if transaction had been undertaken at earlier date.
  - PFFI is used in offer documents to demonstrate effect of transaction on FS of company as if those transactions had occurred at earlier date.
  - Purpose of PFFI is solely to illustrate impact of significant transaction on unadjusted financial information of entity as if transaction had been undertaken at earlier date.
  - This is achieved by applying pro forma adjustments to unadjusted financial information. PFFI does not represent entity's actual financial position.

## Compilation of PFFI and Practitioner's Responsibility

Practitioner has no responsibility to compile PFFI. Such responsibility rests with responsible party (management). Practitioner's sole responsibility is to report on whether PFFI is compiled by responsible party on basis of applicable criteria. It is a reasonable assurance engagement to report on the compilation of pro forma financial information.

**Steps involved in compilation of PFFI include:**

- Identifying source of unadjusted financial information to be used in compiling PFFI and extracting unadjusted financial information from that source.
- Making pro forma adjustments to unadjusted financial information.
- Presenting the resulting PFFI with disclosures.

## Engagement Acceptance

**Before accepting engagement, practitioner shall:**

- Determine that he has capabilities and competence to perform engagement.
- On the basis of discussion with responsible party, determine that applicable criteria are suitable and PFFI will not be misleading.
- If entity's historical FS has not audited, consider whether he can obtain sufficient understanding to perform the engagement.



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- Obtain agreement of responsible party that it acknowledges and understands its responsibility for:

| | | |
|---|---|---|
| ▪ Compiling PFFI on basis of applicable criteria. | | |
| ▪ Adequately disclosing applicable criteria to intended users. | | |
| ▪ Provide the practitioner: | | |
| Access to all info. to evaluate whether PPFI is compiled on basis of applicable criteria. | Any additional information, that practitioner requests. | Unrestricted access to those within entity from whom practitioner can obtain evidence. |

## Planning and Performing the Engagement

**In planning and performing the engagement, practitioner shall:**

- Assess whether applicable criteria are suitable.
- Understanding of how the responsible party has compiled PFFI.
- Consider materiality for evaluating whether PFFI has been compiled on basis of applicable criteria.
- Obtain evidence about appropriateness of source from which unadjusted financial information is extracted.
- Determine whether responsible party has appropriately extracted unadjusted financial information.
- Obtain evidence about appropriateness of pro forma adjustments.

| | |
|---|---|
| **Pro forma adjustments include:** | Adjustments to unadjusted financial information that illustrate impact of significant transaction as if transaction had undertaken at earlier date. |
| | Adjustments to unadjusted financial information that are necessary for PFFI to be compiled on consistent basis with applicable FRF of reporting entity. |

- Evaluate presentation of PFFI.
- Read other information included in Prospectus to identify material inconsistencies with PFFI.
- Obtain WR from responsible party that in compiling PFFI, responsible party has identified all appropriate pro forma adjustments and PFFI has been compiled on basis of applicable criteria.

## Opinion on PFFI

| | |
|---|---|
| **Unmodified Opinion** | Practitioner shall express an unmodified opinion when practitioner concludes that PFFI has been compiled by responsible party on basis of applicable criteria. |
| **Modified Opinion** | ▪ If law or regulation permit publication of prospectus containing modified opinion regarding PFFI and practitioner determines that a modified opinion is appropriate, he shall issue a modified opinion.<br>▪ If law or regulation does not permit publication of prospectus containing modified opinion regarding PFFI, practitioner shall discuss the matter with responsible party. |



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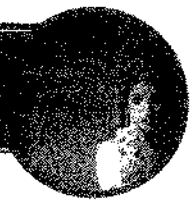
| | |
|---|---|
| | If responsible party does not make necessary changes, practitioner shall withdraw from engagement or take legal advice. |

## The Practitioner's Report on Compilation of PFFI

| **Practitioner's report shall include following basic elements:** |
|---|
| ▪ Title that clearly indicates that report is an independent assurance report |
| ▪ Addressee |
| ▪ Introductory paragraphs that identify PFFI, source from which unadjusted financial information is extracted, period covered and date of PFFI and reference to applicable criteria on basis of which responsible party has performed compilation of PFFI |
| ▪ Statement that responsible party is responsible for compiling PFFI on basis of applicable criteria |
| ▪ <u>Description of practitioner's responsibilities</u><br>➢ Responsibility is to express opinion whether PFFI is compiled by responsible party on basis of applicable criteria<br>➢ Not responsible for updating opinion or report on historical FS used in compiling PFFI<br>➢ Not provide any assurance that actual outcome of transaction at that date would be presented |
| ▪ Statement that engagement was performed as per SAE 3420 |
| ▪ Practitioner's opinion using one of the following phrases:<br>➢ PFFI has been compiled, in all material respects, on basis of applicable criteria, or<br>➢ PFFI has been properly compiled on the basis stated |
| ▪ EOM paragraph (if practitioner consider necessary to draw user's attention to a matter presented or disclosed in PFFI) |
| ▪ Practitioner's signature |
| ▪ Place of signature |
| ▪ Date of report |

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# RELATED SERVICES



## Introduction

- "Assurance engagement" means an engagement in which practitioner expresses an opinion to enhance degree of confidence of intended users so that users are able to make confident decisions.
- Not all engagements performed by practitioners are assurance engagements. CA in practice are often asked to provide services to clients which do not involve expression of an opinion on truth and fairness of FS. For example, following are non-assurance engagements (related services):

| |
|---|
| Preparation of tax returns where no conclusion conveying assurance is expressed. |
| Consulting engagements such as management and tax consulting. |
| Engagements covered by SRS such as agreed-upon procedures and compilation engagements. |

- Following SRS have been issued:

| |
|---|
| SRS 4400 - Engagements to Perform Agreed-upon Procedures Regarding Financial Information |
| SRS 4410 - Compilation Engagements |

## SRS 4400 - Engagements to Perform Agreed-upon Procedures Regarding Financial Information

### Basics

- This SRS provides guidance on practitioner's responsibilities when an engagement to perform agreed-upon procedures regarding financial information is undertaken.
- **Meaning and Objective of agreed-upon procedures engagement**

  In agreed-upon procedures, practitioner is engaged by client to issue report of factual findings based on specified procedures performed on specified elements, accounts or items of FS (accounts payable, accounts receivable, inventory, purchase from related parties, segment profit)

  No assurance is provided in report. Such agreed-upon procedures are non-assurance engagements.
- **General Principles of an agreed-upon procedures engagement**

  Practitioner shall comply with relevant ethical requirements. Ethical principles for this engagement include integrity, objectivity, professional competence & due care, confidentiality, professional conduct and technical standards. However, Independence is not required for such engagement.

### Audit Vs. Agreed-upon Procedures

- Key difference between audit and agreed-upon procedures relates to assurance,
- Audit expresses an opinion and provides assurance to users.
- In agreed-upon procedures engagement, only report of factual findings is provided. No assurance is given to users. Users draw their own conclusions based on factual findings stated in report.



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## Terms and Procedures of Agreed-upon Procedures Engagement

| | |
|---|---|
| **Terms of the Engagement** | Matters to be agreed and included in engagement letter shall include following:<br>(i) Nature of engagement including the fact that no assurance will be expressed.<br>(ii) Stated purpose for engagement.<br>(iii) Identification of financial information to which agreed-upon procedures will be applied.<br>(iv) NTE of procedures to be applied. Listing of procedures to be performed.<br>(v) Limitation on distribution of report of factual finding. Statement that it would be restricted to parties who have agreed to procedures to be performed. |
| | |
| **Procedures** | Procedures applied in engagement to perform agreed-upon procedures may include:<br>➢ Inquiry and analysis<br>➢ Re-computation, comparison and other accuracy checks<br>➢ Observation<br>➢ Inspection<br>➢ Obtaining confirmations |

## Reporting

| **Report of factual findings should contain:** |
|---|
| ▪ Title |
| ▪ Addressee (appointing authority) |
| ▪ Identification of information on which agreed-upon procedures applied |
| ▪ Statement that procedures performed were agreed-upon with recipient |
| ▪ Statement that engagement was performed as per SRS 4400 |
| ▪ Identification of purpose |
| ▪ Listing of specific procedures performed |
| ▪ Description of practitioner's factual findings |
| ▪ Statement that procedures do not constitute audit or review and no assurance is expressed |
| ▪ Statement that report is restricted to those parties that have agreed to procedures |
| ▪ Statement that report relates only to elements, accounts or items of FS |
| ▪ Date of report |
| ▪ Place of signature |
| ▪ Practitioner's signature |

# SRS 4410 - Compilation Engagements

## Basics

- This SRS deals with practitioner's responsibilities when engaged to assist management with preparation and presentation of financial information without obtaining any assurance.
- **Meaning and Objective of compilation engagement**

It is an engagement in which practitioner applies financial reporting expertise to assist management in preparation and presentation of financial information of entity as per FRF.
Compilation engagement is not an assurance engagement. It does not require practitioner to verify accuracy or completeness of information provided by management for compilation or to express audit opinion.

- **Purposes of compilation engagement**

- To comply with mandatory periodic financial reporting requirements as per law or regulation.
- For purposes unrelated to mandatory financial reporting, for example:

| For management/TCWG (such as for internal use). | For external parties under contract (such as for grant funding body). | For transactional purpose (such as for merger or acquisition). |
|---|---|---|

- **Scope of compilation engagement**

Scope of compilation engagement will vary depending on circumstances of engagement. However, in all case it involves assisting management in preparation & presentation of financial information based on information provided by management. Different FRF can be used to prepare and present financial information. Management retains the responsibility for providing financial information.

- **Ethical Requirements and Engagement Level Quality Control**

- Practitioner shall comply with relevant ethical requirements. However, Independence is not required for such engagement.
- Engagement partner shall take responsibility for:
  - ✓ Overall quality of each compilation engagement.
  - ✓ Engagement will be performed as per firm's quality control policies and procedures.

## Engagement Acceptance and Continuance

**Practitioner shall not accept the engagement unless practitioner has agreed the terms of engagement with management/engaging party including:**

(i) Intended use and distribution of financial information and any restrictions
(ii) Identification of applicable FRF
(iii) Objective and scope of compilation engagement



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(iv) Responsibilities of practitioner

(v) Responsibilities of management for:

- Financial information and for preparation & presentation thereof as per FRF acceptable for intended use and users.
- Design, implementation and maintenance of internal control.
- Accuracy and completeness of records and documents provided for compilation engagement.
- Judgments needed in preparation and presentation of FS.

(vi) Expected form and content of practitioner's report.

Practitioner shall record agreed terms in engagement letter prior to performing engagement.

## Performing the Engagement

| Procedure and approach of practitioner in performing compilation engagement | |
|---|---|
| **Obtain Understanding** | Practitioner shall obtain understanding of following matters to perform compilation engagement:<br>➢ Entity's business and operations, including accounting system and records.<br>➢ Applicable FRF, including its application in entity's industry. |
| **Records, Documents & Significant Judgments** | ▪ Practitioner shall compile financial information using records, documents and significant judgments provided by management.<br>▪ Practitioner shall discuss significant judgments with management/TCWG.<br>▪ Prior to completion, practitioner shall read compiled financial information.<br>▪ If records, documents or significant judgments provided by management are incomplete or inaccurate, practitioner shall request for additional or corrected information.<br>▪ If practitioner is unable to complete engagement because management failed to provide requested information, he shall withdraw from engagement and inform management about reasons for withdrawing. |
| **Amendments** | ▪ <u>If practitioner becomes aware during course of engagement that</u>:<br>➢ Compiled financial information does not adequately describe applicable FRF;<br>➢ Amendments to compiled financial information are required for financial information not to be materially misstated; or<br>➢ Compiled financial information is otherwise misleading,<br>he shall propose appropriate amendments to management.<br>▪ If management declines to make proposed amendments, he shall withdraw from engagement and inform management about reasons for withdrawing.<br>▪ If withdrawal is not possible, he shall determine professional and legal responsibilities. |



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| **Acknowledgement** | Practitioner shall obtain acknowledgement from management that they have taken responsibility for final version of compiled financial information. |
| **Communication with Management and TCWG** | Practitioner shall communicate all important matters with management/TCWG on a timely basis during compilation engagement. |

## The Practitioner's Report

| **Report for compilation engagement shall be in writing and include following elements:** |
|---|
| ▪ Title |
| ▪ Addressee |
| ▪ Statement that practitioner has compiled financial information based on information provided by management |
| ▪ Description of responsibilities of management/TCWG |
| ▪ Identification of financial information and applicable FRF |
| ▪ Description of practitioner's responsibilities that engagement was performed as per SRS 4410 |
| ▪ Explanation that since compilation engagement is not assurance engagement, practitioner is not required to verify accuracy or completeness of information provided by management for compilation and practitioner does not express an audit opinion |
| ▪ If financial information is prepared using special purpose FRF, a paragraph that describes such purpose and draws attention of readers that it is prepared as per special purpose framework |
| ▪ Date of report |
| ▪ Practitioner's signature |
| ▪ Place of signature |

## Documentation

**Practitioner shall include following in engagement documentation:**

(i) Significant matters arising during engagement and how those matters were addressed.

(ii) Record of how compiled financial information reconciles with records, documents and information provided by management.

(iii) Copy of final version of compiled financial information and practitioner's report.

In engagement documentation, practitioner may also include copy of entity's trial balance or other information that the practitioner used to perform compilation.

Final engagement file should be assembled on timely basis after engagement report is finalized.

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# DIGITAL AUDITING & ASSURANCE



## Digital Audit

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|---|---|
| **Meaning** | Digital Audit is placing assurance on effectiveness of IT systems implemented in organization. |
| **Key Features** | ▪ It encourages auditee to embrace latest technological advancements.<br>▪ It will help create a future for digital strategy and adopting new technologies.<br>▪ It leads to savings in time & cost which can be utilized for more productive tasks.<br>▪ It improves quality of opinion. This leads to more reliable audit report.<br>▪ It can help auditee to make informed decisions. |
| **Advantages** | ▪ Enhanced Effectiveness & Efficiency: Automated routine task saves time & cost.<br>▪ Lower Costs: Shorten the time to complete audit may lower audit's overall cost.<br>▪ Better Audit Quality: Lowering the chance of misstatements.<br>▪ Better Analytics: Aid management and auditors in seeing trends and patterns.<br>▪ Improved Risk Assessment: Management and auditors put their testing efforts on higher ROMM areas and make informed decisions. |
| **Consideration and Challenges** | ▪ Know what business benefits, organization wants to achieve with automation.<br>▪ Think people first and do not underestimate change is difficult.<br>▪ Choosing the right tool and automating the right process.<br>▪ Ensure process works and it is standardised before automating.<br>▪ Challenges with data security and governance. |
| **Stages** | ▪ Stages involved in digital audit are: Understand - Identify - Assess. |

## Understand the IT Environment

**(1) Auditor's Understanding of Automated Environment should include following:**

- Applications that are being used by company.
- Details of IT infrastructure components for each application.
- Organization structure and governance.
- Policies, procedures and processes followed.
- IT risks and controls.

**(2) Key Considerations/Areas for Auditor to Understand IT Environment**

| | |
|---|---|
| Understand Flow of Transaction | Auditor may focus on identifying and understanding nature and number of IT applications relevant to flow of transactions in information system. |

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|---|---|
| Identification of Significant Systems | Auditor may identify IT application concurrently with his understanding of how financial information flows through entity's information system. |
| Identification of Manual and Automated Controls | Entity's system of internal control contains manual and automated elements. Identification of both are relevant to auditor's identification and assessment of ROMM. |
| Identification of Technologies Used | There is a need to understand the emerging technologies implemented and consider whether there are risks arising from their use. Some examples of emerging technologies are Blockchain, Robotics, Artificial Intelligence, Internet of Things, Biometrics, Drone etc. |
| Assessing Complexity Of IT Environment | Not all applications have same level of complexity. Level of complexity for individual characteristics differs across applications. |

## Identifying the Risks Arising from Usage of IT

### (1) Risks arising from use of IT

- Unauthorized access to data or improper changes to data.
- Possibility of IT personnel gaining extra access.
- Unauthorized changes to data.
- Unauthorized changes to IT applications or other aspects of IT environment.
- Failure to make necessary update to IT applications or other aspects of IT environment.
- Inappropriate manual intervention.
- Data loss or data corruption.

### (2) IT Dependencies

IT Dependencies are created when IT is used to initiate, authorize, record, process, or report transactions or other financial data for inclusion in FS.

Identifying IT dependencies helps to identify entity's reliance upon IT, identify potential risks arising from use of IT and enables auditor to develop effective and efficient audit approach.

| Five Types of IT Dependencies | |
|---|---|
| Type | Description |
| **Automated Controls** | Automated controls are designed into IT environment to enforce business rules. For example, purchase order approval via workflow. |
| **Reports** | System generated reports are information generated by IT systems. These reports are used in performance reviews, selecting items for testing or performing analytical procedure. |
| **Calculations** | Calculations are accounting procedures performed by IT system instead of person. For example, system will apply straight-line formula to calculate depreciation. |



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|---|---|
| **Security** | Security including segregation of duties is enabled by IT environment to restrict access to information and to determine separation of roles and responsibilities. |
| **Interfaces** | Interfaces are programmed logic that transfer data from one IT system to another. |

**General IT Controls to Address Risks related to IT Dependencies**

Management may implement General IT Controls to address risks related to IT dependencies. Overview of Control Objectives and Controls for each area of General IT Controls:

- Access Security Objective: To ensure that data access is authorized to meet FR objectives.
  - Security policies and procedures are maintained
  - Access requests to application are properly authorized and reviewed by management
- Program Change Objective: To ensure modified systems continue to meet FR objectives.
  - Change Management policy and procedures are maintained
  - Changes are adequately tracked and recorded
- Data Centre Objective: To ensure production systems are backed up to meet FR objectives.
  - Policies and procedures for data back and recovery is maintained
  - Data is appropriately backed up and recoverable

## Cyber Risks

### (1) Cyber-attack and its Types

Cyber-attack is an attempt to gain unauthorized access to a computing system or network with intent to damage, steal, expose, alter, disable, or destroy data.

**Most common types of cyber-attacks are:**

- **Malware:** Malware or malicious software is any program or code that is created with intent to do harm to a computer, network or server. **Its subsets are:**

| Type | Description |
|---|---|
| **Ransomware** | In a ransomware attack, adversary encrypts victim's data and offers decryption key in exchange for payment. |
| **Fileless Malware** | Fileless malware is a type of malicious activity that uses legitimate tools built into system to execute cyber-attack. |
| **Trojan** | Trojan is malware that appears to be legitimate software disguised as harmless files like free downloads. |
| **Mobile Malware** | Mobile malware is any type of malware designed to target mobile devices. |

- **Denial-of-Service (DoS) Attacks:** DoS attack is a malicious, targeted attack that floods a network with false requests to disrupt business operations. **In DoS attack, users are unable** to perform routine tasks, such as accessing email, websites or online accounts.

- **Phishing:** Phishing is a type of cyberattack that uses email, SMS, phone and social media to entice a victim to share sensitive information such as passwords or to download a malicious file that will install viruses on their computer or phone.

| Type | Description |
|---|---|
| **Spear Phishing** | Spear-phishing is a type of phishing attack that targets specific individuals or organizations typically through malicious emails. |
| **Whaling** | Whaling attack is a type of social engineering attack specifically targeting senior employees with purpose of stealing money or information. |
| **Smishing** | Smishing is a type of fraudulent practice of sending text messages pretending from reputable companies to induce individuals to reveal personal information. |
| **Vishing** | Vishing (voice phishing) is fraudulent use of calls & voice messages pretending from reputable companies to convince individuals to reveal private information. |

- **Spoofing:** It is a technique through which a cybercriminal disguises themselves as a known or trusted source. Adversary is able to access targeted devices for stealing information etc.

| Type | Description |
|---|---|
| **Domain Spoofing** | Domain spoofing is a form of phishing where an attacker impersonates a known business with fake website or domain to fool people into trusting them. |
| **Email Spoofing** | Email spoofing is a type of cyberattack that targets businesses by using emails with forged sender addresses. |

- **Identity-Based Attacks:** When valid user credentials have been compromised and adversary is pretend to be that user. For e.g., people often use same user ID and password for multiple accounts. Therefore, possessing credentials for one account grant access to other account.
- **Insider Threats:** When current or former employees pose danger to organization because they have direct access to company network, sensitive data or other information.
- **DNS Tunneling:** DNS Tunneling is a type of cyberattack that leverages domain name system (DNS) queries to bypass traditional security measures and transmit data within the network.
- **IoT-Based Attacks:** IoT attack is any cyberattack that targets an Internet of Things (IoT) device or network.

**(2) Stages of Cyber Risks**

| | |
|---|---|
| **Stage 1 - Assessing the Cyber Risk** | No organization is completely immune to cyber risk. Every organization should consider at least common threats:<br>➢ Ransomware disabling their organization<br>➢ Common criminals using email phishing and hacks for fraud and theft.<br>➢ Insiders committing malicious activities or accidental activities. |

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| | |
|---|---|
| **Stage 2 - Impact of Cyber Risk** | Cyber risks are not an issue of IT alone. It is a business risk and has an effect on whole business organization. It leads to many consequences which are:<br>➢ Business interruptions causing an operational challenge for organization<br>➢ Data loss, reputational loss and litigation<br>➢ Intellectual property theft<br>➢ Breach of Privacy<br>➢ Incident response cost for investigations & remediations<br>➢ Regulatory costs<br>➢ Fines and penalties |
| **Stage 3 - Managing the Cyber Risk** | Strategic approach to cyber risk management can help organization to:<br>➢ Gain holistic understanding of cyber risks and threats.<br>➢ Assess existing cybersecurity program against regulatory requirements.<br>➢ Align cybersecurity with strategic objectives. |

**(3) Cyber Security Framework (for managing cyber risks)**

It includes how management is identifying risk, protecting and safeguarding its assets from risk. Management preparedness to detect attacks, anomalies and responsiveness to adverse event.

- Identify the risk: Entity should conduct periodic risk assessment & develop strategy.
- Protect the risk: Entity should implement effective controls for data security.
- Detect the risk: Entity should have controls that identify cybersecurity risks timely.
- Respond to the risk: Entity should have response planning and assess future action plans.
- Recover from risk: Entity should undertake appropriate actions to recover from attack.

**(4) Control Considerations for Cyber Risks**

- Controls around vendor setup and modifications
  - Who is responsible for making changes to master data?
  - Are other communication channels (email) used to request changes to master data?
  - What systems are used to initiate and process requests for changes to master data?
  - Are authentication protocols defined to verify modifications to master data?
- Controls around electronic transfer of funds
  - Are person responsible for wire transfers educated on threats related to phishing scams?
  - What systems are used to initiate and release of wire transfers?
  - Are authentication protocols defined to verify wire transfer requests?
- Controls around patch management
  - Does entity have a patch management program?
  - Does entity run periodic vulnerability scans to identify unapplied patches?
  - How entity is notified of patches by external vendors?

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## Automated Tools used as a part of Emerging Technologies

Enterprises are adopting emerging technologies to create synergies and harness latest technologies.

**Examples of Automated Tools used as a part of Emerging Technologies**

| | |
|---|---|
| **Internet of Things (IoT)** | ▪ Meaning<br>IoT is the concept of connecting any device (cell phones, coffee makers, washing machines, and so on) to the internet. Key components of IoT are data collection, analytics, connectivity, people and process. IoT not only changes the business model, but also affects strategic objectives of organization.<br>▪ Common risks of IoT<br>Key risks associated with IoT are device hijacking, data siphoning, denial of service attacks, data breaches and device theft.<br>▪ Audit Implications<br>A shift to connected devices and systems may result in auditors not being able to rely only on manual controls. Audit firms may need to train and upskill auditors to evaluate design and operating effectiveness of automated controls. |
| **Artificial Intelligence (AI)** | ▪ Meaning<br>AI refers to a system or a machine that can think and learn. AI systems utilize data analysis and algorithms to make decisions based on predictive methods.<br>▪ Common risks of AI<br>AI comes with list of risks. Key risks associated with AI are security, inappropriate configuration and data privacy.<br>▪ Audit Implications<br>Due to invisible nature of algorithms, audits must focus on logical flow of processes. Review of AI should ascertain whether unintended bias is added to algorithms. Auditors should assess effectiveness of algorithms and whether output is reviewed. |
| **Blockchain** | ▪ Meaning<br>Blockchain is based on a decentralized and distributed ledger that is secured through encryption. Each transaction is validated by blockchain participants, creating a block of information that is distributed to all participants. All blocks are sequenced so that any modification or deletion of block disqualifies the information.<br>▪ Common risks of blockchain technology<br>Strengths of blockchain can also be its weakness. Inability to reverse transactions and to access data without required keys make system secure, but also mean that organisations need specific protocols to ensure that they are not locked out and have clear contingency plans. Operating through network nodes could also expose organisation to cyber-attacks and data hacks, so security issues are important. |



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| | ▪ Audit Implications<br>Auditors should consider appropriate governance and security around transactions. As blockchain interacts with legacy systems and business partners, concerns related to insecure APIs, data confidentiality and privacy cannot be ignored.<br>Auditors must be able to determine whether data put on blockchain will expose enterprise to liability for non-compliance with laws and regulations. |
| **Non-Fungible Token (NFT)** | ▪ Meaning<br>NFT means something is unique and cannot be replaced. NFTs are digital assets, e.g., photos, videos, artwork, sports collectibles etc. NFTs are tokens used to represent ownership of unique items. They are secured by blockchain and can only have one official owner at a time.<br>▪ Key Features of NFT<br>➢ Digital Asset - NFT is a digital asset.<br>➢ Unique - It cannot be forged.<br>➢ Exchange - NFT exchanges take place with cryptocurrencies on specialist sites.<br>▪ Challenges of NFT<br>NFTs has its own challenges like ownership and copyright concerns, security risks, market is not that wide, online frauds etc. |
| **Robotic Process Automation (RPA)** | ▪ Meaning<br>RPA is the automation of repetitive processes performed by users. It is a software technology that emulate human actions interacting with digital systems. RPA software bots can interact with any application the same way people do except that RPA bots can operate nonstop, much faster and with 100% reliability and precision.<br>▪ Common Risks of RPA<br>➢ Operational and execution risks: deployed without proper operating model.<br>➢ Change management risks: not following change management lifecycle.<br>➢ RPA strategy risk: setting wrong expectations and unrealistic business goals.<br>▪ Audit Implications<br>It is of utmost importance for auditors to understand RPA processes, which include data extraction, aggregation, sanitization and cleansing. Otherwise, they will not be in a position to initiate audit. Auditors must have an understanding of tools used to develop and maintain RPA. |

## Remote Audit

Remote audit or virtual audit is when the auditor uses online or electronic means to conduct audit. It could be partially or completely virtual.

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| Considerations for Remote Audit | |
|---|---|
| **Feasibility and Planning** | Agreeing on audit timelines, meeting platform (Zoom calls/Google Meet) to be used for audit sessions, document sharing platform etc. |
| **Confidentiality, Security and Data Protection** | ➢ Access to document sharing platform should be restricted and secured by encrypting data.<br>➢ Information reviewed & documented by auditor is removed from platform.<br>➢ Auditor should take legislation and regulations into consideration.<br>➢ Auditor should not take screenshots of auditees as audit evidence.<br>➢ In case of accessing auditee's IT system, auditor should use VPN (Virtual Private Network). |
| **Risk Assessment** | Assessment should be done and documented for each audit. |

| Advantages and Disadvantages of Remote Audit | |
|---|---|
| Advantages | Disadvantages |
| ▪ Cost and time effective: No travel time and travel costs involved. | ▪ Due to network issues, interviews and meetings can be interrupted. |
| ▪ Time required to gather evidence can spread over several weeks instead of small period. | ▪ Opportunity to present doctored documents and to omit relevant information is increased. |
| ▪ Comfort and flexibility to audit team as they would be working from home environment. | ▪ No ability to visualize facility culture of organization and body language of auditees. Time zone issues could also affect efficiency. |
| ▪ Auditor can get first-hand evidence directly from IT system. | ▪ Remote access to sensitive IT systems may not be allowed. |
| ▪ Widens selection of auditors from global network of experts. | ▪ Audit procedures like physical verification of assets and stock taking cannot be performed. |

## Auditing Digitally

| | |
|---|---|
| **Meaning** | Auditing Digitally is using technology advancements for conducting effective and efficient audit. |
| **Key Features or Advantages** | ▪ Improved quality of audit: From sample auditing to full population being reviewed.<br>▪ Decreasing human dependency: Using technology minimizes manual intervention.<br>▪ Increases transparency: Using technology trace the transaction end to end.<br>▪ Automation and ease: Automating tasks like extracting data reduce manual error.<br>▪ Improved efficiency: Increased efficiency and fewer errors.<br>▪ Better risk assessment: Auditor may assess potential risk precisely. |



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## Emerging Technologies in Audit (Data Analytics)

### Meaning of Data Analytics

- Generating and preparing meaningful information from raw system data using tools and techniques is known as Data Analytics.
- Audit analytics or audit data analytics involves analyzing large sets of data to find actionable insights, trends, draw conclusions and for informed decision making. Use of audit analytics enables greater efficiencies and more accurate findings from review process.
- Data Analytics methods used in audit is known as Computer Assisted Auditing Techniques (CAATs).
- It involves use of multiple data analytical tool or visualization tools that helps auditor to deep dive into problem statement and hence increase the audit quality.

### Some Popular Tools used across the Industry as part of CAATs are:

| | |
|---|---|
| **Audit Command Language (ACL)** | ACL Analytics is a data extraction and analysis software used for fraud detection and prevention. It samples large data sets to find irregularities that indicate fraud. |
| **Alteryx** | Alteryx is used to consolidate financial or operational data to assess controls. It can also be used to automate set procedures that are performed periodically like reconciliations, consolidations, system integrations, continuous audits etc. |
| **Power Business Intelligence (Power BI)** | Power BI is a platform that provides non-technical business users with tools for aggregating, analyzing, visualizing and sharing data. Such visualization tools can be used for reporting purpose in an interactive dashboard to higher management. |
| **CaseWare** | CaseWare is a data analysis software and provide tools that helps in conducting audit and assurance engagements quickly, accurately and consistently. It shares analytical insights which help in taking better informed decisions. It helps in streamlining processes and eliminating the routine tasks. |

### Examples of Tests Performed using CAATs

Identify exceptions: Identify exceptional transactions. For e.g, cash transactions above ₹ 10,000.

Identify errors: Identify data which is inconsistent or erroneous.

Verify calculations: Re-perform various computations. For e.g., TDS rate applied as per criteria.

Duplicate payments: Duplicate payment for same invoice.

Accounts exceeding authorized limit: Payment beyond amount due or overdraft allowed beyond limit.

### Considerations

- What problems are you trying to solve?
- Which technology can help you?
- How will you upskill your people to make best use of technology available?
- Range of automated solutions:
  - ✓ Macros and Scripts: Rules-based automation
  - ✓ Business Process Automation (BPA): Reengineering existing business process



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- ✓ Robotic Process Automation (RPA): Automating repetitive activities
- ✓ Intelligent Process Automation (IPA): Combining RPA with AI

## Technology Risks and Control Considerations of Auditing Digitally

**Some examples of technology risks of digital systems are:**

- Reliance on system/programs that are inaccurately processing data or processing inaccurate data.
- Unauthorized access to data.
- Possibility of IT personnel gaining extra access.
- Unauthorized changes to data.
- Unauthorized changes to systems or programs.
- Failure to make changes to systems or programs.
- Inappropriate manual intervention.
- Potential data loss or inability to access data.

**Auditors should consider following control considerations while assessing technology risk:**

- Auditors should gain a holistic understanding of changes in industry and IT environment to effectively evaluate management's process for initiating, processing, and recording transactions.
- Auditors should consider risks resulting from implementation of new technologies and how those risks may differ from those that arise from traditional systems.
- Auditors should consider whether digital upskilling or specialists are necessary to determine impact of new technologies and to assist in risk assessment and understanding of design, implementation, and operating effectiveness of controls. E.g., cybersecurity control experts, IT specialists in team etc.

**Key Steps for Auditors to Evaluate Impact of Technology-driven Changes/Changing Technology Environment:**

- Maintain professional skepticism when reviewing management's risk assessment for new systems.
- Understand effects of new technology and determine how it impacts auditor's risk assessment.
- Assess appropriateness of management's processes to select, develop and maintain controls related to organization's technology.
- Understand how technologies impact flow of transactions and design appropriate audit response.

## Next Generation Audit

Next Generation Audit is human-led, tech-powered and data-driven. It is based on combining emerging technologies to redefine how audits are performed.



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| Example of Emerging Technologies Available for Next Generation Audit | |
|---|---|
| **Drone Technology** | Using drone technology in remote locations for stock counts. Drones have great payload capacity for carrying sensors and cameras, thus they can photograph and physically examine count of large quantities of fixed assets and inventory. |
| **Augmented Reality (AR)** | AR technology allows users to view the real-world environment with augmented (added) elements, generated by digital devices. One famous example was Pokémon Go game. |
| **Virtual Reality (VR)** | VR replaces real world entirely with a simulated environment created through digitally generated images, sounds, touch and smell. Using special equipment, user can explore simulate experiences such as flying or skydiving. |
| **Metaverse** | ▪ **Meaning**<br>Metaverse is emerging 3D digital space that uses AR, VR & other advanced internet technology to allow people to have lifelike personal and business experiences online.<br>▪ **Potential application of metaverse in financial domain are:**<br>➢ Virtual Banking and Transactions: A forward-thinking financial institution establishes a presence in metaverse to offer virtual banking services.<br>➢ Digital Asset Management: A digital asset management company recognizes growing popularity of virtual assets in metaverse.<br>➢ Virtual Financial Education and Training: A financial learning academy aims to enhance financial literacy using metaverse.<br>➢ Virtual Meetings and Conferences: For a leading industry even an organisation hosts a virtual conference within metaverse.<br>➢ Data Visualization and Analytics: A company utilizes metaverse to offer advanced data visualization and analytics tools to financial professionals.<br>▪ **Key considerations for sustainable future of metaverse**<br>➢ Beyond cryptocurrencies and coins, players in metaverse will need to consider how to build digital monetary systems.<br>➢ Governance models will become ever more difficult to balance user contribution with innovation.<br>➢ Practical challenge of identity will have to be considered in metaverse (e.g. KYC).<br>➢ Synchronicity is ability for aspects of metaverse to be multiplayer, simultaneous and real-time. |

**Common Risks Associated**

These technologies also come with challenges such as public safety, cybersecurity, data privacy, data protection, lack of standards and technical challenges. It also raises questions about taxation, jurisdiction, and customer protection. Regulators and auditors have to think of controls around privacy, data security, governance to make it more regulated.

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# GROUP AUDITS



## Applicability of Preparation of Consolidated Financial Statements (CFS)

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|---|---|
| **Applicability as per Companies Act** | ➢ As per section 129 of Companies Act, 2013, where a company has one or more subsidiaries, including associate and joint venture, it shall in addition to its own FS, prepare CFS of company and all subsidiaries.<br>➢ Provisions applicable to preparation and audit of FS of holding company shall, mutatis mutandis, also apply to CFS.<br>➢ CFS shall be made as per Schedule III and applicable accounting standards.<br>➢ Company which is not required to prepare CFS under accounting standards, it shall be sufficient if it complies with provisions of CFS under Schedule III. |
| **Non-Applicability as per Companies Act** | Requirement related to preparation of CFS shall not apply if company meets following all conditions:<br>(i) It is a wholly or partially-owned subsidiary of another company and all its members have been intimated in writing that they do not object to company for not presenting CFS.<br>(ii) Its securities are not listed on any stock exchange in India or outside India.<br>(iii) Its ultimate or intermediate holding company files CFS with Registrar. |
| **Non-Applicability (As per AS)** | As per AS 21, subsidiary should be excluded from consolidation when:<br>➢ Control is intended to be temporary because shares are acquired and held for subsequent disposal in near future; or<br>➢ Subsidiary operates under severe long-term funds transfer restrictions. |
| **Non-Applicability on Investment Entity (As per Ind AS)** | * Investment entity is an entity that:<br>➢ Obtains funds from investors for providing them with investment management services;<br>➢ Commits to investors that its business purpose is to invest funds solely for returns from investment; and<br>➢ Measures and evaluates performance of all investments on fair value basis.<br>* Investment entity need not present CFS if it measures all its subsidiaries at fair value through P&L as per Ind AS 110. However, parent of investment entity shall prepare CFS unless parent is also an investment entity.<br>* However, there is no exemption for temporary control, or for operating under severe long-term funds transfer restrictions in Ind AS 110. |

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## Accounting for Consolidation as per Companies Rules

For consolidation as per Companies (Indian Accounting Standards) Rules, 2015:

- FS of parent and its subsidiaries are combined on line-by-line basis by adding assets, liabilities, income, expenses and cash flows as per Ind AS 110.
- Related goodwill/capital reserve and non-controlling interest is determined as per Ind AS 103.
- Adjustments like elimination of intra-group transactions etc. are made as per Ind AS 110.
- Investment in associates and joint ventures are accounted using Equity Method as per Ind AS 28.
- Business under common control is accounted using pooling of interest method as per Ind AS 103.
- Interests in assets, liabilities, revenues and expenses in a joint operation are accounted as part of separate FS as per Ind AS 111.

For consolidation as per Companies (Accounting Standards) Rules, 2006:

- FS of parent and its subsidiaries are combined on line-by-line basis by adding assets, liabilities, income, expenses and cash flows as per AS 21.
- Certain calculations like determination of goodwill/capital reserve, minorities interest and adjustments like elimination of intra group transactions etc. are made as per AS 21.
- Investments in associates are accounted using Equity Method as per AS 23.
- Interest in jointly controlled entity is accounted using proportionate consolidation method as per AS 27.

Note:

FS of components should be drawn upto same reporting date as that of parent. If FS are drawn upto different reporting dates, adjustments should be made for effects of significant transactions that occur between those dates and date of parent's FS. In any case, difference between reporting dates should not be more than 6 months in case of AS and 3 months in case of Ind AS.

## Responsibility of Parent

Preparation and presentation of CFS is responsibility of management of parent. This includes:

- Identifying components and financial information of components to be included in CFS.
- Obtaining accurate and complete financial information from components.
- Identifying reportable segments for segmental reporting.
- Identifying related parties and related party transactions for reporting.
- Making appropriate consolidation adjustments.
- Harmonization of accounting policies and accounting framework.
- GAAP conversion, where applicable.

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## Objectives of Auditor in Audit of CFS

- To validate requirement of CFS preparation & to satisfy himself that CFS is prepared as per FRF.
- To enable himself to express an opinion on true and fair view presented by CFS.
- To enquire into matters specified in section 143(1) of Companies Act, 2013.
- To report on matters given in section 143(3) of Companies Act, 2013.

## Auditing the Consolidation

### Planning Audit of CFS

Before commencing audit of CFS, auditor should make plans for following:

- Understanding of group structure and group-wide controls including assessment of IT system.
- Understanding accounting policies of parent and its components as well as of consolidation process.
- Determining NTE of audit procedures to be performed based on assessment of ROMM.
- Determining extent of use of other auditor's work in audit.
- Coordinating work to be performed.

### Completeness of Information regarding Inclusion of Components in CFS

Auditor should verify that all components have been included in CFS. In respect of completeness of this information, he should perform following procedures:

- Review his working papers for prior years for known components.
- Review parent's procedures for identification of various components.
- Make inquiries of management to identify any new components.
- Review investments of parent and components to determine shareholding in other entities.
- Review joint ventures, joint arrangements and statutory records maintained by parent.
- Identify changes in shareholding that have taken place during reporting period.

## Permanent Consolidation Adjustments and Current Period Consolidation Adjustments

### Permanent Consolidation Adjustments

| | |
|---|---|
| **Meaning** | Adjustments that are made only on first occasion or subsequently when there is a change in shareholding of entity. These are:<br>• Determination of goodwill or capital reserve.<br>• Determination of equity attributable to minority/non-controlling interests. |
| **Verification** | Auditor shall verify that above calculations is made appropriately. Auditor shall:<br>➢ Pay particular attention to determination of pre-acquisition reserves.<br>➢ Examine whether pre-acquisition reserves have been allocated appropriately.<br>➢ Verify changes taken place in these permanent consolidation adjustments due to subsequent acquisition or disposal of shares in components. |



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| Current Period Consolidation Adjustments | |
|---|---|
| **Meaning** | Adjustments that are made in accounting period for which consolidation of FS is done. They primarily relate to elimination of intra-group transactions and balances including:<br>▪ Intra-group interest paid and received.<br>▪ Unrealised intra-group profit on assets transferred from/to other subsidiaries.<br>▪ Intra-group indebtedness.<br>▪ Adjustments for recognized subsequent events (adjusting and non-adjusting) that occur between balance sheet date and date of auditor's report.<br>▪ Adjustments related to harmonising different accounting policies followed by parent and components.<br>▪ In case of foreign component, adjustments to convert component's FS from local GAAP to the GAAP under which CFS are prepared.<br>▪ Adjustments of deferred tax arising from elimination of intragroup profit & losses. |
| **Verification** | Auditor should review memorandum records to verify adjustment entries made in preparation of CFS. Apart from reviewing memorandum records, auditor shall:<br>➢ Verify that intra group transactions and account balances have been eliminated;<br>➢ Verify that CFS have been prepared using uniform accounting policies.<br>➢ Verify adjustments made to harmonise different accounting policies including adjustments to convert component's FS from local GAAP to the GAAP under which CFS are prepared.<br>➢ Verify adjustments relating to deferred tax arising from elimination of intragroup profit and losses.<br>➢ Verify calculation of minorities/non-controlling interest.<br>➢ Verify that income and expenses of subsidiary are included in CFS from date of gaining control and such income and expenses are based on assets and liabilities recognised in CFS at acquisition date. |

## Consideration regarding Determination of Materiality during Audit of CFS

For determination of materiality during audit of CFS, Principal auditor shall consider following:

- Principal auditor is required to compute materiality for group as a whole. This materiality should be used to assess appropriateness of consolidation adjustments made by management.
- Principal auditor can also use materiality computed on group level to determine whether component's FS are material to the group.
- Principal auditor also computes materiality for each component and communicates to the component auditor, if it is required for true and fair view on CFS.
- Principal auditor also obtains certain confirmation from component auditor like independence etc.

While considering observations (modifications etc) of component auditor in his report on standalone FS, principal auditor should comply with requirements of SA 600. Therefore, concept of materiality would be considered while considering observations of component auditor.

## Disclosure Requirements in CFS

| Disclosures Required to be given in CFS |
|---|
| In CFS, company would need to give all disclosures relevant to CFS only. Following information is also required to be disclosed in CFS separately for parent and each components:<br>▪ Amount of net assets and net assets as a percentage of consolidated net assets.<br>▪ Amount of share in profit/loss and profit/loss as a percentage of consolidated profit/loss.<br>▪ Amount in other comprehensive income (OCI) and OCI as a percentage of Consolidated OCI. |
| **Disclosures need Not Required to be given in CFS** |
| Only those disclosures should form part of notes of CFS which are relevant at group level. Following given in notes of separate FS of parent and subsidiary need not be included in CFS:<br>▪ Source from which bonus shares are issued.<br>▪ Disclosure required under MSMED Act.<br>▪ Value of imports on C.I.F. basis in respect of raw materials, components and capital goods.<br>▪ Value of imported raw materials, spare parts and components consumed.<br>▪ Expenditure in foreign currency on royalty, professional fees, interest, and other matters.<br>▪ Earnings in foreign exchange classified under export of goods, royalty, interest and other income.<br>▪ Disclosure of all unutilised monies out of the issue.<br>▪ Statement of investment separately classifying trade and other investments.<br>▪ Dividend remitted during the year in foreign currency. |

## Management Representations regarding CFS

Auditor of CFS should obtain WR from parent's management on following matters:

- Completeness of components included in CFS.
- Identification of reportable segments for segment reporting.
- Identification of related parties and related party transactions for reporting.
- Appropriateness and completeness of permanent and current period consolidation adjustments.

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## Reporting

**When Parent's Auditor is also Auditor of all its Components**

- Auditor should report whether principles and procedures for preparation and presentation of CFS as laid down in accounting standards have been followed.
- In case of any departure or deviation, auditor should make adequate disclosure in audit report so that users of CFS are aware of such deviation.
- Auditor should issue an audit report expressing opinion whether CFS give a true and fair view of state of affairs of Group as on balance sheet date..

**When Parent's Auditor is not Auditor of all its Components**

- Auditor of CFS should also consider the requirement of SA 600.
- As per SA 706, if auditor wants to make reference to audit of other auditors, auditor's report on CFS should disclose clearly the magnitude of portion of FS audited by other auditors by including Other Matter paragraph in report.
- This may be done by stating aggregate rupee amounts or percentages of total assets, revenues and cash flows of components included in CFS not audited by parent's auditor.
- Such reference is not to be construed as a qualification of opinion but rather as indication of divided responsibility between auditors of parent and its subsidiaries.

**When Component Auditor Reports on FS under Accounting Framework Different than Parent**

- When component FS are prepared under different accounting framework (US GAAP or IFRS), parent's management perform conversion of components audited FS from component framework to framework under which CFS are prepared. Conversion adjustments are required to be audited by principal auditor.
- Component may alternatively prepare FS on basis of parent's accounting policies to facilitate preparation of CFS. Principal auditor should perform necessary procedures to determine compliance of policies with GAAP applicable to parent's FS.

**When Component Auditor Reports under Auditing Framework Different than Parent**

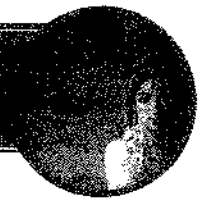
- Components FS should also be audited under framework that corresponds to auditing standards generally accepted in India.

**Components Not Audited**

- Generally, FS of all components included in CFS should be audited.
- If FS of one or more components remain unaudited, auditor reporting on CFS should consider unaudited components in evaluating possible modification to his report on CFS.
- Evaluation is necessary because auditor is not able to obtain SAAE regarding such consolidated amounts/balances.

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# SPECIAL FEATURES OF AUDIT OF BANKS AND NBFCS



## Unit I - Special Features of Audit of Banks

### Legal Framework

| Principal enactments which govern functioning of several types of banks are: | |
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| ▪ Banking Regulation Act, 1949 | ▪ State Bank of India Act, 1955 |
| ▪ Reserve Bank of India Act, 1934 | ▪ Companies Act, 2013 |

### Appointment of Auditor

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| **Appointment Letter** | ▪ For statutory central audit, most banks appoint four or more CA firms to act jointly as statutory central auditors. Appointment letter contains following:<br>➢ Period of appointment.<br>➢ Particulars of other central auditors.<br>➢ Particulars of previous auditors.<br>➢ Statement of division of work & responsibilities among joint auditors.<br>➢ Scope of assignment.<br>▪ However, statutory branch audit is carried out by a single CA firm. In case of statutory branch auditors, appointment letter is similar except particulars of other auditors and statement of division of work. |
| **Appointing Authority** | Auditor of banking company is to be appointed at AGM of shareholders, whereas auditor of nationalised bank is to be appointed by bank acting through its BOD.<br>In either case, approval of RBI is required before appointment is made. |

### Special Considerations in Audit of Banks for Conducting an Audit

**Peculiarities which may Necessitate Special Audit Consideration in Audit of Banks**

Special audit considerations arise in audit of banks because of:

- Particular nature of risks associated with transactions.
- Scale of banking operations and significant exposures which can arise within short time.
- Extensive dependence on IT to process transactions.
- Effect of statutory and regulatory requirements.
- Continuing development of new services and banking practices.

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| Process of Conducting Audit of Banks | |
|---|---|
| **Initial Considerations** | ▪ Acceptance & Continuance<br>▪ Declaration of Indebtedness<br>▪ Terms of Audit Engagements<br>▪ Communication with Previous Auditor<br>▪ Planning<br>▪ Establish Engagement Team |
| **Understanding** | ▪ Understanding Bank and Its Environment including Internal Control<br>▪ Understand Bank's Accounting Process<br>▪ <u>Understanding Risk Management Process</u><br>➢ Oversight by TCWG<br>➢ Identification, measurement and monitoring of risks<br>➢ Control activities<br>➢ Monitoring activities<br>➢ Reliable information systems |
| **Risk Assessment** | ▪ Identifying and Assessing ROMM<br>▪ Assess Risk of Fraud including Money Laundering<br>▪ Assess Specific Risks |
| **Execution** | ▪ Engagement Team Discussions<br>▪ Prepare response to Assessed Risks<br>▪ Determine Audit Materiality<br>▪ Consider Going Concern |
| **Reporting** | ▪ Independent Auditor's Report<br>▪ Long Form Audit Report (LFAR)<br>▪ Report any other matters to Bank, Regulator or Government |

| Special Considerations in IT Environment | |
|---|---|
| **Sharing of Information with Auditors** | <u>Considering importance of IT systems in preparation and presentation of FS, it is imperative that bank should share detailed information with auditors like</u>:<br>▪ Overall IT policy and structure of Bank's IT system<br>▪ Data processing and data interface under various systems<br>▪ Process of generating various information related to disclosures in FS<br>▪ Data integrity and data security<br>▪ Controls on recording of various e-banking and internet banking products<br>▪ MIS reports and major exception reports and their process of generation |



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| **Key Security Aspects that Auditor needs to Address** | Key security control aspects that auditor needs to address when undertaking audit in computerised bank include:<br>▪ Ensure that authorised, accurate and complete data is available for processing.<br>▪ Ensure that in case of power failure, system restarts without distorting records.<br>▪ Ensure that system prevents unauthorised amendments to programmes.<br>▪ Verify that segregation of duties is ensured while granting system access.<br>▪ Verify that changes made in parameters or user levels are authenticated.<br>▪ Verify that exceptional reports are authorised and verified on daily basis. |

## Internal Control in Certain Selected Areas

| Focus Area | Examples of Internal Controls in Bank |
|---|---|
| **Cash** | ▪ Cash should be kept in joint custody of two responsible officers.<br>▪ In addition to normal checking by chief cashier, cash should be test-checked daily.<br>▪ Cashier should have no access to customer ledger accounts and Day Book.<br>▪ Payments should be made only after vouchers passed by authorised officer.<br>▪ High value cash receipts and payments should be verified by higher officer. |
| **Loans and Advances** | ▪ Bank should make advances only after satisfying about creditworthiness of borrowers and after obtaining sanction from proper authorities.<br>▪ All necessary documents should be executed by parties before advances are made.<br>▪ Sufficient margin should be kept against securities taken to cover decline in value.<br>▪ All securities should be kept in joint custody of two responsible officers.<br>▪ All securities should be registered in name of bank.<br>▪ All account should kept within drawing power & sanction limit. Additional temporary limit may be sanctioned for maximum 20% of existing limit and 90 days tenure.<br>▪ All accounts which exceed limit/power should be brought to management regularly.<br>▪ Operation in each advance account should be reviewed at least once every year. |
| **Credit Card Operations** | There should be a system for:<br>▪ Effective screening of applications.<br>▪ Strict control over storage and issue of cards.<br>▪ Prompt reporting by merchants of all settlements accepted through credit cards.<br>▪ Ensuring statements are sent regularly and promptly to customer.<br>▪ Monitor and follow-up customers payments.<br>▪ Identification of payments overdue beyond reasonable period.<br>▪ Periodic review of credit card holders account. |
| **Clearings** | As per RBI guidelines, branch is required to either call the customer or email him for any cheque received of ₹ 5 lacs and above in respect of inward clearings. |

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| **Bills Purchased** | In case of bills purchased outstanding at close of the year, discount received thereon should be properly apportioned between two years. |
| **Demand Draft** | All DD issued by branch will be immediately confirmed by advice to paying branch. |

## Compliance with CRR and SLR Requirements

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| **Meaning** | ▪ Cash Reserve Ratio (CRR) is a specified minimum fraction of total customers deposits, which banks have to hold as reserves either in cash or deposits with RBI.<br>▪ Statutory Liquidity Ratio (SLR) is the requirement that bank is required to maintain in form of liquid assets such as gold and cash before providing credit to customers. |
| **Audit Procedure** | <u>Special points in audit of compliance with CRR and SLR requirements</u>:<br>▪ Verify compliance with SLR requirements of 12 odd dates not being Fridays.<br>▪ Obtain understanding of relevant circulars/instructions of RBI.<br>▪ Examine whether consolidations prepared by bank include information of all branches.<br>▪ Examine consolidations regarding DTL (Demand and Time Liabilities) position prepared by bank with related returns received from branches.<br>▪ In DTL computation, examine following items is excluded from liabilities:<br>➢ Paid up capital, reserves, loan taken from RBI and refinance taken from EXIM Bank/NHB/ SIDBI/NABARD.<br>➢ Part amount of recoveries from borrowers in respect of bad debts.<br>➢ Amounts received against import bills in Indian currency.<br>➢ Un-adjusted balances for agency business.<br>➢ Margins held in sundry deposits for funded facilities.<br>➢ Bills discounted by a bank with eligible financial institutions as approved by RBI.<br>➢ Net Income tax provision.<br>➢ Amount received from DICGC and ECGC.<br>➢ Amount received from insurance companies for ad hoc settlement of claims.<br>➢ Amount received from court receiver.<br>➢ Unrealized gain/loss arising from derivatives transactions.<br>➢ Annual fees and other charges received in advance which are not refundable.<br>➢ Liabilities arising on utilisation of limit under 'Bankers' Acceptance Facility' (BAF).<br>▪ Similarly, examine following items is included in liabilities:<br>➢ Net credit balance in branch adjustment accounts.<br>➢ Borrowings from abroad and adverse balances in nostro mirror account.<br>➢ Interest accrued on deposits whether or not accounted in books of accounts.<br>➢ Cash collaterals received under collateralized derivative transactions. |

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## Verification of Asset Classification, Income Recognition and Provision for NPA

| Focus Area | Suggested Audit Procedures |
|---|---|
| Classification and Provision | ▪ Verify whether bank has a system of classification of advances through CBS without manual intervention.<br>▪ Examine whether classification made by branch is appropriate.<br>▪ Examine whether secured and unsecured portions of advances have been segregated correctly and provisions have been calculated properly.<br>▪ Review and compare date of NPA of loan accounts mentioned in current year statements with previous year. Reasons for any change should be ascertained. |
| Accounts Regularized near Balance Sheet Date | ▪ As per RBI guidelines, if account has been regularised before balance sheet date by payment through genuine sources, account need not be treated as NPA.<br>▪ If subsequently, branch has provided further funds to borrower, auditor should carefully assess whether repayment was out of genuine sources or not.<br>▪ If account indicates inherent weakness, account should be deemed as NPA. |
| Drawing Power Calculation | ▪ Ensure that drawing power is calculated as per guidelines formulated by BOD.<br>▪ Special consideration should be given to proper reporting of sundry creditors and stocks covered under LCs/guarantees for calculating drawing power.<br>▪ Drawing power needs to be calculated carefully in case of working capital advances to companies engaged in construction business.<br>▪ Stock auditors report should be reviewed for comments made on drawing power. |
| Limits not Reviewed | ▪ Accounts where regular/ad hoc limits are not reviewed within 180 days from due date/date of ad hoc sanction, should be considered as NPA.<br>▪ Ensure that ad hoc/short reviews are not done on repetitive basis. |
| Accounts with Temporary Deficiencies | ▪ Banks should not classify an advance account as NPA merely due to existence of some temporary deficiencies such as non-availability of drawing power based on latest available stock statement, balance outstanding exceeding the limit temporarily and non-renewal of limits on due date.<br>▪ However, stock statements for determining drawing power should not be older than 3 months. Ensure adherence to these guidelines. |
| Asset Classification Borrower wise | ▪ Ensure that asset classification is borrower wise and not facility wise.<br>▪ It is to be ensured that all facilities granted by a bank to borrower will be treated as NPA and not particular facility which has become irregular. |
| Government Guaranteed Advances | ▪ If government guaranteed advance becomes NPA, then income on such advance is recognised only when interest is realized.<br>▪ For asset classification, Central Government guaranteed advances is treated as NPA only when Govt. repudiates its guarantee, when invoked. State Government |

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| | guaranteed advances is treated NPA if it remains overdue for more than 90 days.<br>▪ In case bank has not invoked Central Government Guarantee though amount is overdue for long, it should be duly reported in LFAR. |
| **Agricultural Advances** | ▪ Ensure that NPA norms have been applied as per crop season (short term/long term) on all direct agricultural advances listed in circular.<br>▪ For agricultural loans not specified in circular, ensure that identification of NPA has been done on same basis as non-agricultural advances. |
| **Restructured Advances** | ▪ Restructuring is an act in which a lender grants concession to borrower for reasons relating to borrower's financial difficulty.<br>▪ It may involve modification of terms of advances including alteration of instalment amount/repayment period/rate of interest/sanction etc.<br>▪ Banks may restructure the accounts classified under any categories. Banks cannot restructure accounts with retrospective effect.<br>▪ On restructuring, account will be downgraded from standard to substandard. NPAs will remain in same category. |
| **Upgradation of Account** | ▪ Examine all accounts upgraded from NPA to standard category during the year, to ensure that upgrading is strictly as per RBI guidelines.<br>▪ There can be a possibility of incorrect upgradation of account on basis of partial recoveries made in account and overdue portion might not wiped out completely.<br>▪ There can also be a possibility of recoveries being made in account after cut-off date and account being upgraded as on date of balance sheet. |
| **Sale/Purchase of NPAs** | <u>In case of sale/purchase of NPA by bank, auditor should examine</u>:<br>▪ Policy laid down by BOD relating to procedures, valuation and delegation of powers for sale/purchase.<br>▪ Only such NPA has been sold which remained NPA in books for at least 2 years.<br>▪ NPA have been sold/purchased 'without recourse' only i.e entire credit risk associated with NPA transferred to purchasing bank.<br>▪ Subsequent to sale of NPA, bank does not assume any risk relating to sold NPAs.<br>▪ NPA has been sold at cash basis only.<br>▪ bank has not purchased an NPA which it had originally sold.<br>▪ <u>Special points in case of sale of NPA</u>:<br>➢ NPA has been removed from books of selling bank.<br>➢ If sale below NBV (net book value), shortfall should be debited to P&L.<br>➢ If sale more than NBV, excess will utilise to meet loss on sale of other NPA.<br>▪ <u>Special points in case of purchase of NPA</u>:<br>➢ Provision should be made for NPA purchased as per classification status in books of purchasing bank. |



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| | ➢ Any recovery from NPA purchased is first adjusted against its acquisition cost and excess has been recognised as profit.<br>➢ For capital adequacy, banks assigned 100% risk weights to NPAs purchased from other banks. |

## Verification of Assets

| Focus Area | Suggested Audit Procedures |
|---|---|
| Advances | **Substantive Audit Procedures**<br>▪ Check parameters like instalments, EMI, rate of interest, tenure of loans etc.<br>▪ Examine all large advances while other advances may examined on sample basis.<br>▪ Examine identified problem accounts which are not yet slipped into NPA category.<br>▪ Examine accounts which are adversely commented by concurrent auditors/bank internal inspection/RBI inspection team.<br>▪ Examine restructured accounts list to ensure restructure is as per RBI guidelines.<br>▪ Verify completeness and accuracy of interest charged.<br>**Recoverability of Advances**<br>▪ Review periodic statements submitted by borrowers indicating compliance with terms and conditions.<br>▪ Review latest FS of borrowers.<br>▪ Review reports on inspection of security.<br>▪ Review auditor's report of borrowers having credit facilities beyond cut-off limit. |
| Cash | Carry out physical verification of cash (including foreign currency, cash at ATM and cash deposit machines) near balance sheet date. |
| Balance with RBI and Other Banks | Review reconciliation statements, paying special attention to following items:<br>▪ Cash transactions remaining unresponded.<br>▪ Other credit and debit entries remaining unresponded for more than 15 days.<br>▪ Revenue items requiring adjustments/write-offs.<br>▪ Balances with banks outside India should be converted into Indian currency at exchange rates prevailing on balance sheet date. |
| Money at Call and Short Notice | ▪ Examine whether there is proper authorisation for lending at call or short notice.<br>▪ Verify that interest is properly accounted for year-end outstanding balances.<br>▪ Call loans made by a bank cannot be netted-off against call loans received. |
| Non-Banking Asset Acquire in satisfaction of Claims | ▪ Ensure asset is recorded at lower of net book value of advance or NRV of asset.<br>▪ Check that ownership of property is legally vested with bank.<br>▪ Ensure that these are being held with intention of being disposed off.<br>▪ Verify such asset with reference to relevant documentary evidence. |



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| | Bank is restricted from holding any immovable property for period exceeding 7 years from date of acquisition, unless such property is required for bank's own use. |
| **Investments** | ▪ Banks should undertake half-yearly reviews (as of 30th September and 31st March) of their investment portfolio.<br>▪ Banks are required to get their investments under PMS separately audited by external auditors.<br>▪ <u>Verification of Investments</u><br>➢ Internal Control Evaluation and Review of Investment Policy<br>➢ Separation of Investment Functions (Segregation of Duties)<br>➢ Examination of Documents, Reconciliation and Valuation<br>➢ Examination of Classification and Shifting<br>✓ Entire investment of bank is classified under 3 categories (HTM, HFT & AFS)<br>✓ Shifting of investment from AFS to HTM is duly approved by BOD<br>➢ Physical Verification<br>✓ Obtain written explanation from management for Bank Receipts outstanding |

## Verification of Capital and Liabilities

| Focus Area | Suggested Audit Procedures |
|---|---|
| **Capital** | ▪ <u>Capital is divided into two tiers</u><br>➢ Tier I capital consists mainly of share capital and disclosed reserves and it is a bank's highest quality capital because it is fully available to cover losses.<br>➢ Tier II capital consists of certain reserves and certain types of subordinated debt. Loss absorption capacity of Tier II capital is lower than Tier I capital.<br>▪ <u>Capital Risk Adequacy Ratio (CRAR)</u><br>$\frac{\text{Eligible Total Capital Funds}}{\text{Risk weighted assets \& off-balance sheet items}} \times 100$<br>▪ RBI requires banks to maintain minimum CRAR of 9%. |
| **Borrowings** | ▪ Obtain and verify confirmation certificates and other documents.<br>▪ Comply with requirements of SA 505 "External Confirmations".<br>▪ Examine whether clear distinction is made between 'rediscount' and 'refinance'.<br>▪ Examine whether borrowings of money at short notice are properly authorised. |
| **Bills Payable** | ▪ Evaluate existence and effectiveness of internal controls over bills payable. Such controls should usually include following:<br>➢ Drafts, mail transfers etc. should be made out in standard printed forms.<br>➢ Unused forms should be kept under custody of responsible officer.<br>➢ Bank should have a reliable private code known only to responsible officers. |

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| | ➢ Signatures on demand draft should be checked by officer with signature book.<br>▪ Examine sample of outstanding items in bills payable with relevant registers. |
| **Deposits** | **Current and Saving Accounts (CASA)**<br>▪ Verify accounts opened during year on sample basis for adherence to KYC norms.<br>▪ Verify balances in individual accounts on sample basis.<br>▪ Check interest calculations on test check basis.<br>▪ Examine whether balance confirmation procedure has been followed consistently.<br>▪ Current/saving account is treated as inoperative if there are no transactions for two years. Verify some inoperative accounts revived/closed on sample basis.<br>**Term Deposits**<br>▪ Verify in case of bulk deposits (₹ 2 crore and above for scheduled commercial banks presently), correct interest rate has been offered.<br>▪ Examine that interest accrued but not due on deposits is not included under relevant deposits but is shown under head 'other liabilities and provisions'.<br>▪ Verify some recurring deposit accounts opened during the year on sample basis.<br>▪ In case of closure of term deposit, check foreclosure penalty has been deducted.<br>**Deposits Designated in Foreign Currencies**<br>▪ Examine whether they are converted into Rupees at rate notified by head office.<br>▪ Examine whether any resultant increase or decrease has been taken to P&L A/c.<br>▪ Verify that interest on deposits has been paid on basis of 360 days in a year. |

## Verification of Contingent Liabilities

| | |
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| **Disclosure Requirement** | Disclosure requirement of contingent liabilities for banks<br>▪ Claims against the bank not acknowledged as debts.<br>▪ Liability for partly paid investments.<br>▪ Liability of outstanding forward exchange contracts & derivative contracts<br>▪ Guarantees given on behalf of constituents in India or outside India.<br>▪ Acceptances, endorsements and other obligations.<br>▪ Other items for which bank is contingently liable. |
| **Management Representation** | Auditor should obtain representation from management that:<br>▪ All off-balance sheet transactions are accounted when they are taken place.<br>▪ All off-balance sheet transactions are entered after following due procedure.<br>▪ All off-balance sheet transactions are supported by underlying documents.<br>▪ All year end contingent liabilities have been disclosed.<br>▪ Disclosed contingent liabilities do not include any crystallised liabilities which require creation of provision in FS. |

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| **Audit Procedure** | ▪ Test completeness of recorded obligations.<br>▪ Review reasonableness of year-end amount of contingent liabilities.<br>▪ Review minutes of board meetings, contracts, agreements and list of pending legal cases to identify claims against bank.<br>▪ Ascertain status of claims outstanding at end of year from management.<br>▪ Verify outstanding forward exchange contracts with statement generated from bank accounting system.<br>▪ Ascertain whether there are adequate internal controls over issuance of guarantees and unused guarantee forms.<br>▪ Evaluate adequacy of internal controls over issuance of letters of credit. |

## Auditor's Report

### (1) Reporting to Central Government

In case of nationalised bank, auditor is required to make a report to Central Government in which auditor should state following:

- In case auditor had called for any explanation or information, whether it has been given.
- Whether, balance sheet contains all necessary particulars and is properly drawn up so as to exhibit a true and fair view of affairs of bank.
- Whether profit and loss account shows true balance of profit or loss for period covered.
- Whether transactions which have come to auditor's notice, are within powers of bank.
- Whether returns received from branches of bank have been found adequate for audit.
- Any other matter which auditor considers to be brought to notice of Central Government.

### (2) Reporting of Matters Covered under Companies Act, 2013

- Auditor of a banking company is also required to state in report the matters covered by Section 143 of Companies Act, 2013.
- Auditor's report shall also include their views and comments on following matters, namely:
  - Whether company has disclosed impact of pending litigations in FS.
  - Whether company has made provision for material foreseeable losses on contracts.
  - Whether there has been any delay in transferring amounts to Investor Education and Protection Fund by company.
  - Whether dividend declared or paid by company is in compliance with Companies Act, 2013.
  - Whether company has used such accounting software for maintaining its books which has feature of recording audit trail facility and same has been operated throughout year.
- Reporting requirements relating to Companies (Auditor's Report) Order, 2020 are not applicable to a banking company.

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### (3) Long Form Audit Report (LFAR)

- LFAR is to be given by statutory branch auditors as well as statutory central auditors.
- LFAR for branch auditors is in form of questionnaire where observations/comments have to be provided on range of matters including cash, balance with banks, investments, advances, etc. These are submitted by statutory branch auditors to statutory central auditors.
- Consolidation is done at head office level and LFAR for bank is submitted by statutory central auditors to management.
- Copy of LFAR together with Board views or directions, is submitted to RBI within 60 days of submission of LFAR by statutory auditors.

### (4) Other Reports and Certificates

Statutory central auditor also provides reports and certificates on following:

- Report on operating effectiveness of Internal financial controls over financial reporting
- Report on any serious irregularity as per section 143(12) of Companies Act, 2013
- Long form audit report (LFAR)
- Report on compliance with SLR requirements
- Report on income recognition, asset classification and provisioning
- Certificate on corporate governance

## Concurrent Audit

### (1) Meaning

Concurrent audit is an audit or verification of transactions or activities of an organisation concurrently as the transaction/activity takes place. It is not a pre-audit.

Concept in this audit is to verify authenticity of transaction/activity within shortest possible time. It is similar to internal audit.

### (2) Scope and Coverage

- Detailed scope of concurrent audit and coverage of branches is determined by Inspection & Audit Department of bank with approval of Audit Committee of Board of Directors (ACB).
- Guidelines issued by RBI cover all key areas of activities of branch which is under concurrent audit. Following areas are covered by these guidelines - Cash, Deposits, Advances, Investments, Foreign Exchange, House Keeping and Other Items.

### (3) Focus Areas

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| Advances | Audit Procedure/Focus Areas in case of Advances:<br>▪ Ensure that loans and advances have been sanctioned properly.<br>▪ Ensure that securities have been received and properly registered. |



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| | ▪ Ensure that post disbursement supervision and follow-up is proper.<br>▪ Check whether letters of credit issued are within delegated power.<br>▪ Check whether bank guarantees issued are properly recorded in register.<br>▪ Ensure proper follow-up of overdue bills of exchange.<br>▪ Verify whether classification of advances is done as per RBI guidelines. |
| **Foreign Exchange** | <u>Audit Procedure/Focus Areas in case of Foreign Exchange Transactions</u>:<br>▪ Check whether inward/outward remittance have been properly accounted.<br>▪ Examine extension and cancellation of forward contracts for purchase and sale of foreign currency.<br>▪ Ensure that balances in Nostro accounts in foreign currencies are within limit.<br>▪ Ensure reconciliation of Nostro and Vostro account balances.<br>▪ Ensure adherence to guidelines issued by RBI about dealing room operations. |

## (4) Appointment of Concurrent Auditors

- Concurrent audit can be done by bank's own staff or external auditors.
- If bank has engaged its own officials, they should be experienced, well trained and senior. They must be independent of branch where concurrent audit is to be conducted.
- ACB of bank shall decide maximum tenure of external concurrent auditors. Generally, it shall not be more than 5 years. However, no concurrent auditor shall continue with a branch for more than 3 years.
- If any serious irregularities are noticed in working of external concurrent auditors, their appointment may be cancelled and fact may be reported to RBI & ICAI.

## (5) Reporting System in Concurrent Audit

- There should be proper reporting of findings of concurrent auditors in structured format.
- There should be zone-wise reporting of findings of concurrent audit to ACB.
- Before submission of report, auditor should discuss important issues with branch manager.
- Minor irregularities are to be rectified in a timely manner. Serious irregularities should be reported to head office for immediate action.
- If fraudulent transactions are detected, they should immediately be reported to Inspection & Audit Department of bank, Chief Vigilance Officer and concerned Branch Managers.
- Follow-up action on concurrent audit reports should be given high priority.

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## Unit II - Special Features of Audit of Non-Banking Financial Companies

### Definition, Registration and Regulation of NBFC

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| **Definition** | RBI Act, 1997 defines NBFC as:<br>➢ A financial institution which is a company;<br>➢ A non-banking institution which is a company with principal business of receiving of deposits or lending in any manner;<br>➢ Such other non-banking institution, as RBI may specify by notification in Official Gazette with previous approval of Central Government. |
| **Registration and Regulation** | ▪ Company will be treated as NBFC when a company's:<br>(i) Financial assets constitute more than 50% of total assets (excluding intangible assets) and<br>(ii) Income from financial assets constitute more than 50% of gross income.<br>Company which fulfils both these criteria shall qualify as NBFC and would require to be registered as NBFC by RBI.<br>▪ No NBFC shall commence or carry on business of NBFC without:<br>➢ Obtaining certificate of registration issued by RBI and<br>➢ Having net owned fund of ₹ 10 crores [₹ 2 crores for NBFC-P2P, NBFC-AA, and NBFCs with no public funds. ₹ 300 crores for NBFC-IFC and IDF-NBFC] |
| **Companies Exempted from Registration under RBI** | ▪ Merchant Banking Companies, Venture Capital Fund Companies, Stock-broking Companies, Stock Exchanges (regulated by SEBI).<br>▪ Nidhi Companies (regulated by MCA)<br>▪ Insurance companies (regulated by IRDA)<br>▪ Chit Companies, Securitisation & Reconstruction Companies, Mutual Benefit Companies, Alternative Investment Fund Companies<br>▪ Core Investment Companies with asset size of less than ₹ 100 crore, and those with asset size of ₹ 100 crore and above but not accessing public funds. |
| **Difference Between Banks and NBFC** | NBFCs lend and make investments and hence, their activities are similar to banks. However, there are few differences between the two as given below:<br>➢ NBFC cannot accept demand deposits, however some can accept term deposits.<br>➢ NBFCs do not form part of payment system and cannot issue cheques.<br>➢ Deposit insurance facility is not available to depositors of NBFC, unlike in banks.<br>➢ No minimum exposure to priority sector required by NBFC. |

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## Types and Classification of NBFC

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|---|---|
| **Types** | NBFCs registered with RBI are categorized as follows:<br>▪ Deposit and Non-Deposit taking NBFCs.<br>▪ Non deposit taking NBFCs by their size into systemically important and non-systemically important (NBFC-NDSI and NBFC-ND).<br>▪ By kind of activities, they conduct. Types of NBFC in this category are:<br>➢ Non-Operative Financial Holding Company - (NOFHC)<br>➢ Infrastructure Finance Company (IFC)<br>➢ Systemically Important Core Investment Company (CIC-ND-SI)<br>➢ Infrastructure Debt Fund (IDF-NBFC)<br>➢ Investment and Credit Company (ICC)<br>➢ Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI) |
| **Classification** | NBFCs are classified into four layers. These four layers are:<br>(i) NBFC-Base Layer (NBFC-BL)<br>It comprises of:<br>➢ Non-deposit taking NBFCs below asset size of ₹ 1,000 crores.<br>➢ NBFC-Peer to Peer Lending Platform (NBFC-P2P),<br>➢ NBFC-Account Aggregator (NBFC-AA),<br>➢ Non-Operative Financial Holding Company (NOFHC)<br>➢ NBFC not availing public funds<br>(ii) NBFC-Middle Layer (NBFC-ML)<br>It consists of:<br>➢ All deposit taking NBFCs irrespective of asset size.<br>➢ Non-deposit taking NBFCs with asset size of ₹ 1,000 crores and above.<br>➢ NBFCs undertaking following activities - Infrastructure Finance Companies (IFC), Core Investment Companies (CIC), Infrastructure Debt Fund (IDF-NBFC), Housing Finance Companies (HFC) and Standalone Primary Dealers.<br>(iii) NBFC Upper Layer (NBFC-UL)<br>It comprise of those NBFCs which are specifically identified by RBI. Top 10 eligible NBFCs in terms of their asset size shall always reside in upper layer.<br>(iv) NBFC-Top Layer (NBFC-TL)<br>It will ideally remain empty and will be filled by RBI based on required need. |

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## Classification of Frauds By NBFC

- Misappropriation and criminal breach of trust.
- Fraudulent encashment through forged instruments or manipulation of books of account.
- Unauthorised credit facilities extended for reward.
- Negligence and cash shortages.
- Cheating and forgery.
- Irregularities in foreign exchange transactions.
- Any other type of fraud not coming under above heads.

Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' are to be reported as fraud only if intention to cheat is proved except in following cases:

- cash shortages more than ₹ 10,000 and
- Cash shortages more than ₹ 5,000 if detected by management/auditor and not reported on occurrence by persons handling cash.

## Prudential Norms

**(1) Capital Requirements**

Every NBFC shall maintain minimum capital ratio consisting of Tier I and Tier II capital which shall not be less than 15 % of its aggregate risk weighted assets. Tier I capital shall not be less than 10% (12% if lending against gold jewellery) at any time.

**Tier 1 and Tier 2 Capital**

- Tier 1 Capital for NBFCs is the sum of:
  - Owned fund as reduced by investment in shares of other NBFCs and in shares, debentures, bonds, outstanding loans and advances and deposits with subsidiaries and companies in same group in aggregate exceeding 10% of owned fund.
  - Perpetual debt instruments issued by non-deposit taking NBFCs in each year but upto 15 % of aggregate Tier 1 capital of such company as on March 31 of previous accounting year.

  [NBFCs-BL are not eligible to include perpetual debt instruments in their Tier 1 capital.]
- Tier 2 Capital for NBFCs is the sum of:
  - Preference shares other than those compulsorily convertible into equity.
  - Revaluation reserves at discounted rate of 55%.
  - Provisions & loss reserves to meet unexpected loss upto 1.25% of risk weighted assets.
  - Hybrid debt capital instruments and Subordinated debt.
  - Perpetual debt instruments issued by non-deposit taking NBFC which is in excess of what qualifies for Tier 1 capital but upto Tier 1 capital.

  [NBFCs-BL are not eligible to include perpetual debt instruments in their Tier 2 capital.]

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| Risk Weighted Assets | |
|---|---|
| Value of each asset requires to be multiplied by relevant risk weights to arrive at risk adjusted value of assets. Percentage of risk weight assigned to assets are: | |
| Assets | Weight % |
| Cash & Bank Balances, Investment in Approved Securities, Fully Secured Loans & Advances, Loan to Staff, TDS, Advance Tax, Interest on Government Securities, Central Government Guaranteed Claims | 0 |
| Investment in Bonds of Public Sector Banks, State Government Guaranteed Claims not in default/in default upto 90 days | 20 |
| Infrastructure Projects in existence over a year of commercial operation | 50 |
| Consumer credit exposure (outstanding as well as new), Credit card receivables | 125 |
| Others (including ROU assets) | 100 |

**(2) Asset Classification**

- Standard Asset

  It mean asset for which no default in repayment of principal or interest is perceived.

- Non-Performing Asset (NPA)
  - Asset for which interest has remained overdue for more than 180 days.
  - Term loan for which installment or interest has remained overdue for more than 180 days.
  - Demand or call loan or bill or lease rental or hire purchase installment or any dues on sale of assets/services rendered which has remained overdue for more than 180 days.

  Note: Applicable NBFCs shall adhere to 90 days NPA norm instead of 180 days by 31.3.2026.

| | |
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| **Sub-Standard Asset** | For Base Layer NBFCs<br>Asset which has been classified as NPA for not exceeding 18 months.<br>For Other NBFCs<br>Asset which has been classified as NPA for not exceeding 12 months. |
| **Doubtful Asset** | For Base Layer NBFCs<br>Asset which remains sub-standard asset for exceeding 18 months.<br>For Other NBFCs<br>Asset which remains sub-standard asset for exceeding 12 months. |
| **Loss Asset** | • Asset identified as loss asset by NBFC or its internal or external auditor or by RBI during inspection, upto extent of not written off.<br>• Asset adversely affected by potential threat of non-recoverability. |

**(3) Provisioning Requirements**

Every NBFC shall make provision against loss assets, doubtful assets, sub-standard assets and standard assets as follows:

| Assets | Provision % | | |
|---|---|---|---|
| Loss Assets | | | 100 |
| Doubtful Assets | Unsecured | | 100 |
| | Secured | If doubtful upto 1 year | 20 |
| | | If doubtful 1-3 years | 30 |
| | | If doubtful more than 3 years | 50 |
| Sub-standard Assets | | | 10 |
| Standard Assets | NBFC (Base Layer) | | 0.25 |
| | NBFC (Middle Layer) | | 0.40 |

## Audit Procedures

| Areas which are Mandatorily part of Audit Procedure for Conducting Audit of NBFC | |
|---|---|
| Ascertaining Business of Company | First step in audit of NBFC is to scan through Memorandum and Articles of Association of company, so as to acquaint oneself with the type of business that the company is engaged into. |
| Evaluation of Internal Control System | Auditor should understand accounting system and related internal controls adopted by NBFC to determine NTE of his audit procedures. Auditor should also ascertain whether internal controls put in place by NBFC are adequate. |
| Registration with RBI | Auditor should verify whether dual conditions relating to registration with RBI and maintenance of minimum net owned funds have been duly complied with by NBFC. |
| NBFC Acceptance of Public Deposit Directions | <u>Ascertain whether company has complied with following aspects in relation to activity of mobilization of public deposits</u>:<br>▪ Ceiling on quantum of public deposits is linked to credit rating. Obtain copy of credit rating assigned to NBFC and check whether public deposits accepted are as per credit rating assigned to it. In event of upgrading/downgrading of credit rating, ensure that NBFC has informed the same to RBI.<br>▪ In event of downgrading below minimum specified grade, NBFC shall:<br>➢ Stop accepting fresh and renewing existing deposits;<br>➢ All existing deposits shall run off to maturity; and<br>➢ Report position within 15 days to RBI.<br>▪ Test check interest calculations of public deposits mobilised by NBFC.<br>▪ Verify deposit register maintained and test check particulars with supporting receipts. |



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| | ▪ Check whether investments made in liquid assets lodged in safe custody with scheduled bank.<br>▪ Check whether NBFC has filed returns in timely manner.<br>▪ In case of NBFCs not accepting deposits, check whether board resolution is passed. |
| **NBFC Prudential Norms Directions** | <u>To ensure compliance of prudential norms by NBFC, auditor shall</u>:<br>▪ Check compliance of norms relating to income recognition, income from investments, asset classification, provision for bad debts, capital adequacy norm, norms for concentration of credit etc.<br>▪ Ensure that unrealised income from NPA has not been taken to P&L.<br>▪ Check whether all accounts which have been classified as NPAs in previous year also continue to be shown as such in current year also.<br>▪ Verify loan and advances have been properly classified as standard/ substandard/doubtful/loss and proper provision has been made.<br>▪ Ensure that BOD of NBFC shall frame a policy for granting demand loans. |

## Audit Checklist in case of NBFC - Investment and Credit Company

| Verification Procedure/Points to be covered in Audit of Investment and Credit Company |
|---|
| ▪ Physically verify all shares and securities held by NBFC.<br>▪ Verify that dividend income is duly received by NBFC and interest is duly accounted.<br>▪ Obtain list of group companies from management and verify investments made in group companies.<br>▪ Check whether investments have been valued as per NBFC Prudential Norms Directions.<br>▪ Check whether NBFC has not invested in excess of specified limits.<br>▪ Verify board minutes for purchase and sale of investments.<br>▪ Examine whether each loan or advance has been properly sanctioned.<br>▪ Check classification of loans and advances made by NBFC into standard, sub-standard, doubtful and loss assets.<br>▪ Verify whether NBFC has not advanced any loans against security of its own shares.<br>▪ Obtain balance confirmations from concerned parties. |

## Auditor's Duty to Report

| Matters to be included in Auditor's Report to Board of Directors of NBFC | |
|---|---|
| **In case of All NBFCs** | <u>Auditor shall include a statement on following matters</u>:<br>▪ Whether company has obtained Certificate of Registration (CoR) from RBI.<br>▪ In case of company holding CoR, whether company is entitled to hold CoR. |

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| | ▪ Whether NBFC is meeting net owned fund requirement. |
| **In case of NBFCs Accepting/Holding Public Deposits** | Auditor shall include a statement on following matters:<br>▪ Whether public deposits accepted by company are within admissible limits.<br>▪ Whether company has violated any restriction on acceptance of deposit.<br>▪ Whether capital adequacy ratio disclosed in return is correctly determined and whether it is in compliance with minimum CRAR prescribed.<br>▪ Whether company has complied with prudential norms.<br>▪ Whether company has complied with liquid assets requirement.<br>▪ Whether company has furnished return on deposits and quarterly return on prudential norms to RBI within stipulated period. |
| **In case of NBFCs Not Accepting Public Deposits** | Auditor shall include a statement on following matters:<br>▪ Whether BOD has passed resolution for non-acceptance of public deposits.<br>▪ Whether company has accepted any public deposits during relevant period.<br>▪ Whether capital adequacy ratio disclosed in form NBS – 7 has been correctly arrived and whether it is in compliance with minimum CRAR prescribed.<br>▪ Whether company has complied with prudential norms. |
| **Obligation of Auditor to Submit Exception Report to RBI** | Auditor has obligation to submit exception report to RBI on following matters:<br>▪ Where, in case of NBFC, statement regarding any item is unfavourable or qualified, or in opinion of auditor company has not complied with:<br>➢ Provisions of Chapter III B of RBI Act; or<br>➢ NBFC Acceptance of Public Deposits Directions, 2016; or<br>➢ Master Direction – RBI (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023.<br>It shall be obligation of auditor to make a report containing details of such unfavourable or qualified statements and about non-compliance of company to concerned Regional Office of Non-Banking Supervision of RBI.<br>▪ Duty of auditor shall be to report only contraventions of provisions referred above and such report shall not contain any statement regarding compliance of any of those provisions. |
| **Certificate from Statutory Auditor** | ▪ Every NBFC shall submit a certificate from its statutory auditor that it is engaged in business of NBFC requiring it to hold CoR and is eligible to hold it.<br>▪ This certificate (with reference to position of company as at March 31) may be submitted to Regional Office of Department of Non-Banking Supervision under whose jurisdiction NBFC is registered, within 5 working days from date of signing of auditor's report but not later than 31st December of same year. |

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## Difference between Division II (Ind AS - Other than NBFCs) and Division III (Ind AS - NBFCs) of Schedule III

**Presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for following:**

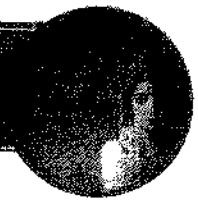
- NBFCs are allowed to present items of balance sheet in order of liquidity which is not allowed under Division II.
- NBFCs are required to separately disclose by way of note, any item of 'other income' or 'other expenditure' which exceeds 1% of total income. Division II requires disclosure for any item of income or expenditure which exceeds 1% of revenue or ₹ 10 lakhs, whichever is higher.
- NBFCs are required to separately disclose under 'receivables', debts due from LLP in which its director is a partner or member.
- NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on face of P&L instead of as part of notes.
- Separate disclosure of trade receivables which have significant increase in credit risk.
- Conditions or restrictions for distribution of statutory reserves have to be separately disclose.

## Compliance with CARO, 2020

Already covered in "Chapter 3 - Reporting"

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# OVERVIEW OF AUDIT OF PUBLIC SECTOR UNDERTAKINGS



## Basics

- **Categories for organisation of PSUs**

| Departmentally managed undertaking which form part & parcel of government activities<br>Example - Railways, Postal Services | Government companies & deemed government companies under Companies Act, 2013 | Corporations setup under specific acts of legislature<br>Example - LIC, UTI |
|---|---|---|

- **Definition of "Government Company"**

  Government Company means a company in which not less than 51% paid-up share capital is held by Central Government or by State Government or partly by Central Government and partly by one or more State Governments, and includes a company which is subsidiary of such Government company.

- In India, PSU audit is performed by Comptroller and Auditor General of India (C&AG) through Indian Audit and Accounts Department.

| **Number of organisations subject to audit of C&AG is very large. This includes:** |
|---|
| ➢ All government departments and offices including railways, posts and telecommunications. |
| ➢ Public commercial enterprises controlled by government, i.e. government companies. |
| ➢ Non-commercial autonomous bodies and authorities owned or controlled by Union or States. |
| ➢ Authorities and bodies substantially financed from Union or State revenues. |

- As per Companies Act 2013, in case of government company, C&AG has power to direct auditor the manner in which accounts of company are audited and auditor shall submit audit report which include directions issued by C&AG, action taken thereon and its impact on accounts and FS of company.

## C&AG and Committees

- **C&AG Status as per Indian Constitution**

| Article 148 to 151 of Constitution gives special status to C&AG and safeguard his independence. | |
|---|---|
| 148 | Appointment of C&AG by President and Salary etc. to be determined by Parliament.<br>Special procedure for removal of C&AG, only on ground of proven misbehaviors or incapacity. |
| 149 | Perform such duties and exercise such powers as prescribed under C&AG's Act, 1971. |
| 150 | On C&AG advice, President to prescribe form in which accounts of Union & States shall kept. |
| 151 | Audit report of C&AG on accounts of Central/State Government should be submitted to President/Governor of State and to be laid before Parliament/State Legislative Assemblies. |

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C&AG shall hold office for term of 6 years or upto age of 65 years, whichever is earlier. He can resign at any time through a resignation letter addressed to the President.

- **Committees**

Parliament and State Legislatures have constituted specialized committees to which these audit reports and annual accounts automatically stand referred.

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| **Public Accounts Committee (PAC)** | It is the duty of PAC to satisfy itself that:<br>➢ Moneys were disbursed legally on purpose to which they were applied.<br>➢ Expenditure incurred was authorised.<br>➢ Re-appropriation has been made as per provisions made.<br>➢ Examine C&AG report on accounts of autonomous & semi-autonomous bodies. |
| **Estimates Committee** | This committee examines the estimates with a view to:<br>➢ Report what economies, improvements in organization, efficiency or administrative reform, consistent with policy may be effected.<br>➢ Suggest alternative policies.<br>➢ Examine whether money is well laid out within limit.<br>➢ Suggest form in which estimates shall be presented to Parliament. |
| **Committee on Public Undertakings (COPU)** | COPU exercises same financial control on PSUs as PAC exercises over functioning of Government departments. Functions of committee are:<br>➢ Examine reports and accounts of public undertakings.<br>➢ Examine reports of C&AG on public undertakings.<br>➢ Examine autonomy and efficiency of public undertakings.<br>➢ Exercise such other functions vested in PAC and estimates committee as not covered above and allotted by speaker from time to time. |

- **C&AG's Role as 'friend, philosopher and guide' of committees**

C&AG plays a key role in functioning of financial committees of Parliament and State Legislatures. He has recognised as 'friend, philosopher and guide' of committees. It is ensured as follows:

➢ His reports generally form basis of Committees working.

➢ He scrutinises notes submitted by ministries to Committees to check correctness of submissions.

➢ For those audit reports which could not be discussed in detail by Committees, written answers are obtained from Department/Ministry concerned.

## Objective and Scope of PSU Audits

- Audit of PSUs not constrained to Financial and Compliance but it extends also to Performance
- Propriety Audit



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- Comprehensive Audit
- Fiscal and Managerial Accountability
  - Fiscal Accountability includes audit of provisions of funds, compliances and propriety.
  - Managerial Accountability includes audit of efficiency, economy and effectiveness (efficiency-cum-performance audit).

## Elements and Principles of PSU Audits

**Audit of all PSUs have Following Basic Elements:**

- Three parties - Auditor, Responsible Party and Intended Users
- Subject matter, criteria and subject matter information
- Types of engagement - Attestation Engagements and Direct Reporting Engagement
  - Financial audits are always attestation engagements.
  - Compliance audits and performance audits are generally direct reporting engagements.

**Principles of PSU Audits**

- General Principles: Ethics & Independence, Professional Judgment, Quality Control, Audit Risk etc
- Principles related to Audit Process: Planning Audit, Conducting Audit, Reporting & Follow-up

## Financial Audit

- Financial audit is primarily conducted to express an audit opinion on FS to enhance degree of confidence of intended users in FS.
- C&AG shall express an opinion as to whether FS are prepared as per applicable FRF.

## Compliance Audit

| | |
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| **Meaning** | Compliance audit is independent assessment of whether given subject matter is in compliance with applicable criteria. |
| **Concern** | Compliance audit is concerned with:<br>Regularity - adherence of criteria emanating from applicable laws and regulations.<br>Propriety - observance of principles governing ethical conduct of public officials. |
| **Perspective** | Compliance audit is generally conducted either:<br>➢ in relation with audit of FS, or<br>➢ separately as individual compliance audit, or<br>➢ in combination with performance audit. |

## Performance Audit

### (1) Meaning

Performance audit is an objective and systematic examination of evidence for providing independent assessment of performance of government organization, program, activity, or function to improve public accountability and facilitate decision making.

### (2) Objectives of Performance Audit

- Objectives of performance auditing are evaluation of economy, efficiency, and effectiveness of policy, programmes, organization and management.
- It also promotes accountability by assisting TCWG to improve performance.
- It focuses on areas which have greatest potential for development.

### (3) Issues addressed by Performance Audit

| | |
|---|---|
| **Economy** | It is minimising cost of resources used for activity with appropriate quantity, quality and at best price. |
| **Efficiency** | It is the input-output ratio. Efficiency is achieved when output is maximised at minimum input, or input is minimised for any given output.<br>**Aspects to be looked to assess efficiency:**<br>➢ Sound procurement practices are followed.<br>➢ Resources are properly protected and maintained.<br>➢ Human, financial and other resources are efficiently used.<br>➢ Optimum amount of resources and efficient operating procedures are used.<br>➢ Public sector activities are efficiently managed and organised. |
| **Effectiveness** | It is the extent to which objectives are achieved and relationship between intended and actual impact of activity. In auditing effectiveness:<br>➢ Assess whether objectives of public sector programme are proper and consistent with policy.<br>➢ Determine extent to which program achieves desired results.<br>➢ Assess effectiveness of program and individual program components.<br>➢ Assess compliance with laws and regulations applicable to program.<br>➢ Identify ways of making programmes work more effectively. |

### (4) Planning for Performance Audit

| Factors should be considered while planning a performance audit / Following steps are suggested to the auditors for planning while conducting performance audit: | |
|---|---|
| **Understanding the Entity/Programme** | It is the starting point for planning individual performance audit.<br>**Auditor may use following sources for understanding the entity:**<br>➢ Documents of entity: Annual reports, minutes of meetings etc. |

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| | ➢ Legislative documents: Reports of committees, letters from MP etc.<br>➢ Policy documents: Documents of Ministry of Finance etc.<br>➢ Past audits: Past financial and performance audits of entity.<br>➢ Media coverage: Print and electronic media. |
| **Defining Objective & Scope of Audit** | Audit objectives should be defined in a crisp & clear manner. Defining scope mainly focuses on nature, timing and extent of audit. |
| **Determining Audit Criteria** | Audit criteria are standards used to determine whether program meets expectations. They are reasonable & attainable performance standards against which economy, efficiency and effectiveness of programmes and activities can be assessed.<br>Audit criteria can be obtained from following sources:<br>➢ Procedure manuals of entity.<br>➢ Policies, standards, directives and guidelines.<br>➢ Criteria used by same entity or other entities in similar programmes.<br>➢ Independent expert opinion.<br>➢ New or established scientific knowledge.<br>➢ General management and subject matter literature. |
| **Deciding Audit Approach** | It involves determine methods and means used for conducting audit.<br>Methods which could be used in conducting performance audit include:<br>➢ Analysis of procedures: It involves review & examination of documents.<br>➢ Analysis of results: Output-input analysis to determine efficiency.<br>➢ Quantitative analysis: Examination of data relating to financials.<br>➢ Case studies: It is a descriptive analysis of entity/programme.<br>➢ Surveys: It is a method of collecting information from population. |
| **Developing Audit Questions** | Audit team is required to prepare list of questions to which they would seek answers. |
| **Assessing Audit Team Skills** | It is essential that performance auditor possess special aptitude and knowledge so that they perform their tasks effectively & efficiently. |
| **Preparing Audit Design Matrix** | Audit team should prepare an ADM. It highlights audit objective, questions, criteria, data collection & analysis method as well as type of evidence required to support opinion. |
| **Establishing Time Table & Resources** | It is significant to determine timetable and desirable resources. Selection of appropriate audit team is most vital component in planning audit. |
| **Intimation of Audit Programme to Audit Entities** | Entities must be intimated about intention of taking up planned performance audit alongwith scope and extent of audit |

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## Comprehensive Audit

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| **Meaning** | It is an efficiency-cum-performance audit which locates area of weakness and extravagance for management information.<br>Indian Audit and Accounts Department constitutes Audit Boards for conducting comprehensive audit. |
| **Areas Covered** | Areas covered in comprehensive audit naturally vary from enterprise to enterprise depending on nature and operations of enterprise.<br>Some broad areas are - budgetary control, investment decisions, project formulation, capacity utilisation, management of plant and machinery, materials management, production performance, etc. |
| **Issues Examined / Matters covered in Reporting** | Matters covered in reporting in case of comprehensive audit / Issues examined in comprehensive audit are:<br>▪ How does overall capital cost of project compare with approved planned costs? If any substantial increase, whether there is evidence of unnecessary expenditure?<br>▪ Has planned rate of return achieved?<br>▪ Are systems of project formulation and execution sound?<br>▪ Has there been under-utilisation of installed capacity?<br>▪ Does enterprise has adequate system of repairs and maintenance?<br>▪ Are cost control measures and purchase policies adequate?<br>▪ Are procedures effective and economical?<br>▪ Does enterprise have R&D programmes? |

## Propriety Audit

| | |
|---|---|
| **Meaning** | Propriety audit stands for verification of transactions on the tests of public interest, commonly accepted customs and standards of conduct. |
| **Principles** | Principles of Propriety Audit are:<br>▪ Expenditure is not more than occasion demands and every official exercises same degree of vigilance on expenditure as ordinary person would exercise on own money.<br>▪ Authority should not exercise its power of sanctioning expenditure for own advantage.<br>▪ Funds are not utilised for benefit of particular person.<br>▪ Apart from agreed remuneration or reward, no other avenue is open to indirectly benefit employees and others. |
| **Functions of Auditor** | Functions of auditor in the context of Propriety Audit are to:<br>▪ See that expenditure incurred are properly planned. |

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| | ▪ See that size of expenditure are rightful and expected to give maximum results.<br>▪ Appraise whether those expenditure are likely to give optimum result.<br>▪ See that any substitute action plan can bring improvement on current operation.<br>▪ Examine actions and decisions of management whether they are in public interests. |
| **Propriety Audit Issues** | ➢ Problems in propriety audit arise mainly because of its distinct nature.<br>➢ In propriety audit, formulation of auditing propositions poses the problem.<br>➢ Propriety audit has inherent element of subjectivity because it is very difficult to establish standards of public interest, commonly accepted customs and conduct. |

## Audit Report of C&AG

**Contents of Audit Report of C&AG**

To facilitate proper consideration, reports of C&AG on audit of PSUs are presented to Parliament in several parts consisting of following:

- Introduction containing general review of working results of Government companies, deemed Government companies and corporations.
- Results of comprehensive appraisals of selected undertakings conducted by Audit Board.
- Significant results of audit of undertakings not taken up for appraisal by Audit Board.
- Resume of company auditors report submitted by them under directions issued by C&AG and that of comments on accounts of Government companies.

For certain specified states, C&AG submit a separate audit report (commercial) to legislature, while for other states, there is a commercial chapter in main audit report.

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# INTERNAL AUDIT

## Meaning and Objectives of Internal Audit

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| **Meaning** | **Internal Audit provides** independent assurance on effectiveness of internal controls and risk management processes **to enhance governance and achieve organisational objectives.** |
| **Objectives and Scope** | ▪ **Monitoring of internal controls**<br>▪ **Risk management**<br>▪ **Examination of financial and operating information**<br>▪ **Review of operating activities**<br>▪ **Review of compliance with laws and regulations**<br>▪ **Governance** |

## Internal Audit Applicability and Appointment of Internal Auditor

**As per section 138 of Companies Act 2013, following companies shall be required to appoint an internal auditor:**

| | | |
|---|---|---|
| ▪ Every Listed Company | | |
| ▪ Unlisted Public Company **having:** | ➢ **Paid up share** capital of ₹ 50 crores or more; **or**<br>➢ Turnover of ₹ 200 crores or more; **or**<br>➢ **Outstanding** loans or borrowings **from banks or public financial institutions** exceeding ₹ 100 crores **at any time; or**<br>➢ **Outstanding** deposits of ₹ 25 crores or more **at any time** | **during** preceding **financial year** |
| ▪ Private Company **having:** | ➢ Turnover of ₹ 200 crores or more; **or**<br>➢ **Outstanding** loans or borrowings **from banks or public financial** exceeding ₹ 100 crores **at any time.** | **during** preceding **financial year** |

**Company which gets covered under above criteria shall comply with requirements** within 6 months **of such applicability.**

### Who can be Appointed as an Internal Auditor?

- **Internal auditor may either be an individual or partnership firm or body corporate.**
- **Internal auditor shall either be a** CA or CMA **(whether engaged in practice or not),** or such other professional as decided by Board **to conduct internal audit of functions and activities of company.**
- **Internal auditor** may or may not be an employee **of company.**
- **Internal auditor must be regarded as** part of management **and not merely as an assistant.**

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## Activities and Responsibilities of Internal Auditor

### Activities performed by Internal Audit Function

Internal Audit Function performs number of activities to achieve its objectives as outlined in its Charter (or Terms of Engagement). Critical activities are as follows:

- Define overall plan, scope and methodology of Internal Audit Function on a periodic basis.
- Oversee and monitor various audit assignments, their planning, execution and reporting of findings.
- Plan, engage and review performance, training and development of staff and other resources.
- Identify and engage external experts and technical solutions.
- Communicate with all key stakeholders regarding achievement of objectives.
- Develop quality evaluation and improvement program.

### Responsibilities of Internal Auditor

With respect to accounting function & financial records, responsibilities of internal auditor include:

- To ascertain adequacy of internal control & provide safeguards against misappropriation of assets.
- To operate independently of accounting staff and not divest with responsibilities placed upon him.
- Not to involve in performance of executive functions.
- To observe facts and situations and bring them to notice of authorities.
- To associate closely with management and keep knowledge up to date.

## Scope of Internal Auditing

### Scope of Internal Auditing / Review of Work by Internal Auditor

Each managerial functions should be reviewed by internal auditor. Scope of internal auditor's work should include a review of:

| | |
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| **Internal Control System & Procedures** | It involves assessing operational efficiency and effectiveness of internal control system to strengthen overall internal control environment of entity. System should be reviewed considering limitations of internal controls. |
| **Custodianship & Safeguarding of Asset** | It involves:<br>➢ Verifying existence of assets.<br>➢ Reviewing segregation of duties is in place.<br>➢ Ensuring all assets are accounted fully.<br>➢ Reviewing control system for intangible assets. |
| **Compliance with Policies, Plans & Regulations** | Internal auditor has no responsibility to manage compliance framework or to take compliance decisions. It is management's responsibility. Internal auditor is responsible for auditing/reviewing compliance framework. |
| **Relevance & Reliability of Information** | Internal auditor should review information systems to evaluate reliability of information given to management and external agencies. |



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| **Organisational Structure** | Internal auditor should conduct appraisal of organisation structure to know whether it is in harmony with objectives. For this purpose, he should:<br>➢ See that responsibilities of managerial staff do not overlap with chief executives.<br>➢ Review adequate segregation of duties is considered.<br>➢ Examine reasonableness of span of control of each executive.<br>➢ Examine organization chart to check whether structure is simple.<br>➢ Evaluate process of managerial development in enterprise. |
| **Utilisation of Resources** | ➢ Internal auditor should check whether proper standards and norms have been established for measuring efficient use of resources.<br>➢ They should be detailed enough for being used by operating personnel.<br>➢ He should review methods of establishing standards and norms.<br>➢ If there is wide divergence between actual performance and corresponding standards, reasons may be considered. |
| **Accomplishment of Goals & Objectives** | Internal auditor should review overall objectives of enterprise to evaluate whether they are clearly stated and attainable. |

## Integrity, Objectivity, Independence and Qualities of Internal Auditor

**Integrity, Objectivity, Independence of Internal Auditor**

Internal Auditor shall:

- Free from any undue influences which force him to deviate from truth.
- Resist any undue pressure in establishing scope of assignments.
- Honest, truthful and person of high integrity.
- Avoid all conflicts of interest and not derive any undue personal advantage from his position.
- Conduct his work in a highly objective manner and not allow bias to override his objectivity.

**Qualities of Internal Auditor**

Some specialised knowledge and expertise that internal auditor should obtain are:

- Special expertise for evaluating control systems.
- Accounting and financial expertise to discharge duties.
- Knowledge of technology and commercial practices of enterprise.
- Knowledge of commerce, laws, taxation, cost accounting, economics and controls related to IT.
- Understanding of accounting software, ERP system and other applications used by organization.
- Understanding of management principles and ability to deal with people.

## Performing Internal Audit Engagement

Internal Auditor should follow following five steps in performing internal audit engagement:

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| **Step 1** - Obtain knowledge of Business and its Environment | Internal Auditor must conduct meetings with stakeholders and directors to obtain understanding of organization's business environment. He must obtain understanding of various business documents. |
| **Step 2** - Perform Audit Planning | Internal Auditor must plan audit engagement as per Standard on Internal Audit. Scope must be approved by Audit Committee and Board of Directors. |
| **Step 3** - Gather Required Information | Internal Auditor must obtain the required information directly from the source. |
| **Step 4** - Perform Audit Checks | Internal Auditor should collate all data and perform analytical procedures to identify key trends. He must select the sample as per SIA. Adequate documentation of internal audit work papers need to be ensured. |
| **Step 5** - Reporting of Internal Audit Issues | Internal Auditor must prepare a draft report of issues. He must also review status of actions taken by management agreed during previous audits. He should thereafter circulate final report to Audit Committee. |
| All these steps are to be performed while performing Internal Audit engagement in same sequence. | |

## Internal Audit Plan

Internal auditor should, in consultation with TCWG and audit committee, develop and document a plan for each internal audit engagement to conduct engagement in efficient and timely manner.

Internal audit plan should be developed such that appropriate consideration is made to following:

- Risk underlying the business process
- Risk Appetite of organization
- Effort involved in conducting internal audit
- Value that internal audit can provide to organization
- Coverage of all auditable areas within defined time range

## Internal Audit Report

### Stages of Reporting

Reporting of internal audit results is generally undertaken in two stages:

- At end of particular assignment, report covering specific area of entity is prepared by internal auditor highlighting key observations. It is issued to auditee with copies shared with management.
- On periodic basis, at close of a plan period, a comprehensive report of all internal audit activities covering plan period is prepared by chief internal auditor. Such reporting is normally done on quarterly basis and submitted to Audit Committee.



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| Key Elements of Internal Audit Report |
|---|
| Internal auditor shall issue a clear, well documented report which includes following key elements:<br>▪ Overview of objectives, scope and approach of audit assignments.<br>▪ Fact that an internal audit has been conducted as per Standards on Internal Audit.<br>▪ Executive summary of key observations covering all important aspects.<br>▪ Summary of corrective actions required for each observation.<br>▪ Nature of assurance which can be derived from observations. |
| **Content and Format of Internal Audit Report** |
| Typical internal audit report should include following:<br>▪ Audit scope performed<br>▪ Audit period covered<br>▪ Executive summary and summary of critical findings<br>▪ Audit recommendation/corrective actions to improve control environment<br>▪ Response received from responsible authority containing action plan and timelines for action |
| **Documentation** |
| ▪ Copies of draft and final internal audit report to be maintained.<br>▪ Management action plans may be counter signed by respective management personnel. |
| **Follow Up** |

| | |
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| **Responsibility for Follow Up** | ➢ Chief internal auditor is responsible for continuously monitoring closure of prior audit issues through timely implementation of action plans. Management is responsible to implement action plans.<br>➢ Internal auditor should review whether follow-up action is taken by management. Where management has not implemented his recommendations, internal auditor should ascertain reasons thereof.<br>➢ Where management has implemented his recommendations, internal auditor should review extent of implementation and report recommendations to management which have not been implemented. |
| **Action Taken Report** | Internal auditor should report summary of action taken by management of previous audits throgh Action Taken Report.<br>Typical Action Taken Report may include following:<br>▪ Reference to previous audit reporting containing the reported issues.<br>▪ Implementation action agreed by management with target implementation date.<br>▪ Status of action taken by management classified as implemented/not implemented.<br>▪ Residual risk and rating for unimplemented action.<br>▪ Any critical audit finding that require immediate action. |

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## Relationship between Internal and External Auditors

**Relationship between Internal and External Auditors is covered under SA 610.**

| Difference Between Internal and External Audit | | |
|---|---|---|
| **Basis** | **Internal Audit** | **External Audit** |
| **Performed by** | Independent internal audit department within organisation or by external body. | Independent body which is not a part of organization. |
| **Examination** | Examines operational controls adequacy. | Examines accuracy and validity of FS. |
| **Appointment** | By Audit Committee or BOD. | By Members. |
| **Users of Report** | Top Management and Statutory Auditor. | Stakeholders. |
| **Reporting** | On weakness in internal controls and effectiveness of operational activities. | On truthfulness and fairness of FS. |
| **Auditor Status** | Could be an employee of company. | Cannot be an employee of company. |

## Audit Trail

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|---|---|
| **Meaning** | Audit Trail (or Edit Log) is a visible trail of evidence enabling one to trace information contained in reports. Audit trails are chronological record of changes made to data. |
| **Records Maintained as Audit Trail** | Records maintained as audit trail may include following information:<br>➢ when changes were made (timestamp)<br>➢ who made the change (user Id)<br>➢ what data was changed (data/transaction reference) |
| **Internal Controls** | In order to demonstrate that audit trail feature was functional, operated and was not disabled, company shall design and implement specific internal controls.<br>List of internal controls to be implemented and operated are controls that ensure:<br>▪ Audit trail feature has not been disabled or deactivated.<br>▪ User IDs are assigned to each individual and that user IDs are not shared.<br>▪ Access to audit trail is restricted and access logs are maintained.<br>▪ Configurations changes of audit trail are authorized and changes logs are maintained.<br>▪ Periodic backups of audit trails are taken and archived as per statutory period. |

## Internal Audit as a Management Function

- Management functioning is a set of five general functions: planning, organizing, staffing, directing and controlling.
- Controlling is the critical function that is key to preserve stakeholder's wealth.
- Internal Audit is an important element of management controlling function.
- Internal Auditor is expected to critically evaluate the management activities. He is expected to report on areas of weak internal control and suggest appropriate mitigating steps.



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## Factors Responsible for High Employee Attrition Rate

(i) Job stress & work life imbalance

(ii) Wrong policies of management

(iii) Unbearable behaviour of senior staff

(iv) Safety factors

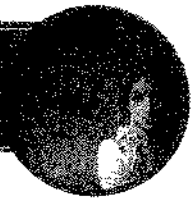
(v) Limited opportunities for promotion

(vi) Low monetary benefits

(vii) Lack of labour welfare schemes

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# DUE DILIGENCE, INVESTIGATION & FORENSIC ACCOUNTING



## Unit I - Due Diligence

### Due Diligence Basics

| | |
|---|---|
| **Meaning** | Due diligence is a measure of prudence activity ordinarily exercised by any prudent person. It involves careful study of financial and non-financial possibilities.<br>It is a process of investigation into details of potential investment such as examination of operations and management and verification of material facts.<br>It is not necessary that due diligence can only be carried out by a Chartered Accountant. Due diligence can be performed by any person. |
| **Areas of Due Diligence** | Areas where due diligence may be undertaken are:<br>✓ Business acquisition and corporate restructuring<br>✓ Venture capital financing<br>✓ Public offerings |
| **Audit v/s Due Diligence** | Difference between Due Diligence and Audit<br>Audit is an independent examination and evaluation of FS to express an opinion. Whereas, due diligence refers to examination of potential investment to confirm all material facts of prospective business opportunity. It involves review of financial and non-financial records. Due diligence aims to take the care that a reasonable person should take before entering into agreement or transaction with another party. |
| **Importance of Due Diligence** | There are many reasons for carrying out due diligence including:<br>➢ To confirm that business is what it appears to be.<br>➢ To identify 'deal killer' defects in target company and avoid bad transaction.<br>➢ To gain information that will be useful for valuing assets and negotiating price.<br>➢ To verify that transaction complies with investment or acquisition criteria. |
| **Classification of Due Diligence** | Due Diligence can be classified in following manner:<br>➢ Commercial/Operational: Evaluation from commercial and operational perspective.<br>➢ Financial: Analysis of books and other information relating to financial matters.<br>➢ Tax: Accountant has to look at the tax effect of merger or acquisition.<br>➢ Information systems: Pertains to all computer systems and related matters.<br>➢ Legal: Required where legal aspects of functioning of entity are reviewed.<br>➢ Environmental: Study environment and its adaptiveness to acquirer entity.<br>➢ Personnel: Ascertain that entity's personnel policies are in line or can be changed. |

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## Process/Procedure or Scope of Financial Due Diligence

| If a full-fledged financial due diligence is conducted, it would include following matters in its scope: | |
|---|---|
| **History of Target & Promoter Background** | Accountant should begin financial due diligence review by looking into history of company and background of promoters. |
| **Accounting Policies** | Accountant should study accounting policies being followed by target company and ascertain whether any accounting policy is inappropriate. |
| **Review of Financial Statements** | Accountant should examine whether FS of target company is prepared as per statute governing target company and relevant accounting standards. |
| **Taxation** | Check whether company is regular in paying various taxes to government. |
| **Cash Flow** | Review of historical cash flows reflect cash generating abilities of target company. It is necessary to check that:<br>➢ Is company able to honor its commitments to trade payables, banks, government and other stakeholders?<br>➢ How well is company able to turn its trade receivables and inventories?<br>➢ How well does it deploy its funds?<br>➢ What is investment pattern of company and are they easily realisable?<br>➢ Are there any funds lying idle? |
| **Financial Projection** | Accountant should obtain projections for next five years from target company with detailed assumptions and workings |
| **Management and Employees** | It is important to check that all employee benefits like PF, ESI, gratuity and superannuation have been properly paid. |
| **Statutory Compliance** | It is important to make list of applicable laws and checklist of compliance. |

## Hidden Liabilities and Overvalued Assets

Objective of Due Diligence will look specifically for any hidden liabilities or over-valued assets.

**Hidden Liabilities**

- Company may not show any show cause notices as contingent liabilities.
- Tax liabilities under direct and indirect taxes.
- Long pending sales tax assessments.
- Pending final assessments of customs duty.
- Agreement to buy back shares.
- Future lease liabilities.
- Environmental claims.
- Huge labour claims under negotiation.

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| Overvalued Assets |
|---|
| ▪ Uncollectable receivables.<br>▪ Obsolete, non-moving inventories or inventories valued above NRV.<br>▪ Underused or obsolete plant and machinery and their spares.<br>▪ Litigated assets and property.<br>▪ Investments carried at cost though realizable value is much lower.<br>▪ Infructuous project expenditure/deferred revenue expenditure etc.<br>▪ Intangible assets of no value.<br>▪ Group company balances not reconciled. |

## Work Approach to Due Diligence and How to Conduct Due Diligence

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|---|---|
| **Work Approach to Due Diligence** | **Purchase of business may be most expensive asset purchase in lifetime and therefore some caution should be exercised through due diligence process.**<br>▪ Reviewing and reporting on financials submitted by target company.<br>▪ Assessing the business first hand by site visit.<br>▪ Working through due diligence process with investor by defining key areas.<br>▪ Helping prepare an offer based on completion of due diligence. |
| **How to Conduct Due Diligence** | ▪ Start with an open mind. Do not assume that anything wrong will be found.<br>▪ Get the best team of people. Hire due diligence experts, if required.<br>▪ Get help in all areas to get a 360-degree view of acquisition candidate.<br>▪ Talk to customers, suppliers and employees.<br>▪ Prepare a comprehensive report detailing compliances and substantive issues. |

## Contents of Due Diligence Report

| Example of Headings of Due Diligence Report |
|---|
| ▪ Introduction<br>▪ Executive Summary<br>▪ Background of Target company<br>▪ Brief history of company<br>▪ Objective of due diligence<br>▪ SWOT Analysis<br>▪ Assessment of management structure, valuation of assets, operating results, financial liabilities, taxation liabilities, litigation liabilities and net worth<br>▪ Comments on future projections |

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# Unit II - Investigation

## Investigation Basics

### (1) Meaning

Investigation means systematic and in-depth examination or inquiry to establish a fact or to evaluate specific situation.

### (2) Audit versus Investigation

| Basis | Investigation | Audit |
|---|---|---|
| Objective | Aims at establishing a fact or assessing a particular situation. | Verify whether FS display a true and fair view of state of affairs of entity. |
| Scope | Governed by statute or it may be non-statutory. | Scope is wide and in case of statutory audit, scope is governed by law. |
| Periodicity | Not limited by rigid time frame. | Quarterly, half-yearly or yearly. |
| Nature | Requires detailed examination. | Involves test checking or sampling. |
| Limitations | No inherent limitation. | Suffers from inherent limitation. |
| Evidence | Seeks conclusive evidence. | Concerned with prima-facie evidence. |
| Appointment | Appointed by even third party. | Appointed by owner/shareholders. |
| Reporting | Reported to person on whose behalf investigation is carried out. | Reported to owners of business entity. |

### (3) Steps in Investigation

Step 1: Determination of objectives and establishment of scope of investigation
Step 2: Formulation of investigation programme
Step 3: Collection of evidence
Step 4: Analysis and interpretation of findings
Step 5: Reporting of findings

### (4) Investigation Programme should be drawn up having regard to

- Nature of business.
- Structure of business organization.
- Instructions from client.
- Scope and depth of investigation.
- Necessity to extend investigation into books and records belonging to others.

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### (5) Important Issues to be kept in mind by Investigator while Preparing his Report

- Report should not contain anything which is irrelevant.
- Every word should be properly used to minimize possibility of different interpretation.
- Bases and assumptions made should be explicitly stated.
- Report should clearly spell out nature and objective of assignment accepted.
- Report should be made in paragraph form with headings for paragraphs.
- Opinion of investigator should appear in final paragraph of report.

## Special Issues in Investigations

- **Whether an investigator is required to undertake cent percent verification approach or whether he can adopt selective verification**

  It depends on circumstances of case under investigation. In case of cash defalcated by cashier, examine all cash vouchers. In case of arriving at profitability, verify on selective basis.

- **Whether the investigator can put reliance on already audited statement of account**

  Investigator is entitled to put reliance on audited FS unless he finds that audit is done very casually. However, if investigation is launched due to some doubt in audited FS, no question of reliance arises.

- **Whether an investigator necessarily requires assistance of expert**

  Investigator may obtain views and opinions of experts after obtaining written consent of his client.

- **Whether an investigator can make futuristic statements even if appointing authority is willing to obtain futuristic statement**

  Investigator should refuse to be futuristic.

- **Whether to retain working papers or not**

  Investigator should retain full notes of work carried out and all working papers in his files.

- **Basis of opinion of an investor**

  Investigator should refrain from issuing speculative opinion. He should confine his opinion to established facts and nothing more.

## Special Aspects in Connection with Business Investigations

| Factors to be considered while Studying Economic and Financial Position of Business |
|---|
| ▪ Adequacy of fixed and working capital. |
| ▪ Trend of sales and profits in future. |
| ▪ Whether profit expected to maintain in future would yield adequate return on capital employed? |
| ▪ Whether business is operating at 100% capacity? |

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| Factors to be considered in Assessing Future Maintainable Turnover |
|---|
| ▪ Trend: Past trend of sales |
| ▪ Marketability: Possibility to extend sales in new markets |
| ▪ Political and economic considerations: Effect of government policies and economic trends on sales |
| ▪ Competition: Effect of competition and company's share in total trade |

## Types of Investigation

| | |
|---|---|
| **Statutory** | Investigation under Companies Act, 2013 |
| **Non-statutory** | ▪ Investigation on behalf of an incoming partner<br>▪ Investigation for valuation of shares in private companies<br>▪ Investigation on behalf of a bank proposing to advance loan to a company<br>▪ Investigation on behalf of an individual or a firm proposing to buy a business<br>▪ Investigation in connection with review of profit/financial forecast<br>▪ Investigation of frauds |

## Investigation on behalf of an Incoming Partner

| Steps involved while conducting Investigation on behalf of Incoming Partner are: |
|---|
| ▪ Ascertain history and growth of firm. |
| ▪ Study provisions of partnership deed. |
| ▪ Scrutiny of profitability record of firm's business. |
| ▪ Examination of asset and liability position. |
| ▪ Position of orders in hand and quality of clientele. |
| ▪ Position and terms of loan finance. |
| ▪ Study composition and quality of key personnel employed by firm. |
| ▪ Reasons for offer of admission to a new partner should be ascertained. |
| ▪ Manner of computation of goodwill on admission and retirement should be ascertained. |

## Investigation for Valuation of Shares in Private Companies

| There are two main methods of valuation of equity shares. | |
|---|---|
| **Net Worth Basis** | Value is determined on basis of net worth of company. Amount of net worth is divided by number of equity shares to arrive at value for one share. |
| **Yield Basis** | Average profit earned by company during preceding 5-7 years is computed. Then, value of business is calculated by capitalising average profit at reasonable rate of interest. |

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## Investigation on behalf of Bank/Financial Institution Proposing to Loan to a Company

Investigating accountant shall collect information on following points:

- Purpose for which the loan is required.
- Schedule of repayment of loan submitted by borrower.
- Financial standing and reputation of directors and officers of company.
- Whether company is authorised by memorandum or articles of association to borrow money.
- History of growth and development of company and its performance during past 5 years.

To investigate profitability of business for judging accuracy of repayment schedule furnished by borrower, as well as value of security in the form of assets of business already possessed and those which will be created out of loan, investigating accountant shall take following steps:

- Prepare a condensed income statement from P&L for past 5 years.
- Compute mentioned ratios separately - Sales to Inventories held, Sales to Fixed Assets, Current Ratio, Quick Ratio, Equity to Long Term Loans and Return on Capital Employed.
- Enter break-up of annual sales product-wise to show their trend.

## Investigation on behalf of an Individual or Firm Proposing to Buy a Business

**In case of Proprietary Concerns or Partnerships**

- Reasons for sale of business
- Length of lease under which premises are held
- Unexpired period of patents
- Age of present managerial staff and prospects of their continuity in service
- Valuation of goodwill

**If Business belongs to Company**

- Authorised and issued capital
- Uncalled liability on shares
- Particulars of dividend paid in past and arrears of dividend
- Mortgage on asset created in register of charges
- Price at which shares are offered

## Investigation in connection with Review of Profit/Financial Forecasts

There are many investigations which involve an examination of future profits like:

- Future profit reports can be required for purchase of business.
- By banks and financial institutions regarding project cash flow and profitability statements for appraisal of loan application submitted by borrowers.



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## Investigation of Frauds

**Categories/Types of Fraud**

- Fraudulent Financial Reporting
- Mis-appropriation of Assets
- Corruption (Bribery)

**Fraud at Different Levels**

| Corporate Frauds/Irregularities |
|---|
| ▪ Advance Billing: It is a situation where company officials indulge in booking fictitious sales in anticipation of actual sales. This results in misrepresentation of revenue in the books.<br>▪ Shell/Dummy Company Schemes: It represents a 'fictitious company' or a 'paper company' to transfer profits or funds from main company.<br>▪ Money-Laundering Activities: Converting illegal money into the banking system. |
| **Fraud at Operational Level Employees** |
| ▪ Tampering of Cheques: Payee name altered or preparation of cheques without issued to payee.<br>▪ Off Book Frauds: Fraud perpetrator misappropriates cash before sale is recorded in the books.<br>▪ Cash Misappropriation: Cash is misappropriated after entries are already passed in the books.<br>▪ Fraudulent Disbursements: Issuing of false bills or personal bills converted into official bills.<br>▪ Expense Reimbursement Schemes: Claiming reimbursement of personal expenses.<br>▪ Payroll Fraud: Payment to non-existent employees or showing higher pay than actual disbursement.<br>▪ Commission Schemes: Exaggerates sales through fictitious billings to earn higher commission. |

| Some Situations in which Fraud can occur alongwith Investigation Procedure | |
|---|---|
| **Cash Receipts** | Cash receipt frauds may be done in following form:<br>▪ Showing larger cash discount than actually allowed.<br>▪ Adjusting fictitious credit in customer account.<br>▪ Adjusting cash sale as a credit sale.<br>▪ Writing off good debt as bad and irrecoverable.<br>▪ Under-casting receipts side of cash book.<br>Verification of cash receipts<br>➢ Carbon copies of receipts marked 'duplicate' should be scrutinised.<br>➢ Cash sales should be vouched in detail.<br>➢ Recoveries from customers and cash discounts should be checked.<br>➢ All withdrawals from bank should be checked. |
| **Inflating Cash Payment** | Cash payment frauds may be done in following form:<br>▪ Making double payment of invoice or paying false invoice. |

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|---|---|
| | ▪ Paying personal expenses out of business by falsifying details.<br>▪ Falsely adjusting refund in customer account.<br>▪ Wrong excess totalling of wage sheets.<br>Verification of cash payments<br>➢ All the evidence as regards cash payments made should be carefully scrutinised.<br>➢ All payments by bearer cheques should be examined.<br>➢ All withdrawals from bank should be checked from entries in bank pass book.<br>➢ System of recording of wages should be reviewed. |
| **Frauds through Suppliers Ledger** | Frauds through suppliers ledger may be done in following form:<br>▪ Adjusting duplicate invoices as purchases in suppliers account.<br>▪ Suppressing credit notes issued by suppliers.<br>▪ Withdrawing amounts unclaimed by suppliers.<br>▪ Accepting purchase invoices at higher than market prices.<br>Verification of balances in suppliers ledger<br>➢ Verify purchase journal with goods inward book and suppliers invoices to confirm that suppliers accounts is credited correctly.<br>➢ Request all suppliers to furnish statements of their accounts.<br>➢ Identify possibilities of collusion with suppliers. |
| **Customers Ledger** | Frauds through customers ledger may be done in following form:<br>▪ 'Teeming and lading' method, i.e., misappropriating amount collected from a customer and crediting his account only when amount is subsequently collected from another customer.<br>▪ Misappropriating amount collected from a customer and subsequently adjusting his account by crediting amount as a rebate.<br>▪ Crediting amount received from a customer to account of another customer and subsequently withdrawing amount wrongly credited.<br>Verification of balances in customers ledger<br>➢ Special attention should be paid to amount adjusted for goods returned or difference in price.<br>➢ Obtain confirmation of customers for balance standing in their accounts. |
| **Inventory Frauds** | Inventory frauds may be done in following form:<br>▪ Employees may remove goods from premises.<br>▪ Theft of goods may be concealed by writing them off as damaged goods.<br>▪ Inventory records may be manipulated by employees who have committed.<br>▪ Inflating quantities issued for production.<br>Verification procedure for defalcation of inventory |

| | |
|---|---|
| | ➢ Entire system of receipts, storage and dispatch of all goods should be reviewed.<br>➢ Establish items and quantities of inventory defalcated by physical verification.<br>➢ Check whether material issued for production was excessive. |

| Indicators of Fraud |
|---|
| Several indications of possible frauds are:<br>▪ Discrepancies in accounting records including incorrect/delayed/non-recording of amounts.<br>▪ Conflicting or missing evidence including missing and altered documents.<br>▪ Unacceptable management responses such as - denial of access to records, unusual delays in providing requested information, unwillingness to address deficiencies in internal control etc.<br>▪ Other indications such as frequent changes in accounting estimates etc. |

| Fraud Diamond: Four Elements of Fraud |
|---|
| ▪ Incentive: I want to, or have a need to, commit fraud.<br>▪ Opportunity: There is a weakness in system that the right person could exploit. Fraud is possible.<br>▪ Rationalization: I have convinced myself that this fraudulent behavior is worth the risks.<br>▪ Capability: I have necessary traits and abilities to be the right person to pull it off. |

| Auditor's Ability to Detect Fraud |
|---|
| Auditor's ability to detect fraud depends on factors such as:<br>▪ Skillfulness of perpetrator<br>▪ Frequency & extent of manipulation<br>▪ Degree of collusion involved<br>▪ Relative size of amount manipulated<br>▪ Seniority of individuals involved |

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## Unit III – Forensic Accounting

### Forensic Accounting Basics

**(1) Meaning**

Forensic accounting is the application of investigative and analytical skills for purpose of resolving financial issues in a manner that meets standards required by court of law.

**(2) Difference between Forensic Accounting and Assurance Engagement/Other Audits**

| Particulars | Other Audits | Forensic Accounting |
|---|---|---|
| Objectives | Express an opinion on 'True & Fair' presentation. | Whether fraud has actually taken place in books. |
| Techniques | Substantive and Sample based. | Investigative or in depth checking. |
| Period | Normally for accounting period. | No such limitations. |
| Verification of stock, provisions etc. | Relies on management representation. | Independent verification of suspected/selected items. |
| Off balance sheet items | Used to vouch arithmetic accuracy & compliance with procedures. | Regulatory & propriety of these transactions are examined. |
| Adverse findings, if any | Qualified opinion expressed with/without quantification. | Legal determination of fraud impact and identification of perpetrators. |

**(3) Forensic Professional**

- Forensic Professional can be engaged in public practice or employed by organizations.
- Forensic Accounting Services rendered by Forensic Professional are:
  - Financial Statement manipulations
  - Fund diversions/Asset tracing
  - Anti-Money laundering
  - Licence Fees/Dues/Tax Evasion
  - Related party transactions
  - Estimations of loss/damage
  - Suspicious transactions under IBC (Insolvency and Bankruptcy Code)
- Forensic Professional is often involved in:
  - Fraud Detection: Detecting financial frauds and tracing misappropriated funds.
  - Computer Forensics: Developing applications for recovery & analysis of financial evidence.
  - Fraud Prevention: Reviewing or providing consultation regarding internal controls.
  - Providing Expert Testimony: Assisting in legal proceedings/court as an expert witness.

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## Process of Forensic Accounting

| Forensic Accounting assignments generally include following steps: | |
|---|---|
| **Step 1 Initialization** | Meet the client to obtain an understanding of important facts and issues. Carry out preliminary investigation prior to development of detailed plan of action. |
| **Step 2 Develop Plan** | Develop plan by considering knowledge gained on meeting with client and carrying out initial investigation. |
| **Step 3 Obtain Evidence** | Evidence should be sufficient to prove identity of fraudster, mechanics of fraud scheme, and amount of financial loss suffered.<br>Team is skilled in collecting evidence and should keep a clear chain of custody till evidence is presented in court. If there are gaps in chain of custody, then evidence may be challenged in court or even become inadmissible. |
| **Step 4 Perform the Analysis** | Actual analysis performed is dependent upon nature of assignment and may involve:<br>➢ Summarizing large number of transactions.<br>➢ Calculating economic damages.<br>➢ Performing present value calculations.<br>➢ Performing regression or sensitivity analysis.<br>➢ Performing a tracing of assets.<br>➢ Utilizing charts and graphics to explain the analysis. |
| **Step 5 Reporting** | Issuing a report is final step of forensic accounting. Areas of information that needs to be incorporated in report of Forensic Professional are:<br>➢ Section on nature of assignment, scope, limitations of scope and findings.<br>➢ Schedules and graphics to properly support and explain the findings.<br>➢ Information detailing the fraudulent activity, if any has been found.<br>➢ How fraudster set up fraud scheme and which controls were circumvented. |
| **Step 6 Court Proceeding** | Evidence gathered will need to be presented at court to explain how suspect was identified. |

## Forensic Accounting and Investigation Report

| Forensic Accounting Report | |
|---|---|
| **Written Report** | Professional shall issue a written report which conveys results of assignment clearly and accurately. |
| **Report Addressee and Distribution** | Report shall be addressed to primary stakeholders and shared with other stakeholders, if required. |

| | |
|---|---|
| **Format or Content of Report** | Professional shall include following key element/content in report (indicative list):<br>▪ Title, addressee and distribution list<br>▪ Scope and objectives of assignment<br>▪ Executive Summary of results, covering all important aspects of findings<br>▪ Reference to use of an expert<br>▪ Fact that assignment is conducted as per FAIS (Forensic Accounting & Investigation Standards)<br>▪ List of findings supported by key evidences and sources of evidences<br>▪ Assumptions, limitations and disclaimers of assignment<br>▪ Conclusions drawn from assessment undertaken |
| **Discussion of Draft Report** | Where engagement mandatory requires discussion of draft findings with subject party, any response received from them shall be included in final report issued by Professional. |
| **Assumptions and Limitations** | Professional shall list relevant assumptions made during assignment. Professional may encounter limitations such as lack of management support, restricted access to records, information or people. These disclaimers would be covered in the report as a key element of report. |
| **Reporting Timelines** | Report shall be issued within reasonable time frame as per engagement terms. Professional may also be required to provide interim reports as per terms. |
| Report shall not express an opinion or pass any judgement on guilt or innocence. Determination of culpability is either a disciplinary or judicial process. | |

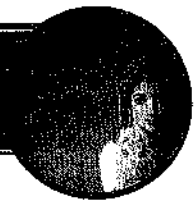
## Overview of Forensic Accounting and Investigation Standards (FAIS)

FAIS seek to provide:

- Professionals with standard for undertaking forensic accounting & investigation (FAI) assignment
- Users of FAI services with indication of service quality expected from such engagements.
- Regulators & Government agencies with appreciation of what can be expected from FAI services.
- To everyone, guidance on implementation matters and related practical issues.

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# EMERGING AREAS: SDG & ESG ASSURANCE



## SDG and ESG Basics

- Sustainable development is development that try to meet needs of developing countries to achieve sustainable world. It addresses needs of present moment without compromising future generations.
- There are 17 sustainable development goals (SDG). These are:

| | | |
|---|---|---|
| No Poverty | Clean Water & Sanitization | Life Below Water |
| Zero Hunger | Decent Work & Economic Growth | Life on Land |
| Good Health & Well Being | Sustainable Cities & Communitites | Affordable & Clean Energy |
| Quality Education | Responsible Consumption & Production | Reduced Inequalitites |
| Gender Equality | Peace, Justice & Strong Institutions | Partnership for the Goals |
| Climate Action | Industry Innovation & Infrastructure | |

- Sustainable development encompasses three pillars of sustainability. These pillars constitute ESG.

| Three Pillars / Nature of ESG Reporting | |
|---|---|
| Environment (E) | Environmental stands for corporate climate policies, energy use, waste, pollutions, and natural resource conservation. It includes natural resources that every entity absorbs for its functioning like coal, electricity, water etc.<br>This pillar includes following elements:<br>✓ Natural Resources: water stress<br>✓ Pollution & Waste: toxic emission and waste<br>✓ Environment Opportunity: renewable energy |
| Social (S) | It addresses the relationships the entity has and reputation it fosters with people and institutions. It further includes labour relations, diversity, and inclusions.<br>This pillar includes following elements:<br>✓ Human Capital: labour management, health & safety<br>✓ Product Liability: product safety & quality<br>✓ Social Opportunity: access to health care |
| Governance (G) | It is the internal system of practices and procedures entity adopts to govern itself, make investment decisions, comply with law, and meet needs of all stakeholders.<br>This pillar includes following elements:<br>✓ Corporate Governance: ownership, accounting<br>✓ Corporate Behaviour: business ethics, tax transparency |

- ESG reporting is all about disclosure of information and data that explain value added in these three areas. ESG reporting can be both quantitative and qualitative in nature.

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## Sustainable Reporting

### (1) Meaning

Sustainability reporting is an organization practice of reporting publicly on its economic, environmental and social impacts, and its contributions towards goal of sustainable development.

Sustainability reporting refers to information that companies provide about their performance to the outside world on regular basis in structured way.

### (2) Expected Benefits

- It can help stakeholders to understand organization performance vis a vis sustainability.
- Such reporting can help entities to focus on long-term value creation by addressing ESG issues. Investors can use ESG performance of companies to make investment decisions.
- It will not only improve own business continuity of companies but also put them in a better position with their B2B customers as well as enable them to acquire new ones.

### (3) Global Trends in Sustainable Reporting

Corporations report their sustainability performance through:

(i) Global Reporting Initiative (GRI) - Most widely used framework in the world.

(ii) Carbon Disclosure Project (CDP)

(iii) International Integrated Reporting Framework (IIRC)

## Integrated Reporting

| There are 6 Cs of Integrated Reporting – also Known as 6 Capitals | |
|---|---|
| **Financial Capital** | ▪ Pool of funds that is available to organization for use in production of goods or provision of services.<br>▪ Obtained through financing, such as debt, equity, or grants, or generated through operations or investments. |
| **Manufactured Capital** | ▪ Seen as human-created, production-oriented equipment and tools.<br>▪ Available to organization for use in production of goods or provision of services, including buildings, equipment and infrastructure. |
| **Natural Capital** | ▪ Is an input to production of goods or provision of services.<br>▪ Organization activities also impact on natural capital.<br>▪ Includes water, land, minerals, forests, and ecosystem health. |
| **Human Capital** | People skills and experience, capacity, including their:<br>▪ Alignment with organization governance framework & ethical values.<br>▪ Ability to understand and implement organization strategy.<br>▪ Loyalties and motivations for improving processes and their ability to lead. |

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|---|---|
| **Social Capital** | ▪ Institutions and relationships established within each community, stakeholders and other networks to enhance individual and collective well-being.<br>▪ Includes:<br>➢ Common values and behaviour.<br>➢ key relationships, trust and loyalty that organization has developed.<br>➢ Organization social license to operate. |
| **Intellectual Capital** | Key element in organization future earning potential with a tight link between investment in R&D, innovation and human resources. |

Note: Integrated Reporting is voluntary for top 500 listed entities.

## Business Responsibility and Sustainability Report (BRSR)

- Top 1000 listed companies by market capitalization are required to mandatorily furnish BRSR.
- Reporting questionnaire is divided into three sections:

| | |
|---|---|
| Section A: General Disclosures | Contains details of company regarding its products, services, employees and its subsidiary/associate companies etc. |
| Section B: Management Process and Disclosures | Contains details related to leadership, governance and management processes. |
| Section C: Principle-wise Performance Disclosures | ▪ Essential indicators (Mandatory disclosures) - Include data regarding core elements.<br>▪ Leadership indicators (Optional disclosures) - Include additional inputs, programmes, life cycle assessments etc. |

## Principles of BRSR

Nine principles in BRSR are categorized into ESG components of Environment, Social and Governance with two in Environment, three in social and four in Governance.

**Principle 1 - Ethics, Transparency and Accountability**

This principle emphasizes that business decisions in organisation should be open to disclosure and accessible to relevant interested parties.

Essence of core elements associated with principle are:

- Entities should develop policies & procedures for work areas, so that ethics is not compromised.
- Information relating to policies and procedures should be made available to stakeholders.
- In case of adverse effects, more care has to be taken for transparent disclosures.
- Entities in value chain should be encouraged to adopt these principles.
- Entities should proactively respond to outside entities (suppliers etc) that violate BRSR principles.

**Principle 2 – Safe and Sustainable Goods and Service**

Entities should make sure that their goods, services & operations result in better life for consumers.

Essence of core elements associated with principle are:

- Entities are also responsible to educate their consumers and clients about their rights.
- Production methods and technologies (R&D) have to be devised to make product sustainable.
- Entities should reduce over-exploitation of nature resources by reuse and recycling of resources.

**Principle 3 – Promote well-being of All Employees including those in Value Chain**

This principle relates to all initiatives an entity has to take for benefit of its employees.

Essence of core elements associated with principle are:

- Entity should ensure compliance with all regulatory requirements regarding employees.
- Entities should prevent all kinds of child labour, bonded labour and any other involuntary labour.
- Entities should have a system in which work-life balance of employees is not compromised.
- Entities should ensure timely payment of wages as per living wages and respect their dignity.
- Skill development and training of workforce is another responsibility of entities employing them.
- Creation of workplace which is safe and free of harassment is also a responsibility of entity.

**Principle 4 – Respect for Stakeholders Interests and Responsiveness**

Concept of interested party or stakeholders to a business has been a point of discussion in all regulatory and voluntary systems of any organisation.

Essence of core elements associated with principle are:

- Entities have to be transparent and communicate with stakeholders about impacts of their operations and business decisions on people and nature.
- Entities should fairly share benefits to stakeholders in an equitable manner.

**Principle 5 – Respect and Promote Human Rights**

It refers to human rights issues that happen directly or indirectly due to operation of business.

Essence of core elements associated with principle are:

- Entities should have clear understanding of human rights from perspective of Indian Constitution.
- Entities should integrate human rights element into their policies and procedures.
- Entities should recognize and respect human rights of all relevant stakeholders.

**Principle 6 – Protection and Restoration of Environment**

This principle looks at environmental responsibility for economic prosperity and sustainability.

Essence of core elements associated with principle are:

- Entities should make use of natural and manmade resources in an optimum manner.
- Entities should have policies and procedures in place to assess and rectify impact on environment.
- Entities should measure their performance relating to prevention of pollution, energy use etc.
- Entities have to contribute towards climate change resilience in line with national action plans.
- Entities should compare its activities with industry to reduce, reuse and recycling of resources.



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**Principle 7 – Influence on Public and Regulatory Policy**

This principle of influencing policy formulation recognizes that business operate within framework of statutory and legislative policies of governing authority.

This principle further highlights that:

- Core elements should be met holistically when organisation go ahead with policy formulation.
- Collective association (trade group & industry chamber) should be utilized while policy formulation.
- Policy formulation by organisation should encourage fair competition & prevent human right abuse.

**Principle 8 – Promote Inclusive Growth and Equitable Development**

This can work only with close participation and collaboration among entities for better livelihood and assistance to marginalized communities.

Essence of core elements associated with principle are:

- Entities should have systems in place to identify and address impacts of their activities on people.
- Entities should review adverse impacts of their activities and make action plans to mitigate them.
- Entities should bring up creative products and technologies that help marginalized communities.
- Entities in their CSR activities should review priorities to help marginalized communities.
- Entities should ensure that displacement or relocation of communities does not happen otherwise provide fair compensation to affected people.

**Principle 9 – Provide Value to Consumers in a Responsible Manner**

Purpose of business is to provide useful products and services to customer for reasonable profits.

Essence of core elements associated with principle are:

- Entities should transparently disclose all kinds of adverse impacts to user from their products.
- Entities should make efforts to reduce negative impact of their products & services on consumers.
- Entities should inform customers on safe ways of usage and disposal of their products.
- Entities should ensure that misleading information is not given to customers while advertising.
- When handling customer data, right to privacy of customer needs to be maintained.
- Entities should not prevent freedom of choice while designing and marketing their products.
- Entities should make available transparent grievance redressal & feedback system for customers.

## Assurance in BRSR

ICAI has recently issued Standard on Sustainability Assurance Engagements (SSAE). This Standard deals with all assurance engagements on entity's sustainability information.

**Methodology to provide Assurance on BRSR**

- Preliminary review of ESG report
- On-site assessment/verification of ESG report
- Issuance of assessment report and assessment statement



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- Review of responses and clarifications on findings
- Submission of findings of on-site assessment and document review
- Preparation of assessment/verification report including final results of assessment

## Role of Auditor – Consideration of Climate Related Risks (ESG Aspects) in Audit of FS

- Role of auditor is to obtain reasonable assurance whether FS as a whole are free from material misstatement due to fraud or error.
- In developing understanding of entity, auditor should consider climate-related risks and how these risks may be relevant to audit.
- Auditor should also determine whether entity has appropriately disclosed relevant climate-related information in FS as per FRF before considering climate-related matters in auditor's report.
- Many investors and stakeholders are seeking information from auditor's report about how climate-related risks were addressed in audit. With this increased user focus on climate change, auditor may face increasing pressure for transparency about climate matters in auditor's report.
- Auditor's report is a key mechanism of communication to users about the audit that was performed. In addition to audit opinion, it provides information about auditor's responsibilities. In some circumstances, it may warrant inclusion of EOM paragraph to draw attention to disclosures that are of fundamental importance to users understanding of FS.
- Auditor should also read other information for consistency with information disclosed in FS and information that may be publicly communicated to stakeholders outside FS as per SA 720.

## Standard on Sustainability Assurance Engagements (SSAE) 3000

- ICAI has recently issued SSAE 3000 - Assurance Engagements on Sustainability Information.
- This Standard deals with assurance engagements on entity sustainability information. This is an umbrella standard applicable to all assurance engagements on sustainability information.
- Intended users of this Standard include:
  - Assurance providers providing assurance on sustainability information.
  - Entities seeking to engage a professional auditor.
  - Regulators, investors and other users of sustainability reporting data.

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# PROFESSIONAL ETHICS & LIABILITIES OF AUDITORS



## Overview of the Code of Ethics

### (1) Fundamental Principles

To achieve objectives of accountancy profession, professional accountants have to observe a number of prerequisites or fundamental principles.

| The fundamental principles as per ICAI Code of Ethics are: | |
|---|---|
| **Integrity** | ▪ It requires professional accountant to be straightforward and honest in all relationships.<br>▪ He shall not knowingly be associated with information where he believes that the information:<br>✓ Contains materially false or misleading statement.<br>✓ Contains statements or information provided negligently.<br>✓ Omits required information.<br>However, professional accountant will not be considered to be in breach of matters mentioned above if he provides modified report in respect of above matter.<br>▪ If he becomes associated with information described above, he shall take steps to be disassociated from that information. |
| **Objectivity** | It requires an accountant not to compromise judgment because of bias, conflict of interest or undue influence of others. |
| **Professional Competence & Due Care** | ▪ It requires an accountant to attain & maintain professional knowledge and act diligently as per technical and professional standards.<br>▪ It requires exercise of sound judgment in applying professional knowledge and skill when undertaking professional activities.<br>▪ Maintaining professional competence requires continuing awareness and understanding of technical and professional developments.<br>▪ Accountant shall take reasonable steps to ensure that those working under his authority have appropriate training and supervision. |
| **Confidentiality** | ▪ It requires an accountant to respect confidentiality of information acquired as a result of professional and employment relationships.<br>▪ <u>However, following are circumstances where professional accountants might be required to disclose confidential information or when such disclosure might be appropriate</u>:<br>o Disclosure is required by law. |

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| | ○ Disclosure is permitted by law and is authorized by client or employing organisation.<br>○ There is professional duty or right to disclose:<br>✓ To comply with requirements of Peer or Quality Review of ICAI.<br>✓ To respond to inquiry or investigation by regulatory body.<br>✓ To protect his interest in legal proceedings.<br>✓ To comply with technical and professional standards.<br>▪ In deciding whether to disclose confidential information, professional accountants should consider following points:<br>○ Whether all relevant information is known and substantiated.<br>○ Proposed type of communication, and to whom it is addressed.<br>○ Whether parties to whom it is addressed are appropriate recipients. |
| **Professional Behavior** | ▪ It requires an accountant to comply with relevant laws and regulations and avoid any conduct that might discredit the profession.<br>▪ When promoting himself and his work, he shall not bring profession into disrepute.<br>▪ He shall be honest and truthful and should not make:<br>✓ Exaggerated claims for services, qualifications or experience.<br>✓ Disparaging references or unsubstantiated comparisons to work of others.<br>✓ Any direct or indirect measures to advertise in violation of Advertisement Guidelines. |
| Professional accountant might face a situation where complying with one principle conflicts with other. In such case, he should consult with others within organisation, TCWG, ICAI or legal counsel.<br>However, such consultation does not relieve accountant from responsibility to exercise professional judgment to resolve the conflict or disassociate from matter creating conflict. | |

(2) **Threats**

| Threats to compliance with fundamental principles fall into following categories: | |
|---|---|
| **Self-interest threats** | ▪ Financial or other interest will influence professional accountant judgment or behaviour.<br>▪ Examples of Circumstances<br>✓ Direct financial interest or close business relationship with client.<br>✓ Holding financial interest or receiving loan from employing organization. |
| **Self-review threats** | ▪ Professional accountant will not appropriately evaluate results of previous judgment made or activity performed by accountant. |



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| | ▪ Examples of Circumstances<br>✓ Issuing report on effectiveness of systems after implementing systems.<br>✓ Determining appropriate accounting treatment for business combination after performing feasibility study supporting the purchase. |
| **Advocacy threats** | ▪ Professional accountant will promote client or employing organization position to the point that the accountant's objectivity is compromised.<br>▪ Examples of Circumstances<br>✓ Acting as advocate on behalf of assurance client in litigation or disputes.<br>✓ Manipulate information in prospectus to obtain favorable financing. |
| **Familiarity threats** | ▪ Due to long/close relationship with client or employing organization, professional accountant will be too sympathetic to their interests.<br>▪ Examples of Circumstances<br>✓ Close family relationship with client or long association with client.<br>✓ Long association with individuals influencing business decisions. |
| **Intimidation threats** | ▪ Professional accountant will be deterred from acting objectively because of actual or perceived pressures.<br>▪ Examples of Circumstances<br>✓ Being threatened with dismissal by client.<br>✓ Facing threat of dismissal or replacement by employing organization. |

**(3) Addressing Threats**

If professional accountant determines that identified threats to compliance with fundamental principles are not at an acceptable level, he shall address the threats by eliminating them or reducing them to an acceptable level. He shall do so by:

- Eliminating circumstances including interests or relationships that are creating threats, or
- Applying safeguards to reduce threats to an acceptable level, or
- Declining or ending specific professional activity.

**(4) Safeguards**

Safeguards are actions that the accountant takes to reduce threats to an acceptable level.

Examples of actions to address threats include:

- Having an appropriate reviewer, who was not a member of team, to review work performed.
- Using different partners & teams for provision of non-assurance services to assurance client.
- Involving another firm to perform or re-perform part of engagement.
- Separating teams when dealing with matters of a confidential nature.

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## Non-Compliance with Laws and Regulations (NOCLAR)

### (1) Meaning

Non-compliance with laws and regulations means acts of omission or commission, intentional or unintentional, which are contrary to prevailing laws or regulations committed by:

| Client/professional accountant's employing organisation | TCWG of client or employing organisation | Management of client/employing organisation | Other individuals working for client/employing organisation |
|---|---|---|---|

NOCLAR does not address personal misconduct unrelated to business of client/employing organisation and non-compliance by parties other than listed out in NOCLAR definition.

### (2) Following examples would be covered in NOCLAR

- Fraud, corruption and bribery
- Money laundering, terrorist financing and proceeds of crime
- Securities markets and trading
- Data protection
- Environmental protection
- Public health and safety
- Tax and pension liabilities and payments

### (3) Applicability of Responding to NOCLAR in India

| | |
|---|---|
| Professional Accountants in service: | Applicable to Senior Professional Accountants in service, being employees of listed entities. Senior Professional Accountants means key managerial personnel (directors/officers/senior employees). |
| Professional Accountants in practice: | Applicable to audit engagements of listed entities in India having net worth of ₹ 250 crores or more. |

### (4) Responding to NOCLAR

Steps to be taken for responding:

- Obtaining an understanding of the matter
- Addressing the matter
- Seeking Advice
- Determining whether further action is needed
- Imminent Breach
- Determining whether to disclose the matter to an Appropriate Authority
- Documentation

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### (5) Documentation Requirements in NOCLAR

Professional accountant should follow the additional documents requirement as under:

- How management/TCWG have responded to matter.
- Course of action considered by accountant, judgments made and decisions taken.
- How accountant is satisfied that responsibility of public interest has been fulfilled.

This documentation is in addition to complying with documentation requirements under SA.

### (6) NOCLAR vs. SA 250

| SA 250 | NOCLAR |
|---|---|
| Applicable only on Audit, and not on other Assurance engagements. | Applicable on professional accountants in service, and in practice. |
| Covers responsibilities for laws having direct effect on determination of material amounts and disclosures in FS and other laws that do not have direct effect but compliance may fundamental to operating aspect of business. | Covers non-compliance that causes substantial harm in financial or non-financial terms. |
| Does not define stakeholders. | Related to affect of non-compliance on investors, creditors, employees & general public. |
| No provision of imminent breach. | If professional accountant become aware of imminent breach of law or regulation, he shall determine whether to disclose this immediately to appropriate authority to prevent or mitigate consequences of such imminent breach. |

## Membership of the Institute

### (1) Types of Members of the Institute

The members shall be divided into two classes designated as Associates and Fellows.

| | |
|---|---|
| Associate Member (ACA) | Any person whose name has been entered in the Register. |
| Fellow Member (FCA) | ▪ Associate member who has been in continuous practice in India for at least 5 years, or<br>▪ Associate member who possesses such qualifications equivalent to 5 years continuous practice. |

### (2) Disabilities for the Purpose of Membership

Following person is debarred from having his name entered in Register of Members:

(i) If he has not attained the age of 21 years.

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(ii) If he is of unsound mind.

(iii) If he is an undischarged insolvent.

(iv) If he is a discharged insolvent and has not obtained a certificate from court stating that his insolvency was caused by misfortune without any misconduct on his part.

(v) If he has been convicted by a competent Court of an offence involving moral turpitude and punishable with transportation or imprisonment unless he has either been granted a pardon or Central Government has removed the disability.

**(3) Removal of Name from the Register**

Council may remove the name of any member from Register in following cases:

(i) who is dead.

(ii) from whom a request has been received to that effect.

(iii) who has not paid prescribed fee required to be paid by him.

(iv) who is found to have any disabilities mentioned above.

**(4) Restoration of Membership**

- If name of any member is removed from Register for non-payment of prescribed fee, then his name may be entered again on payment of arrears of fee along with additional fee.
- If name is removed due to orders of Board of Discipline, Disciplinary Committee, Appellate Authority or High Court, then restoration shall be in accordance with such orders.

**(5) Penalty for Falsely Claiming to be a Member etc.**

Any person who:

(i) not being a member of Institute, represents that he is a member or uses designation CA.

(ii) being a member of Institute, but not having a certificate of practice (CoP), represents that he is in practice

shall be punishable.

- On first conviction - Fine upto ₹ 1,000
- On Any subsequent conviction - Imprisonment upto 6 months or fine upto ₹ 5,000, or both.

## Chartered Accountants in Practice

A practicing CA is a person who is a member of Institute and is holding CoP and includes such members of Institute who are deemed to be in Practice.

**(1) Significance of the CoP**

- No member of Institute shall be entitled to practice unless he has obtained CoP.
- A member who is not in practice is precluded from accepting engagement to render any service prescribed for CA even though for doing so, he does not require special qualification.



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- A member of Institute can have no other capacity in which he can take up such practice, separable from his capacity to practice as a member of Institute.
- This is because once the person becomes a member of Institute, he is bound by provisions of CA Act and its Regulations. If he appears before Income-tax Tribunal as an Income-tax representative after having become a member of Institute, he could so appear only in his capacity as a CA and a member of Institute.
- He could not contend that even though he continues to be a member of Institute and has punished by suspension from practice, he would be entitled to practice in other capacity.

**(2) Cancellation and Restoration of CoP**

CoP shall be liable for cancellation, if:

(i) Name of CoP holder is removed from Register.

(ii) CoP was issued on basis of incorrect, misleading or false information, or by mistake.

(iii) Member has ceased to practise.

(iv) Member has not paid annual fee for CoP till 30th September of relevant year.

Council may restore the CoP with effect from the date on which it was cancelled, to a member whose certificate has been cancelled due to non-payment of annual fee and whose application along with fee, is received by Secretary before expiry of relevant year.

**(3) Members - deemed to be in Practice**

A member of Institute shall be deemed to be in practice when individually or in partnership with CA in practice in consideration of remuneration, he:

(i) engages himself in the practice of accountancy.

(ii) offers to perform or performs service involving auditing or verification of financial transactions, books, accounts or records, or preparation, verification or certification of financial accounting or holds himself out to the public as an accountant.

(iii) renders professional services or assistance relating to accounting procedure or recording, presentation or certification of financial facts or data.

(iv) renders such other services as, in the opinion of Council, are rendered by a CA in practice.

Pursuant to (iv) above, Council has permitted CA in practice to render entire range of "Management Consultancy and other Services" which shall include following:

- ✓ Financial management planning and financial policy determination.
- ✓ Capital structure planning and advice regarding raising finance.
- ✓ Preparing project reports and feasibility studies.
- ✓ Valuation of shares & business and advice regarding amalgamation & merger.
- ✓ Working capital management, Cost management and Decision making.
- ✓ Preparing budget, profitability statements etc.

- ✓ Setting up executive incentive plans, wage incentive plans etc.
- ✓ Management and Operational Audit, Quality Audit, Environment Audit, Energy Audit.
- ✓ Personnel recruitment and selection (including development of human resources, designing and conduct of training programmes).
- ✓ Acting as Registered Valuer under Companies Act (valuation of securities or financial assets only and not for plant and machinery etc).
- ✓ Acting as Insolvency Professional as per Insolvency and Bankruptcy Code.
- ✓ Acting as Recovery Consultant in Banking Sector.
- ✓ Acting as advisor or consultant to an issue, including such matters as drafting of prospectus and memorandum, filing of documents with SEBI, preparation of publicity budget, advice regarding selection of brokers & underwriters etc.
  However, CA in practice is not permitted to undertake activities of broking, underwriting and portfolio management services.
- ✓ Administrative Services. Administrative services involve assisting clients with their routine or mechanical tasks. Such services require little to no professional judgment and are clerical in nature. For example - word processing services, preparing and submitting forms, functions of a GST practitioner etc.
- ✓ Market research and demand studies, business policy, corporate planning etc.
- ✓ Systems analysis & design, computer related services and services relating to EDP.
- ✓ Advice regarding selection of ad-media, centres for holding conferences of brokers etc., bankers to issue, collection centres, various agencies connected with issue and post issue activities.
- ✓ Investment counselling in respect of securities.
- ✓ Acting as registrar to an issue and for transfer of securities.
- ✓ Insurance Financial Advisory Services under IRDA Act including Insurance Brokerage.
- ✓ Member is deemed to be in practice during the period he renders service with armed forces.

**(4) Certain Services not to be rendered by Auditor [Section 144 of Companies Act, 2013]**

Company auditor shall not provide following services to company or its holding or subsidiary company: Accounting & book-keeping services, Internal audit, Design & implementation of any financial information system, Actuarial services, Investment advisory services, Investment banking services, Rendering of outsourced financial services, Management services & Any other services as prescribed.

**(5) Maintenance of Branch Offices**

- If a CA in practice or CA Firm has more than one office in India, each one of such offices should be in separate charge of a member of Institute.

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- Failure on the part of member/firm would constitute professional misconduct.
- CA in-charge of the branch should be associated with member/firm either as a partner or paid assistant (whole time employment). [atleast situated/attend office for 182 days]
- Exemption from separate CA in-charge

(i) Exemption is given to members practicing in hill areas subject to following conditions:

- Allowed to open temporary offices in a city in plains for maximum 3 months in a year.
- Regular office need not be closed during this period.
- Name board of firm in temporary office should not be displayed other than the period such office is permitted to function as above.
- Temporary office should not be mentioned in letterheads, visiting cards or any other documents as a place of business.
- Before commencement of every winter it shall be obligatory to inform the Institute about opening of temporary office.

(ii) Exemption may be granted to member/firm to have a second office without such second office being under separate charge of a member of Institute, provided:

- Second office is located in same premises in which first office is located or,
- Second office is located in same city in which first office is located or,
- Second office is located within a distance of 50 km. from municipal limits of a city, in which first office is located.

A member having two offices of the type referred to above shall have to declare, which of the two offices is his main office, which would constitute his professional address.

- With regard to the use of name-board, there will be no bar for putting up a name-board in place of residence of a member with the designation Chartered Accountant, provided it is a name-plate or a name-board of an individual member and not of the firm.

## (6) Member in Practice Prohibited from using a Designation Other Than "Chartered Accountant"

| | |
|---|---|
| **Designation** | Member in practice cannot use any designation other than "Chartered Accountant" but a member who is not in practice and does not use designation Chartered Accountant may use other description. |
| **Title/Letters/Initials** | However, use of title/letters/initials is allowed (C.A./C.S./C.M.A. etc) |

## (7) Companies not to Engage in Accountancy

No company shall practice as CA. "Company" include any LLP which has company as its partner.

## (8) KYC Norms for CA in Practice

Financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). Keeping in mind highest standards of CA profession in India, Council of ICAI issued such norms to be observed by members in practice.

| KYC Norms approved by Council of ICAI are given below: | |
|---|---|
| General Information | ▪ Name and Address of Individual/Partner/Entity<br>▪ Copy of PAN No.<br>▪ Business Description<br>▪ Copy of last Audited FS<br>▪ Name of Parent Company in case of Subsidiary (Only Company) |
| Engagement Information | ▪ Type of Engagement |
| Regulatory Information (Only Company) | ▪ Company Identification No.<br>▪ Directors' Names & Addresses<br>▪ Directors' Identification No. |

## Types of Misconduct: Professional or Other Misconduct

| | |
|---|---|
| **Professional Misconduct** | Professional misconduct has been defined in part I, II and III of the First Schedule; and part I and II of the Second Schedule. |
| **Other Misconduct** | ▪ Other misconduct has been defined in part IV of the First Schedule and part III of the Second Schedule.<br>▪ These provisions empower the Council to inquire into any misconduct of a member even it does not arise out of his professional work. This is considered necessary because a CA is expected to maintain highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action. |
| A member is liable to disciplinary action under section 21 of Chartered Accountants Act, if he is found guilty of any Professional or Other Misconduct. | |

## Schedules to the Act

| Schedule | Part | Applicability | Clauses | Type of Misconduct |
|---|---|---|---|---|
| First Schedule | I | CA in Practice | 12 | Professional Misconduct |
| | II | CA in Service | 2 | |
| | III | All CA | 3 | |
| | IV | All CA | 2 | Other Misconduct |
| Second Schedule | I | CA in Practice | 10 | Professional Misconduct |
| | II | All CA | 5 | |
| | III | All CA | 1 | Other Misconduct |

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## The First Schedule

### PART I - Professional Misconduct in relation to CA in Practice

A CA in practice is deemed to be guilty of professional misconduct if he:

| | |
|---|---|
| Clause (1) | **Allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him.** |

| | |
|---|---|
| Clause (2) | **Pays or allows or agrees to pay or allow**, directly or indirectly, **any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of Institute or a partner or a retired partner or legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualification as may be prescribed**, for the purpose of rendering such professional services from time to time in or outside India. |

**Additional Points**

- Prescribed members of other professional bodies are as under [Regulation 53A]:
  CS (ICSI), CMA (ICMAI), Advocate (Bar Council of India), Architect (Indian Institute of Architects), Actuary (Institute of Actuaries of India), MBA, Bachelor in Engineering/ Technology/Law from a university/institution established or recognised by law.
- Sharing/Payment of audit fees to state treasury (State Government) in case of audit of state Co-operative Societies is allowed.
- In case of partnership firm, legal representative of deceased partner can continue to receive share of firm only if deed contains such provision.
- Share of Profit and Sale of Goodwill in case of death of Proprietor (Proprietorship Case)

| | |
|---|---|
| No sharing of fees between Legal Representative & purchaser of Goodwill on death of Sole Proprietor.<br>Goodwill Payment may be made in instalments if sale agreement provides. | Goodwill can be sold/transferred to another CA if sale is completed within 1 year of death.<br>Legal heir has to obtain permission of Council within 1 year of death of proprietor.<br>Name of concern would be kept in abeyance (not removed) only upto 1 year from death of proprietor.<br>[if dispute regarding legal heir, then 1 year from settlement of dispute] |

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| | |
|---|---|
| **Clause (3)** | **Accepts or agrees to accept any part of the profits of professional work of a person who is not a member of Institute.**<br>**Provided that nothing herein** contained shall be construed as **prohibiting a member from** entering into profit sharing or other similar arrangements, including **receiving any share commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as referred in Clause (2) of this part.** |

**Additional Points**

- Charging Referral Fees (fees obtained by a member in practice from another member in practice in relation to referring a client to him) is not prohibited.

| | |
|---|---|
| **Clause (4)** | **enters into partnership**, in or outside India, **with any person other than Chartered Accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under section 4(1)(v) or whose qualifications are recognized by Central Government or Council for the purpose of permitting such partnerships.** |

**Additional Points**

- Prescribed members of other professional bodies are as under [Regulation 53B]:
  CS (ICSI), CMA (ICMAI), Advocate (Bar Council of India), Architect (Indian Institute of Architects), Actuary (Institute of Actuaries of India), Engineer.

| | |
|---|---|
| **Clause (5)** | Secures either through the services of a person who is not an employee of such Chartered Accountant or who is not his partner or by means which are not open to a Chartered Accountant, any professional business. Provided that nothing herein contained shall be construed as prohibiting any agreement permitted in item (2), (3) and (4) of this part. |
| **Clause (6)** | **Solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.** |

**Additional Points**

(1) Above clause does not prohibit:

(i) A CA from applying, requesting or securing professional work from another CA in practice.

(ii) A CA from responding to tenders or enquiries issued by organizations and securing work. However, a member shall not respond to any tender issued by organization in areas of services exclusively reserved for CAs, such as audit and attestation/assurance services. Such restriction shall not apply where minimum fee of assignment is prescribed in tender document itself or where the areas are open to other professionals along with CAs.
Members are also permitted to pay reasonable amount towards earnest money/security deposits.



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(2) Members should not adopt any indirect methods to gain publicity and thereby solicit clients or professional work. Such a restraint must be practiced so that members may maintain their independence of judgment and may be able to command the respect of their prospective clients.

(3) **Some forms of soliciting work are:**

(i) **Advertisement and note in the press**

However, following advertisements/announcements are permissible:

- Changes in partnerships or dissolution, change in address and telephone numbers.
- Advertisement for recruiting staff in own office.
- Advertisement on behalf of client requiring staff or to acquire/dispose property.
- Advertisement for sale of property by member acting as trustee/liquidator/receiver.
- Advertisement in journal/newsletter of Institute for sharing professional work, seeking partnership or employment.

(ii) **Publishing advertisements under box numbers:** Prohibited

(iii) **Advertisement for silver, golden, platinum or centenary celebrations**

Not permitted to advertise events organised by CA firm. However, it may be published in newspaper or newsletter.

(iv) **Advertisement of coaching/teaching activities**

Not permitted to advertise his classes/coaching institute. He may put sign board outside coaching premises mentioning name of institute, contact details and subjects taught.

(v) **Educational videos**

However, educational videos may be uploaded without reference of CA firm, contact details or website address by members.

(vi) **Giving public interviews**

Not permitted to give interviews which results in publicity

(vii) **Television or movie credits**

Member/firm name can be included in television or movie credits provided name exhibition is not made differently as compared to other entries in credits.

(viii) **Mentioning professional attainments in books, articles or presentations**

Not permissible to mention professional attainments in a book/article published by him. However, he can mention designation "Chartered Accountant" and firm name.

(ix) **Issue of greeting cards or invitations**

Not permissible to issue greeting cards or invitations indicating professional attainments. However, he can mention designation "Chartered Accountant" and firm name in greeting cards and invitations for marriage, religious ceremonies and office inauguration provided that such cards or invitations etc. are sent to clients, relatives and friends of concerned member only (even not to relatives and friends of other partner of firm).

(x) **Application for empanelment for allotment of audit and other professional work**

Government departments, courts, co-operative societies and banks prepare panels of CAs for allotment of audit and other professional work.

Where existence of such panel is within knowledge of member, he can request concerned organization to place his name on panel. However, member is not permissible to make roving enquiries regarding existence of such panel.

If name is on panel, request by member to allot work is not permissible.

(xi) **Sponsoring activities**

Not permitted to sponsor an event. However, he may sponsor an event conducted by Programme Organizing Unit (POU) of ICAI with prior approval of CPE directorate of ICAI

In sponsoring activities relating to CSR, members may mention their individual name with prefix "CA". However, mention of Firm name or CA Logo is not permitted.

(xii) **Acceptance of original professional work by a member emanating from the client introduced to him by another member**

If any professional work of such client comes to him directly, he has duty to ask the client that he should come through the other member dealing with his original work.

(xiii) **Sharing firm profile with prospective client**

Not permitted unless it is in response to specific query of proposed client.

**(4) Scope of representation which an auditor is entitled to make u/s 140(4) of Companies Act**

Letter should set out in a dignified manner how he has been acting independently throughout his term and may indicate his willingness to continue as auditor if reappointed by shareholders.

**(5) Appearance of CA on Electronic Media (including Internet)**

Members may appear on television, films and Internet and agree to broadcast in Radio or give lectures at forums and may give their names and describe themselves as CA. Special qualifications or specialised knowledge directly relevant to programme may also be given. Firm name may also be mentioned. What he may say or write must not be promotional.

**(6) Website Guidelines**

- CA/CA firm is free to create their own website. Actual format of Website is not prescribed nor any standard format is given. There is no restriction on colours used in website.
- Website should be run on a "pull" model and not a "push" model. Information contained in website should not be circulated on their own or E-mail except on specific "pull" request.
- CA is permitted to mention their website on professional stationery, letters heads, visiting cards and email but soliciting people to visit website is not permitted.
- Following information can be displayed on website:
  - (i) Member/Firm name
  - (ii) Year of establishment (allowed on website but not on letter heads etc.)

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(iii) Address, Telephone Number & E-mail ID

(iv) Details of Employees

(v) Job vacancies

(vi) Partners Details (partner experience to be displayed only on specific "pull" request)

(vii) No. of articled assistants. (on specific "pull" request)

(viii) Nature of services rendered and assignments handled (on specific "pull" request)

- Names of clients and fee charged cannot be given (permissible only if required by regulator).
- No photograph of any sort is permitted. Only display of passport size photo is permitted.
- Website may provide a link to website of ICAI, its Regional Councils and Branches and also the website of Govt./Govt. Departments/Regulatory authorities/other Professional Bodies.
- Members may include articles, bulletin boards, professional updation etc. on website. Educational videos on professional topics are permissible.
- Chat rooms can be provided which permit chatting amongst members, firms and its clients.
- Firm can provide link of its page on Social Networking site without solicit people to visit.
- Members/firms can provide on line advice to their clients who specifically request for advice.
- Website should be befitting the CA profession.
- No Advertisement of any nature will be permitted on the Website.
- Website address is to be filed by the member on annual basis in annual form to Institute.

**(7) Online Third Party Platforms**

CA/CA firms can provide consultation and advice through Online Third Party Platforms. However, firm name and contact address should not be provided.

**(8) Application based Service provider Aggregators**

Not permissible for members to list themselves with online Application based service provider Aggregators wherein other categories are also listed.

It is permissible for members to get registered on government portals since it does not amount to listing on Aggregator. Aggregator is operated by third party whereas Government portal is operated by the client (government) itself.

**(9) Publication of Name or Firm Name by Chartered Accountants in the Telephone or other Directories published by Telephone Authorities or Private Bodies**

CA/CA firm may have entries made in a Telephone Directory either by making a special request or by means of an additional payment.

- Entry should appear in CA category and order of entries should be alphabetical.
- CA/CA firm should belong to town in which directory is published.
- Members can also include their names in trade/social directories.

| | |
|---|---|
| Clause (7) | Advertises his professional attainments or services, or uses any designation or expressions other than the Chartered Accountant on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a University established by law in India or recognized by the Central Government or a title indicating membership of the Institute of Chartered Accountants or of any other institution that has been recognized by the Central Government or may be recognized by the Council. |

## Additional Points

### (1) Advertisement of Professional Attainments or Services

- Advertise through a write up: Member may advertise through a write up, setting out the service provided by him or his firm subject to following guidelines issued by Council:
  - No exaggerated claims for the services offered, qualifications or experience.
  - Should not contain testimonials or endorsements.
  - Should not contain information about achievement/awards (except given by Government).
  - Should not be of font size exceeding 14.
- Notice in press relating to success in examination: It should not contain any undesirable publicity relating to articled/audit assistant/employee/member/firm.
- Writing articles or letters to press: Member may give their name and use description CA.
- Organising training courses/seminars for staff: He may also invite staff of other CAs and clients. However, undue prominence should not be given to CA name in any document issued.

### (2) Other Designations

- It is improper for CA to use designation such as, Cost Accountant, Company Secretary, Cost Consultant, Management Consultant, Income-tax Consultant, Advocate, Corporate Lawyer, Cybersecurity Expert, Member of Parliament or Municipal Councilor simultaneously.
- However, members are permitted to use title/letters/initials indicating membership of other professional bodies or institutions (CS, CMA, ACCA, CFA, LLB, ICAEW etc.).

  Members are also permitted to mention title indicating membership of foreign Institute of Accountancy, recognized by Council through agreement (MoU/MRA) with said Institute.

  Example: South African Institute of Chartered Accountants (SAICA), Institute of Certified Public Accountants (CPA Ireland) and Institute of Chartered Accountants in England and Wales (ICAEW). However, members are not permitted to use initials 'CPA'.
- Members who are Directors in Companies, CA Cells or Members of political parties, holding positions in clubs or other organisations are not permitted to mention any positions.
- In Client Companies' offer documents (prospectus) and advertisements regarding capital issue, name and address of CA acting as Advisor or Consultant to the Issue could be indicated under caption "Advisor/Consultant to the Issue". However, prospectus should not contain professional attainments of member.

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Further, members should not use designation of "Merchant Banker or Advisor/Consultant to Issue" in their own letterheads, visiting cards, professional documents, etc.

- Member can mention "Insolvency Professional" or "Registered Valuer".

**(3) Establishment Date, Firm Name, QR Code, Sign Board and Logo**

- Date of setting up practice or establishment of firm on letter heads and other professional documents should not be mentioned.
- Member is allowed to print name of all firms on personal letter heads in which he is a partner.
- Member is allowed to print Quick Response Code (QR Code) on visiting card, provided that Code does not contain information that is not permissible to be printed on visiting card.
- Size of sign board: Members have own discretion regarding size of sign board. However, use of glow signs or lights on large-sized boards as used by shopkeepers is not permissible.
- Use of logo/monogram of any kind/form/style/design/colour etc on anything: Prohibited. Only use of CA logo is permissible, subject to CA logo guidelines.

| Clause (8) | **Accepts a position as auditor previously held by another chartered accountant** or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 **without first communicating with him in writing.** |
|---|---|

**Additional Points**

**(1) Objective and Reasons**

- Object of incoming auditor in communicating with retiring auditor is to ascertain from him whether there are any circumstances which warrant him not to accept the appointment.
- The professional reasons for not accepting an audit would be:
  - (i) Non-compliance of provisions of Sections 139 and 140 of Companies Act, 2013.
  - (ii) Non-payment of undisputed Audit Fees by auditees other than in case of Sick Units.
  - (iii) Issuance of a qualified report.

  In first two cases, auditor who accepts the audit would be guilty of professional misconduct.

  In last case, he may accept audit if attitude of retiring auditor was not proper. If he feels that retiring auditor had qualified report for valid reasons, he should not accept the audit.

**(2) Cases where Communication is Required**

- Communication is mandatorily required for all types of Audit if previous auditor is a CA.
- Communication in case of Joint Audit: It is necessary for new auditor appointed to act jointly with earlier auditor to communicate with such earlier auditor.
- This clause is applicable in situation of replacing of one auditor by another auditor. Internal auditor and statutory auditor are parallel positions and not replacement positions. In this situation there is no need for communication by one to other.



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(3) **Mode of Communication, Response and Conditional Acceptance**

- Mere posting of a letter "under certificate of posting" is not sufficient to establish communication with retiring auditor unless there is evidence that letter has reached the person communicated with. Following shall provide such evidence:
  - (i) Communication by a letter sent through "Registered Acknowledgement due", or
  - (ii) By hand against a written acknowledgement, or
  - (iii) Acknowledgement from retiring auditor's vide email address registered with ICAI or his official email address or Unique Identification Number (UDIN).
- If retiring auditor fails to respond due to feeling of hurt because of change. Auditor appointed can act after waiting for a reasonable time.
- Premises found locked: Communication received back with "Office found Locked" written shall be deemed as delivered to retiring auditor.
- Firm not found at the given Registered address: If communication sent by incoming auditor is received back with remarks "No such office exists at this address", and address of communication is same as registered with Institute on date of dispatch, letter will be deemed to be delivered, unless the retiring auditor proves that it was not really served.
- In case of government companies/banks audit, if there is no time to wait for reply from outgoing auditor, incoming auditor may give conditional acceptance of appointment and commence the work.

| Clause (9) | **Accepts an appointment as auditor of a Company without first ascertaining from it whether the requirements of Sections 139 to 141 of the Companies Act, 2013 or any other law pertaining to appointment of auditors, in respect of such appointment have been duly complied with.** |
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**Additional Points**

- It is not sufficient for incoming auditor to accept certificate from management of company that above sections have been complied. Hence, it is necessary for incoming auditor to verify records.
- Appointment of Auditors (other than Government Companies)
  In case of First Auditor and Casual Vacancy (Death/Disqualification/Resignation) - By BOD
  In other case - By Members

| Clause (10) | **Charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.** |
|---|---|

**Additional Points**



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- Fees should not be regarded as being contingent if fixed by court or other public authority.
- **Exceptions (Regulation 192)**

| In case of | Fees may be based on |
|---|---|
| Auditor of Co-operative Society | Percentage of paid up capital/working capital/income |
| Valuer | Percentage of value of property valued |
| Receiver or Liquidator | Percentage of realization or disbursement of assets |
| Fund Raising Services | Percentage of fund raised |
| Debt Recovery Services | Percentage of debt recovered |
| Cost Optimisation Services | Percentage of benefit derived |
| Insolvency Professional<br>Other Non Assurance Services | Percentage basis |

| Clause (11) | **Engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage.** |
|---|---|

**Additional Points**

- Nothing contained herein shall disentitle a CA from being a director of company (Not managing or whole time director) unless he or any of his partners is interested in such company as an auditor.
- CA in practice is generally permitted to engage in following occupations for which no specific permission from Council is necessary (General Resolution)
  - (i) Employment under CA in practice/CA firms.
  - (ii) Private tutorship.
  - (iii) Authorship of books and articles.
  - (iv) Holding of life insurance agency license for getting renewal commission.
  - (v) Attending classes and appearing for any examination.
  - (vi) Holding of public elective offices such as M.P., M.L.A. and M.L.C.
  - (vii) Honorary office leadership of charitable-educational or other non-commercial organisations.
  - (viii) Acting as notary public, justice of the peace, special executive magistrate.
  - (ix) Part-time tutorship under coaching organisation of ICAI.
  - (x) Valuation of papers, acting as paper-setter, head-examiner or moderator for any exam.
  - (xi) Editorship of professional journals.
  - (xii) Acting as surveyor and loss assessor under Insurance Act.
  - (xiii) Acting as recovery consultant in banking sector
  - (xiv) Owning agricultural land and carrying out agricultural activity.
  - (xv) Director Simplicitor (ordinary/simple director) who is not managing or whole time director.
  - (xvi) Promoter/Promoter Director/Signatory to the memorandum and articles of association.

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- CA in practice may engage in following business or occupations after obtaining specific and prior approval of Council (Specific Resolution - Regulation 190A)
  - (i) Full-time or part-time employment in business concerns or non-business concerns.
  - (ii) Managing or whole-time director of a body corporate.
  - (iii) Interest in family business concerns.
  - (iv) Interest in educational institution.
  - (v) Part-time/full-time lectureship for courses other than relating to ICAI examinations.
  - (vi) Part-time/full-time tutorship under educational institution other than ICAI organisation.
  - (vii) Editorship of journals other than professional journals.
  - (viii) Any other business or occupation for which Executive Committee considers that permission may be granted (selling domain name for earning royalty etc).
- Teaching hours should not exceed 25 hours a week in any cases mentioned above.
- CA may take up appointment made by Central or State Government or court or any other legal authority or may act as Secretary provided his employment is not on a salary-cum-full-time basis.
- Auditor of subsidiary company cannot be a director of its holding company, as it will affect independence of auditor.

| Clause (12) | **Allows a person not being a member of institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.** |
|---|---|

**Additional Points**

- Power to sign routine documents may be delegated in following instances (Non Applicability):
  - (i) Issue of audit queries during audit.
  - (ii) Asking for information or issue of questionnaire.
  - (iii) Letter forwarding draft observations/financial statements.
  - (iv) Initiating and stamping of vouchers and schedules prepared for audit.
  - (v) Acknowledging and carrying on routine correspondence with clients.
  - (vi) Issue of memorandum of cash and other physical verification.
  - (vii) Issuing acknowledgements for records produced and for money receipts.
  - (viii) Attending to routine matters in tax practice, subject to Section 288 of Income Tax Act.
  - (ix) Any other matter incidental to office administration and routine work.
- Sign or Issuance of stock certificate, production certificate, net worth certificate or any other certificate is not a routine work and cannot be delegated.

CAFinalNotes

**PART II - Professional misconduct in relation to Members of the Institute in Service**

A member of Institute (other than a member in practice) shall be deemed to be guilty of professional misconduct, if he being an employee of any company, firm or person:

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| **Clause (1)** | **Pays or allows or agrees to pay directly or indirectly to any person any share in the emoluments of the employment undertaken by him.** |

**Additional Points**

- This clause does not restricts such sharing among relatives, dependents, friends etc., if payment is not a consideration for job procurement or retainership.

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| **Clause (2)** | **Accepts or agrees to accept any part of fees, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.** |

**PART III - Professional Misconduct in relation to Members of the Institute generally**

A member of Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he:

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| **Clause (1)** | Not being a fellow of the Institute, acts as a fellow of the Institute. |

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| **Clause (2)** | **Does not supply the information called for, or does not comply with requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority.** |

**Additional Points**

- Examples of Misconduct under this clause
  - Failed to reply to letters of Institute asking member to confirm date of appointment or date of leaving the service as an employee.
  - Failure to furnish information required by ICAI to be submitted online within stipulated time.
  - While applying for CoP, did not fill in the columns about engagement in other business.

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| **Clause (3)** | While inviting professional work from another chartered accountant or while responding to tenders or enquiries or while advertising through a write up, or anything as provided in items (6) and (7) of Part I of this Schedule, gives information knowing it to be false. |

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**PART IV- Other Misconduct in relation to members of the Institute generally**

A member of Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he:

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| **Clause (1)** | **Is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months.** |

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| **Clause (2)** | **In the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.** |

**Additional Points**

- Examples of Misconduct under this clause
  - Auditor used his position to obtain funds and failed to repay the same to the bank.
  - Cheques were dishonoured due to insufficiency of funds.
  - Withdraw the money from bank which does not belongs to him.
  - Retains books & documents of client and fails to return these on request without any cause.
  - Personal benefit taken by council member of Institute.
  - Not replying within reasonable time and without any cause to public authorities letter.
  - Advising unethical practice to the client.

## The Second Schedule

**PART I - Professional Misconduct in relation to Chartered Accountants in Practice**

A CA in practice is deemed to be guilty of professional misconduct if he:

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| **Clause (1)** | **Discloses Information acquired in the course of his professional engagement to any person other than his client so engaging him without the consent of his client or otherwise than as required by any law for the time being in force.** |

**Additional Points**

- Duty not to disclose continues even after completion of assignment.
- CA may disclose information if it is required as a part of performance of his professional duties.
- In case of sole proprietary concern, consent may be given by proprietor or his constituted attorney who is legally empowered to give such consent. In case of partnership firm, consent may be given by any partner. In case of company, consent may be given by Board of Directors.



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- Examples of Misconduct under this clause
  - Disclosed vital information of his client's business without consent of client under impression that it will help the nation to compete with other countries at International level.
  - During seminar, used actual data of client with full identification of client details displayed to explain query.

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| **Clause (2)** | Certifies or submits in his name or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice. |

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| **Clause (3)** | **Permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in manner which may lead to the belief that he vouches for the accuracy of the forecast.** |

**Additional Points**

- SAE 3400 "The Examination of Prospective Financial Information", provides that management is responsible for preparation and presentation of prospective financial information. CA may be asked to examine and report on PFI to enhance its credibility.
- CA can participate in preparation of profit or financial forecasts and can review them, provided he indicates clearly in his report the sources of information, basis of forecasts and also major assumptions made in arriving at forecasts and he does not vouch for the accuracy of forecasts.

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| **Clause (4)** | **Expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.** |

**Additional Points**

- Applicable on all types of attest/assurance functions by the members.
- However, non-assurance functions (example - evaluate cost of products manufactured) can be provided even in case of any interest in enterprise.
- Member shall also not express his opinion on FS of any business or enterprise if relative of member (as per AS 18) has substantial interest in said business or enterprise.
- If CA is a director of company, then such CA or firm (in which he is a partner), shall not express any opinion on FS of such company.
- Cooling off period after completion of tenure as Director

  A member shall not accept the audit of a company for a period of two years from the date of completion of his tenure/resignation as Director of the said company.



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- Other prohibition in this clause
  - CA should not accept audit of college, if he is working as a part-time lecturer in college.
  - CA should not accept audit of Trust where his partner is an employee/trustee of Trust.
  - Members are not permitted to write books of account of their auditee clients.

| Clause (5) | **Fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity.** |
|---|---|

**Additional Points**

- Determination of materiality is provided in SA 320, "Materiality in Planning and Performing Audit".
- Examples of Misconduct under this clause
  - Auditor has come across information that a loan has been taken by company from Employees Provident Fund and the said loan has not been reflected in books of accounts.
  - Failed to give disclosure of charge created against Guarantee given in favour of Group Company.

| Clause (6) | **Fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity.** |
|---|---|

**Additional Points**

- If CA is acting as authorized representative and submitted incorrect statements on instructions of his client to authorities, he is not liable for misconduct under clause (5) & (6).

| Clause (7) | **Does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.** |
|---|---|

**Additional Points**

- It is a vital clause which gets attracted whenever it is necessary to judge whether CA has honestly discharged his duties. The expression negligence covers wide field from fraud to minor negligence.
- Examples of Misconduct under this clause
  - Submitting stock audit report by relying on M.I.S. Report without physically verifying stock.
  - Certified circulation figures based on M.I.S. Report without examining books of account.
  - Issuing clean reports on Financial Statements without examining accounts.
  - Digitally signed the form without verifying genuineness.
  - Failed to confirm/verify value of investments from any proper source.
  - Not exercise reasonable skill and care and performed his work in a casual manner.
  - Not completed his audit work and not submitted his audit report in due time.

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| Clause (8) | **Fails to obtain sufficient information which is necessary for expression of an opinion** or its exceptions are sufficiently material to negate the expression of an opinion. |

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| Clause (9) | **Fails to invite attention to any material departure from the generally accepted procedure of audit** (Engagement & Quality Control Standards) **applicable to circumstances.** |

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| Clause (10) | **Fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.** |

**Additional Points**

- Member has to utilize such funds only as per instructions of client or purposes intended by client.
- Advance received by a CA against services to be rendered does not fall under this clause.
- Moneys received for expenses (payment of statutory fees, purchase of stamp paper etc.), which are intended to be spent within a short time need not be put in a separate bank account.
- Moneys received by a CA, in his capacity as trustee, executor, liquidator etc. must be put in a separate bank account immediately.

**PART II - Professional Misconduct in relation to Members of the Institute generally**

A member of Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he:

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| Clause (1) | **Contravenes any of the provisions of this Act or the regulations made there under or any guidelines issued by the Council.** |

**Additional Points**

- This clause requires every member of Institute to act within framework of CA Act and Regulations and Guidelines made by Council thereunder. Any violation by a member would amount to misconduct.
- Regulations under which cases of contravention have generally come to the notice of Council are:
  - Regulation 47 Premium/loan/deposit from Articled Assistant
  - Regulation 48 Stipend to Articled Assistant (Monthly Payment)
  - Regulation 65 Articled Assistant not to engage in any other occupation
- As per UDIN Guidelines (Chapter XIV) issued by council, CA in practice shall generate Unique Document Identification Number (UDIN) for all kinds of certification, Audit Reports and other Audit, Assurance and Attestation functions undertaken/signed by him.
- Statement on Peer Review shall be deemed to be a guideline of Council. Audit of Listed Companies shall be done by only those auditors who have subjected to Peer Review process of Institute



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- Examples of Misconduct under this clause
  - Issued a certificate/report as a CA in practice without even applied for CoP (Violation of Act).
  - Failed to make payments of stipend to articled assistant every month (Violation of Regulation).

| | |
|---|---|
| **Clause (2)** | **Being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment except as and when required by any law for the time being in force or except as permitted by the employer.** |

| | |
|---|---|
| **Clause (3)** | **Includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline. Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false.** |

- Example of Misconduct under this clause

  In application for empanelment as auditor of branches of banks submitted to Institute, Included another CA name as a partner in firm (who was not a partner of said firm on date of application).

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|---|---|
| **Clause (4)** | Defalcates or embezzles money received in his professional capacity. |

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|---|---|
| **Clause (5)** | Acts as an auditor of the company in contravention of the provisions of the Companies Act, 2013. |

**PART III- Other Misconduct in relation to Members of the Institute generally**

A member of Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he:

| | |
|---|---|
| **Clause (1)** | **Is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.** |

CA Final Notes

## Council General Guidelines, 2008

### Chapter II - Conduct of a Member being an Employee

A CA employee shall exercise due diligence and shall not be grossly negligent in conduct of his duties.

### Chapter V - Maintenance of Books of Account

A CA in practice or CA firm in which he is a partner, shall maintain and keep in respect of his professional practice, proper books of account including Cash Book and Ledger

### Chapter VI - Tax Audit Assignments u/s 44AB of Income Tax Act, 1961

- A CA in practice shall not accept, in a financial year, more than "specified number of tax audit assignments" u/s 44AB of Income-tax Act, 1961. Specified number of tax audit assignments" means 60 tax audit assignments per CA or per partner in a financial year.
- Where a CA is a partner in more than 1 firm, number of tax audit assignments in relation to such partner shall be taken as aggregate for all the firms together.
- One partner can individually sign all tax audit reports subject to specified tax audit assignment limits on behalf of all partners in CA firm or all partners can collectively sign tax audit reports.
- Audits conducted u/s 44AD, 44ADA and 44AE of Income Tax Act, 1961 shall not be taken.
- Audit of head office and branch offices of a concern taken as one tax audit assignment.
- Part time practicing partner of CA firm shall not be taken for above limit.

### Chapter VII - Appointment of an Auditor in case of non-payment of Undisputed Fees

- A CA in Practice shall not accept appointment as auditor of an entity in case undisputed audit fee of another CA for carrying out audit has not been paid.
- Provision for audit fee in accounts signed by both auditee and auditor shall be considered as "undisputed audit fees".
- In case of sick unit, above prohibition shall not apply. "Sick unit" means a unit registered for atleast 5 years, which has accumulated losses $\geq$ net worth at the end of any financial year.

### Chapter VIII - Specified Number of Audit Assignments

- A CA in practice shall not hold at any time appointment of more than "specified number of audit assignments" of Companies under Section 141 of Companies Act 2013.
- "Specified number of audit assignments" means 30 audit assignments per CA or per partner except one person companies and dormant companies.

## Chapter IX - Appointment as Statutory Auditor

- A CA in practice shall not accept appointment as statutory auditor of Public Sector Undertaking/ Government Company/Listed Company and other Public Companies having turnover of ₹ 50 crores or more in a year where he accepts any other work or assignment or service in regard to same Undertaking/Company on a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same Undertaking/company.
- Term "other work" or "service" or "assignment" shall include Management Consultancy and all other professional services permitted by Council but shall not include:
  (i) audit under any other statute.
  (ii) certification work required to be done by statutory auditors.
  (iii) any representation before an authority.

## Chapter X - Appointment of an Auditor when he is Indebted to a Concern

- A CA in practice or CA firm or relative of such member or partner shall not accept appointment as statutory auditor of a concern while indebted to the concern or given any guarantee or provided any security in connection with indebtedness of any third person to the concern, for limits fixed in the statute and in other cases for amount exceeding ₹ 1,00,000.
- Limit as per Companies Act - ₹ 5,00,000 for indebtedness and ₹ 1,00,000 for guarantee & security.
- If auditor receives fees on progressive basis, he cannot be said to be indebted to the concern.

## Chapter XV - Networking Guidelines

- **Concept of Network**

  To enhance ability to provide professional services, firms frequently form larger structures with other firms and entities. Where entities within the structure share:
  - profit or cost
  - common ownership, control, management, business strategy or brand name
  - professional resources such as systems, staff, technical departments and training courses

  It is deemed to be a network.

- **Forms of Network**

  A network can be constituted as:
  - Mutual entity which will act as a facilitator for constituents of Network. In such case, Network itself will not carry out any professional practice.
  - Partnership firm (maximum 20 partners).
  - LLP.
  - Company (for management consultancy services).

  A firm is allowed to join only one network. Firms having common partners shall join one network.

- **Name of Network**
  - Network may have distinct name which should be approved by Institute. To distinguish a Network from CA firm, words "& Affiliates" shall be used after the name of network and the words "& Co."/"& Associates" shall not be used.
  - Institute shall approve or reject the name of Network and intimate the same to Network within 30 days from the date of receipt of Form.
- **Registration of Network**
  - After name is approved, Institute will reserve such name for 3 months from date of approval.
  - Network shall get itself registered with the Institute within 3 months. Name assigned shall cancelled on the expiry of said period.
  - Registration of Network with Institute is mandatory.
- **Listing of Network with Entities outside India**
  - Network shall file a declaration with Institute for listing within 30 days from date of entering into such arrangement.
  - Members/Firms are allowed to join only one such network with entities outside India.
- **Change in Constitution of Registered Network**

  In case of change in constitution due to any entry or exit from Network, network shall communicate the same to Institute within 30 days from the date of change in constitution.
- **Ethical Compliance**

  Network has to comply with all applicable ethical requirements prescribed by Institute:
  - If one firm of network is statutory auditor of entity then the network & associate shall not accept internal audit, book-keeping or other assignments which are prohibited for such firm.
  - If rotation of firm provision is applicable, no firm of network can accept appointment as an auditor in place of retiring firm.
  - Network may advertise the network to the extent permitted by Advertisement Guidelines issued by Institute. Firms constituting the network are permitted to use the words "Network Firms" on their professional stationery.
  - Ceiling on non-audit fees is applicable to Network as follows:

    For a network firm who is doing statutory audit it shall be the same as mentioned.

    For other firms of same network collectively, it shall be 3 times of statutory audit fee.
- **Framework of Internal Byelaws of Network**

  To streamline networking, network shall formulate bye-laws. Bye-laws may contain following clauses on which affiliates of network may enter into written agreement among themselves:

  (i) Appointment of Managing Committee

  (ii) Administration of network

  (iii) Contribution of membership fees to meet administration cost of network

  (iv) Identifying a partner responsible for assignment (engagement partner)



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(v) Dispute settlement procedures through arbitration and conciliation

(vi) Development of training materials

(vii) Determining methodology and compensation for drawing resources from each member firm

**Chapter XVI - Logo Guidelines**

- Guidelines for using new "CA India" logo for CA members prescribes that logo consists of letters 'CA' in blue colour with a tri colour tick mark (upside down) with white background.
- There should be no alteration of font (colour, bold/unbold, size) and no change in spacing and dimensions. The logo should not be shrunk or distorted.
- Do not change design and colours, including background. Refrain from rotating or tilting logo.

**Chapter XVII - Guidelines for Corporate Form of Practice**

- Council has allowed members in practice to hold office of MD, WTD or Manager of body corporate that is engaged exclusively in rendering Management Consultancy and Other Services.
- Members can retain full time CoP along with MD, WTD or Manager of such Management Consultancy Company. There is no restriction on equity holding of members in such Company.
- However, no audit practice can be done in Corporate Form.
- Name of Management Consultancy Company is required to be approved by Institute and such Company has to be registered with Institute.
- **Ethical Compliance**
  - If member of management consultancy company is statutory auditor of entity, then such company shall not accept internal audit, book-keeping or other assignments from entity which are prohibited for statutory auditor.
  - Management Consultancy Company shall comply with clauses (6) & (7) of Part-I of First Schedule of CA Act, 1949.

## Recommended Self-Regulatory Measures

Council has given certain self-regulatory measures to ensure healthy growth of profession. The self-regulatory measures are recommendatory.

- **Branch Audits**

  Branch audits of a company should not be conducted by its statutory auditors consisting of 10 or more members, but should be conducted by local firms of auditors consisting of less than 10 members. This restriction is not applicable in following cases:

  (i) Accounting records of branches are maintained at head office

  (ii) Significant operations are carried out at branch office.

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- **Joint Audit**

  In Large companies, should associate a firm with less than 5 members as Joint auditors.

- **Ratio Between Qualified and Unqualified Staff**

  CA firm should have at least 1 member for every 5 non-qualified members of staff in every audit.

- **Disclosure of Interest by Auditors in other Firms**

  Auditors should make a disclosure of payments received by them for other services.

- **Recommended Minimum Scale of Fees**
  - Institute has issued minimum scale of fees for professional assignments. The recommended scale of Fees is to be charged for such assignments.
  - Charging excessive fee or low fees for assignment does not constitute any misconduct.
  - Disclosure requirements regarding fees

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| For Non-Public Interest Entities (Non-PIE): | Disclosure is required if gross annual professional fees from audit client for 2 consecutive years is more than 40% of total fees of firm. |
| For Public Interest Entities (PIE): | Disclosure is required if gross annual professional fees from audit client for 2 consecutive years is more than 20% of total fees of firm. |
| Exemption from applicability of above provision<br>(i) If total fees received by firm does not exceed ₹ 20 lacs.<br>(ii) Audit of government companies, public undertakings, nationalised banks, public financial institutions, regulators or where appointment is made by Government. | |

## Recent Decisions of Ethical Standards Board

**Not Permissible for CA in Practice**

- CA cannot become financial advisors and receive commission from financial institutions.
- CA cannot take agencies of UTI, GIC or NSDL.
- CA cannot hold customs brokers licence.
- CA is not permitted to accept audit of bank if he took loan against FD held by him in that bank.
- CA who is a member of trust cannot be the auditor of said trust.
- CA cannot use messaging applications to send messages about his practice & services.
- Internal auditor of PF trust of government company cannot be appointed as its statutory auditor.
- Internal auditor shall not undertake tax audit/statutory audit and vice versa.
- Statutory auditor cannot prepare BRSR study to audit clients. [However, he may provide advisory services on same and can be "Assurance provider of BRSR" for same client].
- Statutory auditor cannot engage in compilation engagement as per SRS 4410 of that entity.
- CA cannot publish/print values, vision or mission statement on letter head, visiting card etc. [It may be printed on firm profile and provided on specific request].



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- Statutory auditor of bank cannot accept ASM assignment of customer of bank simultaneously.
- CA cannot be appointed as internal auditor and procurement officer simultaneously.
- CA cannot act as trademark or patent attorney. [However, advice relating to Intellectual Property Right (IPR) is permissible].
- CA cannot accept appointment of statutory audit of society where immediate family member i.e., spouse/dependent of CA hold position of managing committee of institutes governed by society.
- CA being director simplicitor in company cannot sign ROC forms of company.
- If CA is non-executive director in company, he/his firm cannot accept appointment as statutory auditor of company which is a joint venture of original company, as it would impact independence.
- Statutory/tax auditor cannot be valuer of unquoted equity shares of same entity if law prohibits.
- CA cannot exercise lien over client documents/records for non-payment of his fees.
- If CA is statutory auditor of bank, he cannot accept stock audit/inspection audit of any branches or sister concern of same bank for same financial year.
- Concurrent auditor of bank 'X' cannot appoint as statutory auditor of bank 'Y', sponsored by 'X'.

**Permissible for CA in Practice**

- Hold credit card when he is auditor of a bank, provided o/s balance not exceed ₹ 1 lac.
- Become settlor of trust.
- Act as mediator/arbitrator in court.
- Act as internal auditor of company & statutory auditor of its employees PF fund (not vice-versa).
- Internal auditor of a company can purchase shares of said company.
- Service assessment/performance audit of skill development council centres of government.
- Accept assignment of mystery audit.
- Mention as promoter/director on company portal without professional attainments and firm name.
- Become non-executive/independent director in co-operative Bank, provided he is not involved in day to day activities and he/his partners are not interested as an auditor.
- Become professional director in management board of co-operative bank.
- Become member in management board of primary (urban) co-operative banks where there is no involvement of member in day-to-day operations and only sitting fees is provided for services.
- Set-up practice in IFSC/GIFT city.
- Render services to IFSC units from offices outside IFSC.
- Charge fees on % of utilization amount for certifying amount spent by Institute from grant.
- CA Firm may register itself on Udyog Aadhar, a web portal of MSME Ministry.
- Provide services through kiosk only if services provided are permitted for practicing CA.
- Act as authorized representative of foreign company provided, he is not auditor of said company.
- 2 or more CA collectively can take joint GST training session for their clients and share fees.
- Engage as registration authority for obtaining digital signatures for clients.

CAFinalNotes

- Become equity research adviser. [But cannot publish retail report]
- Engage in derivative transactions in personal capacity but not in professional capacity (for clients). [However, CA in practice cannot transact in commodity derivative transactions in any capacity].

**Permissible for CA in Service**

- Allowed to take e-return registration if it does not conflict with employment obligation. [However, he cannot certify the return].
- Appear as tax representative before tax authorities on behalf of his employer, but not on behalf of other employees of employer.

## Disciplinary Procedure

**Disciplinary Directorate (DD) on receipt of complaint alongwith fee against CA**

Make an opinion that

**CA is guilty**

- In First Schedule
  - Place the matter before Board of Discipline (BOD)
  - If BOD found him
    - Guilty:
      - Reprimand
      - Remove name upto 3 months
      - Impose fine upto ₹ 1 Lac
    - Not guilty: Close the matter
- In Second Schedule or Both
  - Place the matter before Disciplinary Committee (DC)
  - If DC found him
    - Guilty:
      - Reprimand
      - Remove for any time/permanent
      - Impose fine upto ₹ 5 Lacs
    - Not guilty: Close the matter

**CA is not guilty**

- Place the matter before Board of Discipline (BOD)
  - If BOD agree with the opinion of DD
    - Close the matter
  - If BOD disagree with the opinion of DD
    - Advice DD to further investigate.
    - BOD may proceed with matter if it is related to First Schedule.
    - Refer matter to DC if it is related to Second Schedule or Both.

**Appeal to Appellate Authority**

Any member or Director (Discipline) aggrieved by order of Board or Disciplinary Committee can prefer an appeal within 90 days to Appellate Authority.

# Working Notes

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