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CA FINAL AUDIT NOTES

For **May 2025** & Onwards



BY
CA SHUBHAM KESWANI

MM Make My Delivery

Learn With Fun

CA FINAL

(For May 2025 & Exam Onwards)

AUDIT NOTES

CA SHUBHAM KESWANI

Make My Delivery

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By CA Shubham Keswani

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Preface to the 8th edition:

'Fun is just another word for Learning'- Raphael Koster (Creative Director Star Wars Galaxies)

- ✓ There are so many topics, What to learn & What to read?
- ✓ What if I'm unable to cover the syllabus in last 1.5 days?
- ✓ Everyone says learning Key Words is important, but how to identify them?

As a Student I was always bogged down by all such dilemmas & thought how magical it'd be if someone could make notes & guide me that would make revision a cakewalk in last 1.5 days.

Gandhi Ji says,

"Be the change you want to see",

so decided that instead of waiting, I should sit down with ICAI Study Material & finally the journey of these notes began.

It was fun in bringing down a chapter from 60 pages to 15 pages, but it was all my CA Exams Hard work which paved way for this Smart Work.

Never thought such bulky material could be summarised in such concise manner but as they say,

"Where there's a Will, there's a Way"

Having secured an Exemption at both levels in this paper, I knew that the game is all about Key Words, so why not share the Cheat Code with everyone!

I'm sure that this book coupled with the Right study strategy can easily help you get an Exemption in this paper & turn your Fear into Love for Audit.

This is a colour-coded book for easy understanding:

- Black-Headings
- Blue- Main Concept
- Red- Important Points
- Green- Amendments

Thankful to my parents, CA Gobind Ram Keswani & Mrs. Rekha Keswani & sister, Dakksha Keswani for their continuous support.

Heartfelt gratitude for Aadil Sayyed, for designing this masterpiece. Also like to thank Bhanwar Borana Sir for believing in my skill & will to make 'Audit a Fun Learning Experience for Students'. Thankful to Aakash Kandoi Sir for his continuous support. Sincere thanks to Make My Delivery for publishing this book.

For any concerns, feel free to reach out to me at cashubhamkeswani@gmail.com.

"Dedicated to every CA Student working hard day & night to fulfill their dream to be become Chartered Accountant one day"

Trust me,

Notes & Question Bank coupled with class guidance enough to easily score 70+ in Audit.

Do make me PROUD ♡

Happy Learning!
Regards,
CA Shubham Keswani
AIR 8 CA Final & AIR 29 CA IPCC
B.Com(H), Shri Ram College of Commerce

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List of Abbreviations [CA Final Audit Notes]

S No.	Word	Full Form
1	ABCD	Account balance, classes of transactions & Disclosures
2	ACB	Audit Committee Board
3	AOA	Articles of Association
4	AR or A/R	Audit Report
5	ASAP	As soon as practicable
6	b/w	between
7	CAiP	CA in Practice
8	CBS	Core Banking System
9	CCO	Competence, Capability & Objectivity
10	CFS	Consolidated Financial Statements
11	CHIA	Chief Internal Auditor
12	COPU	Committee on Public Undertakings
13	COT	Class of Transaction
14	CSA	Central Statutory Auditor
15	CY	Current Year
16	DIM	Design, Implementation & Maintenance
17	DP	Drawing Power
18	ED	Engg. Documentation
19	EDP	electronic data processing
20	EEE	Economy, Efficiency, Effectiveness
21	ELC	External Legal Counsel
22	Engg.	Engagement
23	EOE	Estimate of Earnings
24	EOM	Emphasis of Matter para
25	EP	Engagement Partner
26	ERCV	Existence, Rights & Obligations, Completeness, Valuation
27	ET	Engagement Team
28	explns	explanations
29	FAIS	Forensic Accounting & Investigation Standards
30	FAP	Further Audit Procedures
31	FCNR	Foreign currency Non Resident a/c
32	FI	Financial Institution
33	fn	function
34	FR	Financial Reporting
35	FRF	Financial Reporting Framework
36	FRP	Financial Reporting Process
37	FS	Financial Statements
38	FV	Fair Value
39	GAAP	Generally Accepted Accounting Principles

40	GAM	Group Accounting Manual
41	GC	Going Concern
42	GRN	Goods Receipt Note
43	HO	Head Office
44	IA	Internal Audit/Auditor
45	IAAD	Indian Audit & Accounts Dept
46	IC	Internal Controls
47	ICFR	Internal Controls over Financial Reporting
48	ILA	Inherent Limitations of Auditing
49	Info.	Information
50	IP	Intellectual Property
51	ISA	International Standards on Auditing
52	IT	Information Technology
53	JE	Journal Entry
54	JV	Joint Venture
55	KAM	Key Audit Matter
56	KMP	Key Managerial Person
57	KPI	Key performance indicator
58	L&R or L/R	Laws & Regulations
59	LAGS	Loans, Advances in nature of Loans, Guarantees, Securities
60	LFAR	Long Form Audit Report
61	mgt	Management
62	MM	Material Misstatement
63	MOA	Memorandum of Association
64	MOM	Month on Month
65	MU	Material Uncertainty
66	MURG	Material Uncertainty Related to Going Concern
67	NOCLAR	Non Compliance with Laws & Regulations
68	NTE	Nature, Timing & Extent
69	o/s	Outside/Outstanding
70	OM	Other Matters Para
71	OPSC	Overall Presentation, Structure & Content
72	P&P	Policies & Procedures
73	PA	Principal Auditor
74	PAC	Public Accounts Committee
75	PAI	Prior Audit Issues
76	PD	Public Deposits
77	PDD	Provision for doubtful debts
78	PFFI	Proforma Financial Information
79	PFI	Prospective Financial Information
80	PM	Performance Materiality
81	PO	Purchase Order

82	PPFS	Preparation & Presentation of Financial Statements
83	PRL	Professional Standards, Regulatory & Legal Requirements
84	PY	Previous Year
85	QC	Quality Control
86	RA	Reasonable Assurance
87	RAP	Risk Assessment Process/Procedures
88	recd	received
89	RoMM	Risk of Material Misstatement
90	RP	Related Party
91	SAAE	Sufficient & Appropriate Audit Evidence
92	SAI	Supreme Audit Institution
93	SBA	Statutory Branch Auditors
94	SCA	Statutory Central Auditors
95	SCoTs	Significant Classes of Transactions
96	SO	Service Organisation
97	SODs	Segregation of Duties
98	SP	Sole Proprietor
99	SPF	Special Purpose Framework
100	SPFS	Special Purpose Financial Statements
101	spl	Special
102	SRE	Standard on Review Engagement
103	SRS	Standards on Related Services
104	SSO	Sub-Service Organisation
105	std	standards
106	t/o	turnover
107	T/R	Trade Receivables
108	TCWG	Those charged with Governance
109	TM	Tolerable Misstatement
110	TOC	Test of Controls
111	TOD	Test of Details
112	trfd	Transferred
113	UDIN	Unique Document Identification Number
114	w.r.t	with respect to
115	WR	Written Representation

If u come across any more short form, let me know via DM on Insta or mail to cashubhamkeswani@gmail.com will include that too & share updated sheet ☺

For all Audit Related Updates (Batches/books/RTPs/MTPs etc)
Join this telegram channel:
https://t.me/ClearCAWithSK

"Khushi se Padhenge,
Tabhi aage badhenge"

CHAPTER 01

Standards on Auditing



SQC 1 "Quality Control for Firms that perform Audits & Reviews of Historical Financial Info, and Other Assurance & Related Services Engagements" (+)

SA 220 Quality Control for an Audit of FS

Firms to have system of quality control that provides reasonable assurance that:

a) Firm & personnel comply with professional standards, regulatory & legal (PRL) requirements, &

b) Reports issued by firm or partners are appropriate in circumstances.

Elements of a System of Quality Control

a) Leadership responsibilities for quality within firm	d) Human resources
b) Ethical requirements	e) Engagement performance
c) Acceptance & continuance of client relationships & engg	f) Monitoring

Leadership Responsibilities for Quality

Firm (SQC-1)	SA 220 (Audit)
✓ Requires firms to establish policies & procedures to promote internal culture that quality is essential in performing engg. ✓ Firm's CEO or managing partners to assume ultimate responsibility for firm's system of quality control. ✓ Example set by firm's leadership encourages an inner culture that recognizes high quality audit work. ✓ Persons assigned operational responsibilities for quality control system should have experience, ability & authority.	Engg partner (EP) shall take responsibility for overall quality on each audit engg assigned. Actions of EP & appropriate msgs to other members of engg team emphasise: (a) The importance to audit quality of: i) Performing work that complies with Professional stds, Regulatory & Legal requirements (PRL) ii) Complying with firm's quality control policies & procedures iii) Issuing appropriate auditor's reports & iv) Engg Team's ability to raise concerns without fear of reprisals (b) Fact that quality is essential in performing audit engg.

Considerations ➔ upholding quality of firm

Following considerations should be taken into account while upholding quality of firm: -

i) Firm's personnel P&P designed to demonstrate its commitment to quality.

ii) Firm devotes sufficient resources for development & documentation of quality control P&P.

iii) Firm assigns its mgt responsibilities that commercial considerations don't override quality of work

iv) Before accepting engg acquire vital info about client.

Decide about integrity of Client, promoters & KMP, competence (including capabilities, time & resources) to perform engg & comply with ethical requirements.

Ethical Requirements

1. Confidentiality 2. Objectivity 3. Integrity 4. Professional Competence & Due Care 5. Professional Behaviour

Independence Policy

Policies & procedures should enable firm to:

- ➢ Communicate independence requirements to personnel & others.
- ➢ Identify & evaluate circumstances & relationships creating threat to independence.
- ➢ Take appropriate action to eliminate threats/reduce to acceptable level/withdrawal from engg.

Notes:

- ✓ There should be mechanism in firm by which EPs provide firm with relevant info. about client engg. & firm personnel promptly notify firm of circumstances & relationships that create threat to independence.
- ✓ All breaches of independence should be promptly notified to firm for appropriate action.
- ✓ At least annually, firm should obtain written confirmation of compliance with P&P on independence from all firm personnel.
- ✓ Familiarity threat is relevant in FS audits of listed entities. EP rotated after 7 years.

Acceptance & Continuance of Client Relationships & Engagement

Info. such as following assists EP in determining whether decisions regarding acceptance & continuance of audit engg. are appropriate:

- Integrity of principal owners, key mgt & TCWG of entity
- Competence (including capabilities, time and resources) to perform engg.
- Compliance with ethical requirements &
- Significant matters arisen during current or previous audit engg, & their implications for continuing the relationship.



Where issues identified & firm decides to accept or continue client relationship or specific engg, it should document how issues were resolved.

Evaluating the Integrity of Client

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

- ✓ Identity & business reputation of client's principal owners, key mgt, related parties & TCWG.
- ✓ Reasons for proposed appointment of firm and non-reappointment of previous firm.
- ✓ Nature of client's operations, including business practices.
- ✓ Info. concerning attitude of client's owners, key mgt & TCWG towards matters such as aggressive interpretation of a/c stds & internal control environment.
- ✓ Whether client is aggressively concerned with maintaining firm's fees as low as possible.
- ✓ Indications of inappropriate limitation in scope of work.

- ✓ Indications that client might be involved in money laundering or other criminal activities.

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Matters to be considered in determining if firm has capabilities, competence, time & resources to undertake new engg:

- ✓ Firm personnel have knowledge of relevant industries or subject matters
- ✓ Firm personnel have experience with regulatory or reporting requirements, or ability to gain necessary skills & knowledge effectively
- ✓ Firm has sufficient personnel with the necessary competence & capabilities
- ✓ Experts are available, if needed
- ✓ Individuals meeting criteria & eligibility requirements to perform EQCR are available and
- ✓ Firm be able to complete engagement within reporting deadline.

Knowledge >> Experience >> Sufficiency >> Experts + EQCR >> Completion

Withdrawal from Engg (Breakup Story)

Policies and procedures on withdrawal from engg include following:

- ✓ Discussing with client's mgt & TCWG regarding action that firm might take based on relevant facts and circumstances.
- ✓ If firm determines it's appropriate to withdraw, discussing with mgt & TCWG withdrawal & reasons for withdrawal from engg.
- ✓ Considering PRL requirement to report withdrawal, with reasons, to regulatory authorities.
- ✓ Documenting significant issues, consultations, conclusions and basis for conclusions.

[Discuss → Withdraw → Reporting → Documenting]

Human Resources

Establish policies/procedures to reasonable assure that:

- Firm has suff. personnel with capabilities, competence & commitment (CCC) to ethical principles &
- EP to issue appropriate report.

Such policies address following personnel issues:

Recruitment → Training → Performance evaluation → Compensation → Career Development

Firm should establish P&P requiring that:

a) Identity & role of engg. partner are communicated to key members of client's mgt & TCWG
b) Engg. partner has appropriate capabilities, competence, authority & time to perform the role;
c) Responsibilities of EP are clearly defined & communicated to that partner

Engg. Performance

Consistency in quality of engg. performance is achieved through:

- Briefing of engg. teams of their objectives,
- Processes for complying with engg. standards,
- Processes of engg. supervision & training,
- Methods of reviewing performance of work,
- Appropriate documentation of work performed.

✓ EP has responsibility for direction, supervision and performance of audit engg.
✓ He is responsible for auditor's report being appropriate in circumstances.
✓ Further, review of audit documentation before issue of audit report is his responsibility.
✓ Ensure that SAAE been obtained to support conclusions reached & for issuance of auditor's report.

Consultation should take place in difficult or contentious matters pertaining to engg.
Includes discussion with individuals within or outside firm having specialized expertise, to resolve difficult or contentious matter.

While reviewing work performed by less experienced members of engg. team, more experienced Reviewers should consider whether:

i) Work has been performed as per PRL requirements.
ii) Significant matters raised for further consideration.
iii) Appropriate consultations & resulting conclusions been documented & implemented.
iv) There is need to revise NTE of work performed.
v) Work performed supports the conclusions reached & appropriately documented.
vi) Evidence obtained is sufficient & appropriate to support the report &
vii) Objectives of engg. procedures been achieved.

Engagement Quality Control Review (EQCR)

Engagement quality control reviewer –

- partner, person in firm (member of ICAI),
- qualified external person, or team of individuals,
- with experience and authority
- to objectively evaluate, before report is issued,

- significant judgments engg. team made & conclusions reached in formulating report.

Basics:

- What EQCR Reviews? Significant judgments made in engg. should be reviewed by EQCR.
- Extent of review depends on complexity of engg. & risk that report might be inappropriate.
- Mandatory for all?

Mandatory for audits of FS of listed entities. For others, firm should devise criteria.

Review Responsibility:

- EP shall take responsibility for reviews being performed as per firm's review policies.
- For audits of FS of listed entities, EP shall:
  - Determine that EQCR has been appointed
  - Discuss significant matters arising during audit engg, with EQCR and
  - Not date auditor's report until completion of EQCR i.e. EQCR should be completed before Audit Report is issued.

EQCR for audits of FS of listed entities includes considering the following:

- ✓ Engg team's evaluation of firm's independence in relation to specific engg.
- ✓ Significant risks identified during the engg & responses to those risks.
- ✓ Judgments made, w.r.t materiality and significant risks.
- ✓ Whether appropriate consultation taken place on differences of opinion or difficult or contentious matters, & conclusions from them.
- ✓ Significance and disposition of corrected & uncorrected misstatements identified during engg.
- ✓ Matters to be communicated to mgt & TCWG & regulatory bodies.
- ✓ Whether working papers selected for review reflect work performed in relation to significant judgments & support conclusions reached.
- ✓ Appropriateness of report to be issued.

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Documentation by EQCR:

1. Procedures required by firm's policies on EQCR have been performed.
2. EQCR has been completed before report is issued
3. Reviewer is not aware of any unresolved matters that would cause reviewer to believe that significant judgments engg. team made & conclusions they reached were not appropriate.



EQCR shall perform objective evaluation of significant judgments made by engg team & conclusions reached in formulating auditor's report.

This evaluation shall involve:

a) Discussion of significant matters with EP

b) Review of FS & proposed auditor's report

c) Review of selected audit documentation relating to significant judgments engg team made & conclusions reached

d) Evaluation of conclusions reached in formulating auditor's report & consideration of whether proposed auditor's report is appropriate

Firm's policies and procedures are designed to maintain objectivity of EQCR.

For eg, engagement quality control reviewer:

✓ Is not selected by EP

✓ Does not participate in engg during period of review

✓ Doesn't make decisions for engg team

✓ Is not subject to other considerations that would threaten reviewer's objectivity.

Can EP consult EQCR during engagement? Yes, as long as it doesn't affect quality of engg. Reviewer's objectivity should be maintained.

Differences of Opinion may arise:

Within Engg Team, With those consulted, or Between EP and EQCR → Engg Team shall follow firm's policies & procedures for dealing with & resolving differences of opinion.

Eg. By consulting another practitioner or firm or a professional or regulatory body.

Engagement Documentation (ED)

✓ Assembly of final engg. files on timely basis. In case of audit, time limit is not more than 60 days after date of auditor's report.

✓ Retention period ordinarily is no shorter than 7 years from date of auditor's report, or, if later, date of group auditor's report.

Ownership of Engagement Documentation (ED):

ED is property of firm. Firm may, at its discretion, make portions of, or extracts from ED available to clients, provided such disclosure doesn't undermine validity of work performed, or, in case of assurance engagements, independence of firm or its personnel.

Electronic & Physical Form of Documentation

- Firm should establish policies & procedures to maintain confidentiality, safe custody, integrity, accessibility & retrievability of engagement documentation.
- Where engg. documentation is in paper or electronic form integrity, accessibility or retrievability of underlying data may be compromised if documentation can be altered, added to or deleted.
- For practical reasons, original paper documentation may be electronically scanned for inclusion in engg. files.

In that case, firm implements appropriate procedures requiring engg. teams to:

a) Generate scanned copies that reflect entire content of original paper documentation, including manual signatures, cross references & annotations

b) Integrate scanned copies into engg files, including indexing & signing off on scanned copies as necessary &

c) Enable scanned copies to be retrieved & printed as necessary.

Complaints & Allegations

i) Firm should establish P&P to provide it with reasonable assurance that it deals with:
   a. Complaints that work performed by firm fails to comply with PRL requirements &
   b. Allegations of non-compliance with firm's system of quality control.

ii) Complaints may originate within or outside the firm. May be made by firm personnel, clients or other third parties. May be received by engg. team members or other firm personnel.

iii) Firm establishes clearly defined channels for firm personnel to raise any concerns without fear of reprisals.

iv) Firm investigates such complaints and allegations as per P&P. Investigation is supervised by a partner with sufficient & appropriate experience & authority within firm but not involved in engg, & includes involving legal counsel. Small firms & sole practitioners may use services of a suitably qualified external person or another firm to carry out investigation. Complaints, allegations & responses to them are documented.

v) Where results of investigations indicate deficiencies in firm's quality control P&P or non-compliance with firm's system of quality control by individual(s) , take appropriate action.

Monitoring

Quality control (QC) of engg. has to be monitored taking into account following factors:

- ✓ Deciding whether QC system of firm appropriately designed & effectively implemented.
- ✓ Examining whether new developments in PRL requirements reflected in quality control policies.
- ✓ Conducting monitoring by entrusting responsibility of monitoring process to a partner or other persons with sufficient and appropriate experience & authority in firm.



- ✓ Dealing with complaints & allegations against firm or any employees of it of non-compliance with professional stds or regulatory requirements by a person within or o/s the firm.
- ✓ Taking appropriate remedial actions against personnel who didn't conform to QC policies.
- ✓ Taking action when deficiencies in design or operation of firm's QC policies & procedures or non-compliance with firm's system of QC identified.

Documentation

- Issues identified wrt compliance with relevant ethical requirements & how they were resolved.
- Conclusions reached regarding acceptance & continuance of client relationships & audit engg.
- Conclusions on compliance with independence requirements & relevant discussions with firm that support these conclusions.
- Nature, scope, & conclusions resulting from consultations undertaken during audit engg.

SQC-1	SA 220
1. Applies to entire firm & fixes responsibility on CEO/Managing partners.	Applies to particular audit engg. & EP takes responsibility.
2. Applicable to Audit, Review of Historical financial info. & related services.	Applicable to audit engg. only.
3. Relates to setting up Quality control system (policies & procedures) for whole firm.	Implement Quality control procedures for particular audit engg.
4. System of quality control provides firm with reasonable assurance that firm & personnel comply with PRL requirements to issue appropriate reports.	It is premised on basis that firm is subject to SQC 1. Therefore, SQC 1 is essential for SA 220. It is within firm's system of quality control, engg. teams implement quality control procedures for audit engg.

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SA 200 Overall Objectives of Independent Auditor and Conduct of an Audit in Accordance with Standards on Auditing

Overall Objective of Auditor?

In conducting an audit of F.S., overall objectives of auditor are:

a) To obtain Reasonable Assurance about whether FS as whole are free from material misstatement, whether due to fraud or error, thereby enabling auditor to express an opinion on whether FS are prepared, in all material respects, as per applicable FRF &

b) To report on FS, & communicate as per SAs.

Definitions

- Applicable financial reporting framework (FRF) -FRF adopted by mgt & TCWG in preparation & presentation of FS that's acceptable in view of nature of entity & objective of FS, or required by law or regulation.

"Fair presentation framework" refer to FRF that requires compliance with framework and:

i) Acknowledges, to achieve fair presentation, it may be necessary to provide disclosures beyond specifically required by framework (+) or

ii) Acknowledges explicitly that it may be necessary to depart from a requirement of framework to achieve fair presentation of FS. Such departures expected in extremely rare circumstances. (-)

"Compliance framework" is FRF that requires compliance with requirements of framework, but doesn't contain acknowledgements in (i) or (ii) above.

- Misstatement -Difference between amount, classification, presentation, or disclosure(a/c/p/d) of a reported FS item & (a/c/p/d) required as per applicable FRF. Misstatements can arise from *error or fraud.*



Misstatements se darr nahi lagta sahab,
material misstatements se lagta hai!

- Those charged with governance (TCWG) - Person(s) or organisation(s) (e.g., a corporate trustee) with responsibility for overseeing strategic direction of entity & obligations related to accountability of entity. (Executive Members-CEO/CFO/MD)



Audit Risk

Risk that auditor expresses inappropriate audit opinion when FS are materially misstated. Audit risk is function of RoMM and detection risk.

Risk of material misstatement (ROMM) - Risk that FS are materially misstated prior to audit. This consists of 2 components, described as follows at assertion level:

Inherent Risk	Control Risk
Susceptibility of an assertion about a ABCD to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.	Risk that a misstatement that could occur in an assertion about a ABCD and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by entity's internal control.

ROMM may exist at two levels:

Overall F.S. level i.e. relate to FS as a whole potentially affecting many assertions	Assertion level for Class of Transactions, a/c balances, and disclosures (ABCD)

Why we assess RoMM at assertion level?

ROMM at assertion level are assessed in order to determine NTE of further audit procedures necessary to obtain SAAE.

Detection risk – Risk that procedures performed by auditor to reduce audit risk to acceptably low level will not detect a misstatement that exists and could be material, either individually or when aggregated with other misstatements i.e. Risk of not detecting a material misstatement.

Sufficient & Appropriate Audit Evidence (SAAE)

To obtain reasonable assurance, auditor shall obtain SAAE to reduce audit risk to an acceptably low level and draw reasonable conclusions on which to base auditor's opinion

- Reasonable assurance – High, but not absolute, level of assurance.
- Audit evidence – Info. used by auditor in arriving at conclusions on which auditor's opinion is based.

(i) Sufficiency is measure of quantity of audit evidence.

Quantity is affected by:

- auditor's assessment of risks of material misstatement (ROMM) &
- quality of such audit evidence.

(ii) Appropriateness is measure of Quality of audit evidence i.e. its relevance & its reliability in providing support for conclusions on which auditor's opinion is based.

Inherent Limitations of Audit (ILA)

Auditor isn't expected to & can't reduce audit risk to zero and therefore can't obtain absolute assurance that FS are free from material misstatement due to fraud or error.

This is because there are inherent limitations of an audit, which result in most of audit evidence being persuasive rather than conclusive.

1. Nature of financial reporting:

   Preparation of F.S. involves judgment by mgt in applying requirements of applicable FRF to facts and circumstances of entity. For eg: A/c estimates

2. Nature of audit procedures:
   - Possibility that mgt & others don't provide complete info relevant to P.P.F.S
   - Fraud may involve sophisticated and carefully organised schemes designed to conceal it.
   - Audit is not an official investigation into alleged wrongdoings. He doesn't have special legal powers eg. search.

3. Timeliness of Reporting & Balance between Benefit and Cost:

   Relevance of info, & thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.

4. In case of certain assertions or subject matters, potential effects of inherent limitations on auditor's ability to detect material misstatements are particularly significant.

   Such assertions or subject matters include:
   - ✓ Fraud, particularly fraud involving senior management or collusion.
   - ✓ Existence and completeness of related party relationships and transactions.
   - ✓ Occurrence of non-compliance with laws and regulations.
   - ✓ Future events or conditions that may cause an entity to cease to continue as a going concern.

Note:
- o Because of 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.
- o Subsequent discovery of material misstatements resulting from fraud/error doesn't by itself indicate a failure to conduct audit as per SAs.
- o However, ILA are not justification for auditor to be satisfied with less-than-persuasive audit evidence.



Professional Skepticism

An attitude that includes a

- ✓ questioning mind (?),
- ✓ being alert to conditions (!) which may indicate possible misstatement due to error or fraud, &
- ✓ critical assessment of audit evidence.

Professional skepticism includes being alert to, for eg:

- Audit evidence that contradicts other audit evidence obtained.
- Info. that brings into Ques. reliability of documents to be used as audit evidence
- Conditions that may indicate possible fraud.
- Circumstances that suggest need for audit procedures in addition to those required by SAs.

Maintaining professional skepticism throughout audit is necessary to reduce risks of:

- Overlooking unusual circumstances.
- Over generalising when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining nature, timing, and extent(NTE) of audit procedures & evaluating the results thereof.

Professional judgment

Application of relevant training, knowledge and experience,

- ✓ within the context provided by auditing, accounting and ethical standards,
- ✓ in making informed decisions about
- ✓ the courses of action appropriate in audit engg.

Professional judgment is necessary in particular regarding decisions about:

- ➢ Materiality and audit risk.
- ➢ Nature, timing, and extent(NTE) of audit procedures used to meet requirements of SAs and gather audit evidence.
- ➢ Evaluating whether SAAE has been obtained, and whether more needs to be done to achieve objectives of SAs and thereby, overall objectives of auditor.
- ➢ Evaluation of mgt's judgments in applying entity's applicable FRF.
- ➢ Drawing of conclusions based on audit evidence obtained, for eg, assessing reasonableness of estimates made by management in preparing F.S.

[Materiality + Risk >> Audit Procedures >> SAAE >> Conclusions >> Mgt judgement]



The Premise (Responsibilities of Mgt & TCWG)

i) For preparation and presentation of financial statements (PPFS) as per applicable FRF this includes design, implementation and maintenance (DIM) of internal control (IC) relevant to PPFS free from material misstatement, whether due to fraud or error; &

ii) To provide auditor with:

a) All info. such as records and documentation, & other matters relevant to PPFS
b) Any additional info that auditor may request from mgt and, where appropriate, TCWG &
c) Unrestricted access to those within entity from whom auditor determines necessary to obtain audit evidence.

As part of their responsibility for PPFS, mgt and, TCWG are responsible for:

- Identification of applicable FRF , in context of relevant laws or regulations.
- PPFS as per that framework.
- Adequate description of that framework in FS

FS may be prepared as per a FRF designed to meet:

- Common financial info. needs of a wide range of users (i.e., "general purpose F.S."); or
- Financial information needs of specific users (i.e., "special purpose F.S.").

Conduct of an Audit in accordance with SAs

- Complying with SAs Relevant to Audit:
  - ➢ Auditor shall comply with all SAs relevant to audit.
  - ➢ SA is relevant to audit when it is in effect and circumstances addressed by the SA exist.
  - ➢ Auditor shall have an understanding of entire text of an SA including application.
  - ➢ Auditor shall not represent compliance with SAs in auditor's report unless auditor has complied with requirements of this SA and all other SAs relevant to the audit.

- Complying with Relevant Requirements
  - ➢ Auditor shall comply with each requirement of SA unless, in circumstances of audit:
    a. An SA is not relevant or
    b. There's conditional requirement & condition doesn't exist.
  - ➢ In exceptional circumstances, auditor may depart from relevant requirement in SA. In such cases, auditor shall perform alternative audit procedures & it shall be documented.

"Do Sufficient & Appropriate coverage to get
Reasonable Assurance of Passing CA Exams"

SA 210 Agreeing the Terms of Audit Engagement

Objective

Objective of auditor is to accept or continue audit engagement only when basis upon which it is to be performed has been agreed, through:

a) Establishing whether preconditions for audit are present &

b) Confirming there is common understanding b/w auditor & mgt , TCWG of terms of audit engg.

Preconditions of Audit

Auditor shall:-

a. Determine whether FRF is acceptable [Factors discussed later]

b. Obtain agreement of mgt that it acknowledges and understands its responsibility:

i) For preparation of FS as per applicable FRF

ii) For such Internal Control (IC) as mgt determines necessary to enable preparation of FS free from material misstatement, whether due to fraud or error &

iii) To provide the auditor with:

a) Access to all info. of which mgt is aware that's relevant to preparation of FS

b) Additional info. that auditor may request for purpose of audit &

c) Unrestricted access to persons within entity from whom auditor determines necessary to obtain audit evidence.

If preconditions not present, auditor shall discuss matter with mgt & not accept proposed audit engagement:

Limitation on Scope Prior to Audit Engagement Acceptance

If mgt or TCWG impose limitation on scope of auditor's work such that auditor believes it'd result in auditor disclaiming an opinion on F/S , shall not accept such audit engg, unless required by law or regulation.

Contents of Agreement on terms of Audit engg.

Agreed terms of audit engg. shall be recorded in audit engg. letter or other written agreement and include:

a. Objective and scope of the audit of FS.

b. Responsibilities of auditor

c. Responsibilities of management

d. Identification of applicable FRF for preparation of FS &

e. Reference to expected form and content of any reports to be issued by auditor and a statement that there may be circumstances in which a report may differ from its expected form & content.



Recurring Audits: New engagement letter each time?

Auditor may decide not to send new audit engg. letter or other written agreement each period.

Following factors make it appropriate to revise terms of audit engg. or remind entity of existing terms:

- ✓ Any indication that entity misunderstands objective and scope of audit.
- ✓ Any revised or special terms of audit engagement.
- ✓ Recent change of senior management.
- ✓ Significant change in ownership.
- ✓ Significant change in nature or size of the entity's business.
- ✓ A change in legal or regulatory requirements.
- ✓ A change in the FRF adopted in the preparation of F.S.
- ✓ A change in other reporting requirements.

Acceptance of a Change in Terms of Audit Engagement

Auditor shall not agree to change in terms of audit engg. where there is no reasonable justification for doing so. If, prior to completing audit engg, auditor is requested to change it to an engagement that conveys lower level of assurance, determine whether there is reasonable justification for doing so.

If terms are changed, auditor and mgt agree on and record new terms of engagement in engagement letter or other suitable form of written agreement.

If auditor unable to agree to change of terms and not permitted by mgt to continue, auditor shall:

a. Withdraw from audit engg. where possible under law or regulation and

b. Determine whether there is obligation, either contractual or otherwise, to report circumstances to other parties, such as TCWG, owners or regulators

FRF Prescribed by Law or Regulation—Other Matters Affecting Acceptance

If auditor has determined → FRF prescribed by law or regulation would be unacceptable but for the fact that its prescribed by law or regulation, auditor shall accept audit engg. only if following conditions are present:

a. Management agrees to provide additional disclosures in F.S. and

b. It is recognised in terms of audit engagement that:

   i) Auditor's report will include EOM para, drawing users' attention to add. disclosures, as per SA 706 &

   ii) Unless auditor is required by law or regulation to express auditor's opinion on F.S. by using phrases "present fairly, in all material respects", or "give a true & fair view" as per applicable FRF , auditor's opinion on F.S. will not include such phrases.

If above conditions not present and auditor reqd. by law or regulation to undertake audit engg., he shall:

(a) Evaluate effect of misleading nature of F.S. on auditor's report and

(b) Include appropriate reference to this matter in terms of audit engg.



Factors relevant to auditor's determination of acceptability of FRF to be applied in preparation of F.S. include:

- Nature of entity (for example, whether it is a business enterprise, or a not for profit organization)
- Purpose of F.S. (for eg, whether they are prepared to meet common financial information needs of a wide range of users or financial information needs of specific users)
- Nature of F.S. (for example, whether F.S. are complete set of F.S or a single F.S.) and
- Whether law or regulation prescribes applicable FRF.

SA 230 "Audit Documentation"

Record of

- ✓ audit procedures performed,
- ✓ relevant audit evidence obtained, and
- ✓ conclusions the auditor reached" (commonly known as working papers).

Purposes of Audit Documentation

1. Assisting engg. team to plan & perform the audit.
2. Assisting members of engg. team responsible for supervision to direct & supervise the audit, & discharge their review responsibilities.
3. Enabling engg team to be accountable for its work.
4. Retaining record of matters of continuing significance to future audits.
5. Enabling conduct of quality control reviews and inspections.
6. Enabling conduct of external inspections.

[Retain → Plan & Perform → Accountable → Review & Inspections]

Form, Content and Extent of Audit Documentation

Auditor shall prepare audit doc. sufficient to enable an experienced auditor to understand:

a. Nature, timing, and extent of audit procedures
b. Results of audit procedures performed, and audit evidence obtained and
c. Significant matters arising during audit and conclusions reached thereon, significant professional judgments made in reaching those conclusions.

In documenting nature, timing and extent of audit procedures performed, auditor shall record:

(i) Identifying characteristics of specific items or matters tested
(ii) Who performed audit work and date such work was completed and
(iii) Who reviewed audit work performed and date and extent of such review



Factors effecting Form, content & extent of audit documentation

1. Size and complexity of entity.
2. Nature of the audit procedures to be performed.
3. Identified risks of material misstatement.
4. Significance of the audit evidence obtained.
5. Nature & extent of exceptions identified.
6. Need to document a conclusion or the basis for a conclusion not readily determinable from documentation of work performed or audit evidence obtained.
7. Audit methodology and tools used.
8. Timely preparation of Audit Documentation.

Learn with Fun ☺

Documentation of Matters Arising after Date of Auditor's Report

If, in exceptional circumstances, auditor performs new or additional audit procedures or draws new conclusions after date of auditor's report, auditor shall document:

1. The circumstances encountered
2. New or additional audit procedures performed, audit evidence obtained, & conclusions reached, & their effect on auditor's report and
3. When & by whom changes to audit documentation were made & reviewed.

Assembly of Final Audit File

Where auditor finds necessary to modify or add new audit documentation after assembly of final audit file completed, auditor shall document:

a. Specific reasons for making them &
b. When and by whom they were made and reviewed.

Q. Its neither necessary nor practicable for auditor to document every matter considered or professional judgement made. Further its unnecessary to document separately compliance with matters for which compliance is demonstrated by documents included within audit file. Explain.

Its unnecessary to document separately (as in a checklist, for eg) compliance with matters for which compliance is demonstrated by documents included within audit file.
For eg:



- ✓ Existence of adequately documented audit plan demonstrates auditor has planned the audit.
- ✓ Existence of signed engg. letter in audit file demonstrates auditor has agreed terms of audit engg. with mgt or TCWG.
- ✓ Auditor's report containing an appropriately qualified opinion demonstrates auditor has complied with requirement to express a Qualified opinion as per SAs.

In relation to requirements that apply generally throughout audit, there may be a no. of ways in which compliance with them may be demonstrated within audit file:

- ✓ For eg, there may be no single way in which the auditor's professional skepticism is documented. But audit documentation may nevertheless provide evidence of auditor's exercise of professional skepticism. Such evidence may include specific procedures performed to corroborate mgt's responses to auditor's inquiries.
- ✓ Similarly, that EP has taken responsibility for direction, supervision and performance of audit in compliance with SAs may be evidenced in a no. of ways. This may include documentation of EP's timely involvement in aspects of audit, such as participation in team discussion reqd. by SA 315.

Learning:

As work not documented is work not done,

questions not practiced by recalling or writing are Questions not done!

Do Practice the Questions Now ☺

SA 240: Auditor's Responsibilities relating to Fraud in an Audit of F.S.

Responsibility for Prevention and Detection of Fraud: Primary Resp. → Mgt & TCWG

Objectives of auditor: -

a) To identify & assess RoMM in FS due to fraud
b) To obtain SAAE about assessed RoMM due to fraud, through designing & implementing appropriate responses &
c) To respond appropriately to identified or suspected fraud.

Techniques: Fraudulent Financial Reporting (FFR) & Mgt override of controls

Fraudulent financial reporting may be accomplished by following:

i. Manipulation, falsification (including forgery), or alteration of a/c records or supporting documentation from which FS are prepared.
ii. Misrepresentation or intentional omission from FS of events, transn. or other significant info.
iii. Intentional misapplication of a/c principles relating to amts, classification, manner of presentation, or disclosure.

It often involves mgt override of controls, misappropriation of assets etc that otherwise may appear to be operating effectively.

Fraud can be committed by management overriding controls using such techniques as:

i) Altering records and terms related to Significant and unusual transactions.
ii) Recording Fictitious journal entries, close to end of accounting period, to manipulate operating results or achieve other objectives.
iii) Inappropriately Adjusting Assumptions & changing judgments used to estimate a/c balances.
iv) Concealing, or not disclosing, facts that could affect amounts recorded in F.S.
v) Engaging in Complex transactions structured to misrepresent financial position or financial performance of entity.
vi) Omitting, advancing or delaying recognition of events and Transactions in FS that have occurred during reporting period.

Techniques of Misappropriation of Assets

i) Embezzling receipts (misappropriating collections from debtors)
ii) Stealing physical assets or intellectual property
iii) Causing entity to pay for goods and services not received (for eg, payments to fictitious vendors, payments to fictitious employees).

iv) Using entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).

What are fraud risk factors?

Fraud risk factors are events or conditions that indicate incentive or pressure to commit fraud or provide an opportunity to commit fraud. For eg: -

- Pressure: Need to meet expectations of 3rd parties to obtain additional equity financing may create pressure to commit fraud
- Incentive: Granting of significant bonuses if unrealistic profit targets are met may create an incentive to commit fraud &
- Opportunity: Control environment that is not effective may create opportunity to commit fraud.

Examples of fraud risk factors

Risk factors relating to misstatements arising from fraudulent financial reporting

Following are eg of risk factors relating to misstatements arising from FFR: -

Incentives/Pressures

Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by): -

Industry:

- High degree of competition or market saturation, accompanied by declining margins.
- Significant declines in customer demand & increasing business failures in industry or overall economy.
- Rapid growth or unusual profitability compared other companies in the same industry.

Operating:

- Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.

Economic:

- High vulnerability to rapid changes, like changes in technology, product obsolescence or intt rates.
- New accounting, statutory, or regulatory requirements.

Excessive pressure exists for mgt to meet requirements or expectations of 3rd parties due to following:

- Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties including expectations created by mgt in, for eg, overly optimistic press releases or annual report messages.
- Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards.
- Need to obtain Additional debt or equity financing to stay competitive— including financing of major R&D or capital expenditures.
- Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.

Info indicates that personal financial situation of mgt or TCWG is threatened by entity's financial performance arising from following: -

- Significant financial interests in entity.
- Personal guarantees of debts of entity.
- Significant portions of their compensation (for eg, bonuses, stock options & earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position or cash flow.
- There is excessive pressure on mgt or operating personnel to meet financial targets established by TCWG, including sales or profitability incentive goals.

Opportunities

Nature of industry or entity's operations provides opportunities to engage in FFR that can arise from following: -

- Strong financial presence or ability to dominate a certain industry that allows entity to dictate T&Cs to suppliers or customers that may result in inappropriate or non-arm's-length transactions.

RPTs

- Significant related-party transactions not in ordinary course of business or with related entities not audited or audited by another firm.
- Use of business intermediaries for which there appears to be no clear business justification.
- Significant, unusual, or highly complex transactions, close to period end that pose difficult "substance over form" questions.

International

- Significant operations located or conducted across international borders in jurisdictions where differing business environments & cultures exist.
- Significant bank a/cs or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.

A/c estimates: Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties difficult to corroborate.

There is a complex or unstable organizational structure, as evidenced by following: -

- Difficulty in determining organization or individuals that have controlling interest in entity.
- Overly complex org structure involving unusual legal entities or managerial lines of authority.
- High turnover of senior mgt, legal counsel, or TCWG.

Internal control components are deficient as a result of the following: -

- Inadequate monitoring of controls, including automated controls & controls over interim financial reporting (where external reporting is required).
- High turnover rates or employment of accounting, internal audit, or IT staff not effective.
- Accounting & info systems that are not effective, including situations involving significant deficiencies in internal control.

Attitudes/Rationalizations

Attitude?

- Excessive interest by mgt in maintaining or increasing entity's stock price or earnings trend.
- Practice by mgt of committing to analysts, creditors, and other 3rd parties to achieve aggressive or unrealistic forecasts.
- An interest by mgt in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
- Known history of violations of securities laws or other L/R, or claims against entity, its senior mgt or TCWG alleging fraud or violations of L/R.
- Low morale among senior mgt.

Others:

- Communication, implementation, support, or enforcement of entity's values or ethical standards by mgt or communication of inappropriate values or ethical standards, that are not effective.
- Non-financial mgt's excessive participation or preoccupation with selection of a/c policies or determination of significant estimates.
- Mgt failing to remedy known significant deficiencies in internal control on a timely basis.
- Owner-manager makes no distinction between personal and business transactions.
- Dispute between shareholders in a closely held entity.
- Recurring attempts by mgt to justify marginal or inappropriate a/c on basis of materiality.

Relationship b/w mgt and current or predecessor auditor is strained, as exhibited by following: -

- Domineering mgt behaviour in dealing with auditor, especially attempts to influence scope of auditor's work or selection or continuance of personnel assigned to or consulted on audit engg.
- Unreasonable demands on auditor, such as unrealistic time constraints regarding completion of audit or issuance of auditor's report.
- Frequent disputes with current or predecessor auditor on accounting, auditing, or reporting matters.
- Restrictions on auditor that inappropriately limit access to people or info or ability to communicate effectively with TCWG.

Risk Factors Relating to Misstatements Arising from Misappropriation of Assets:

1. Incentives/Pressures: Personal financial obligations may create pressure on mgt or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

Adverse relationships between entity & employees with access to cash or other assets susceptible to theft may motivate employees to misappropriate those assets.

For eg, adverse relationships may be created by following:

- ✓ Known or anticipated future employee layoffs.
- ✓ Recent or anticipated changes to employee compensation or benefit plans.
- ✓ Promotions, compensation or other rewards inconsistent with expectations.

2. Opportunities: Certain circumstances increase susceptibility of assets to misappropriation.

For eg, opportunities to misappropriate assets increase in case of following:

- ✓ Large amounts of cash on hand
- ✓ Inventory items → small in size, of high value, or in high demand.
- ✓ Easily convertible assets, such as bearer bonds, diamonds, or computer chips.
- ✓ Fixed assets → small in size, marketable, or lacking observable identification of ownership.

Inadequate IC over assets may increase susceptibility of misappropriation of those assets

For eg, misappropriation of assets may occur because of following:

- Inadequate Segregation of Duties or independent checks.
- Inadequate oversight of senior mgt expenditures, eg travel and other reimbursements.
- Lack of timely & appropriate documentation of transactions, for eg, credits for merchandise returns.
- Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
- Inadequate record keeping with respect to assets.

3. Attitudes/Rationalizations

- ✓ Disregard for need for monitoring or reducing risks related to misappropriations of assets.



- ✓ Disregard for internal control over misappropriation of assets by overriding existing controls or failing to take remedial action on known deficiencies.
- ✓ Behavior indicating displeasure or dissatisfaction with entity or its treatment of employee.
- ✓ Changes in behavior or lifestyle that may indicate assets have been misappropriated.
- ✓ Tolerance of petty theft.

Responsibilities of Auditor

Auditor is responsible for obtaining reasonable assurance that F.S. as a whole are free from material misstatement, whether due to fraud or error.

- ➢ Owing to inherent limitations of audit as per SA 200 there's unavoidable risk that some material misstatements may not be detected, even though audit is planned and performed as per SAs.
- ➢ Risk of not detecting M.M. from fraud > error. Because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to auditor.
- ➢ Risk of not detecting M.M. from management fraud > employee fraud as mgt is in position to directly or indirectly manipulate a/c records or present fraudulent financial information.

Auditor's duties for prevention and detection of fraud

- ➢ Auditor is responsible for maintaining attitude of professional scepticism throughout audit.
- ➢ Considering potential for mgt override of controls & recognizing fact that audit procedures that are effective for detecting error may not be effective in detecting fraud.

Responses to assessed RoMM due to fraud at FS level

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

a. Assign & supervise personnel considering their knowledge, skill & ability of individuals to be given significant engg responsibilities

b. Evaluate selection & application of a/c policies by entity, related to subjective measurements & complex transactions, whether it's of FFR resulting from mgt's effort to manage earnings

c. 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 FAP whose NTE are responsive to assessed RoMM due to fraud at assertion level.
- ✓ Auditor may change NTE of audit procedures to obtain audit evidence that's more reliable & relevant or obtain additional corroborative info.

For eg, if auditor identifies mgt is under pressure to meet earnings expectations, risk that mgt is inflating sales by entering sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery.

- ✓ Auditor may design external confirmations not only to confirm o/s amounts, but also confirm details of sales agreements, including date, rights of return & delivery terms.
- ✓ In addition, auditor might supplement such external confirmations with inquiries of non-financial personnel in entity regarding any changes in sales agreements & delivery terms.

Audit Procedures Responsive to Risks Related to Mgt Override of Controls

Mgt is in unique position to perpetrate fraud because of its ability to manipulate a/c records & prepare fraudulent FS by overriding controls that otherwise appear to be operating effectively. Due to unpredictable way in which such override could occur, it's a ROMM due to fraud & thus a significant risk.

Irrespective of auditor's assessment of risks of mgt override of controls, auditor shall design and perform audit procedures to:

a. Test appropriateness of journal entries recorded in general ledger and other adjustments in FS.
b. Review a/c estimates for biases and evaluate whether circumstances producing bias represent ROMM due to fraud.
c. For significant transactions o/s normal course of business or appear to be unusual
   - ✓ Evaluate whether business rationale (or lack thereof) of transactions suggests they have been entered to engage in FFR or conceal misappropriation of assets.

[JE Testing → A/c estimates → o/s Normal course of business]

Considering Whether an Identified Misstatement may be Indicative of Fraud

If there is indication → consider implications of misstatement in relation to other aspects of audit, particularly reliability of management representations (SA 580).

Auditor Unable to Complete Engagement

If auditor concludes it isn't possible to continue performing audit as result of misstatement resulting from fraud or suspected fraud, auditor should:

i. consider professional & legal responsibilities, including requirement for to report to person(s) who made audit appointment or regulatory authorities
ii. consider possibility of withdrawing from engg. &
iii. If auditor withdraws:
   - ➢ discuss with mgt and TCWG, withdrawal from engg. & reasons &
   - ➢ consider professional or legal requirement to report to person(s) who made audit appointment or regulatory authorities, withdrawal & reasons for withdrawal.

Enquiring about Mgt Assessment of Fraud Risk

Auditor shall make inquiries of mgt regarding:

a. Mgt's assessment of ROMM due to fraud

b. Mgt's process for identifying & responding to risks of fraud in entity

Written Representations

a) They acknowledge responsibility for DIM of IC to prevent and detect fraud

They have disclosed to auditor:

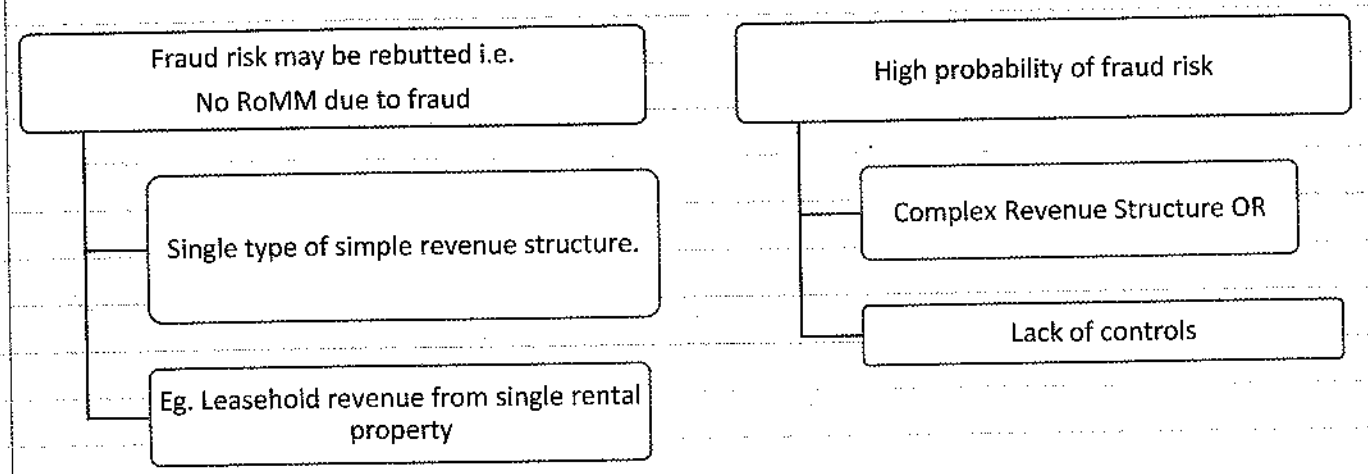
b) results of mgt's assessment of risk that FS may be materially misstated as a result of fraud

c) knowledge of fraud or suspected fraud affecting entity involving mgt, employees who have significant roles in internal control or where fraud could have a material effect on FS &

d) knowledge of allegations of fraud, or suspected fraud, affecting entity's FS communicated by employees, former employees, analysts, regulators or others.

Presumption of Fraud Risk in Revenue Recognition

Auditor based on presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.



When auditor concludes presumption that Fraud Risk related to revenue recognition is not applicable in circumstances of engg, auditor shall document reasons for that conclusion.

SA 250: Consideration of Laws and Regulations in an Audit of F.S.

Mgt Responsibility for compliance with laws and regulation (L/Rs)

Following are procedures entity implement to assist in prevention and detection of non-compliance with laws and regulations:

a) Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
b) Instituting and operating appropriate systems of internal control.
c) Developing, publicising and following a code of conduct.
d) Ensuring employees are properly trained and understand code of conduct.
e) Monitoring compliance with code of conduct and acting appropriately to discipline employees who fail to comply with it.
f) Engaging legal advisors to assist in monitoring legal requirements.
g) Maintaining register of significant laws and regulations with which entity has to comply within its particular industry and a record of complaints.

Auditor's responsibility in relation to Compliance with Laws & Regulations (L/Rs)

Auditor is responsible for obtaining reasonable assurance that FS are free from material misstatement, whether by fraud/error.

- In an audit of FS, auditor takes into account applicable legal & regulatory framework.
- Owing to inherent limitations of audit, there is unavoidable risk that some material misstatements in may not be detected, even though audit is properly planned & performed as per SAs.

In context of L/Rs, potential effects of inherent limitations on auditor's ability to detect material misstatements are greater for such reasons as following: -

a) There are many laws & regulations, relating principally to operating aspects of entity that typically don't affect FS & are not captured by entity's info. systems relevant to financial reporting.
b) Non-compliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, mgt override of controls or intentional misrepresentations to auditor.
c) Whether act is a non-compliance is ultimately matter for legal determination by court of law.

2 Types of L/Rs

This SA distinguishes auditor's responsibilities in relation to compliance with 2 different categories of laws and regulations as follows:

i. Provisions of those L&R having a direct effect on determination of material amounts and disclosures in F.S. such as tax and labour laws and
ii. Other L/Rs that don't have direct effect on determination of amounts and disclosures in F.S., but compliance with which may be fundamental to operating aspects of business.



- ✓ For 1st category, auditor's responsibility is to obtain SAAE about compliance with Laws & Regulations.
- ✓ For 2nd category, auditor's responsibility is limited to undertake specified audit procedures to help identify non-compliance with those L/Rs that may have material effect on FS.

Auditor's Consideration of Compliance with Laws and Regulations

Understanding → SAAE → Non-Compliance → Remain Alert → WR

1. Auditor shall obtain a general understanding of:
   a) legal & regulatory framework applicable to entity & industry in which entity operates &
   b) How entity is complying with that framework.

2. Auditor shall obtain SAAE regarding compliance with those laws and regulations that have a direct effect on determination of material amounts & disclosures in FS
3. Auditor shall perform following audit procedures to identify instances of noncompliance with other laws and regulations that may have a material effect on F.S:
   a) Inquiring of management; and
   b) Inspecting correspondence, if any, with relevant licensing or regulatory authorities.

4. During audit, auditor shall remain alert to possibility that other audit procedures may bring instances of non-compliance or suspected non-compliance with laws and regulations to auditor's attention.

5. Obtain written representation that known instances of non-compliance with L&Rs have been disclosed to auditor

Audit Procedures When Non-compliance is Identified or Suspected

If auditor becomes aware of instance of Non-compliance with L&Rs, auditor shall obtain:

a) Understanding of nature of activity & circumstances in which it has occurred and
b) Further info. to evaluate possible effect on FS
   - If auditor suspects there may be non-compliance, auditor shall discuss with mgt and TCWG.
   - If mgt or TCWG don't provide sufficient info. & impact maybe material, auditor shall consider need to obtain legal advice.
   - If sufficient info can't be obtained, evaluate effect of lack of SAAE on auditor's opinion.
   - Auditor shall evaluate effect of non-compliance on other aspects of audit, including auditor's risk assessment & reliability of written representations, & take appropriate action.

Reporting of Identified or Suspected Non-Compliance with L/R (NOCLAR)

Reporting Non Compliance to TCWG:

- If, non-compliance is intentional and material, communicate matter to TCWG as soon as practicable.
- If auditor suspects mgt or TCWG involved in noncompliance, communicate matter to next higher level of authority at entity, such as audit committee or supervisory board. Where no higher authority exists, or if auditor believes communication may not be acted upon, obtain legal advice.

Reporting Non-Compliance in the Auditor's Report on FS

- ✓ If auditor concludes that non-compliance has a material effect on F.S. and has not been adequately reflected in FS, express Qualified or Adverse opinion on FS.
- ✓ If auditor precluded by mgt or TCWG from obtaining SAAE, express Qualified or Disclaim an opinion.
- ✓ If auditor is unable to determine whether non-compliance has occurred because of limitations imposed by circumstances rather than mgt or TCWG, evaluate effect on auditor's opinion.

Reporting Non-Compliance to Regulatory and Enforcement Authorities

If auditor identified or suspects NOCLAR, auditor shall determine whether he has a responsibility to report identified or suspected non-compliance to parties outside the entity.

Indicators of Non-Compliance with laws and regulations

- ✓ Investigation by regulatory org., Govt deptt. or payment of fines, additional taxes or penalties.
- ✓ Payments for unspecified services/Loans to consultants, Related parties, employees/govt employees.
- ✓ Sales commission or Agent's fees that appear excessive in relation to ordinarily paid by entity
- ✓ Purchases at Prices Significantly above or below market price.
- ✓ Unusual Payments in Cash, purchases in form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.
- ✓ Unusual payments towards legal and retainerShip fees.
- ✓ Unusual transactions with companies registered in Tax Haven.
- ✓ Adverse Media comment

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SA 260 (Revised) "Communication with Those Charged With Governance"

Role of communication

Effective two-way communication is important in assisting:

a. Auditor and TCWG in understanding matters related to audit & developing a constructive working relationship.

b. Auditor in obtaining info. from TCWG relevant to audit. For eg, TCWG may assist auditor in understanding entity and its environment, identifying appropriate sources of audit evidence, & providing info about specific transactions or events.

c. TCWG in fulfilling their responsibility to oversee financial reporting process (FRP), thereby reducing ROMM of FS.

Auditor's Objective

- To communicate clearly with TCWG responsibilities of auditor and planned scope & timing of audit.
- To obtain from TCWG info relevant to audit.
- To provide TCWG with timely observations significant & relevant in overseeing FRP.
- To promote effective two-way communication between auditor and TCWG

Matters to be communicated

- Auditor's responsibilities in relation to F.S. Audit

  a) Auditor is responsible for forming and expressing an opinion on FS and

  b) Audit of FS doesn't relieve mgt or TCWG of their responsibilities

- Planned Scope & Timing of Audit

✓ Assist TWCG to understand consequences of auditor's work, discuss issues of risk & materiality & identify areas where auditor should undertake additional procedures &

✓ Assist auditor to better understand entity & its environment.

✓ Auditor communicates significant risks. Communicating significant risks helps TCWG understand those matters & why they require spl. audit consideration. This assist TCWG in fulfilling responsibility to oversee financial reporting process.

✓ Care is necessary to not compromise effectiveness of audit, where TCWG are involved in managing entity. For eg, communicating nature & timing of detailed audit procedures may reduce effectiveness of those procedures by making them too predictable.

- Significant Findings from the Audit : Auditor shall communicate with TCWG:

a) Auditor's views about significant qualitative aspects of entity's a/c practices, including a/c policies, a/c estimates and FS disclosures

b) Significant difficulties, if any, encountered during audit

Examples of Significant difficulties:

- Mgt's unwillingness to make or extend assessment of entity's ability to continue as going concern when requested.
- Restrictions imposed on auditor by mgt
- Unavailability of expected info
- Extensive unexpected effort required to obtain SAAE
- Significant delays by mgt to provide required info
- An unnecessarily brief time to complete audit

Note: Such difficulties may constitute a scope limitation leading to modification of auditor's opinion.

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c. Unless all of TCWG are involved in managing entity:
   - ✓ Significant matters of audit discussed or subject to correspondence with mgt &
   - ✓ Written representations auditor is requesting

d. Circumstances that affect form and content of auditor's report, if any

e. Any other significant matters that in auditor's professional judgment, significant to oversight of financial reporting process.

Significant matters discussed, or subject to correspondence with mgt may include such matters as: -

- Significant events or transactions that occurred during the year.
- Business conditions affecting entity & business plans & strategies that may affect RoMM.
- Concerns about mgt's consultations with other accountants on accounting or auditing matters.
- Discussions or correspondence in connection with initial or recurring appointment of auditor regarding accounting practices, application of auditing standards, or fees for audit or other services.
- Significant matters on which there was Disagreement with mgt, except initial differences of opinion because of incomplete facts or info that are later resolved by auditor obtaining additional info.

Circumstances in which auditor is required to include add. info in auditor's report as per SAs, & for which communication with TCWG is required, include when:

- Auditor expects to modify opinion in auditor's report as per SA 705.
- A material uncertainty related to going concern is reported as per SA 570.
- Key audit matters are communicated as per SA 701.
- Auditor includes EoM paragraph or OM para as per SA 706 or required by other SAs.
- Auditor concluded there is uncorrected material misstatement of other info as per with SA 720

Auditor Independence (Listed Entities)

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

a) Statement that engg. team & others in firm have complied with relevant ethical requirements regarding independence and

b) All relationships and other matters between firm, network firms, and entity that bear on independence.

This shall include total fees charged during period covered by FS,

- ✓ for audit & non-audit services provided
- ✓ by firm & network firms
- ✓ to entity & components controlled by entity.

These fees shall be allocated to categories that are appropriate to assist TCWG in assessing effect of services on independence of auditor;

c) Related safeguards applied to eliminate identified threats to independence or reduce them to acceptable level.

Communication of Key Audit Matters [Timing & Usefulness]

SA 260 requires auditor to communicate with TCWG on a timely basis.

SA 701 states that appropriate timing for communications about KAM will vary with circumstances of engg. However, auditor may communicate preliminary views about KAM when discussing planned scope & timing of audit, & further discuss when communicating about audit findings.

Doing so may help to alleviate practical challenges to have a robust 2 - way dialogue about KAM at time the FS are finalized for issuance.

Communication with TCWG enables them to be aware of KAM & provides them opportunity to obtain further clarification if necessary. Auditor may provide TCWG with draft of auditor's report to facilitate this discussion.

Communication with TCWG recognizes their important role in overseeing financial reporting process, & understand basis for auditor's decisions in relation to KAM & how these matters will be described in auditor's report.

Also enables TCWG to consider whether new or enhanced disclosures may be useful in light of fact that these matters will be communicated in auditor's report.

SA 265 "Communicating Deficiencies in Internal Control to TCWG & Management"

Auditor's Objective

To communicate to TCWG and mgt, deficiencies in internal control that auditor identified and in auditor's professional judgment are of sufficient importance to merit their respective attentions.

Requirements

- Auditor shall determine whether, on basis of audit work performed, he has identified one or more deficiencies in IC.
- If identified one or more deficiencies in IC, determine, on basis of work performed, whether, individually or in combination, they constitute significant deficiencies.
- Auditor shall communicate in writing significant deficiencies in IC identified during audit to TCWG on a timely basis.
- Auditor shall also communicate to mgt at an appropriate level of responsibility on a timely basis:
  a. In writing, significant deficiencies in IC that auditor has communicated or intends to communicate to TCWG, unless it would be inappropriate to communicate directly to mgt in circumstances and
  b. Other deficiencies in internal control identified during audit that haven't been communicated to mgt by other parties and in auditor's professional judgment, are of sufficient importance to merit mgt's attention.

- Written communication to TCWG

Auditor shall include in written communication of significant deficiencies in internal control:

a. Description of deficiencies & explanation of their potential effects &
b. Sufficient info. to enable TCWG and mgt understand context of communication.

In particular, auditor shall explain that:

- Purpose of audit was to express an opinion on FS
- Audit included consideration of Internal Controls relevant to preparation of F.S. in order to design audit procedures that are appropriate in circumstances, but not for purpose of expressing opinion on effectiveness of IC &
- Matters reported are limited to deficiencies that auditor identified during audit and concluded are of sufficient importance to merit being reported to TCWG.



How to determine if there are significant deficiencies in Internal Control?

Indicators of significant deficiencies in internal control include, for eg:

- Evidence of ineffective entity risk assessment process (RAP), such as management's failure to identify a ROMM that auditor would expect entity's risk assessment process to have identified.
- Misstatements detected by auditor's procedures that were not prevented, or detected and corrected(P/D/C), by entity's IC.
- Disclosure of material misstatement due to error or fraud as prior period items in CY's P&L.
- Evidence of mgt's inability to oversee the preparation of F.S.
- Evidence of ineffective response to identified significant risks (eg, absence of controls over such risk).
- Evidence of ineffective aspects of control environment, such as:

a) Identification of mgt fraud, whether or not material, not prevented by entity's IC.

b) Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.

c) Absence of a risk assessment process (RAP) within entity where such process would ordinarily be expected to have been established.

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- Ineffective RAP
- Misstatement detected
- Prior period item
- Inability to oversee preparation of F.S.
- Ineffective response
- Ineffective aspects of control environment (fraud/fail/absence)

How to decide if Identified Deficiency is Significant or Not?

Eg. of matters that auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

- Likelihood of deficiencies leading to MM in F.S. in future.
- Interaction of deficiency with other deficiencies in internal control.
- Volume of activity that has occurred or could occur in account balance or class of trans actions exposed to deficiency or deficiencies.
- FS amounts exposed to deficiencies.
- Susceptibility to loss or fraud of related asset or liability.
- Importance of controls to financial reporting process; for example:
  - General monitoring controls (such as oversight of management).
  - Controls over the prevention and detection of fraud.
  - Controls over the selection and application of significant accounting policies.
  - Controls over significant transactions with related parties.

- Controls over significant transactions o/s entity's normal course of business.
- Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).

Likelihood >> Interaction >> Volume of Activity >> F.S. Amts expose >> Loss/fraud >> Imp of controls

When to communicate?

- Listed Entities: Before date of approval of FS
- Other Entities: Before assembly of audit file [actual date]

Notes:

- If previously communicated significant deficiency remains, current year's communication may repeat description from previous communication, or simply reference previous communication.
- May communicate orally before writing.

SA 299 (Revised) "Joint Audit of Financial Statements"

Joint audit is audit of FS of entity by 2 or more auditors appointed with objective of issuing audit report. Such auditors are described as joint auditors.

Audit Planning, Risk Assessment and Allocation of Work

- EP and other key members of team from each of joint auditors involved in planning.
- Joint auditors jointly establish overall audit strategy that sets scope, timing and direction of audit, and guides development of audit plan.
- Prior to commencement of audit, joint auditors shall discuss and develop a joint audit plan.

In developing joint audit plan, joint auditors shall:

a) Identify division of audit areas and common audit areas amongst joint auditors that define scope of work of each joint auditor
b) Ascertain reporting objectives of engagement to plan timing of audit and nature of communications required
c) Communicate among all joint auditors factors significant in directing engagement team's efforts
d) Consider results of preliminary engagement activities and knowledge gained on other engagements performed earlier by respective EP(s) for relevant entity(s)
e) Ascertain NTE of resources necessary to perform engagement

✓ At this stage, RoMM need to be considered & assessed by each joint auditor & communicated to other joint auditors & documented, whether pertaining to overall FS level or area of allocation among other joint auditors.



- ✓ Joint auditors discuss and document NTE of audit procedures for common and specific allotted areas of audit to be performed by each of them and communicate to TCWG.
- ✓ Joint auditors shall obtain common Engg Letter and common mgt representation letter.
- ✓ After identification and allocation of work among joint auditors, work allocation document shall be signed by all joint auditors and communicated to TCWG.

Responsibility and Co-ordination among Joint Auditors

- ➢ In respect of audit work divided, each joint auditor shall be responsible only for work allocated.
- ➢ All the joint auditors shall be jointly and severally responsible for:

a. audit work not divided among joint auditors and is carried out by all joint auditors
b. decisions taken by all joint auditors under audit planning for common areas concerning NTE of procedures to be performed by each Joint Auditor [Execution → Individual Responsibility]
c. matters brought to notice by any one of them & on which there is agreement among all
d. examining that FS of entity comply with requirements of relevant statutes
e. presentation and disclosure of F.S. as required by applicable FRF
f. ensuring A/R complies with requirement of relevant statutes, SAs & ICAI pronouncements

- ➢ Where joint auditor comes across matters relevant to areas of responsibility of others & deserve their attention, he shall communicate to others in writing prior to completion of audit.
- ➢ Responsibility of each joint auditor to determine NTE of audit procedures to be applied in relation to areas of work allocated.
- ➢ Individual responsibility of each joint auditor to study & evaluate system of internal control & assessment of risk relating to areas of work allocated to said joint auditor.

Audit Conclusion & Reporting

- Joint auditors are required to issue common audit report, however, where there's disagreement w.r.t opinion or any matters of audit report, they shall express opinion in a separate audit report.
- A joint auditor is not bound by views of majority and shall express opinion in separate audit report in case of disagreement.
- In such circumstances, audit report(s) issued by joint auditor(s) shall make a reference to separate audit report(s) issued by other joint auditor(s).
- Further, separate audit report shall also make reference to report issued by other joint auditor.
- Such reference shall be made under heading OM Para as per SA 706.

Each joint auditor is entitled to assume that:

a. Others have carried out their part of audit work as per SAs.
It isn't necessary for joint auditor to review work performed by other joint auditors or perform any tests in order to ascertain whether work has actually been performed in such a manner.

b. Other joint auditors have brought to said joint auditor's notice any departure from applicable FRF or significant observations noticed in course of audit.

Division/Branch: Where FS of a division/branch are audited by one of joint auditors, other joint auditors are entitled to assume that such FS comply with all legal & regulatory requirements & present true & fair view of state of affairs & results of operations of division/branch concerned.

Before finalizing their audit report, joint auditors shall discuss and communicate with each other their respective conclusions that would form the content of audit report.

Communication with TCWG

- When expect to modify opinion, communicate with TCWG circumstances that led to modification & proposed wording of modification to comply with SA 705.
- If expect to include EOM or OM para, communicate with TCWG to ensure compliance with SA 706.

"Performing well in Exams is a JOINT effort of Teacher & Student,
So do REVISE well, so that our efforts pay off well"

SA 315: Identifying and Assessing Risk of Material Misstatement (ROMM) through understanding Entity and its Environment

Objective of Auditor is to:

Identify and assess ROMM, whether due to fraud or error,

- at F.S. and assertion levels,
- through understanding entity and its environment, including entity's internal control,
- thereby providing basis for designing and implementing responses to assessed ROMM.

Assertions - Representations by mgt, embodied in F.S, used by auditor to consider different types of potential misstatements that may occur.

Assertions about classes of transactions and events for the period under audit: (OCACC)

i) Occurrence—transactions and events recorded have occurred and pertain to entity.
ii) Completeness—all transactions and events that should have been recorded → recorded.
iii) Accuracy—amounts and recorded transactions and events → recorded appropriately.
iv) Cut-off—transactions and events recorded → correct accounting period.
v) Classification—transactions and events recorded → proper accounts

Assertions about account balances at the period end: (ERCV)

i) Existence—assets, liabilities, and equity interests exist.
ii) Rights and obligations—rights to assets, and liabilities are obligations of the entity.
iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded.
iv) Valuation and allocation—assets, liabilities, and equity interests are included in F.S. at appropriate amounts and any resulting valuation appropriately recorded.

Assertions about presentation and disclosure: (OCCA)

i) Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to entity.
ii) Completeness—all disclosures that should have been included in F.S. have been included.
iii) Classification and understandability—financial information is appropriately presented and described, and disclosures are clearly expressed.
iv) Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts.

Internal control (IC)

Process designed, implemented and maintained (DIM) by TCWG, mgt and other personnel to provide reasonable assurance about achievement of an entity's objectives with regard to

- ✓ reliability of financial reporting,
- ✓ effectiveness and efficiency of operations,
- ✓ safeguarding of assets, and
- ✓ compliance with applicable laws and regulations

SCORE

What methods included in Auditor's Risk assessment procedures (RAP)

Audit procedures performed to obtain understanding of entity & its environment, including internal control, to identify and assess ROMM, whether due to fraud or error, at FS & assertion levels.

Risk assessment procedures shall include following:

a. Inquiries of mgt and others within entity who in auditor's judgment may have info. that's likely to assist in identifying ROMM due to fraud or error.
b. Analytical procedures.
c. Observation and inspection.

Auditor shall obtain an understanding of following: [Knowledge of Business]

a. Relevant industry, regulatory, and other external factors including applicable FRF.
b. Nature of entity, including:
   i) its operations;
   ii) its ownership and governance structures;
   iii) types of investments that entity is making and plans to make, investments in special-purpose entities; and
   iv) way that entity is structured and how it is financed; to enable auditor to understand classes of transactions (COT), account balances(AB) , and disclosures (D) to be expected in F.S.
c. Entity's selection & application of A/C policies, including reasons for changes thereto.
d. Entity's objectives and strategies, and those related business risks that may result in ROMM.
e. Measurement and review of entity's financial performance.

Auditor's Process of Assessing the RoMM

a. Identify risks throughout process of obtaining understanding of entity and its environment, including controls that relate to risks, and considering ABCD in F.S
b. Assess identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions
c. Relate identified risks to what can go wrong at assertion level, taking account of relevant controls that auditor intends to test &



d. Consider likelihood of misstatement, including possibility of multiple misstatements, and whether potential misstatement is of magnitude that could result in material misstatement.

Identify >> Assess >> WCGW & Controls >> Likelihood & Magnitude

IT Risks

Specific Risks related to IT an entity's internal control, including, for example:

- Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- Unauthorised access to data that may result in destruction of data or improper changes to data
- Possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- Unauthorised changes to data in master files.
- Unauthorised changes to systems or programs.
- Failure to make necessary changes to systems or programs.
- Inappropriate manual intervention.
- Potential loss of data or inability to access data as required.

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Significant Risks

An identified and assessed RoMM that, in auditor's judgment, requires special audit consideration.

Examples of Significant Risk?

a. Whether the risk is a risk of fraud
b. Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention
c. The complexity of transactions
d. Whether the risk involves significant transactions with related parties
e. The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty and
f. Whether the risk involves significant transactions that are outside normal course of business for the entity, or that otherwise appear to be unusual.

SA 330: The Auditor's Responses to Assessed Risks

Further Audit Procedures in Response to assessed ROMM at assertion level

In designing further audit procedures to be performed, the auditor shall:

(a) Consider reasons for assessment given to RoMM at assertion level for each ABCD, including:

(i) Likelihood of material misstatement due to particular characteristics of relevant ABCD (i.e., inherent risk) and

(ii) Whether risk assessment takes into account relevant controls (i.e., control risk), thereby requiring auditor to obtain audit evidence to determine whether controls are operating effectively (i.e., auditor intends to rely on operating effectiveness of controls in determining NTE of substantive procedures) and

(a) Obtain more persuasive audit evidence higher auditor's assessment of risk.

Reason for assessment [Likelihood of M.M. + Internal control] → more persuasive higher the risk

Further Audit Procedures comprise of:

i) Tests of controls, when required by SAs or when auditor has chosen to do so and

ii) Substantive procedures, including tests of details and substantive analytical procedures.

Test of controls – Audit procedure designed to evaluate operating effectiveness of controls in preventing, or detecting and correcting (P/D/C), material misstatements at assertion level.

Auditor shall design and perform TOCs to obtain SAAE as to operating effectiveness of relevant controls when:

a. Auditor's assessment of RoMM at assertion level includes an expectation that controls are operating effectively (i.e., auditor intends to rely on operating effectiveness of controls in determining NTE of substantive procedures) or

b. Substantive procedures alone can't provide SAAE at assertion level.

Should we test controls every time we do Audit?

Factors that warrant retest of controls:

- ✓ A deficient control environment.
- ✓ Deficient monitoring of controls.
- ✓ Deficient general IT-controls.
- ✓ A significant manual element to the relevant controls.
- ✓ Personnel changes that significantly affect the application of the control.
- ✓ Changing circumstances that indicate the need for changes in the control.



What will auditor consider while determining whether evidence of previous audits can be used for Test of Controls?

a. Effectiveness of other elements of internal control, including control environment, entity's monitoring of controls, and entity's risk assessment process
b. Risks arising from characteristics of control, including whether it is manual or automated
c. Effectiveness of general IT-controls
d. Effectiveness of control and its application by entity, including nature and extent of deviations in application of control noted in previous audits, and whether there have been personnel changes that significantly affect application of control
e. Whether lack of a change in a particular control poses a risk due to changing circumstances and
f. ROMM and extent of reliance on the control

If auditor plans to use audit evidence from previous audit, establish continuing relevance by obtaining audit evidence about whether significant changes have occurred in controls.

Obtain this evidence by performing inquiry combined with observation or inspection, confirm understanding of those specific controls, and:
(a) If there have been changes that affect continuing relevance of audit evidence from previous audit, shall test controls in current audit.
(b) If there have not been such changes, auditor shall test controls at least once in every third audit.
Controls over Significant Risks to be tested in current period.

How to know, how much testing is to be done?

Matters auditor may consider in determining extent of tests of controls include following:

✓ Frequency of performance of control by entity during period.
✓ Length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
✓ Expected rate of deviation from a control.
✓ Relevance and reliability of audit evidence to be obtained regarding the operating effectiveness of control at assertion level.
✓ Extent to which audit evidence is obtained from tests of other controls related to the assertion.

Using audit evidence obtained during an interim period

When auditor obtains audit evidence about operating effectiveness of controls during interim period, auditor shall:

a. Obtain audit evidence about significant changes to those controls subsequent to interim period &
b. Determine the additional audit evidence to be obtained for the remaining period.

Substantive procedure: Audit procedure to detect Material misstatement at assertion level.

Substantive procedures comprise:

i) Tests of details (of classes of transactions, account balances, and disclosures), and

ii) Substantive analytical procedures.

Substantive Procedure compulsory? Irrespective of assessed RoMM, design and perform substantive procedures for each material ABCD

This requirement reflects the facts that:

i) auditor's assessment of risk is judgmental and so may not identify all RoMM &

ii) there are inherent limitations to internal control, including management override.

SA 320: Materiality in Planning & Performing an Audit

Performance Materiality (PM) means

- amount or amounts set by auditor
- at less than materiality for F.S. as whole
- to reduce to appropriately low level probability that
- aggregate of uncorrected and undetected misstatements
- exceeds materiality for F.S. as a whole.

If applicable, PM also refers to amt or amounts set by auditor at less than materiality level or levels for particular ABCD.

Determining Materiality & Performance Materiality when planning Audit

When establishing overall audit strategy, auditor shall determine materiality for F.S. as whole.

- If, there is one or more particular ABCD for which misstatements of lesser amounts than materiality for FS as a whole could reasonably be expected to influence economic decisions of users taken on basis of F.S, auditor shall also determine materiality level or levels for those particular ABCD.
- Auditor shall determine performance materiality for purposes of assessing ROMM and determining nature, timing and extent of FAP.

Revision of Materiality

Auditor shall revise materiality for F.S. as a whole (& if applicable, materiality level for particular ABCD) in event of becoming aware of info.* during audit that would have caused auditor to have determined different amount initially.

* may need to be revised as a result of

a. a change in circumstances that occurred during audit (for eg, decision to dispose of a major part of entity's business),

b. new information, or

c. a change in auditor's understanding of entity and its operations as a result of performing FAP.

For eg, if during audit it appears actual financial results are likely to be substantially different from anticipated period end financial results that were used initially to determine materiality for F.S. as a whole, auditor revises that materiality.

If auditor concludes lower materiality for FS as a whole (and, if applicable, materiality level or levels for particular ABCD) than initially determined, auditor shall determine whether its necessary to revise PM, & whether NTE of FAP remain appropriate.

Benchmark

Determining materiality involves exercise of professional judgment. A percentage is often applied to a chosen benchmark as starting point in determining materiality for F.S. as a whole.

Factors that affect identification of an appropriate benchmark include following:

- The elements of F.S. (for eg, assets, liabilities, equity, revenue, expenses)
- Whether there are items on which attention of users of particular entity's F.S. tends to be focused (for eg, for evaluating financial performance users may focus on profit, revenue or net assets)
- Nature of entity, where entity is in its life cycle, industry & economic environment in which entity operates
- Entity's ownership structure and way it is financed (for eg, if entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on entity's earnings) &
- The relative volatility of benchmark.

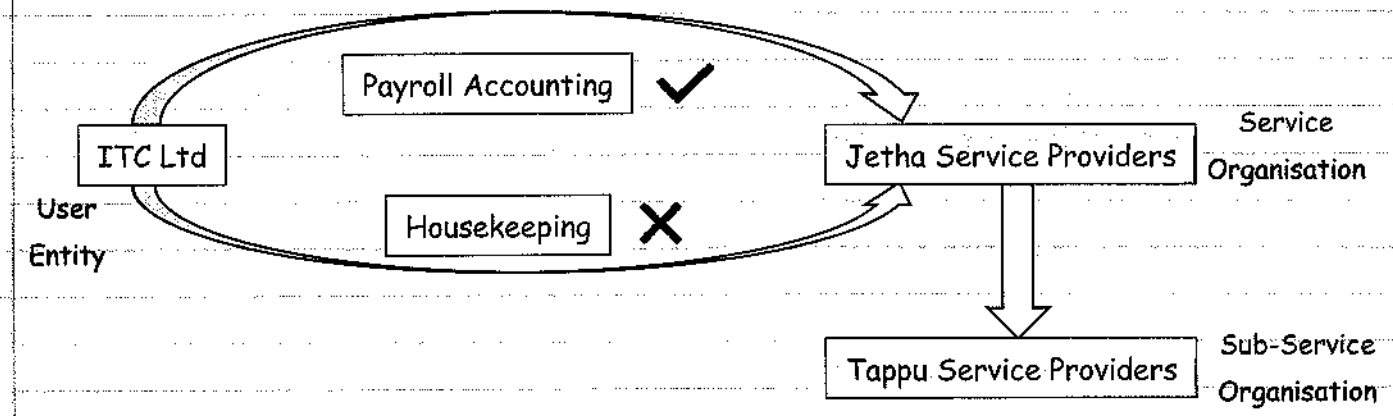
Element of F.S. >> Focus >> Ownership structure >> Life cycle >> Volatility

Note: There is a relationship between %age and chosen benchmark, such that a percentage applied to PBT from continuing operations will normally be higher than %age applied to total revenue.

Examples of benchmarks include categories of reported income such as profit before tax, total revenue, gross profit, total expenses, total equity or net asset value.

Type of Entity	Benchmark
Profit oriented entities	PBT from continuing operations
If PBT Volatile	Gross Profit or Total Revenues
Public utility programs/projects	Total cost or net cost [expenses less receipts]
Custody of assets	Assets

SA 402: Audit Considerations relating to an Entity Using a Service Organisation (S.O.)



Note:

Services provided by SO are relevant to audit of a user entity's F.S. when those services, & controls over them, are part of user entity's information system, including related business processes, relevant to financial reporting.

How to know if SO's services are relevant to user entity's Financial Reporting?

A SOs services are part of user entity's info. system, including related business processes, relevant to financial reporting if these services affect any of following:

a. SCoTs: Classes of transactions in entity's operations that are significant to FS
b. Procedures: Procedures, within both IT and manual systems, by which those transactions are initiated, recorded, processed, corrected, trfd to general ledger & reported in FS.
c. Records: Related a/c records, supporting info. and specific accounts in FS used to initiate, record, process & report transactions; includes correction of incorrect info and how info is trfd to general ledger. Records may be in either manual or electronic form
d. Info system: How info. system captures events & conditions, other than transactions, significant to FS.
e. FRP: Financial reporting process used to prepare entity's FS, including significant a/c estimates and disclosures
f. Unusual Transactions: Controls surrounding journal entries, including non-standard JEs used to record non-recurring, unusual transactions or adjustments.

SCoTs >> Procedures + A/c records >> NSCoTs >> FRP + JEs



Auditor's Objective

a. To obtain understanding of nature & significance of services provided by SO and effect on user entity's internal control relevant to audit, sufficient to identify and assess ROMM &

b. To design and perform audit procedures responsive to those risks.

Types of Reports

Type 1 Report: Description & design of ICs at Specified date

Type 2 Report: Description, design & Operating effectiveness of ICs throughout period

[Covered in Detail in SAE 3402]

Obtaining understanding of services provided by Service Organisation (S.O.)

a. Nature of services provided by SO and significance of those services to user entity, including effect on user entity's internal control. Info can be taken from User manuals, Contract, report by Service Auditor etc

b. Nature and materiality of transactions processed or accounts or financial reporting processes affected by SO

c. Degree of interaction between activities of S.O. and those of user entity i.e. extent to which user entity has implemented effective controls over processes performed by SO.
Eg. High degree of interaction if entity authorised transn. processed by SO.

d. Nature of relationship between user entity and S.O., including relevant contractual terms for activities undertaken by S.O.

Nature & Significance/Materiality >> Interaction + Relationship

Auditor's Considerations

- User auditor shall evaluate design and implementation of controls at user entity that relate to services provided by S.O.
- User auditor shall determine whether sufficient understanding of nature and significance of services provided by service organisation and their effect on user entity's internal control relevant to audit has been obtained to provide basis for identification and assessment of ROMM.

If auditor unable to obtain sufficient understanding from user entity, perform following procedures:

a) Obtaining a Type 1 or Type 2 report, if available
b) Contacting SO, through user entity, to obtain specific info
c) Visiting SO and performing procedures that will provide info about controls at SO
d) Using another auditor to perform procedures that provide necessary info about controls at SO

Type 1/2 >> Contact >> Visit >> Another Auditor

Using Type 1 Or Type 2 Report to Support User Auditor's Understanding of SO:

In determining SAAE provided by Type 1 or 2 report, user auditor shall be satisfied as to: -

(a) Service auditor's professional competence (except where service auditor is member of ICAI) & independence from SO &

(b) Adequacy of standards under which Type 1 or 2 report was issued.

If user auditor plans to use Type 1/2 report as audit evidence to support user auditor's understanding about design and implementation of controls at SO, user auditor shall:

a. Evaluate whether description & design of controls at SO is at a date or for a period that is appropriate for user auditor's purposes

b. Evaluate sufficiency & appropriateness of evidence provided by report for understanding user entity's internal control relevant to audit &

c. Determine whether complementary user entity controls identified by SO relevant to user entity and if so, obtain understanding of whether user entity has designed and implemented such controls.

Complementary user entity controls refer to controls that SO assumes, in design of its service, will be implemented by user entities, and which, if necessary to achieve control objectives, are identified in description of its system.

Tests of Controls

When user auditor's risk assessment includes expectation that controls at SO are operating effectively, user auditor shall obtain audit evidence about operating effectiveness of those controls from one or more of following procedures: -

a. Obtaining a Type 2 report, if available

b. Performing appropriate TOCs at SO or

c. Using another auditor to perform TOCs at SO on behalf of user auditor.

Using a Type 2 report as audit evidence that controls at SO are operating effectively

If, user auditor plans to use a Type 2 report as audit evidence that controls at SO are operating effectively, user auditor shall determine whether service auditor's report provides SAAE about effectiveness of controls to support user auditor's risk assessment by:

a. Evaluating whether description, design & operating effectiveness of controls at SO is at date or period appropriate for user auditor's purposes

b. Determine whether complementary user entity controls identified by SO are relevant to user entity and, if so, obtaining understanding of whether user entity has designed & implemented such controls and, if so, testing their operating effectiveness

c. Evaluating adequacy of time period covered by TOCs & time elapsed since performance of TOCs

d. Evaluating whether TOCs performed by service auditor & results, as described in service auditor's report, relevant to assertions in user entity's FS & provide SAAE to support user auditor's risk assessment.

Information w.r.t controls at Sub-Service Organisation (SSO)

- If SO uses SSO, service auditor's report may include or exclude SSO's relevant control objectives & related controls in SO's description of its system and in scope of service auditor's engg.
- These 2 methods of reporting are known as inclusive method & carve-out method, respectively.
- If Type 1 or Type 2 report excludes controls at SSO, & services are relevant to audit of user entity's FS, apply this SA in respect of SSO.
- Nature & extent of work to be performed regarding services by SSO depend on nature & significance of services to user entity & relevance to audit.

Reporting by User Auditor

- User auditor shall modify opinion in user auditor's report as per SA 705 if user auditor is unable to obtain SAAE regarding services provided by SO relevant to audit of user entity's FS.
- User auditor shall not refer to work of service auditor in user auditor's report containing unmodified opinion unless required by L/R. If such reference required by L/R, indicate reference doesn't diminish user auditor's responsibility for audit opinion.
- If reference to work of service auditor relevant to understand modification of opinion, auditor's report shall indicate such reference doesn't diminish user auditor's responsibility for opinion.

SA 450: Evaluation of Misstatements Identified during the Audit

Objective

Objective of the auditor is to evaluate:

a. Effect of identified misstatements on audit and

b. Effect of uncorrected misstatements, if any, on F.S

Accumulation of Identified Misstatements

Auditor shall accumulate misstatements identified during audit, other than clearly trivial.

- Auditor may designate an amount below which misstatements would be clearly trivial & wouldn't be accumulated because auditor expects accumulation of such amounts clearly wouldn't have a material effect on FS.
- "Clearly trivial" is not same as "not material" [wholly different (smaller) order of magnitude + clearly inconsequential, whether taken individually or aggregate & whether judged by any criteria of size, nature or circumstances]
- When there is any uncertainty about whether one or more items are clearly trivial, matter is considered not to be clearly trivial.

In evaluating effect of misstatements accumulated & communicating misstatements to mgt & TCWG, let's distinguish b/w factual, judgmental and projected misstatements.

- ✓ Factual misstatements: Misstatements about which there is no doubt.
- ✓ Judgmental misstatements: Differences of judgments of mgt concerning a/c estimates that auditor finds unreasonable, or selection/application of a/c policies that auditor finds inappropriate.
- ✓ Projected misstatements: Auditor's best estimate of misstatements in populations, involving projection of misstatements in audit samples to entire populations from which samples were drawn.

Consideration of Identified Misstatements as Audit Progresses

Auditor shall determine whether overall audit strategy & audit plan need to be revised if:

a. Nature of identified misstatements & circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with accumulated ones, could be material OR

b. Aggregate of misstatements accumulated approaches materiality determined as per SA 320.

If, at auditor's request, mgt has examined & corrected misstatements that were detected, auditor shall perform additional audit procedures to determine whether misstatements remain.

Communication and Correction of Misstatements

- Auditor shall communicate all misstatements accumulated during audit with appropriate level of mgt. Requesting mgt to correct those misstatements.



- If mgt refuses, obtain understanding of reasons for not making corrections & evaluate whether FS as whole are free from material misstatement. [Maybe an indicator of mgt bias]

Uncorrected misstatements

Misstatements that auditor has accumulated during audit and not corrected.

Discuss impact of uncorrected misstatements identified during audit & auditor's response to same

Prior to evaluating effect of uncorrected misstatements, auditor shall reassess materiality as per SA 320, to confirm whether it remains appropriate in context of entity's actual financial results.

As per SA 450 auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, auditor shall consider- (size & effect)

i) Size & nature of misstatements, both in relation to particular ABCD & FS as whole, & particular circumstances of their occurrence &

ii) Effect of uncorrected misstatements related to prior periods on relevant ABCD, and FS as a whole.

Communication with TCWG:

✓ Auditor shall communicate with TCWG uncorrected misstatements and effect on opinion in auditor's report, unless prohibited by L/R.

✓ Auditor's communication shall identify material uncorrected misstatements individually.

✓ Auditor shall request that uncorrected misstatements be corrected.

Written Representation

Auditor shall request for WR from mgt and TCWG that they believe effects are immaterial to F.S. as a whole. A summary of such items shall be included in or attached to the WR.

Conclusion:

If mgt refuses to adjust financial info. & results of extended audit procedures don't enable auditor to conclude that aggregate of uncorrected misstatements isn't material, auditor should report accordingly.

Documentation

a) Amount below which misstatements would be regarded as clearly trivial

b) All misstatements accumulated during the audit & whether they have been corrected &

c) Auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate & basis for that conclusion.

SA 500: Audit Evidence

Objective

To design & perform audit procedures to enable him to obtain SAAE to draw reasonable conclusions to base auditor's opinion.

Information to Be Used as Audit Evidence

Auditor shall consider relevance and reliability of information to be used as audit evidence.

Mgt's expert –Individual or organisation possessing expertise in a field other than accounting or auditing, whose work is used by entity in preparing FS.

Auditor's responsibility when relying on Audit evidence prepared using Mgt Expert's work

a) Evaluate competence, capabilities and objectivity(CCO) of that expert

Info. regarding CCO of a mgt's expert may come from a variety of sources, such as:

- ✓ Personal experience with previous work of expert.
- ✓ Discussions with expert.
- ✓ Discussions with others who are familiar with expert's work.
- ✓ Knowledge of expert's qualifications, membership of professional body or industry association, license to practice, or other forms of external recognition.
- ✓ Published papers or books written by that expert.
- ✓ Auditor's expert, if any, who assists auditor in obtaining SAAE wrt info produced by mgt's expert.

Evaluating Objectivity of Mgt Expert [RTP Nov-23]

1. A range of circumstances may threaten objectivity, for eg, self-interest threats, advocacy threats, familiarity threats, self-review threats and intimidation threats. [SSAFI]
2. Safeguards may reduce such threats and may be created either by
   - ✓ external structures (for eg, mgt's expert's profession, legislation or regulation), or
   - ✓ mgt's expert's work environment (for eg, quality control policies and procedures).

- Safeguards can't eliminate all threats, threats such as intimidation threats may be of less significance to an expert engaged by entity than to an expert employed by entity & effectiveness of safeguards such as quality control policies and procedures may be greater.
- Because threat to objectivity created by being an employee of entity will always present, expert employed by entity can't ordinarily be regarded as being more likely to be objective than other employees of entity.



Audit Procedures:

When evaluating objectivity of expert, it may be relevant to discuss with mgt & expert any interests & relationships that may create threats to expert's objectivity & applicable safeguards, including any professional requirements that apply to the expert; & evaluate whether safeguards are adequate.

Interests and relationships creating threats may include:

- Financial interests.
- Business and personal relationships.
- Provision of other services.

b) Obtain understanding of work of expert and

Aspects of mgt's expert's field relevant to auditor's understanding may include:

Assumptions & methods used by mgt's expert & whether they are generally accepted within that expert's field & appropriate for financial reporting purposes.

c) Evaluate appropriateness of that expert's work as audit evidence for relevant assertion.

Considerations when evaluating appropriateness of mgt's expert's work as audit evidence for relevant assertion may include:

- ✓ Relevance and reasonableness of expert's findings or conclusions, consistency with other audit evidence, & whether they have been appropriately reflected in FS
- ✓ If expert's work involves use of significant assumptions and methods, relevance & reasonableness of those assumptions & methods
- ✓ If expert's work involves significant use of source data, relevance, completeness, and accuracy of that source data.

CCO ➔ Understanding ➔ Appropriateness [Source data/Assumptions/Findings]

Matters affecting NTE of Audit Procedures in case of info. produced using work of mgt expert

- ✓ Nature and complexity of matter to which mgt's expert relates.
- ✓ ROMM in the matter.
- ✓ Availability of alternative sources of audit evidence.
- ✓ Nature, scope and objectives of mgt's expert's work.
- ✓ Whether mgt's expert is employed by entity, or is party engaged by it to provide relevant services.
- ✓ Extent to which management can exercise control or influence over work of mgt's expert.
- ✓ Whether mgt's expert is subject to technical performance standards or other professional or industry requirements.
- ✓ Nature and extent of controls within entity over mgt's expert's work.



- ✓ Auditor's knowledge and experience of mgt's expert's field of expertise.
- ✓ Auditor's previous experience of work of that expert.

Methods of obtaining Audit Evidence

- Observation: Looking at a process or procedure being performed by others, for eg, auditor's observation of inventory counting by entity's personnel, or of performance of control activities.
- Inspection: Examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of asset.
- External Confirmation: Audit evidence obtained by auditor as a direct written response from a 3rd party (confirming party), in paper form, or by electronic or other medium.
- Recalculation: Checking mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.
- Reperformance: Auditor's independent execution of procedures or controls that were originally performed as part of entity's internal control.
- Analytical Procedures: Evaluations of financial information made by a study of plausible relationships among both financial and non-financial data.

- Inquiry:
  - ✓ Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within entity or outside entity.
  - ✓ Inquiries may range from formal written inquiries to informal oral inquiries.
  - ✓ Inquiry is used extensively throughout audit in addition to other audit procedures.
  - ✓ Evaluating responses to inquiries is an integral part of the inquiry process
  - ✓ Responses to inquiries may provide auditor with info. not previously possessed or corroborative audit evidence. Alternatively, responses might provide info. that differs significantly from other info. that auditor has obtained, for eg, info. regarding possibility of mgt override of controls.
  - ✓ In some cases, responses to inquiries provide a basis for auditor to modify or perform additional audit procedures.
  - ✓ Although corroboration is important, in case of inquiries about mgt intent info. to support mgt's intent may be limited. In these cases, understanding mgt's past history, reasons for choosing particular course of action & ability to pursue a specific course of action may provide relevant info. to corroborate evidence obtained through inquiry.
  - ✓ Auditor may consider necessary to obtain written representations from mgt & TCWG to confirm responses to oral inquiries.

Factors indicating Reliability of Audit Evidence [A.E.]

- Reliability of A.E. increased when obtained from independent sources outside entity
- Reliability of A.E. generated internally increased when related controls are effective

- A.E. obtained directly by auditor (for eg, observation of application of control) more reliable than one obtained indirectly or by inference (for eg, inquiry about application of control)
- A.E. in documentary form more reliable than obtained orally
- A.E. provided by original documents more reliable than photocopies/facsimiles/documents filmed/ digitised or electronic form

[Independent >> Internally >> Directly >> Documentary >> Original]

Inconsistency or doubts over reliability of audit evidence

Determine modifications or additions to audit procedures necessary to resolve the matter & the effect on other aspects of the audit.

SA 501: Audit Evidence—Specific Considerations for Selected Items

Objective of auditor is to obtain SAAE regarding:

(a) Existence and condition of inventory

(b) Completeness of litigation and claims involving entity

(c) Presentation and disclosure of segment information in accordance with applicable FRF.

Inventory

When inventory is material to FS, auditor shall obtain SAAE regarding existence and condition of inventory by:

(a) Attendance at physical inventory counting, unless impracticable, to:

(i) Evaluate mgt's instructions and procedures for recording results of entity's physical inventory counting

(ii) Observe performance of mgt's count procedures

(iii) Inspect the inventory

(iv) Perform test counts &

(b) Performing audit procedures over entity's final inventory records to determine whether they accurately reflect actual inventory count results.

Procedures in Special Circumstances

1. Physical inventory count at date other than date of F.S:

- Yes, it can be done for practical reasons.
- Mgt can determine inventory quantity by annual physical inventory counting or perpetual inventory system.
- In either case, effectiveness of controls over changes in inventory determines whether conduct of physical inventory counting at date other than date of FS is appropriate for audit.



- Auditor perform audit procedures to obtain audit evidence about whether changes in inventory between count date and date of FS are properly recorded.

Matters that Auditor shall consider when designing audit procedures to obtain audit evidence about whether changes in inventory amounts are properly recorded include:

1. Whether perpetual inventory records are properly adjusted.
2. Reliability of entity's perpetual inventory records.
3. Reasons for significant differences between physical count and perpetual records.

2. Auditor unable to attend inventory count:

- If auditor is unable to attend physical inventory counting due to unforeseen circumstances, auditor shall observe some physical counts on an alternative date.
- Perform audit procedures to assess whether changes in inventory between date of physical count and period end date are correctly recorded.
- Auditor would also verify treatment given for discrepancies noticed during physical count.
- Auditor would also ensure that appropriate cut off procedures were followed by mgt.
- He should also get management's written representation on
  a. completeness of info provided regarding inventory, and
  b. assurance with regard to adherence to laid down procedures for physical inventory count.

3. If attendance is impracticable:

- This may be due to location & nature of inventory. Eg. Location pose threat to Auditor
- As per SA 200 → matter of difficulty, time, or cost involved is not a valid basis for auditor to omit an audit procedure or settle for less than persuasive Audit Evidence.
- Perform alternative audit procedures to obtain SAAE regarding existence & condition of inventory.
- For eg, inspection of documentation of subsequent sale of specific inventory items purchased prior to inventory counting, may provide SAAE
- If not possible, modify opinion as per SA 705.

4. Inventory in custody of 3rd Party:

When inventory under custody of 3rd party is *material* to FS, obtain SAAE regarding existence and condition of inventory by performing one or both of following:

a. Request confirmation from 3rd party as to quantities and condition of inventory held on behalf of entity.
b. Perform inspection or other audit procedures appropriate in circumstances.



If doubt over integrity & objectivity of 3rd party:

- ✓ Attending or arranging another auditor to attend 3rd party's physical counting of inventory, if practicable.
- ✓ Obtaining another auditor's report or service auditor's report on adequacy of 3rd party's internal control that inventory is properly counted and adequately safeguarded.
- ✓ Inspecting documentation regarding inventory held by 3rd parties, for eg, warehouse receipts.
- ✓ Requesting confirmation from other parties when inventory has been pledged as collateral.

Note: Also inspect record of goods sent by tracing it to challans, e-ways bills etc.

Matters Relevant in Planning Attendance at Physical Inventory Counting

- Locations at which inventory is held, including Materiality of inventory & RoMM at different locations, in deciding at which locations attendance is appropriate
- Nature of inventory.
- The nature of the internal cOntrOl related to inventory.
- Whether adequate Procedures established & proper instructions issued for inventory counting.
- Whether entity maintains a Perpetual inventory system.
- Romm related to inventory.
- Stages of completion of work inprogress.
- Timing of physical inventory counting.
- Whether assistance of an auditor's experT is needed.

Litigation & Claims

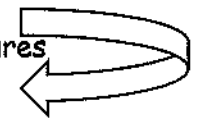
Auditor shall identify litigation and claims through following procedures:

a. Inquiry of mgt & others within entity, including in-house legal counsel
b. Reviewing minutes of meetings of TCWG & correspondence b/w entity & external legal counsel
c. Reviewing legal expense a/c

Direct Communication with External legal counsel (ELC)

- ➢ If auditor assesses ROMM regarding litigation or claims identified, or
- ➢ Audit procedures indicate other material litigation or claims may exist → seek direct communication with entity's ELC.
- ➢ Auditor shall do so through letter of inquiry, prepared by mgt & sent by auditor, requesting entity's ELC to communicate directly with auditor.
- ➢ If law, regulation or respective legal professional body prohibits entity's ELC from communicating directly with auditor, perform alternative audit procedures.

If mgt refuses to permit or ELC refuses to respond and
Auditor is unable to obtain SAAE by performing alternative audit procedures
Modify opinion as per SA 705



Written Representation from mgt & TCWG that all litigation and claims whose effects should be considered when preparing the F.S.

- have been disclosed to auditor and
- appropriately accounted for and disclosed in accordance with the applicable FRF

Segment Information

Auditor shall obtain SAAE about presentation & disclosure of segment info as per applicable FRF by:

a. Obtaining understanding of methods used by Mgt in determining segment information, &
   i) Evaluating whether such methods likely to result in disclosure as per applicable FRF &
   ii) Where appropriate, testing application of such methods; and
b. Performing analytical procedures or other audit procedures appropriate in circumstances.

'Example of matters' relevant when obtaining understanding of methods used by mgt in determining segment information include:

i) Sales, transfers and charges between segments, and elimination of inter-segment amounts.
ii) Comparisons with budgets and other expected results, for eg, operating profits as %age of sales.
iii) Allocation of assets and costs among segments.
iv) Consistency with prior periods, and adequacy of disclosures w.r.t inconsistencies.

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SA 505: External Confirmations

External confirmation - Audit evidence obtained as a direct written response to auditor from a 3rd party (confirming party), in paper form, or by electronic or other medium.

Exception - A response that indicates a difference between info. requested to be confirmed, or contained in entity's records, & info. provided by confirming party.
Auditor shall investigate exceptions to determine whether or not they are indicative of misstatement.



External Confirmation Procedures

When using external confirmation procedures, auditor shall maintain control over external confirmation requests, including:

a. Determining info. to be confirmed or requested
b. Selecting appropriate confirming party
c. Designing confirmation requests, including determining that requests are properly addressed & contain return info. for responses to be sent directly to auditor
d. Sending the requests, including follow-up requests when applicable, to confirming party.

Factors to consider when designing confirmation requests include:

- Layout & presentation of confirmation request.
- Assertions being addressed.
- Prior experience on the audit or similar engg.
- Specific identified ROMM, including fraud risks.
- Mgt's authorisation or encouragement to confirming parties to respond to auditor. Confirming parties may only be willing to respond to a confirmation request containing mgt's authorisation.
- Method of communication (for eg, in paper form, or by electronic or other medium).
- Ability of intended confirming party to confirm or provide requested info. (for eg, individual invoice amount versus total balance)

Mgt's Refusal to Allow the Auditor to Send a Confirmation Request

If mgt refuses to allow auditor to send a confirmation request, auditor shall:

a. Inquire mgt's reasons for refusal & seek audit evidence of their validity & reasonableness
b. Evaluate implications of mgt's refusal on auditor's assessment of ROMM, including risk of fraud, and NTE of other audit procedures &
c. Perform alternative audit procedures to obtain relevant and reliable audit evidence.
   - ✓ If auditor concludes mgt's refusal is unreasonable or unable to obtain relevant & reliable audit evidence from alternative audit procedures, communicate with TCWG as per SA 260.
   - ✓ Auditor shall determine implications for audit & auditor's opinion as per SA 705.

Positive Confirmation Requests (PCR)

- ✓ PCR asks confirming party to reply in all cases, either by indicating agreement or providing info.
- ✓ Response to PCR is expected to provide reliable audit evidence.
- ✓ There is risk that confirming party may reply without verifying if info. is correct.
- ✓ Auditor may reduce this risk by not stating amt (or other info) on confirmation request, and ask confirming party to fill amount or furnish other info.
- ✓ On other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required by confirming parties.

Negative Confirmations Request (NCR)

A request that confirming party respond directly to auditor only if confirming party disagrees with info. provided in request. NCR provide less persuasive evidence than positive confirmations.

Auditor shall not use NCR as sole substantive audit procedure to address assessed ROMM at assertion level unless all of following are present:

a. Auditor has assessed ROMM as low & obtained SAAE regarding operating effectiveness of controls
b. Population comprises large no. of small, homogeneous, account balances, transactions or conditions
c. A very low exception rate is expected &
d. Auditor is not aware of circumstances that would cause recipients to disregard such requests.

No response in case of Negative confirmation:

- Failure to receive response doesn't indicate receipt by intended confirming party of confirmation request or verification of accuracy of info contained in request.
- Accordingly, failure of confirming party to respond provides significantly less persuasive audit evidence than positive confirmation request.
- Confirming parties also may be more likely to respond indicating their disagreement with confirmation request when info. requested is not in their favour, & less likely to respond otherwise.

Alternate Audit Procedures: Non-Responses

Examples of alternative audit procedures auditor may perform include:

- Accounts receivable balances – examining specific subsequent cash receipts, shipping documentation, & sales near period-end.
- Accounts payable balances – examining subsequent cash disbursements or correspondence from 3rd parties, & other records, such as goods received notes.

Reliability of Response

SA 505 states if auditor determines response to confirmation request isn't reliable, evaluate implications on RoMM, including risk of fraud & NTE of other audit procedures.

As per SA 500, even when audit evidence obtained from external sources, circumstances may exist that affect its reliability. All responses carry risk of interception, alteration or fraud. Such risk exists regardless of whether response is obtained in paper form, or by electronic or other medium.

Factors that may indicate doubts about reliability of a response include that it:

- Was received by auditor indirectly or
- Appeared not to come from originally intended confirming party.
- Unreliable responses may indicate a fraud risk factor that requires evaluation.



Topics related to External Confirmation given in SA 330

Areas where external confirmation procedures may be used:

- ✓ Bank balances and other information relevant to banking relationships.
- ✓ Accounts receivable balances and terms.
- ✓ Inventories held by third parties at bonded warehouses for processing or on consignment.
- ✓ Property title deeds held by lawyers or financiers for safe custody or as security.
- ✓ Investments held by 3rd parties, or purchased from stockbrokers but not delivered at BS date.
- ✓ Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
- ✓ Accounts payable balances and terms.

How to know if we can use External Confirmations as Audit Procedures?

Factors that may assist auditor in determining whether external confirmations to be performed as substantive audit procedures include:

- ➢ Confirming party's knowledge of subject matter
- ➢ Ability or willingness of intended confirming party to respond – for eg, confirming party:
  - ✓ May not accept responsibility for responding to confirmation request;
  - ✓ May consider responding too costly or time consuming;
  - ✓ May have concerns about the potential legal liability resulting from responding;
  - ✓ May account for transactions in different currencies; or
  - ✓ May operate in environment where responding to confirmation requests is not a significant aspect of day-to-day operations.
- ➢ Objectivity of intended confirming party – if confirming party is related party of entity, responses to confirmation requests may be less reliable.

Knowledge → Ability/Willingness → Objectivity

SA 510: Initial Audit Engagements—Opening Balances

Initial audit engg. – An engg. in which either:

i) FS for prior period → not audited or

ii) FS for prior period audited by a predecessor auditor.

Objective

To obtain SAAE about whether:

a) Opening balances contain misstatements that materially affect current period's FS

b) Appropriate a/c policies reflected in opening balances have been consistently applied in current period's FS, or changes properly accounted, presented & disclosed as per FRF.

Opening balances –

- A/c balances that exist at beginning of period. Based upon closing balances of prior period & reflect effects of transactions & events of prior periods & a/c policies applied in prior period.
- Also include disclosures that existed at beginning of period, such as contingencies and commitments.

Audit Procedures: Opening Balances

Auditor shall read most recent financial statements (MRFS), if any, & predecessor auditor's report if any, for info. relevant to opening balances, including disclosures.

Auditor shall obtain SAAE about whether opening balances contain misstatements that materially affect current period's FS by:

a) Determining whether prior period's closing balances correctly brought forward to current period or, any adjustments have been disclosed as prior period items in current year's P&L
b) Determining whether opening balances reflect application of appropriate a/c policies &
c) Performing one or more of following:
   i) Where prior year FS were audited, perusing copies of audited FS
   ii) Evaluating whether audit procedures performed in current period provide evidence relevant to opening balances or
   iii) Performing specific audit procedures to obtain evidence regarding opening balances.

If auditor obtains audit evidence that opening balances contain misstatements that could materially affect current period's FS then perform additional audit procedures to determine effect on current period's FS

If auditor concludes misstatements exist in current period's FS, communicate misstatements with mgt & TCWG as per SA 450.

Opening current assets & liabilities → audit evidence obtained during current audit procedures

1. Debtors/Creditors

Collection (payment) of opening a/c receivable (a/c payable) during current period will provide some audit evidence of their ERCV at beginning of period.

2. Inventories

Current period's audit procedures on closing inventory balance provide little audit evidence regarding inventory at beginning of period.

Additional audit procedures may be necessary, and one or more of following may provide SAAE:

- Observing a current physical inventory count & reconciling to opening inventory quantities.
- Performing audit procedures on valuation of opening inventory items.

- Performing audit procedures on gross profit & cut-off.

3. Non- current assets and liabilities

i. PPE, investments and long-term debt → Examine a/c records & other info underlying opening balances.

ii. In certain cases, obtain some audit evidence regarding opening balances through confirmation with 3rd parties. For eg, long-term debt and investments

Consistency of A/c Policies

Auditor shall obtain SAAE that:

- A/c policies have been consistently applied in current period F.S. &
- any changes have been properly accounted for & adequately presented & disclosed as per FRF.

If not → Qualified/Adverse opinion as per SA 705

Conclusion & Reporting

- Unable to obtain SAAE → Qualify/Disclaimer of opinion as per SA 705
- Opening balance contain misstatement → materially affects current period FS & not properly accounted for & disclosed → Qualified/Adverse Opinion as per SA 705
- Modification to opinion in predecessor audit report: If modication is relevant & material to current period's FS, modify current period audit report.

SA 510 will return in SA 710

SA 520: Analytical Procedures

"Analytical procedures" means

evaluations of financial information → through analysis of plausible relationships → among both financial and non-financial data*

Objectives of Auditor

Obtaining relevant & reliable audit evidence when using substantive analytical procedures	To design & perform An Pro. near end of audit assisting auditor when forming overall conclusion as to whether FS are consistent with auditor's understanding of entity.

Substantive Analytical Procedures (SAP)

When designing and performing SAP, either alone or in combination with TOD auditor shall:

a) Determine suitability of particular SAP for given assertions, taking account of assessed ROMM & tests of details for these assertions

b) Evaluate reliability of data from which auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation

c) Develop expectation of recorded amounts or ratios and evaluate whether expectation is sufficiently precise to identify misstatement that may cause F.S. to be materially misstated and

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

Suitability >> Reliability >> Expectation >> Investigation

Analytical Procedures that assist when Forming Overall Conclusion

- Design & perform analytical procedures near end of audit assist auditor when forming an overall conclusion as to whether FS are consistent with auditor's understanding of entity.
- Intention is to verify conclusions formed during audit of individual components or elements of FS.
- This assists auditor to draw reasonable conclusions to base auditor's opinion.
- Results of such analytical procedures may identify a previously unrecognised RoMM.
- SA 315 requires auditor to revise RoMM & modify FAP.
- Analytical procedures performed above may be similar to risk assessment procedures.

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Investigating Results of Analytical Procedures

If auditor identifies fluctuations or relationships inconsistent with other relevant info or differ from expected values by significant amt, auditor shall investigate such differences by:

a) Inquiring of mgt & obtaining appropriate audit evidence relevant to mgt's responses
Audit evidence relevant to mgt's responses may be obtained by evaluating responses considering understanding of entity & environment & other audit evidence obtained during audit.

b) Performing other audit procedures necessary in circumstances.
Need to perform other audit procedures may arise when,
- mgt is unable to provide expln, or
- expln, together with audit evidence obtained, is not considered adequate.

SA 530: Audit Sampling

Objective:

To provide reasonable basis for auditor to draw conclusions about population from which sample is selected.

Audit sampling (sampling) -Application of audit procedures to less than 100% items within a population such that all sampling units have a chance of selection to provide auditor with a reasonable basis on which to draw conclusions about entire population.

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

Types of Sampling Risks?

Sampling risk can lead to 2 types of erroneous conclusions:

(i) In case of TOCs → controls are more effective than they actually are, or in case of TODs → material misstatement does not exist when in fact it does.
The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

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

Statistical sampling - An approach to sampling that has following characteristics:

i. Random selection of sample items &
ii. Use of probability theory to evaluate sample results, including measurement of sampling risk.

Sampling approach that doesn't have above characteristics is considered non-statistical sampling.

Tolerable misstatement [TM]

- Monetary amt set by auditor for which auditor seeks to obtain appropriate level of assurance that this amount isn't exceeded by actual misstatement in population.
- Further, while designing a sample, auditor determines tolerable misstatement to address risk that aggregate of individually immaterial misstatements may cause FS to be materially misstated & provide a margin for possible undetected misstatements.
- Its application of performance materiality, to a sampling procedure. It may be same amount or amount lower than performance materiality.

For eg: I've set materiality as 5% of NP (100 Cr), Materiality = 5 Cr, let's say PM = 1 Cr (less than materiality for FS as whole). Now, Tolerable Misstatement can be equal to lower than PM, let's say TM = 50 L, now I'll use ₹50 Lakhs for sampling purpose.

Sample Design, Size & Selection of Items for Testing

i) When designing audit sample, consider purpose of audit & characteristics of population from which sample will be drawn.
ii) Auditor shall determine sample size sufficient to reduce sampling risk to acceptably low level.
iii) Auditor shall select items in a way that each sampling unit in population has chance of selection.

Stratification & Value-Weighted Selection (For understanding only)

Stratification: Audit efficiency may be improved if auditor stratifies a population by dividing it into discrete sub-populations (Stratum) having identifying characteristics.

Objective is to reduce variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

How?

- When performing TODs, population often stratified by monetary value. This allows greater effort directed to large value items, as these items likely to be overstated.
- Similarly, population may be stratified as per particular characteristic that indicates higher RoMM, for eg, when testing provision for doubtful a/c in valuation of debtors, balances may be stratified by age.

Projection:

- Results of samples drawn under each sub population are projected to that respective stratum.

- Projected misstatements of each stratum will be combined together to consider possible effect of misstatement in account balances and class of transactions.

Value-Weighted Selection: When performing TODs it may be efficient to identify sampling unit as individual monetary units that make up population.

- Selecting specific monetary units from population, for eg, a/c receivable balance, auditor may examine individual balances, that contain those monetary units.
- One benefit is that audit effort is directed to larger value items as they have greater chance of selection & can result in smaller sample sizes.
- This approach may be used in conjunction with systematic method of sample selection & is most efficient when selecting items using random selection.

Performing audit procedures

- ✓ Auditor shall perform audit procedures, appropriate to purpose, on each item selected.
- ✓ If audit procedure isn't applicable to selected item, auditor apply procedure on replacement item.
- ✓ If auditor is unable to apply designed audit procedures, or alternative procedures, to selected item, auditor shall treat that item as deviation from prescribed control, in case of TOCs, or misstatement, in case of TODs.

Nature and Cause of Deviations & Misstatements

- ✓ Auditor shall investigate nature & cause of deviations or misstatements identified, & evaluate possible effect on audit procedures & other areas of audit.
- ✓ In extremely rare circumstances when auditor considers a misstatement or deviation to be anomaly, obtain high degree of certainty that such misstatement or deviation is not representative of population.
- ✓ Auditor shall perform additional audit procedures to obtain SAAE that misstatement or deviation does not affect remainder of population.

Projecting Misstatements

- ✓ Auditor project misstatements for population to obtain broad view of scale of misstatement but this projection may not be sufficient to determine amount to be recorded.
- ✓ When misstatement considered anomaly, its excluded when projecting misstatements to population.
- ✓ However, effect of such misstatement, if uncorrected, needs to be considered in addition to projected misstatement.
- ✓ For TOD, auditor shall project misstatements to population whereas for TOCs, no explicit projection of deviations is necessary since sample deviation rate is also projected deviation rate for population.

Evaluating Results of Audit Sampling

Auditor shall evaluate-

a) The results of sample and

b) Whether use of audit sampling has provided reasonable basis for conclusions about the population tested.

In case auditor concludes audit sampling hasn't provided reasonable basis for conclusions about population tested, auditor may

i. request mgt to investigate misstatements, potential for further misstatements & make adjustments OR

ii. tailor NTE of further audit procedures to best achieve required assurance.

For eg, in TOCs, auditor might extend sample size, test alternative control or modify related substantive procedures.

Sample Selection Methods (For understanding only)

There are many methods of selecting samples. Principal methods are as follows:

(a) Random selection (applied through random number generators, for eg, random number tables).

- Simple Random Sampling: Whole population has equal chance of selection
- Stratified Sampling: Dividing population in few separate groups called strata & taking samples from each of them.

✓ Each stratum treated as a separate population & proportionate items selected from each stratum.

✓ No. of groups into which whole population is divided is determined on basis of auditor judgment.

Example

Trade receivables balances may be divided into four groups as follows:-

(a) balances in excess of ₹10,00,000; [100% testing]

(b) balances in the range of ₹7,75,001 to ₹10,00,000; [50% testing]

(c) balances in the range of ₹5,50,001 to ₹7,75,000; [25% testing]

(d) balances in the range of ₹ 2,25,001 to ₹5,50,000; [10% testing]

(e) balances ₹2,25,000 and below [2% testing]

✓ Random sample is chosen from each stratum using random number tables.

✓ Reasoning behind stratified sampling is that for a highly diversified population, weights should be allocated to reflect these differences.

✓ This is achieved by selecting different proportions from each strata.

✓ It can be seen that stratified sampling is simply an extension of simple random sampling.

✓ Therefore, we can say that random selection method is applied through random number generators, for eg, random number tables.

(b) Systematic selection, in which no. of sampling units in population divided by sample size to give a sampling interval.

✓ For eg, there are 5000 items & I want 100 samples, interval=5000/100= 50, & having determined starting point within first 50, each 50th sampling unit thereafter is selected.

✓ Although starting point may be determined haphazardly, sample is more likely to be truly random if it is determined by use of a computerised random no. generator or random no. tables.

(c) Monetary Unit Sampling is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

(d) Haphazard selection, select sample without following structured technique. Avoid bias/predictability & ensure all items have chance of selection. Not appropriate when using statistical sampling.

(e) Block selection involves selection of a block(s) of contiguous items within the population. Block selection cannot be used in audit sampling because most populations are structured such that items in a sequence expected to have similar characteristics, but different characteristics from items elsewhere in population.

Factors affecting sample size

TOCs

1. Increase in extent to which auditor's risk assessment takes into account relevant controls: Increase
2. An increase in tolerable rate of deviation: Decrease
3. An increase in expected rate of deviation of population to be tested: Increase
4. Increase in auditor's desired level of assurance that tolerable rate of deviation is not exceeded by actual rate of deviation in population: Increase
5. An increase in number of sampling units in population: Negligible effect

TODs

1. An increase in auditor's assessment of risk of material misstatement: Increase
2. An increase in use of other substantive procedures directed at same assertion: Decrease
3. An increase in auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in population: Increase
4. An increase in tolerable misstatement: Decrease
5. An increase in amount of misstatement the auditor expects to find in the population: Increase
6. Stratification of the population when appropriate: Decrease

Factors determining extent of checking on a Sampling Plan

i) Size of organization	iv) Tolerable error range
ii) State of Internal Control	v) Degree of desired Confidence
iii) Adequacy & reliability of books & records	

SA 540: Auditing A/c Estimates, including Fair Value Accounting Estimates & Related Disclosures

Nature of A/c Estimates: Some FS items can't be measured precisely, can only be estimated. In this SA, such items referred to as accounting estimates [A/c Estimates]

Info. available to mgt to make a/c estimate varies widely that affects degree of estimation uncertainty. Degree of estimation uncertainty affects ROMM of a/c estimates.

A/c estimates involve relatively low estimation uncertainty and give rise to lower ROMM

- ✓ A/c estimates derived from data that's readily available, such as published intt. rate data or exchange-traded prices of securities. Such data may be referred as "observable" in context of FV a/c estimate
- ✓ FV a/c estimates where method of measurement prescribed by FRF is simple & applied easily to asset or liability requiring measurement at FV.
- ✓ A/c estimates arising in entities that engage in business activities that aren't complex
- ✓ A/c estimates that are frequently made and updated because they relate to routine transactions
- ✓ FV a/c estimates where model used is well-known or generally accepted, provided that assumptions or inputs to model are observable.



[FV → Fair Value]

Learn with Fun ©

A/c estimates with relatively high estimation uncertainty, based on significant assumptions

- ✓ FV a/c estimates for which highly specialised entity-developed Model used or for which assumptions or inputs can't be observed in marketplace.
- ✓ A/c estimates relating to Outcome of litigation.
- ✓ FV a/c estimates for Derivative financial instruments not publicly traded.



Degree of estimation uncertainty varies based on :

- Nature of a/c estimate,
- Extent to which there is a generally accepted method make a/c estimate,
- Subjectivity of assumptions to make the a/c estimate

Eg. of situations where a/c estimates, other than FV a/c estimates, may be required:

- ✓ Allowance for doubtful a/c.
- ✓ Inventory obsolescence.
- ✓ Warranty obligations.
- ✓ Depreciation method or asset useful life.
- ✓ Provision against the carrying amount of investment where there is uncertainty regarding its recoverability.
- ✓ Outcome of long term contracts.
- ✓ Financial Obligations / Costs arising from litigation settlements and judgments.

Eg. of situations where fair value a/c estimates may be required include:

- ✓ Complex financial instruments, which are not traded in an active and open market.
- ✓ Share-based payments.
- ✓ Property or equipment held for disposal.
- ✓ Certain assets or liabilities acquired in business combination, including goodwill and intangible assets.
- ✓ Transactions involving exchange of assets/liabilities between independent parties without monetary consideration, for eg. non-monetary exchange of plant facilities in different lines of business.

Risk Assessment Procedures & Related Activities

Identifying & Assessing ROMM

a. In identifying & assessing ROMM as per SA 315, evaluate degree of estimation uncertainty.

b. Determine whether any a/c estimate identified as having high estimation uncertainty give rise to significant risk.

How auditor minimizes Risk of Material Misstatement?

- Obtain understanding of
  - ✓ Requirements of FRF
  - ✓ How mgt identifies those transactions, events or conditions that may give rise to a/c estimates by making inquiries
- Estimation making process of mgt:
  - i. Method used in making accounting estimate
  - ii. Relevant controls
  - iii. Whether mgt has used an expert
  - iv. Assumptions underlying accounting estimates
  - v. Whether there has been change from prior period in methods for making a/c estimates, & if so, why &
  - vi. Whether and, if so, how mgt has assessed effect of estimation uncertainty.



Inquiries from Management

Inquiries of mgt about changes in circumstances may include, for example, inquiries about whether:

- ✓ Entity has engaged in new types of transactions that may give rise to a/c estimates.
- ✓ Terms of transactions that gave rise to a/c estimates that have changed.
- ✓ A/c policies relating to a/c estimates have changed, as a result of changes to requirements of applicable FRF or otherwise.
- ✓ Regulatory or other changes o/s mgt control that may require mgt to revise or make new a/c est.
- ✓ New conditions or events have occurred that give rise to need for new or revised a/c estimates.

Auditor may identify transactions, events and conditions that give rise to need for a/c estimates that mgt failed to identify. SA 315 deals with such circumstances in determining whether there is significant deficiency in internal control with regard to entity's RAP.

Recognition and Measurement Criteria: For a/c estimates giving rise to significant risks, obtain SAAE whether following are as per applicable FRF:

a) mgt's decision to recognise, or to not recognise, a/c estimates in FS; and
b) selected measurement basis for a/c estimates.

Identifying and Assessing RoMM [SA 315]

a) In identifying & assessing RoMM as per SA 315, auditor shall evaluate degree of estimation uncertainty associated with a/c estimates.
b) Auditor shall determine whether any a/c estimate having high estimation uncertainty give rise to significant risk.

Auditor's Response to Assessed RoMM [SA 330]

Based on assessed RoMM, auditor shall determine: -

a) Whether mgt has appropriately applied requirements of applicable FRF to a/c estimate &
b) Whether methods for making a/c estimates are appropriate & applied consistently & changes in a/c estimates or method from prior period are appropriate.

In responding to assessed RoMM, as per SA 330, undertake one or more of following:

a) Determine whether events occurring up to date of auditor's report provide audit evidence regarding a/c estimate.
b) Test how mgt made a/c estimate and data on which it is based.

In doing so, auditor shall evaluate whether:

i. Method of measurement is appropriate in circumstances &
ii. Assumptions are reasonable in light of measurement objectives of applicable FRF.

c) Test operating effectiveness of controls over how mgt made a/c estimate, together with substantive procedures.

d) Develop a point estimate or a range to evaluate mgt's point estimate.

For this purpose:

i. When auditor uses assumptions or methods different from mgt's, obtain understanding of mgt's assumptions or methods to ensure auditor's point estimate or range considers relevant variables & evaluate significant differences from mgt's point estimate.

ii. When auditor concludes it's appropriate to use a range, auditor shall narrow the range, based on audit evidence available, until all outcomes within range are considered reasonable.

Estimation Uncertainty: Accounting estimates with Significant Risk

For a/c estimates that give rise to significant risks, in addition to other substantive procedures performed to meet requirements of SA 330, auditor shall evaluate following:

i. How mgt has considered alternative assumptions or outcomes, and why rejected them, or how mgt otherwise addressed estimation uncertainty in making a/c estimate.

ii. Whether significant assumptions used by mgt are reasonable.

iii. Where relevant to reasonableness of significant assumptions used by mgt or appropriate application of applicable FRF, mgt's intent to carry out specific courses of action & ability to do so.

iv. If, in auditor's judgment, mgt hasn't adequately addressed effects of estimation uncertainty on a/c estimates that give rise to significant risks, auditor shall develop a range to evaluate reasonableness of a/c estimate.

[Alternate assumptions → Reasonable → Intent & Validity → Estimation Uncertainty]

Understanding of Assumptions

Matters that the auditor may consider in obtaining an understanding of assumptions underlying the accounting estimates include, for example:

- ✓ Nature of assumptions, including which of the assumptions are likely to be significant assumptions.
- ✓ How mgt assesses whether assumptions are relevant and complete (i.e. all relevant variables have been considered).
- ✓ How mgt determines that assumptions used are internally consistent.
- ✓ Whether assumptions relate to
  - ➢ matters within control of mgt (for eg, assumptions about maintenance programs that may affect estimation of asset's useful life), and how they conform to entity's business plans and external environment, or
  - ➢ matters outside its control (for eg, assumptions about interest rates, mortality rates, potential judicial or regulatory actions, or variability and timing of future cash flows).



- ✓ Nature and extent of documentation, if any, supporting the assumptions.

Nature >> Internally Consistent + Completeness >> Documentation >> Control

What factors influence degree of Estimation Uncertainty? [ICAI Pronouncement topic]

But what is Estimation Uncertainty (EU)?

Susceptibility of a/c estimate & related disclosures to inherent lack of precision in its measurement.

Degree of estimation uncertainty of a/c estimate may be influenced by factors such as:



- ➢ Extent to which a/c estimate depends on judgment.
- ➢ Sensitivity of a/c estimate to changes in assumptions.
- ➢ Existence of recognised measurement techniques that may mitigate E.U.
- ➢ Length of forecast period & relevance of data drawn from past events to forecast future events.
- ➢ Availability of reliable data from external sources.
- ➢ Extent to which a/c estimate is based on observable or unobservable inputs.

Indian Idol: Judgment → Sensitive → Data → Measurement Tech → Length → Observable

Review of Outcome of Accounting Estimates

- ➢ Auditor shall review outcome of a/c estimates included in prior period FS or their subsequent re-estimation for purpose of current period.
- ➢ Nature and extent of review takes account of
  - ✓ nature of a/c estimates and
  - ✓ whether info. obtained from review would be relevant to identifying & assessing ROMM of a/c estimates made in current period FS.
- ➢ However, review is not intended to question judgments made in prior periods based on info. available at that time.
- ➢ Outcome of a/c estimate will often differ from a/c estimate recognised in prior period F.S.
- ➢ By performing RAP to identify & understand reasons for such differences, auditor may obtain:
  - ✓ Info. regarding effectiveness of mgt's prior period estimation process, from which auditor can judge effectiveness of mgt's current process.
  - ✓ Audit evidence pertinent to re-estimation, in current period, of prior period a/c estimates.
  - ✓ Audit evidence of matters, such as estimation uncertainty, that may require disclosure in FS.
- ➢ It may assist auditor, in current period, in identifying circumstances or conditions that increase susceptibility of a/c estimates to possible mgt bias.
- ➢ Auditor's professional scepticism assists in identifying such circumstances and determining NTE of further audit procedures.

Disclosures in F.S.

Obtain SAAE about whether disclosures in FS are as per FRF. For a/c estimates that give rise to significant risks, evaluate adequacy of disclosure of their estimation uncertainty in FS.

a. Presentation of FS as per FRF includes adequate disclosure of material matters.
These disclosures may include,

- ✓ Assumptions used.
- ✓ Method of estimation used, including any applicable model.
- ✓ Any changes in method of estimation from prior period and its subsequent effect.
- ✓ Basis for selection of estimate.
- ✓ Sources and implication of estimation uncertainty.

b. In relation to a/c estimate having significant risk, even when disclosures are as per FRF, auditor may conclude disclosure of estimation uncertainty is inadequate in light of circumstances & facts involved.

Written Representations (WR)

SA 580 discusses use of WR. Depending on nature, materiality and extent of estimation uncertainty, WR about accounting estimates recognised or disclosed in FS may include representations:

- ✓ About appropriateness of measurement processes, including assumptions & models, used by mgt in determining a/c estimates as per FRF & consistency in application of processes.
- ✓ That assumptions appropriately reflect mgt's intent & ability to carry out specific courses of action on behalf of entity, where relevant to a/c estimates & disclosures.
- ✓ That disclosure related to a/c estimates are complete & appropriate under applicable FRF.
- ✓ That no subsequent event requires adjustment to a/c estimates and disclosures included in FS.

Method >> Assumptions >> Disclosures >> SA 560



SA 550: Related Parties (RP)

Objectives of Auditor

a) Obtain understanding of RP relationships & transactions sufficient:
   i. To recognise fraud risk factors, arising from RP relationships and transaction &
   ii. To conclude whether FS:
      ✓ Achieve true and fair presentation (for fair presentation frameworks) or
      ✓ Are not misleading (for compliance frameworks)

b) Obtain SAAE whether RP relationships & transn identified, accounted & disclosed in FS

Related party – A party that is either:

(i) RP as defined in FRF or

(ii) Where FRF establishes minimal 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 or
   c) Another entity that is under common control with reporting entity through having:
      i. Common controlling ownership
      ii. Owners who are close family members or
      iii. Common key management

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

<u>But as per Ind AS 24, entity required to disclose:</u>

1. Name of govt & nature of its relationship with reporting entity (i.e. control, joint control or significant influence)
2. Following info. in sufficient detail to enable users to understand effect of RP transactions FS:
   (i) nature and amount of each individually significant transaction &
   (ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

Engagement Team Discussion

Matters that may be addressed in discussion by engg. team may include:

✓ Nature & extent of entity's relationship & transactions with Related Parties
✓ Records or documents that may indicate existence of RP relationships or transactions



- ✓ Emphasis on maintaining professional skepticism throughout audit for potential of material misstatements from RP relationships & transactions
- ✓ Circumstances or condn. that indicate RP relationships or transn. not disclosed by mgt to Auditor
- ✓ Importance mgt & TCWG attach to maintaining internal controls regarding identification, accounting & disclosure of RP relationships & transactions

RP (Nature & Extent) >> Records & Documents >> Prof. Skep >> Not disclosed >> Internal Controls

Understanding Entity's Related Party Relationships and Transactions

Auditor shall inquire of management regarding:

a) Identity of entity's RP, including changes from prior period
b) Nature of relationships between entity & these RP and
c) Whether entity entered into transn. with these RP during period and, if so, type & purpose of transn.

Auditor shall inquire of mgt & others within entity, to obtain understanding of controls that mgt has established to:

a) Identify, account & disclose RP relationships & transactions as per FRF
b) Authorise and approve significant transactions and arrangements with RP and
c) Authorise and approve significant transactions and arrangements o/s normal course of business.

Maintain alertness for RP information when reviewing Records/Documents

Auditor shall remain alert, when inspecting records or documents, that may indicate existence of RP relationships or transactions that mgt has not previously identified or disclosed to auditor.

Documents to be inspected for identifying RP

Auditor shall inspect following documents for RP relationships or transactions that mgt has not previously identified or disclosed to auditor:

a) Bank, legal and 3rd party confirmations obtained as part of auditor's procedures
b) Minutes of meetings of shareholders and of TCWG and
c) Such other records or documents as auditor considers necessary in circumstances of entity.

Eg of Other records/Docs:

- Entity income tax returns.
- Internal auditors' reports.
- Info. supplied by entity to regulatory authorities.
- Documents associated with entity's filings with a securities regulator (e.g, prospectuses).
- Shareholder registers to identify entity's principal shareholders.
- Records of entity's investments & its pension plans.

- Statements of conflicts of interest from mgt & TCWG.
- Contracts and agreements with key mgt or TCWG.
- Significant contracts re-negotiated by the entity during the period.
- Significant contracts and agreements not in entity's ordinary course of business.

If auditor identifies significant transactions o/s entity's normal course of business when performing audit procedures , he shall inquire mgt about:

a) Nature of transactions &
b) Whether RP could be involved.

Fraud Risk Factor associated with a Related Party with Dominant Influence

Domination of mgt by a single person or small group of persons without compensating controls is a fraud risk factor.

Identification of Previously Unidentified/Undisclosed RP or Significant RP Transactions

a) Promptly communicate to other members of engg team
b) Where FRF establishes RP requirements:
   - Request mgt to identify all transactions with newly identified RP
   - Inquire as to why entity's IC failed to identify or disclose RP relationship/transaction
c) Perform Substantive procedures relating to newly identified RP relationship/transaction
d) If non-disclosure appears intentional, evaluate implications for audit.

[Prompt communication >> Mgt [Identify + Inquire] >> Perform >> Intentional [evaluate implications]

Eg. of arrangements that indicate existence of RP relationships or transactions that mgt hasn't previously identified or disclosed to auditor include:



- Participation in unincorporated partnerships with other parties.
- Agreements for provision of services to certain parties under T&Cs that are o/s entity's normal course of business.
- Guarantees and guarantor relationships.

What if Identified Significant RP Transactions o/s Entity's Normal Course of Business?

a) Inspect underlying contract/agreement & evaluate:
   - Business rationale (or lack thereof) suggest transaction entered to engage in fraudulent financial reporting or conceal misappropriation of assets
   - Terms of transactions are consistent with mgt explanation &
   - Transaction accounted & disclosed as per FRF
b) Obtain Audit evidence that transaction authorised & approved.



Eg. of transactions o/s entity's normal course of business may include:

- Complex equity transactions, such as corporate restructurings or acquisitions.
- Leasing of premises or rendering of mgt services to another party if no consideration is exchanged.
- Sales transactions with unusually large discounts or returns.
- Transactions with circular arrangements, for eg, sales with commitment to repurchase.
- Transactions with offshore entities in jurisdictions with weak corporate laws.
- Transactions under contracts whose terms are changed before expiry.

Obtain Written Representation that:

a. all related parties & related party transactions have been disclosed to auditor &
b. all such transactions have been properly accounted & disclosed.

Communication with TCWG

Significant matters arising during audit in connection with entity's related parties.

Documentation

Names of related parties & nature of related party transactions.

SA 560: Subsequent Events

- Events occurring b/w date of FS & date of auditor's report &
- Facts that become known to auditor after date of auditor's report

Events occurring b/w date of FS & date of Audit Report

a. Obtain SAAE to ensure events which require adjustment or disclosure in FS have been identified.
b. In determining NTE of Audit procedures, he shall:
   - ✓ Obtain understanding of mgt procedures of identifying subsequent events
   - ✓ Inquiring* of mgt as to occurrence of subs. Events which affect FS
   - ✓ Read minutes of mgt meetings held after date of FS
   - ✓ Read latest subsequent interim FS, if any
   - ✓ If auditor identifies events which require adjustment or disclosure in FS, then determine if it's appropriately adjusted or disclosed in FS

Written Representation from mgt that all events occurring subsequent to date of FS & that require adjustment or disclosure have been adjusted or disclosed.

*Specific inquiries to be made from mgt:

- ➢ Whether new commitments, borrowings or guarantees have been entered into.
- ➢ Whether sales or acquisitions of assets have occurred or are planned.

- Whether any assets have been appropriated by govt or destroyed, for eg, by fire or flood.
- Whether any events have occurred that are relevant to recoverability of assets.
- Whether there have been increases in capital or issuance of debt instruments, such as issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
- Whether there have been any developments regarding contingencies.
- Whether any unusual accounting adjustments have been made or are contemplated.
- Whether any events have occurred or are likely to occur that will bring into Question (?) appropriateness of a/c policies used in F.S, for eg, events call into question going concern assumption.
- Whether any events have occurred relevant to measurement of estimates or provisions made in FS.

Liabilities >> Assets >> Capital >> Contingencies >> A/c estimates/policies/adjustments

Facts that become known to auditor after date of Audit report but before FS are issued

a) Auditor has no obligation to perform any procedure regarding FS after issue of AR.

b) However, if a fact becomes known to auditor that had been known before issue of AR, it may have amended the AR, he shall:
   - Discuss matter with mgt & TCWG
   - Determine if FS need amendment & if so
   - Inquire how mgt intends to address the matter in FS

c) If mgt amends FS, he shall,
   - Carry our audit procedures on amendment
   - Extend these procedures to date of new AR &
   - Provide a new AR on amended FS dated not earlier than date of approval of amended FS

d) If law or reg. or FRF doesn't prohibit mgt from restricting amendment of FS to subsequent event, auditor is permitted to restrict audit procedures to that amendment.

Auditor shall either:

- Amend AR to include an additional date that conveys audit procedures restricted to amendment in FS [Dual Dating] OR
- Provide a new or amended AR that includes EOM/OM para that conveys audit procedures on subsequent events restricted to amendments in FS [EOM/OM Para]

e) If mgt doesn't amend FS when auditor requires:

If AR not provided to entity ⇓ modify opinion as per SA 705 & provide AR

If AR provided to entity ⇓ notify mgt & TCWG to not issue FS to 3rd parties. If mgt still issues FS, auditor shall take action to prevent reliance on AR (obtain legal advice)

Facts which become known to auditor after F.S. are issued

a) After FS have been issued auditor has no obligation.

b) However if any fact becomes known to auditor, had it been know at date of AR, he may have amended the AR, he shall:



- Discuss with mgt & TCWG
- Determine if FS need amendment & if so,
- Inquire how mgt intends to address the matter

c) If mgt amends the FS, auditor shall:

- Carry out audit procedures necessary in circumstances of amendment
- Review steps taken by mgt that everyone in receipt of previously issued FS with AR has been informed of the situation
- If restricted amendment allowed → Dual Dating/SA 706(OM or EOM para)
- If Not, then Extend audit procures to date of new AR, dated no earlier than date of approval of amended FS
- Provide a new AR on amended FS
- In New or amended AR include EOM/OM para referring to note in FS discussing reasons for amendment in FS & AR

d) If mgt doesn't amend FS & inform users about the situation → auditor shall notify mgt & TCWG that auditor seek to prevent future reliance on AR

e) If despite such notification, mgt & TCWG don't take steps, auditor shall take action to prevent reliance on AR (obtain legal advice)

SA 570: Going Concern (GC)

Deals with :

(I) Auditor's responsibilities in audit of FS relating to GC and

(II) Implications for auditor's report.

SA 701 explains that a material uncertainty related to events or conditions that may cast significant doubt on entity's ability to continue as a GC is, by its nature, a KAM.

Going Concern Basis of Accounting

- FS are prepared on assumption that entity will continue operations for foreseeable future.
- General purpose FS are prepared using GC basis of accounting, unless mgt either intends to liquidate entity or to cease operations, or has no realistic alternative but to do so.
- Special purpose F.S. may or may not be prepared as per GC basis of accounting.
- When use of GC basis is appropriate, assets and liabilities are recorded on basis that entity will be able to realize its assets & discharge liabilities in normal course of business.



Responsibility for Assessment of the Entity's Ability to Continue as a Going Concern

a) It is mgt responsibility to assess entity's ability to continue as GC.

b) Mgt's assessment of entity's ability to continue as GC involves making judgment, at particular point in time, about inherently uncertain future outcomes of events or conditions.

c) Following factors are relevant to that judgment:

- Size and complexity of entity, nature and condition of business & degree to which it is affected by external factors.
- Degree of uncertainty associated with outcome of an event or condition.
- Any judgment about future is based on info. available at the time judgment is made. Subsequent events may result in outcomes inconsistent with judgments reasonable at time they were made.

Size & Complexity → Degree [Affected + Uncertainty] → Subsequent events

Auditor's Responsibilities

- Auditor's responsibilities are to obtain SAAE & conclude on, appropriateness of mgt's use of GC basis of accounting
- To conclude whether a material uncertainty exists about entity's ability to continue as a GC.
- SA 200 → potential effects of inherent limitations on auditor's ability to detect MM are greater for future events or conditions that may cause entity to cease to continue as GC
- Auditor cannot predict such future events or conditions.
- Absence of reference to material uncertainty about entity's ability to continue as G.C. in A/R can't be viewed as a guarantee as to entity's ability to continue as GC.

Risk Assessment Procedures & Related Activities

When performing RAP as per SA 315, auditor shall consider whether events or conditions exist that may cast significant doubt on entity's ability to continue as a G.C.

In doing so, determine whether mgt has already performed a preliminary assessment of entity's ability to continue as a G.C. &

a) If assessment performed → discuss the assessment with mgt and determine whether mgt has identified events or conditions that, individually or collectively, cast significant doubt on entity's ability to continue as going concern and, if so, mgt's plans to address them or

b) If assessment not performed → discuss with mgt basis for use of going concern basis of accounting, and inquire whether events or conditions exist that, individually or collectively, may cast significant doubt on entity's ability to continue as going concern.

Note: Auditor shall remain alert throughout audit for audit evidence of events or conditions that cast significant doubt over entity's ability to continue as G.C.



Evaluating mgt assessment of Going Concern [G.C.]

- Auditor shall evaluate mgt's assessment of entity's ability to continue as G.C.
- Cover same period as used by mgt to make its assessment as required by applicable FRF, or L/R if it specifies longer period.
- If mgt's assessment covers less than 12 months from date of FS, request mgt to extend assessment period to at least 12 months.
- In evaluating mgt's assessment, consider whether it includes all relevant info of which auditor is aware as result of audit.

Additional Audit Procedures When Events or Conditions Are Identified

a. Where mgt has not yet performed GC assessment, requesting mgt to make its assessment.
b. Evaluating mgt's plans for future actions, whether outcome of these plans likely to improve situation & whether plans are feasible in the circumstances.
c. Where entity has prepared cash flow forecast & analysis of forecast is a significant factor in considering future outcome of events or conditions:
   i. Evaluating reliability of underlying data generated to prepare forecast &
   ii. Determining whether there is adequate support for assumptions underlying forecast.
d. Considering whether any additional facts or info available since date mgt made its assessment.
e. Requesting written representations from mgt and TCWG , regarding plans for future actions & their feasibility.

Request for assessment >> Plan (Improve + Feasible) >> Cash flow forecast (Data + Assumptions) >> Add. Facts/Info >> WR (Plans + feasible)

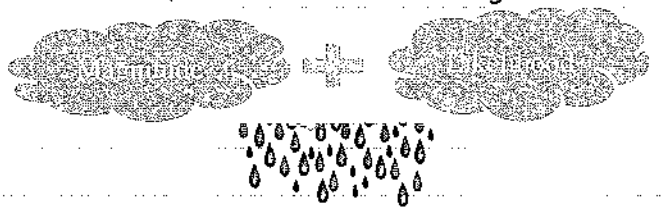
Additional procedures:

- ✓ Analysing and discussing cash flow, profit and other relevant forecasts with mgt.
- ✓ Analysing and discussing entity's latest available interim financial statements.
- ✓ Reading terms of debentures and loan agreements and determining whether any have been breached.
- ✓ Reading minutes of meetings of shareholders, TCWG and committees for reference to financing difficulties.
- ✓ Inquiring of entity's legal counsel regarding existence of litigation and claims and reasonableness of mgt's assessments of their outcome and estimate of financial implications.
- ✓ Confirming existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing financial ability of such parties to provide additional funds.
- ✓ Evaluating entity's plans to deal with unfilled customer orders.
- ✓ Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect entity's ability to continue as a going concern.

- ✓ Confirming existence, terms and adequacy of borrowing facilities.
- ✓ Obtaining and reviewing reports of regulatory actions.
- ✓ Determining adequacy of support for any planned disposals of assets.

Auditor's Conclusion

- Auditor shall evaluate whether SAAE obtained & conclude on, appropriateness of mgt's use of going concern basis of accounting in preparation of FS.
- Based on audit evidence obtained, conclude whether material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on entity's ability to continue as a GC.
- Material uncertainty exists when magnitude of impact & likelihood of occurrence is such that, appropriate disclosure is necessary for:
  a) In case of a fair presentation FRF → fair presentation of F.S. or
  b) In case of compliance framework, FS not to be misleading.



Material Uncertainty

Adequacy of Disclosures

<u>When Events or Conditions Identified & Material Uncertainty Exists</u>

Auditor shall determine whether FS:

a. Adequately disclose principal events or conditions that may cast significant doubt on entity's ability to continue as a GC & mgt's plans to deal with these events or conditions and

b. Disclose clearly that there is material uncertainty related to events or conditions that may cast significant doubt on entity's ability to continue as a GC and it may be unable to realize its assets & discharge its liabilities in normal course of business.

<u>When Events or Conditions Identified but No Material Uncertainty Exists</u>

Auditor shall evaluate whether FS provide adequate disclosures about these events or conditions.

Implications for Reporting

<u>Use of Going Concern Basis of Accounting Is Inappropriate</u> → Express adverse opinion.

<u>Use of Going Concern Basis of Accounting Is Appropriate but a Material Uncertainty Exists</u>

Adequate Disclosure of M.U. Is Made in F.S. => Auditor shall express unmodified opinion & report shall include separate section under heading "Material Uncertainty Related to Going Concern" to:
(a) Draw attention to note in F.S. that discloses the matters and
(b) State that these events or conditions indicate that M.U. exists that may cast significant doubt on entity's ability to continue as a G.C. and auditor's opinion isn't modified in respect of the matter.

Adequate Disclosure of M.U. Is Not Made in F.S. → If adequate disclosure about M.U. is not made in FS, auditor shall:

a) Express a qualified or adverse opinion, as appropriate, as per SA 705 (Revised) &
b) In Basis for Qualified (Adverse) Opinion section of auditor's report, state that M.U. exists that may cast significant doubt on entity's ability to continue as GC & FS don't adequately disclose this matter.

Management Unwilling to Make/Extend Its Assessment → Consider implications for auditor's report.

Communication with TCWG

a) Whether events or conditions constitute a material uncertainty
b) Whether mgt's use of going concern basis of accounting is appropriate in preparation of FS
c) The adequacy of related disclosures in FS
d) Where applicable, implications for auditor's report.

Significant Delay in Approval of FS

Inquire reasons for delay. If delay related to events or conditions relating to GC assessment perform additional audit procedures & consider effect on auditor's conclusion regarding existence of a M.U.

Events or Conditions That May Cast Significant Doubt on Entity's Ability to Continue as a Going Concern

Financial

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment or excessive reliance on short-term borrowings to finance long-term assets.
- Inability to pay creditors on due dates.
- Indications of withdrawal of financial support by creditors.
- Substantial operating losses or significant deterioration in value of assets.
- Arrears or discontinuance of dividends.
- Negative operating cash flows indicated by historical or prospective F.S.
- Adverse key financial ratios.
- Change from credit to cash-on-delivery transactions with suppliers.



Operating

- Management intentions to liquidate the entity or to cease operations.
- Loss of key mgt without replacement.
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- Labor difficulties.
- Shortages of important supplies.
- Emergence of a highly successful competitor.

Supplies >> Labor >> key mgt >> market >> competitor >> Intention to liquidate

Other

- Non-compliance with capital or statutory or regulatory requirements
- Pending legal or regulatory proceedings against entity that may result in claims that entity is unlikely to satisfy.
- Changes in law or regulation or government policy expected to adversely affect entity.
- Uninsured or underinsured catastrophes when they occur.

Non-compliance >> Legal proceedings >> change in law >> catastrophe

SA 580: Written Representations (WR)

- Written statement by mgt to auditor to confirm certain matters or to support other audit evidence.
- WR in this context don't include F.S., assertions therein, or supporting books and records.
- WR provide necessary audit evidence, they don't provide SAAE on their own about any of matters with which they deal.
- Fact that mgt has provided reliable WRs does not affect nature or extent of other audit evidence that auditor obtains about fulfilment of mgt's responsibilities or about specific assertions.

Objectives of Auditor

a) To obtain WR from mgt that they believes they have fulfilled their responsibility for preparation of FS & for completeness of info. provided to auditor

b) To support other audit evidence relevant to FS or specific assertions in FS by means of WR, if determined necessary by auditor or required by other SAs and

c) To respond appropriately to
   - ➢ WR provided by mgt or
   - ➢ if mgt don't provide WRs requested by auditor.

Date & Period covered by WR

Date



- WRs are necessary audit evidence, auditor's opinion can't be expressed & report can't be dated before date of WRs.
- Further, auditor is concerned with events occurring up to date of audit report that may require adjustment or disclosure, WRs are dated as near as practicable to but not after date of audit report
- Sometimes it may be appropriate to obtain WR about a specific assertion in FS during audit. In such case, it may be necessary to request an updated WR.

Period

- WRs are for all periods referred in audit report because mgt needs to reaffirm that WR it previously made wrt prior periods remain appropriate.
- Auditor & mgt may agree to a form of WR that updates WRs relating to prior periods by addressing whether there are any changes to such WRs and, if so, what they are.
- Situations may arise where current mgt were not present during all periods referred in audit report. Such persons may assert that they are not in position to provide some or all of WRs because they were not in place during prior period.
- This fact, however, doesn't diminish such persons' responsibilities for FS as whole. Accordingly, requirement for auditor to request WRs that cover all relevant period(s) still applies.

Doubt as to Reliability of Written Representations

- If auditor has concerns about competence, integrity, ethical values or diligence (DICE) of mgt, determine effect on reliability of representations (oral or written) & audit evidence in general.
- In particular, if WR are inconsistent with other audit evidence, auditor shall perform audit procedures to resolve the matter.
- If matter remains unresolved, reassess DICE of mgt & determine effect on reliability of representations (oral or written) & audit evidence in general.
- If auditor concludes that WR are not reliable, take appropriate actions, including determining possible effect on opinion in auditor's report as per SA 705 i.e. Disclaimer of Opinion.

Requested Written Representations Not Provided

If mgt doesn't provide one or more of requested WRs, auditor shall:

a) Discuss matter with mgt
b) Re-evaluate integrity of mgt & evaluate effect on reliability of representations (oral or written) & audit evidence in general &
c) Take appropriate actions, including possible effect on opinion as per SA 705 i.e. Disclaimer of opinion.

Like Auditor gets assurance with Mgt's Written Representations,
You'll get assurance only after some written practice!!
Do complete Tests & Assignments on time ☺

SA 600: Using the work of Other Auditor

Principal Auditor (PA)

- Auditor who uses work performed by other auditors is PA.
- Responsibility for reporting on financial information of an entity when that financial information includes financial information of one or more components audited by another auditor.

Other Auditor: Auditor, other than PA with responsibility for reporting on financial info. of a component included in financial info. audited by PA.

"Component" means a division, branch, subsidiary, joint venture, associate or other entity whose financial info. included in financial info. audited by PA.

Note: SA 600 doesn't apply to joint audit nor with auditor's relationship with a predecessor auditor.

Acceptance as Principal Auditor

Auditor should consider following before accepting his position as PA:

a. Materiality of portion of financial info. which PA audits
b. PA's degree of knowledge regarding business of components
c. RoMM in financial info. of components audited by other auditor
d. Performance of additional procedures regarding components audited by other auditor resulting in PA having significant participation in such audit.

Materiality of own >> Knowledge of other + RoMM >> Add. Procedures

Principal Auditor's Procedures

1. Right to visit component & examine books of a/cs & records, if necessary in special circumstances.
2. If planning to use work of other auditor evaluate his competence if he isn't member of ICAI
3. Perform procedures to obtain SAAE that work of other auditor is adequate for PA's purpose.
   - ➢ Advise other auditor of use of his work & co-ordinate at planning stage.
   - ➢ Inform auditor about
     - ✓ Procedures for identifying inter-component transaction & time table for audit completion.
     - ✓ Areas requiring spl. consideration,
     - ✓ Significant Accounting, auditing & reporting requirements & obtain representation as to compliance with them.



4. PA might discuss with other auditor procedures applied or review written summary of his audit procedures in form of questionnaire or checklist. May also plan to visit other auditor.



5. NTE of audit procedures would depend on his knowledge of professional competence of other auditor that can be enhanced from review of his previous audit work.

PA should consider significant findings of other auditor

- PA may discuss audit findings/other matters affecting financial info. of components with other auditor & mgt of component,
- May also decide supplementary procedures that supplement tests of records or FS of component.
- Such tests depending on circumstances, maybe performed by PA or other auditor.

When other auditor not professionally qualified auditor

Where component is situated in foreign country & applicable laws permit a person other than a professionally qualified auditor to audit FS of such component.

Documentation

- PA to document in his working papers –components whose financial info. audited by other auditors.
- Also document procedures performed & conclusions reached.

Eg. Auditor would document results of discussions with other auditor & review of written summary of other auditor's procedures.

- Need not document reasons for limiting procedures where SAAE previously obtained that acceptable quality control P&P are complied with in conduct of other auditor's practice.
- Where other auditor's report other than unmodified: Also document how PA dealt with qualifications or adverse remarks contained in other auditor's report in framing his own report.

Role of Principal & Other Auditor (Coordination b/w Auditors)

There should be sufficient liaison between principal auditor and other auditor

Role of Principal Auditor:

i. It is necessary to issue written communication(s) as PA to other auditor.
ii. PA should advise other auditor of any matters that come to his attention that may have important bearing on other auditor's work.
iii. When considered necessary by him, PA may require other auditor to answer a detailed questionnaire regarding matters on which PA requires info.

Role of Other Auditor:

i. Other auditor, knowing context in which his work is to be used by PA, should co-ordinate with PA. For eg, bringing to PA's immediate attention significant findings to be dealt at entity level, adhering to time-table for audit of component, etc.
ii. He should ensure compliance with relevant statutory requirements.

iii. Other auditor should respond to questionnaire sent by PA on a timely basis.

Reporting Considerations

Qualified or Disclaimer of opinion in case of a limitation on the scope of audit

When PA concludes

- ✓ work of other auditor can't be used &
- ✓ unable to perform sufficient additional procedures regarding financial info. of component audited by other auditor
- ✓ express a Qualified/Disclaimer of opinion because there is limitation on scope of audit.

If other auditor issues a Modified Report

If other auditor issues, or intends to issue, modified A/R, PA should consider whether subject of modification is of such nature & significance, in relation to financial info. of entity that it requires modification of PA's report.

Division of Responsibility

- ➢ PA not responsible for work of other auditors, except in suspicious circumstances about reliability of work performed by other auditors.
- ➢ When PA has to report on FS of entity as whole relying upon reports of other auditors, report should clearly state division of responsibility for financial info. of entity by indicating extent to which financial info. of components audited by other auditors. However, if PA notices any material discrepancies, inform other Auditor. This should be included in the Audit Report.

SA 620: Using work of Auditor's Expert

SA 620 deals with auditor's responsibilities regarding use of work in a field of expertise other than accounting or auditing when that work is used to assist the auditor in obtaining SAAE.

Types of report or opinions Auditor can obtain from Auditor's expert?

- ➢ Valuation of complex financial instruments, land & buildings, plant & machinery, jewellery, works of art, antiques, intangible assets, assets acquired & liabilities assumed in business combinations and assets that may have been impaired.
- ➢ Actuarial calculation of liabilities associated with insurance contracts or employee benefit plans.
- ➢ Estimation of oil and gas reserves.
- ➢ Valuation of environmental liabilities, and site clean-up costs.
- ➢ Interpretation of contracts, laws and regulations.
- ➢ Analysis of complex or unusual tax compliance issues.



Objectives of Auditor

a) To determine whether to use work of auditor's expert &
b) If using the work then determining whether work is adequate for auditor's purposes.

Areas where Auditor's expert can assist the auditor

- Obtaining an understanding of entity and its environment, including its internal control. (SA 315)
- Identifying and assessing ROMM. (SA 315)
- Determining and implementing overall responses to assessed risks at F.S. level. (SA 330)
- Designing and performing further audit procedures to respond to assessed risks at assertion level, comprising tests of controls or substantive procedures. (SA 330)
- Evaluating sufficiency & appropriateness of audit evidence in forming opinion on F.S. (SA 500)

Considerations when deciding to use work of Auditor's Expert

- Whether mgt has used a mgt's expert in preparing F.S.
- Nature and significance of matter, including its complexity.
- ROMM in matter.
- Expected nature of procedures to respond to identified risks, including auditor's knowledge and experience with work of experts in relation to such matters &
- Availability of alternative sources of audit evidence.

When mgt has used a mgt's expert

When mgt has used mgt's expert in preparing FS, auditor's decision on whether to use auditor's expert may also be influenced by such factors. [Same as SA 500]

- Nature, scope and objectives(NSO) of mgt's expert's work.
- Whether mgt's expert is employed by entity or engaged by it to provide relevant services.
- Extent to which mgt can exercise control or influence work of mgt's expert.
- Mgt's expert's competence & capabilities.
- Whether mgt's expert is subject to technical performance standards.
- Any controls within entity over mgt's expert's work.

Nature, Timing & Extent of Audit Procedures when using work of Auditor's Expert

Auditor shall consider Matters including:

a. Nature of matter to which that expert's work relates
b. RoMM in the matter to which that expert's work relates
c. Significance of that expert's work in the context of the audit
d. Auditor's knowledge of and experience with previous work performed by that expert and
e. Whether that expert is subject to auditor's firm's quality control policies and procedures.



Following factors may suggest need for more extensive procedures:

- Work of auditor's expert relates to significant matter that involves subjective & complex judgments.
- Auditor has not previously used work of auditor's expert, & has no prior knowledge of expert's competence, capabilities and objectivity.
- Auditor's expert is performing procedures integral to audit, rather than being consulted to provide advice on individual matter.
- Expert is auditor's external expert & not subject to firm's quality control policies and procedures.

Competence, Capability & Objectivity of Auditor's Expert [Similar to SA 500]

Evaluating objectivity of auditor's external expert [Similar to SA 500]

When evaluating objectivity of auditor's external expert, it may be relevant to:

a) Inquire entity about any known interests or relationships that it has with auditor's external expert.

b) Discuss with that expert any applicable safeguards, including professional requirements that apply to him; and evaluate adequacy of safeguards to reduce threats to acceptable level.

Interests and relationships that may be relevant to discuss with the auditor's expert include:

- Financial interests.
- Business and personal relationships.
- Provision of other services by expert
- In some cases, it may also be appropriate for auditor to obtain written representation from auditor's external expert about interests or relationships with entity of which expert is aware.

Agreement with Auditor's Expert [Imp.]

Auditor shall agree, in writing when appropriate, on following matters with auditor's expert:

a. Nature, scope and objectives of that expert's work

b. Respective roles and responsibilities of auditor and expert

c. Nature, timing and extent of communication between auditor and expert, including form of report to be provided by expert &

When work of auditor's expert relates to significant risk, both formal written report at conclusion of expert's work & oral reports as the work progresses, may be appropriate.

Identification of specific partners or staff who will coordinate with expert, & procedures for communication between expert & entity, assists timely & effective communication, on larger engg.

d. Need for auditor's expert to observe confidentiality requirements.

Following factors suggest need for more detailed agreement or written agreement:

- ✓ Auditor has not previously used work performed by that expert.
- ✓ Auditor's expert will have access to sensitive or confidential entity information.

- ✓ Matter to which auditor's expert's work relates is highly complex.
- ✓ Greater the extent of auditor's expert's work, and its significance in context of audit.

Evaluating Adequacy of Auditor's Expert Work

Specific procedures to evaluate adequacy of auditor's expert's work for auditor's purposes:

- ➢ Inquiries of auditor's expert.
- ➢ Reviewing auditor's expert's working papers and reports.
- ➢ Corroborative procedures, such as:
  - o Observing the auditor's expert's work
  - o Examining published data, such as statistical reports from reputable, authoritative sources;
  - o Confirming relevant matters with 3rd parties
  - o Performing detailed analytical procedures &
  - o Re-performing calculations.
- ➢ Discussion with another expert with relevant expertise when, for eg, findings or conclusions of auditor's expert are not consistent with other audit evidence.
- ➢ Discussing auditor's expert's report with mgt.

Use of Significant assumptions & methods (Relevance & Reasonableness)

Factors relevant to auditor's evaluation of those assumptions & methods include whether they are:

- Generally accepted within auditor's expert's field
- Consistent with requirements of applicable FRF
- Consistent with mgt & if not, reason & effects of, differences.
- Dependent on use of specialised models

Source Data (Relevance, Completeness & Accuracy)

- Verifying origin of data, including obtaining understanding, & where applicable testing, internal controls over data & where relevant, its transmission to expert.
- Reviewing data for completeness & internal consistency

Inadequate work

If auditor determines that work not adequate for auditor's purposes, auditor shall:

a. Agree with that expert on nature & extent of further work to be performed by expert or
b. Perform further audit procedures appropriate to circumstances (more work by expert & auditor or employing another expert)

Reporting: If work isn't adequate for auditor's purposes + cannot resolve matter through additional audit procedures → express modified opinion as per SA 705 because not obtained SAAE.



Reference to Auditor's Expert in Auditor's Report

- Not refer to work of auditor's expert in A/R containing unmodified opinion unless required by L/R.
- If such reference required by L/R, report that reference doesn't reduce auditor's responsibility for audit opinion.
- In some cases, L/R may require reference to work of an auditor's expert, for purposes of transparency in public sector
- If auditor makes reference to work of auditor's expert in audit report because reference is relevant to understanding modification of opinion, indicate that such reference doesn't reduce auditor's responsibility for opinion.

Summary: Unmodified Opinion _____ unless required by L/R

Modified Opinion _____



SA 700: Forming an Opinion & Reporting on the Financial Statements

Objective

a) To form opinion on FS based on evaluation of conclusions drawn from audit evidence obtained &
b) To express clearly that opinion through a written report.

Specific Evaluations by the Auditor

In particular, auditor shall evaluate whether:

a. FS adequately disclose significant a/c policies selected & applied
b. A/c policies selected & applied are consistent with applicable FRF & appropriate
c. A/c estimates made by mgt are reasonable
d. FS provide adequate disclosures to enable intended users to understand effect of material transactions and events on info. conveyed in FS
e. Info. presented in FS is relevant, reliable, comparable, & understandable
f. Terminology used in FS, including title of each FS, is appropriate.

Forming an opinion on FS

Form opinion, whether FS are prepared in all material respects as per applicable FRF.

To form opinion, obtain reasonable assurance about whether FS as whole are free from material misstatement, due to fraud or error.

Further, when FS are prepared as per fair presentation framework, evaluate whether FS achieve fair presentation considering:

1. Overall presentation, structure and content (OPSC) of FS &
2. Whether FS, including related notes, represent transactions & events in a manner that achieves fair presentation.

In other words, express unmodified opinion when auditor concludes FS are prepared, in all material respects, as per applicable FRF.

Basic Elements of Audit Report

1. Title: Independent Auditor's Report
2. Addressee: Addressed as required by circumstances of engg. Report could be addressed to Members in case of general purpose (statutory) FS and BOD for special purpose FS
3. Auditor's Opinion: First section of auditor's report

Opinion section of auditor's report shall also:

a) Identify entity whose FS have been audited
b) State that FS have been audited

c) Identify title of each statement comprising FS.
d) Refer to notes, including summary of significant a/c policies
e) Specify date or period covered by, each FS comprising the FS.

4. Basis for Opinion: Auditor's report shall include a section, directly following Opinion section, with heading "Basis for Opinion", that:
a. States that audit was conducted as per Standards on Auditing
b. Refers to Section of auditor's report that describes auditor's responsibilities under SAs
c. Includes Statement that auditor is independent of entity & has fulfilled other ethical responsibilities. Refer to Code of Ethics issued by ICAI
d. States whether auditor believes that audit evidence obtained is Sufficient and appropriate to provide basis for auditor's opinion.

5. Going Concern: Already covered in SA 570.

6. Key Audit Matters: For audits of FS of listed entities → communicate KAM in auditor's report as per SA 701.

7. Other Information: Where applicable, auditor shall report as per SA 720 (Revised).

8. Responsibilities for FS : Section with heading "Responsibilities of Mgt for FS." In some entities reference may be to TCWG.
This section of auditor's report shall describe mgt's responsibility for:
a. Preparing FS as per applicable FRF & internal control to enable preparation of FS free from M.M., due to fraud/error &
b. Assessing entity's ability to continue as going concern & whether use of GC basis of accounting is appropriate as well as disclosing matters relating to GC.
Also identify those responsible for oversight of financial reporting process. In this case, heading of this section shall also refer to "TCWG". When FS prepared as per fair presentation framework, auditor's report shall refer to "preparation & fair presentation of FS" or "preparation of FS that give a true & fair view," as appropriate.

9. Auditor's Responsibilities for Audit of FS:
(I) This section of auditor's report shall:
a) State objectives of auditor are to:
   i. Obtain reasonable assurance whether FS are free from MM, whether due to fraud/error &
   ii. Issue an auditor's report that includes auditor's opinion.

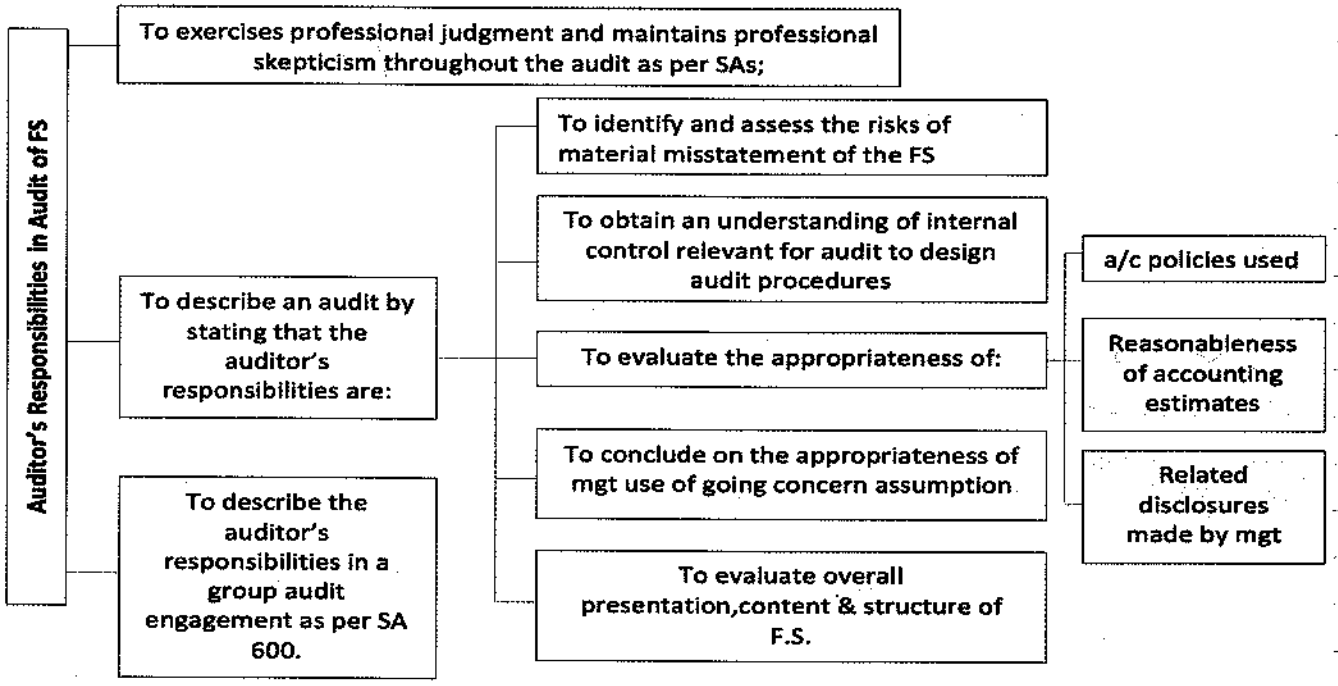
b) State that reasonable assurance is high level of assurance, but not a guarantee that audit conducted as per SAs will always detect a MM when it exists &

c) State that misstatements can arise from fraud/error & either:

i. Describe that they are considered material if, individually or in aggregate could reasonably be expected to influence economic decisions of users taken on basis of these FS or

ii. Provide a definition or description of materiality in accordance with applicable FRF.

(II) Auditor's Responsibilities for Audit of F.S. section of auditor's report shall further:



(III) Auditor's Responsibilities for Audit of FS section of auditor's report also shall:

a. State that auditor communicates with TCWG: planned scope & timing of audit & significant audit findings, including significant deficiencies in internal control that auditor identifies during audit

b. State that auditor provides TCWG with statement that auditor has complied with relevant ethical requirements regarding independence, relationships that affect auditor's independence & related safeguards &

c. For audits of FS of entities for which KAM are communicated as per SA 701, state that, from matters communicated with TCWG, auditor determines those matters that were of most significance in audit of FS of current period & are therefore KAM.

KAM to be presented in Audit Report: As per SA 701, auditor describes these matters in auditor's report unless

✓ law or regulation precludes public disclosure about the matter or



✓ in extremely rare circumstances, auditor determines that a matter should not be communicated in auditor's report because adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

10. Location of description of auditor's responsibilities:

a) Within body of Audit Report	b) Within an appendix to auditor's report in that case auditor shall include reference to location of appendix	c) By specific reference within auditor's report to location of such description on website of appropriate authority, where law, regulation or auditing stds permit.

11. Other reporting responsibilities: Heading " Report on Other Legal & Regulatory Requirements"
12. Signature of auditor: Audit report shall be signed by Auditor in personal name & audit firm. Partner signing needs to mention membership no. + Registration no. of firm + UDIN
13. Place of Signature: Location i.e. city where its signed
14. Date of Audit Report: Not earlier than date when auditor has obtain SAAE

Audit reports for audit as per both SAs & International Stds on Audit

Auditor may be required to conduct audit in addition to SA issued by ICAI, International Standards on Auditing or auditing stds of any other jurisdiction.

In this case, auditor's report may refer to SA in addition to ISA or auditing standards of such other jurisdiction, but only if:

a. There is no conflict between requirements in ISAs or auditing standards of other jurisdiction & SAs that would lead auditor
   i. to form a different opinion, or
   ii. not to include an EOM or OM para that, in particular circumstances, is required by SAs and
b. Auditor's report includes, at minimum, each of elements required by SA. Auditor's report shall thereby identify such Standards on Auditing.

When auditor's report refers to both ISAs or auditing standards of a specific jurisdiction & SA issued by ICAI, auditor's report shall clearly identify the same including jurisdiction of origin of other auditing stds.

No conflict >> minimum elements >> identify ISA + jurisdiction

Supplementary Info. Presented with FS

If supplementary info that isn't required by applicable FRF is presented with audited F.S., auditor shall evaluate whether it's integral part of FS due to its nature or how its presented.

- When it is integral part of F.S → it shall be covered by auditor's opinion.
- If it isn't considered integral part of audited FS → evaluate whether it's presented in a way that differentiates it from audited FS.
- If not, ask mgt to change its presentation.
- If mgt refuses ,
  - auditor shall identify unaudited supplementary info &
  - explain in auditor's report that such supplementary info has not been audited.

Examples:

1. When notes to FS include expln or reconciliation to the extent to which F.S. comply with another FRF. Auditor's opinion will consider such this as supplementary info that can't be differentiated from F.S. His opinion will cover such notes or schedules cross referenced from F.S.
2. When additional p&l that discloses specific items of expenditure as separate schedule included as appendix to F.S. → Auditor shall consider it as supplementary info that can be differentiated from financial info.

SA 701: Communicating Key Audit Matters (KAM) in the Independent Auditor's Report

Applicablity: Applies to audits of complete sets of general purpose FS of listed entities & circumstances when auditor decides to communicate KAM & required by law/regulation.

- KAM are matters that in
  - auditor's professional judgment,
  - were of most significance in audit of FS of current period.
- KAM are selected from matters communicated with TCWG.

Communicating KAM is not:

a. A substitute for disclosures in F.S as per applicable FRF
b. A substitute for auditor expressing a modified opinion as per SA 705
c. A substitute for reporting as per SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a GC
d. A Separate opinion on individual matters.

Factors → Determining Key Audit Matters

a. Areas of higher assessed RoMM, or significant risks identified in accordance with SA 315
b. Significant auditor judgments relating to areas in F.S. that involved significant mgt judgment, including accounting estimates that have been identified as having high estimation uncertainty.
c. Effect on audit of significant events or transactions that occurred during the period.

Eg. of Key Audit Matters

Assessment of Impairment, Provision for losses and contingencies, Valuation of financial instruments, Revenue recognition, Taxation matters (multiple tax jurisdictions, uncertain tax position, deferred tax assets)

Can matters other than disclosed in F.S. be KAM?

- There may be other matters communicated with TCWG that required significant auditor attention & therefore may be determined to be KAM.
- Such matters may include matters relevant to audit not required to be disclosed in FS.
- For eg, implementation of new IT system (or significant changes to existing IT system) during period may be an area of significant auditor attention, if such change had significant effect on overall audit strategy or related to a significant risk (e.g. changes to a system affecting revenue recognition).

Communicating Key Audit Matters

Introductory language in this section of auditor's report shall state that:

a) KAM are those matters that, in auditor's professional judgment, were of most significance in audit of F.S. [of current period] and

b) These matters were addressed in context of audit of FS as a whole, & in forming auditor's opinion thereon, & auditor doesn't provide separate opinion on these matters.

Placement of KAM section in auditor's report?

Generally,

- After Basis for Opinion paragraph & **before** Mgt's Responsibility para.
- In case, MURG section is required as per SA 570(Revised), then KAM is placed after that.

As per SA 706: EOM para may be either directly before or after KAM section, as per auditor's judgment as to relative significance of info. included in EOM para. Auditor may also add further context to heading "Emphasis of Matter", such as "Emphasis of Matter - Subsequent Event", to differentiate EOM para. from individual matters described in KAM.

Basis of opinion | KAM/EOM | Mgt Responsibility

KAM when opinion is modified (Q/A)

- ✓ SA 700 establishes requirements and provides guidance on forming opinion on F.S. Communicating KAM isn't a substitute for disclosures in FS that applicable FRF requires mgt to make or otherwise necessary to achieve fair presentation.

- ✓ SA 705 addresses circumstances in which auditor concludes that there is a M.M. relating to appropriateness or adequacy of disclosures in F.S.



✓ When auditor expresses Q/A opinion as per SA 705, presenting description of matter giving rise to modified opinion in Basis for Q/A Opinion section helps to promote intended users' understanding and to identify such circumstances when they occur.

✓ Separating communication of this matter from other KAM described in KAM section, therefore, gives it appropriate prominence in auditor's report.

✓ When auditor expresses Q/A opinion, communicating other KAM would still be relevant to enhance intended users' understanding of audit & therefore requirements to determine KAM apply.

✓ Since adverse opinion is expressed when auditor concluded that misstatements, individually or in aggregate, are both material & pervasive to FS depending on significance of matter(s) giving rise to adverse opinion, auditor may determine that no other matters are KAM.

✓ In such case Auditor can communicate KAM in below manner:
Key Audit Matters: Except for the matter described in the Basis for Adverse Opinion section, we have determined that there are no other key audit matters to communicate in our report.

SA 700 >> 705 >> Basis Q/A >> Separate from KAM >> Relevant >> Adverse opinion → No KAM

SA 705, "Modifications to the Opinion in the Independent Auditor's Report"

Objective: To express modified opinion on FS when:

a. Auditor concludes, based on audit evidence obtained, FS as a whole are not free from MM or
b. Auditor is unable to obtain SAAE to conclude that FS as a whole are free from MM

Definition of Pervasive: Used in context of misstatements, describe effects/possible effects on FS of Misstatements undetected due to inability to obtain S.A.A.E
Pervasive effects on the financial statements are those that, in auditor's judgement:

i. Are not confined to specific elements, accounts or items of FS
ii. If so confined, represent or could represent a substantial proportion of FS or
iii. In relation to disclosures, are fundamental to users' understanding of FS

Qualified(Q) Opinion: Auditor shall express qualified opinion when:

a. Obtained SAAE → concludes that misstatements, individually or in aggregate, are material, but not pervasive, to FS or
b. Unable to obtain SAAE to base the opinion, but concludes that possible effects on F.S. of undetected misstatements, if any, could be material but not pervasive. (Material but not pervasive)

Spl. Considerations: When auditor expresses (Q) opinion due to MM in F.S, auditor shall state that, in auditor's opinion, except for effects of matter(s) described in Basis for (Q) Opinion section:

1. When reporting as per fair presentation framework, accompanying F.S. present fairly, in all material respects (or give a true and fair view of) [...] in accordance with [applicable FRF] or
2. When reporting as per compliance framework, accompanying F.S. have been prepared, in all material respects, in accordance with [applicable FRF].

When modification arises from inability to obtain SAAE, auditor shall use corresponding phrase "except for possible effects of matter(s) ..." for modified opinion.

Adverse(A) Opinion: Obtained SAAE, concludes misstatements, individually or in the aggregate, both material and pervasive to financial statements.

Spl. Considerations: When auditor expresses an (A) opinion, auditor shall state that, in auditor's opinion, because of significance of matter(s) described in Basis for (A) Opinion section:

1. When reporting as per a fair presentation framework, accompanying F.S. do not present fairly (or give a true and fair view of) [...] in accordance with [applicable FRF] or
2. When reporting as per compliance framework, accompanying F.S. have not been prepared, in all material respects, in accordance with [applicable FRF].

Disclaimer of Opinion: Unable to obtain SAAE to base the opinion, and concludes that possible effects on FS of undetected misstatements, if any, could be both material and pervasive.

Note: Unless required by law or regulation, when auditor disclaims opinion on F.S., auditor's report shall not include KAM section in accordance with SA 701.

Spl considerations: When auditor disclaims an opinion due to inability to obtain SAAE, auditor shall:

1. State that auditor doesn't express opinion on accompanying FS.
2. State that, because of significance of matter(s) described in Basis for Disclaimer of Opinion section, auditor has not been able to obtain SAAE to provide basis for audit opinion on FS and
3. Amend the statement required in SA 700 (Revised), which indicates that F.S. have been audited, to state that auditor was engaged to audit the F.S.

Basis for Modification of Opinion (Qualified/Disclaimer /Adverse)?

When auditor modifies (Q/ D/ A) opinion, auditor shall:

a. Amend the heading "Basis for Opinion" to "Basis for Qualified/Adverse/Disclaimer of Opinion," as appropriate; &
b. Within this section, include description of matter giving rise to modification.

S No.	MM Relates to:	What to include in Basis for Opinion Section
1	Specific amounts in FS (including quantitative disclosures in notes to FS)	✓ Description & quantification of financial effects of misstatement, unless impracticable ✓ If not practicable to quantify the financial effects, auditor shall so state in this section.
2	narrative disclosures	explanation of how the disclosures are misstated
3	non-disclosure of info.	Auditor shall: ✓ Discuss non-disclosure with TCWG ✓ Describe in Basis for Opinion section nature of the omitted information and ✓ Unless prohibited by L/R, include omitted disclosures, provided it is practicable and auditor has obtained SAAE about omitted info.
4	Inability to obtain SAAE	Reasons for that inability

When auditor disclaims opinion on FS, A/R shall not include following elements required by SA 700:

a. Reference to section of A/R where auditor's responsibilities are described &

b. Statement about whether audit evidence obtained is sufficient & appropriate to provide basis for auditor's opinion.

Note: Even if auditor expressed A/D opinion, auditor shall describe in Basis for Opinion section reasons for any other matters of which auditor is aware that would have required a modification to opinion & effects thereof.

Description of Auditor's Responsibilities for Audit of FS →

When Auditor Disclaims an Opinion on FS

When auditor disclaims opinion on FS due to an inability to obtain SAAE, amend description of auditor's responsibilities required by SA 700 to include only the following:

a. Statement that auditor's responsibility is to conduct audit of entity's FS as per SA & issue an A/R

b. Statement that because of matter(s) described in Basis for Disclaimer of Opinion section, auditor was unable to obtain SAAE to provide a basis for audit opinion on FS &

c. Statement about auditor independence & other ethical responsibilities required by SA 700.

SA → ~~SAAE~~ → Independence & ethics

Communication with TCWG

When auditor expects to modify opinion, auditor shall communicate with TCWG

✓ circumstances that led to expected modification &

✓ wording of modification.

Mgt imposed limitation after acceptance of Audit Engagement → Unable to obtain SAAE

- If likely to result in Q/D opinion → request mgt to remove limitation
- If mgt refuses → communicate TCWG & determine whether A.A.P possible to obtain SAAE
- If still can't obtain SAAE & concludes:
  - ✓ Misstatement is material but not pervasive → Qualified opinion
  - ✓ Misstatement is material & pervasive
    - i. Withdraw from engg (practicable & possible under law or regulation)
    - ii. Not practicable to withdraw → Disclaim opinion
- Before withdrawal communicate to TCWG, matters that gave rise to modification

Note: If Auditor expresses Adverse or Disclaimer of Opinion then audit report shall not contain unmodified opinion w.r.t any element of F.S.

SEBI Provisions on Auditor Resignation (Listed entities)

If auditor propose to resign within 45 days from end of qtr → before resignation issue Limited Review (LR) Report for such qtr	If > 45 days from end of qtr → before resignation issue Audit/ LR Report for such qtr & next one	If issued LR report for 1st 3 qtrs → issue Audit Report for full year before resigning

Eg. If auditor resigns on 18.08.24, i.e. >45 days from end of Q1 → Issue LR Report for Q1 & Q2.

ICAI has made announcement that auditor of unlisted Co. shall not mention "professional pre-occupation" as a reason for resignation. Auditor shall mention reasons clearly for resignation in resignation letter issued to Co.

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

a) Circumstances beyond control of entity
- ✓ Entity's accounting records have been destroyed.
- ✓ Accounting records of a significant component have been seized indefinitely by govt. authorities.

b) Circumstances relating to nature or timing of auditor's work or
- ✓ Entity uses equity method of accounting for associated entity, & auditor unable to obtain SAAE about latter's financial info. to evaluate whether equity method has been appropriately applied.
- ✓ Timing of auditor's appointment is such that auditor unable to observe physical inventory count.
- ✓ Auditor determines performing substantive procedures alone isn't sufficient, but entity's controls are not effective.

c) Limitations imposed by mgt



✓ Mgt prevents auditor from observing counting of physical inventory

✓ Mgt prevents auditor from requesting external confirmation of specific account balances.

Special Points:

i) SA 570 If M.U. exists & adequate disclosure isn't there:
   - ✓ No disclosure: Adverse Opinion
   - ✓ Incomplete disclosure: Qualified Opinion

ii) Non consolidation of subsidiary (material + pervasive) => Adverse Opinion

iii) Unable to obtain evidence about a JV investment (representing 90% of entity's net assets) → Disclaimer of Opinion

iv) No agreement of a Loan or Advance (material) → Qualified Opinion

SA 706: Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

Emphasis of matter para

- Para included in Auditor's Report
- refers to matter appropriately presented or disclosed in F.S.
- that in, Auditor's judgment is of
- such importance that its fundamental to user's understanding of F.S.

SAs that contain specific requirements for auditor to include Emphasis of Matter paragraphs in auditor's report in certain circumstances. These circumstances include:

- ➢ When a FRF prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation (SA 210)
- ➢ To alert users that F.S. are prepared in accordance with a special purpose framework
- ➢ 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) (SA 560)

Examples of circumstances where auditor may consider it necessary to include an Emphasis of Matter paragraph are:

- ➢ An uncertainty relating to future outcome of exceptional litigation or regulatory action.
- ➢ A significant subsequent event that occurs between date of F.S and date of auditor's report.
- ➢ Early application (where permitted) of new a/c std that has material effect on F.S.
- ➢ A major catastrophe that has had, or continues to have, significant effect on entity's financial position.

When auditor includes EOM para in auditor's report, auditor shall:

a. Include the paragraph within a separate section of auditor's report with appropriate heading that includes the term "Emphasis of Matter"

b. Include in the paragraph clear reference to matter being emphasized and to where relevant disclosures that fully describe the matter can be found in F.S. The para shall refer only to info. presented or disclosed in F.S. and

c. Indicate that auditor's opinion is not modified in respect of matter emphasized.

Note: EOM para is not substitute for KAM, if matter determined as KAM → represent as KAM

Other Matter Para

- Para included in Auditor's report
- Refers to a matter other than those Presented/Disclosed in F.S.
- relevant to user's understanding of
- Audit, auditor's responsibilities or Audit report

Auditor shall include an EOM/OM para in auditor's report, provided:

a) Not prohibited by law or regulation; and

b) When SA 701 applies, matter has not been determined to be KAM

EOM para. isn't a substitute for:

a. A modified opinion as per SA 705 when required by circumstances of a specific audit engg.

b. Disclosures in F.S. that applicable FRF requires mgt to make, or that are otherwise necessary to achieve fair presentation or

c. Reporting in accordance with SA 570 (Revised) when a material uncertainty.... [माँ मुझे याद आ रहा है]

Communicate with TCWG

Communicate with TCWG this expectation & wording of EOM/OM para.

SA 710: Comparative Information—Corresponding Figures and Comparative FS

Comparative Info:

- Amounts and disclosures included in FS
- in respect of one or more prior periods as per applicable FRF.

Audit Procedures for Comparative Information:

Basic Procedures:

Auditor shall evaluate whether:

a) Comparative info. agrees with amounts & other disclosures in prior period &
b) A/c policies reflected in comparative info are consistent with current period or, if there have been changes, whether changes have been properly accounted, presented and disclosed.

Material Misstatement:

- If auditor becomes aware of possible material misstatement in comparative info while performing current period audit, perform additional audit procedures to obtain SAAE to determine whether material misstatement exists.
- If auditor audited prior period's FS, auditor shall also follow requirements of SA 560.

Written Representations:

- ✓ As per SA 580, auditor shall request WR for all periods referred to in auditor's opinion.
- ✓ Auditor shall also obtain specific WR regarding any prior period item separately disclosed in current year's P&L.

Basic → M.M. → 560 & 580

Corresponding Figures

- Comparative info. where amts & other disclosures for prior period are included as an integral part of current period F.S. & are intended to be read only in relation to amounts and other disclosures relating to current period (referred to as "current period figures").
- Level of detail presented in corresponding amts & disclosures is dictated primarily by its relevance to current period figures.

Reporting for Corresponding Figures:

When corresponding fig. are presented, auditor's opinion shall not refer to corresponding figures except in following circumstances:

1. If auditor's report on prior period included modified opinion & matter which gave rise to modification is unresolved, modify auditor's opinion on current period's FS.

In Basis for Modification para in A/R, auditor shall either:

a) Refer to both current period's fig. & corresponding fig. in description of matter giving rise to modification when effects or possible effects of matter on current period's figures are material or
b) In other cases, explain that audit opinion has been modified because of effects or possible effects of unresolved matter on comparability of current period & corresponding fig.

2. If auditor obtains audit evidence that a M.M. exists in prior period FS. on which unmodified opinion been previously issued, verify whether misstatement has been resolved &, if not, express qualified or adverse opinion in auditor's report on current period FS.



Reporting for Comparative F.S.

- Auditor's opinion shall refer to each period for which the FS are presented.
- When reporting on current period's audit, if auditor's opinion on such prior period FS differs from opinion previously issued on such FS, disclose substantive reason for different opinion in OM para.
- If auditor concludes that material misstatement is present in previously audited figures of F.S, he should report it to mgt and request that predecessor auditor be informed.

If then prior years statements are amended with new report by predecessor auditor, then auditor shall report only on current period.

Reporting treatment common to both (for corresponding figures and comparative information)

i) If F.S. of prior period were audited by predecessor auditor, auditor shall state in OM Para:
   - That FS of prior period were audited by a predecessor auditor
   - Type of opinion expressed by predecessor auditor
   - Date of that audit report.

ii) If prior period F.S. were not audited than he shall report the same in OM Para in his audit report that corresponding/comparative figures are unaudited.

However, disclosure doesn't relieve him from his responsibility of obtaining SAAE that opening balances do not contain misstatements that materially affect current period's FS.

SA 720: The Auditor's Responsibility in Relation to Other Information

Scope

- SA 720 deals with Auditor's responsibilities relating to other info., financial or non-financial contained in Annual Report.
- Auditor's opinion on FS doesn't cover other info. (Annual Report)
- He's just required to read & consider other info. for any materially inconsistent info. from FS that may indicate MM in either FS or Annual Report
- Auditor's responsibility apply whether other info. is received prior to or after auditor's report

Note: This SA doesn't apply to preliminary announcements of financial info. or prospectus.

Obtaining the Other Information

Auditor shall:

a) Determine, through discussion with mgt, which document(s) comprises annual report & entity's planned manner & timing of issuance of such document(s)

b) Make arrangements with mgt to obtain in timely manner &, if possible, prior to date of auditor's report, final version of document(s) comprising annual report &

c) When annual report not available until after the date of auditor's report, request mgt to provide a WR that final version of document(s) will be provided to auditor when available & prior to its issuance by entity, auditor can complete procedures required by this SA.

Reading and Considering the Other Information

Auditor shall read the other info and, in doing so shall:

Consider whether there is material inconsistency between

- other info. and FS &
- other info. and auditor's knowledge obtained in audit, in context of audit evidence obtained & conclusions reached in audit.

While reading other info, remain alert for indications that other info may be materially misstated.

Responding when Material Inconsistency Appears to Exist or Other Info. Appears to be Materially Misstated

Discuss the matter with mgt &, if necessary, perform other procedures to conclude whether:

a. A material misstatement of other info. exists

b. A material misstatement of FS exists or

c. Auditor's understanding of entity & its environment needs to be updated.

When other info. is materially misstated

If auditor concludes that MM of other info. exists, request mgt to correct other info.

If mgt:

a) Agrees to make correction, determine that correction has been made or

b) Refuses to make correction, communicate with TCWG & request that correction be made.

If auditor concludes MM exists in other info. obtained prior to date of auditor's report, & other info. isn't corrected after communicating with TCWG, take appropriate action, including:

a) Considering implications for auditor's report & communicating with TCWG about how auditor plans to address the MM in auditor's report or

b) Withdrawing from engg, where withdrawal possible under applicable L/R.

If auditor concludes that MM exists in other info. obtained after date of audit report:

a. If other info. is corrected, perform procedures necessary in circumstances or

b. If other info. isn't corrected after communicating with TCWG, take appropriate action considering auditor's legal rights & obligations, to seek to have the uncorrected MM appropriately brought to attention of users for whom auditor's report is prepared.

When FS are materially misstated or Auditor's understanding needs to be updated

Respond as per other SAs.

Reporting

Auditor's report shall include separate section with a heading "Other Information" when, at date of auditor's report:

a. For an audit of F.S. of listed entity, auditor has obtained, or expects to obtain, other info or

b. For an audit of F.S of an unlisted corporate entity, auditor has obtained some or all of other info.

When auditor's report is required to include an Other Information section, it shall include:

a) A statement that mgt is responsible for the **other info.** 🤔

b) An identification of: 👇

i. Other info. obtained by auditor prior to date of auditor's report &

ii. For an audit of FS of listed entity, other info, if any, expected to be obtained after date of auditor's report

c) Statement that auditor's opinion doesn't cover other info. & auditor doesn't express (or will not express) audit opinion or any form of assurance conclusion thereon ✕

d) Description of auditor's responsibilities relating to reading, considering & reporting on other info. as required by this SA ✍

e) When other info. has been obtained prior to date of auditor's report, either:

i. A statement that auditor has nothing to report or

ii. If auditor has concluded that there is uncorrected material misstatement of other info, statement that describes the uncorrected material misstatement of other info.

Reporting Prescribed by Law or Regulation

If auditor is required by a relevant L/R to refer to other info. in auditor's report using a specific layout or wording, auditor's report shall refer to SA only if auditor's report includes, at a minimum:

a. Identification of other info. obtained by auditor prior to date of auditor's report

b. A description of auditor's responsibilities w.r.t other info &

c. An explicit statement addressing outcome of auditor's work for this purpose.

Examples of Amounts or Other Items that May Be Included in Other Info.

Following are eg of amounts and other items that may be included in other info.

Amounts

- Items in a summary of key financial results, such as net income, EPS, dividends, sales & other operating revenues, & purchases & operating expenses.



- Selected operating data, such as income from continuing operations by major operating area, or sales by geographical segment or product line.
- Special items, such as asset dispositions, litigation provisions, asset impairments, tax adjustments, environmental remediation provisions, and restructuring and reorganization expenses.
- Liquidity & capital resource info, such as cash, cash equivalents & marketable securities dividends and debt, capital lease & minority interest obligations.
- Capital expenditures by segment or division.
- Amounts involved in, and related financial effects of, off-balance sheet arrangements.
- Amounts involved in guarantees, contractual obligations, legal or environmental claims, and other contingencies.
- Financial measures or ratios, such as gross margin, return on average capital employed, return on average shareholders' equity, current ratio, interest coverage ratio and debt ratio.

Other Items

- Explanations of critical accounting estimates and related assumptions.
- Identification of related parties and descriptions of transactions with them.
- Descriptions of the nature of off-balance sheet arrangements.
- Descriptions of guarantees, indemnifications, contractual obligations, litigation or environmental liability cases, and other contingencies, including management's qualitative assessments of the entity's related exposures.
- Descriptions of changes in legal or regulatory requirements, such as new tax or environmental regulations.
- General descriptions of business environment & outlook.
- Overview of strategy.

"Work hard in Silence,
let your Success be your Noise"

CA SHUBHAM KESWANI

CHAPTER 02

Professional Ethics



Fundamental Principles

a) Integrity:
- straightforward & honest in professional & business relationships
- shall not knowingly be associated with information
  (a) Contains a materially false or misleading statement
  (b) Contains statements or info. provided negligently or
  (c) Omits required info.

b) Objectivity: not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others

c) Professional Competence & Due Care (PCDC):
- Attain & maintain professional knowledge & skill
- Act diligently as per professional standards
- Serving clients & employers with professional competence requires sound judgment in applying professional knowledge & skill.
- Requires continuing awareness & understanding of technical, professional & business developments.
- Continuing professional development enables professional accountant to develop & maintain capabilities to perform competently within professional environment.
- Diligence encompasses responsibility to act as per requirements of assignment, carefully, thoroughly & on a timely basis.
- Take reasonable steps to ensure those working under accountant's authority have appropriate training & supervision.

d) Confidentiality: Not disclose info. acquired from client or employer (including prospective). Not use such info for personal advantage. Continues even after relationship has ended.

Circumstances where professional accountants might be required to disclose confidential info:
- Disclosure is required by law
- Disclosure is permitted by law & authorized by client or employing org
- There is a professional duty or right to disclose, when not prohibited by law:
  (i) To comply with requirements of Peer Review or Quality Review of ICAI
  (ii) To respond to inquiry or investigation by professional or regulatory body
  (iii) To protect the professional interests in legal proceedings or
  (iv) To comply with technical and professional standards, including ethics requirements.

In deciding whether to disclose confidential info. professional accountants should consider following:

a) Whether interests of any party, including 3rd parties might be affected

b) Whether all relevant info is known and substantiated, &

c) Proposed type of communication, & to whom it is addressed

d) Whether parties to whom communication is addressed are appropriate recipients.

e) Professional Behaviour: Comply with relevant laws & regulations & avoid any conduct that accountant knows might discredit the profession.

If a professional accountant faces a situation when complying with one fundamental principle conflicts with others, he should consult:
Others within the organization/TCWG/ICAI/Legal counsel

Types of Threats

- Self-interest threat -threat that a financial or other interest will inappropriately influence a professional accountant's judgment or behaviour
- Self-review threat -threat that a professional accountant will not appropriately evaluate the results of a previous judgment or activity performed
- Advocacy threat -threat that a professional accountant will promote client's or employing organization's position to the point that accountant's objectivity is compromised
- Familiarity threat -threat that due to a long or close relationship with client, or employing organization, professional accountant will be too sympathetic to their interests
- Intimidation threat -threat that a professional accountant will be deterred from acting objectively because of pressures, including attempts to exercise undue influence over accountant.

Circumstances that may create threat for a professional accountant when undertaking a professional service

Self-interest threats

- Direct financial interest in client
- Quoting a low fee to obtain a new engg. & fee is so low that it might be difficult to perform professional service as per applicable technical & professional standards for that price
- Having a close business relationship with a client.
- Having access to confidential information of the client that might be used for personal gain.
- Discovering a significant error when evaluating results of a previous professional service performed by a member of accountant's firm.

Self Review Threat

- Issuing assurance report on effectiveness of financial systems after implementing the systems.
- Having prepared original data used to generate records that are subject matter of assurance engg.



Advocacy threats:

- Promoting the interest of or shares in a client.
- Acting as advocate on behalf of client in litigation or disputes with 3rd parties.
- lobbying in favor of legislation on behalf of a client.

Familiarity threats

- Member of engg. team having a close or immediate family relationship with employee of client who is in position to exert direct & significant influence over subject matter of engg.
- Director/officer of client or employee in position to exert significant influence over subject matter of the engg. Having recently served as Engg. Partner.
- Long association of an audit team member with the audit client.

Intimidation threats

- Being threatened with dismissal from client engg/firm because of disagreement about profession matter
- Being feeling pressured to agree with judgment of client because client has more expertise on matter in question.
- Being informed that planned promotion will not occur unless accountant agrees with inappropriate accounting treatment.
- Accepted a significant gift from client & being threatened that acceptance of this gift will be made public

Circumstances that might create threats for professional accountant when undertaking a professional activity

Self-interest Threats

- Holding a financial interest in, or receiving a loan or guarantee from, employer.
- Participating in incentive compensation arrangements offered by the employer.
- Having access to corporate assets for personal use.
- Being offered a gift or special treatment from a supplier of employer.

Self-review Threats

- Determining appropriate accounting treatment for a business combination after performing feasibility study supporting purchase decision.

Advocacy Threats

- Having opportunity to manipulate info. in prospectus in order to obtain favorable financing.

Familiarity Threats

- Being responsible for financial reporting of employer when an immediate or close family member employed by organization makes decisions that affect financial reporting of org.
- Having a long association with individuals influencing business decisions.

Intimidation Threats

- Professional accountant or immediate or close family member facing threat of dismissal or replacement over a disagreement about:
  - Application of an accounting principle.
  - Way in which financial info. is to be reported.
- An individual attempting to influence decision-making process of professional accountant, for eg w.r.t awarding of contracts or application of an accounting principle.

Safeguards to Address the Threats

Examples of actions that might be safeguards to address threats include:

- Assigning additional time & qualified personnel to required tasks when engg. has been accepted.
- Having appropriate reviewer, not member of team, review work performed or advise to address a self-review threat.
- Using different partners and engg. teams with separate reporting lines for provision of non-assurance services.
- Involving another firm to perform or re-perform part of engg.
- Separating teams when dealing with matters of a confidential nature.

Disabilities for the Purpose of Membership (Sec 8 of the CAs Act, 1949)

- Under 21 years
- Unsound mind and stands so adjudged by competent court
- Undischarged insolvent
- Being a discharged insolvent, has not obtained from court a certificate that insolvency was caused by misfortune without any misconduct on his part
- Convicted by competent Court within or outside India, of offence involving moral turpitude & punishable with transportation or imprisonment unless CG by order in writing, removed disability
- Removed from membership of ICAI been guilty of professional or other misconduct

Types of Members

Associate Member: Person, whose name has been entered in Register, & entitled to use the letters A.C.A. after his name.

Fellow Member: Following types of members shall be registered as Fellow of ICAI, on payment

of such fees along with the application-

(i) Associate member who has been in continuous practice in India for at least 5 years,

(ii) Member who has been associate for continuous period of not less than 5 years & who possesses such qualification experience equivalent to continuous practice for period of 5 years as CA. Entitled to use F.C.A. after his name to indicate that he's a Fellow Member of ICAI.

Removal of Name from the Register: As per Sec 20, Council may remove name of any member , from Register in following cases-

i) who is dead

ii) from whom request received

iii) not paid prescribed fee required to be paid by him

iv) Disqualified u/s 8

Effective date of Restoration in case of Membership Removal

Application for restoration and requisite fees are made within same year of removal	Restoration shall be with effect from the date on which it was removed from the Register.
Removal of name under orders of Board of Discipline or Disciplinary Committee or Appellate Authority or High Court	Restoration shall be in accordance with such orders.
In other cases	Restoration shall be with effect from the date on which the application and fee are received.

Penalty for Falsely Claiming to be a Member

Sec 24 provides that any person who-

i) not being a member of ICAI
   (a) represents that he is member of ICAI or
   (b) uses designation CA

ii) being a member of ICAI, but not having COP, represents he's in practice or practice as a CA, shall be punishable on 1st conviction with fine upto 1000, & on subsequent conviction with imprisonment upto 6 months or fine upto 5,000, or both.

Cancellation and Restoration of Certificate of Practice (COP)

COP shall be liable for cancellation, if:

i) name is removed from the Register or

ii) Council is satisfied,that certificate was issued on basis of incorrect, misleading or false info, or by mistake or

iii) a member has ceased to practise or

iv) a member has not paid annual fee for COP till 30th day of September of relevant year. Where COP is cancelled, holder shall surrender the same to the Secretary.

Note: Regulation 11 on restoration of COP (cancelled due to non-payment of fees) states that, on application made in approved Form & payment of fee, Council may restore COP w.e.f date it was cancelled if application with fees received by Secretary before expiry of relevant year.

Members - deemed to be in Practice

As per Sec 2(2): "A member of ICAI shall be deemed "to be in practice" if he:

i) engages himself in practice of accountancy or

ii) offers to perform or performs service involving auditing or preparation, verification or certification of FS or holds himself out as accountant or

iii) renders professional services about matters of principle or relating to accounting, presentation or certification of financial facts/data or

iv) such other services in opinion of Council, are rendered by CAiP

Explanation –Member who is salaried employee of CA in practice shall be deemed to be in practice for limited purpose of training of Articled Assistants.

Pursuant to Sec 2(2)(iv) above, Council has passed a resolution permitting a CA in practice to render entire range of "Management Consultancy and other Services".

Expression "Management Consultancy and other Services" shall include the following-

- ✓ Financial management planning and financial policy determination*
- ✓ Capital structure planning and advice regarding raising finance*
- ✓ Working capital management*
- ✓ Preparing project reports and feasibility studies*
- ✓ Preparing cash budget, cash flow statements, profitability statements, statements of sources and application of funds etc.
- ✓ Budgeting including capital budgets and revenue budgets.
- ✓ Inventory management, material handling and storage.
- ✓ Market research and demand studies.
- ✓ Price-fixation and other management decision making.
- ✓ Management accounting systems, cost control and value analysis.
- ✓ Control methods and management information and reporting.
- ✓ Personnel recruitment and selection.
- ✓ Setting up executive incentive plans, wage incentive plans etc.
- ✓ Management and operational audits.

*Considering tax implications while rendering these services considered MCS



✓ Valuation of shares & business & advice regarding amalgamation, merger & acquisition. Acting as Registered Valuer under Cos. Act 2013.

✓ Business Policy, corporate planning, organisation development, growth and diversification.

✓ Organisation structure and behaviour, training programmes, work study, job-description, job evaluation

✓ Systems analysis and design, and computer related services and to carry out other professional services relating to EDP.

✓ Acting as advisor or consultant to an issue, including such matters as:

- Drafting of prospectus. Drafting & filing of listing agreement & completing formalities with Stock Exchanges, Registrar of Companies and SEBI.
- Preparation of publicity budget, advice regarding arrangements for selection of:

(i) ad -media, (ii) centres for holding conferences of brokers, investors, etc., (iii) bankers to issue, (iv) collection centres, (v) brokers to issue, (vi) underwriters and the underwriting arrangement.

✓ Advice regarding selection of agencies connected with issue, namely Registrars to Issue, printers & advertising agencies.

✓ Advice on post issue activities, e.g., follow up steps which include listing of instruments & dispatch of certificates & refunds.

Explanation - Portfolio mgt, underwriting & broking (PUB) not permitted.

✓ Investment counselling in respect of securities

✓ Registrar to an issue & for transfer of shares/other securities.

✓ Quality Audit.

✓ Environment Audit.

✓ Energy Audit.

✓ Recovery Consultant in the Banking Sector.

✓ Insurance Financial Advisory Services under IRDA Act 1999, including Insurance Brokerage.

✓ Insolvency Professional in terms of Insolvency and Bankruptcy Code, 2016

✓ Admin Services: Such services require little to no professional judgment & clerical in nature.

Examples of administrative services include:

- Word processing services.
- Preparing administrative or statutory forms for client.
- Submitting such forms as instructed by the client.
- Monitoring statutory filing dates, & advising an audit client of those dates.

Note: CA is deemed to be in practice during period he renders 'service with armed forces'.

Section 6 of CA Act, 1949:-

i) No member of ICAI shall practise in India or elsewhere unless obtained from Council a COP.

ii) Every such member shall pay such annual fee for his certificate as determined by Council.

iii) COP may be cancelled by Council under such circumstances as may be prescribed.

A CAiP has been suspended from practice for period of 6 months and surrendered his COP for said period. During said period of suspension, though member did not undertake any audit assignments, he undertook representation assignments for income tax whereby he would appear before tax authorities in his capacity as a CA.

Undertaking Tax Representation Work: A CA not holding COP cannot take up any other work because it would be violation of relevant provisions of the CA Act, 1949.

- In case a member is suspended & not holding COP, he cannot in any other capacity take up any practice separable from his capacity to practice as a member of ICAI. This is because once a person becomes a member of ICAI; he is bound by the provisions of CA Act, 1949 and its Regulations.
- If he appears before income tax authorities, he is only doing so in his capacity as a CA and a member of ICAI. Having bound himself by said Act and its Regulations made there under, he cannot then set the Regulations at naught by contending that even though he continues to be a member & punished by suspension, he would be entitled to practice in some other capacity.

Conclusion: Thus, in given case, a CA would not be allowed to represent before income tax authorities for period he remains suspended. Accordingly, in he is guilty of professional misconduct.

What if, Suspended CAiP designating himself as Data Privacy consultant, did work of filing Data Privacy related returns & made appearance as a consultant before related authorities in capacity other than CAiP → Allowed

Companies not to practice as CAs → If LLP has Co. as partner it can't engage in practice

Member in Practice Prohibited from using a Designation Other Than CA - Sec 7

- Merchant Banker / Advisor to an issue: Members may obtain registration as category IV Merchant Banker & act as Advisor or Consultant to issue. In client Companies' offer documents and ads regarding capital issue, name and address of CA or CA firm can be indicated under the caption "Advisor/Consultant to Issue". However, name & address of such CA/firm of CAs should not appear prominently.
- Members of ICAI who are also Directors in Companies, members of Political parties or CAs Cells in political parties, holding different positions in clubs are not permitted to mention these positions as these would be violative of provisions of Sec 7 of the Act.
- Member can't designate as Cost Accountant; can use A.C.M.A (Associate) or F.C.M.A (Fellow) after his name.



- Permitted to mention membership of foreign Institute of Accountancy, recognized by Council through MOU / Mutual Recognition Agreement (MRA) with ICAI.
- Improper for CA to state on professional docs → Income-tax Consultant, Cost Accountant, Company Secretary, Cost Consultant or a Management Consultant.
- Designation "Corporate Lawyer" not permitted.
- Use of initials 'CPA' not permitted on visiting cards.

Permission to mention qualifications of certain Institutions: Members are permitted to mention a title on their visiting cards to indicate membership of a foreign Institute of Accountancy , which has been recognised by Council e.g. South African Institute of Chartered Accountants (SAICA), Institute of Certified Public Accountants (CPA Ireland) and Institute of Chartered Accountants in England and Wales (ICAEW)

Branch office (Section 27)

If a CAiP or Firm of CAs has more than one office in India, each one of such offices should be in separate charge of member of ICAI.

Exemption for Hilly Areas

- Temp office in plains allowed for limited period not exceeding 3 months pa
- No need to close regular office & correspondence made at reg office
- Name board on temp office not displayed when its not functional
- Temp office not mentioned on Visit cards/letter heads as Place Of Business
- Before winters, member/firm informs ICAI about opening temp office from particular date & after closure intimated ICAI via regd post

To comply with requirement of being in charge of office:
Member to reside in place office situated/attends the office >= 182 days

Council Decisions:

i) Use of the name-board: Nameboard in place of residence allowed of member with designation of CA, provided it is nameplate of individual member & not of firm.

ii) Exemption may be granted to member or firm of CAs in practice to have a second office without such second office being under separate charge of member of ICAI, provided-

a. second office is in same premises, in which first office is located or,
b. second office is in same city, in which first office is located or,
c. second office is located within 50 km. from the municipal limits of a city, in which the first office is located.

Note: Member having 2 offices of type referred above shall have to declare, which of 2 offices is his main office, which would constitute his professional address.

Mr. Z, a CA started his practice in February 2023 by setting up an office in hill station Manali. Initially, since he was getting very less assignments, he decided to set up a temporary office in nearby city Ambala, situated at about 100 kms from main office. As planned, he took an office space on rent for months of April, May & June. During these months, his regular office wasn't closed and Mr. Z was in-charge for both offices. Mrs. A, another CA who practice in Manali came to know about new office of Mr. Z. She informed ICAI stating that Mr. Z had violated provisions of CA Act.
As a member of Board of Discipline of ICAI, you are requested to analyse this complaint.

Conclusion:

KYC Norms

KYC Norms approved by the Council of ICAI are given below:

1. Where Client is an Individual/ Proprietor

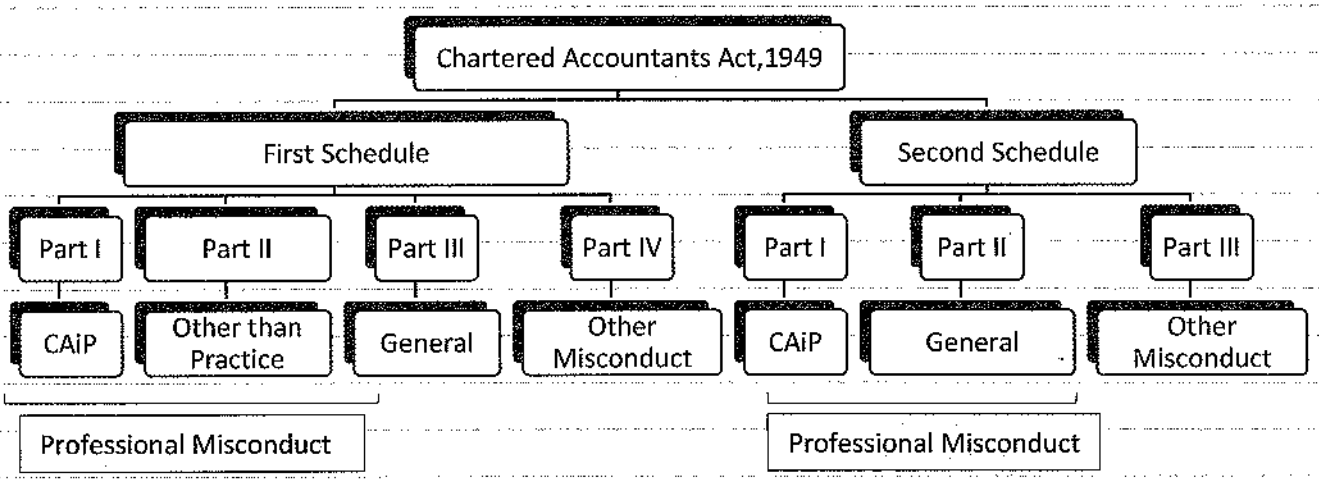
A. General Information	B. Engg. Information
➢ Name of the Individual ➢ PAN No. or Aadhar Card No. of the Individual ➢ Business Description ➢ Copy of last Audited FS	Type of Engg.

2. Where Client is a Corporate Entity

A. General Information	B. Engg. Info.	Regulatory Info.
➢ Name & Address of Entity ➢ Business Description ➢ Name of Parent Co. in case of Subsidiary ➢ Copy of last Audited FS	Type of Engg.	➢ Company PAN No. ➢ Company Identification No. ➢ Directors' Names & Addresses ➢ Directors' Identification No.

3. Where Client is a Non-Corporate Entity

A. General Information	B. Engg. Information
➢ Name & Address of Entity ➢ Copy of PAN No. ➢ Business Description ➢ Partner's Names & Addresses (with their PAN/Aadhar Card/DIN No.) ➢ Copy of last Audited FS	Type of Engg.



Note: Member is liable to disciplinary action u/s 21 of CA Act, if he is found guilty of any Professional or Other Misconduct.

First Schedule

PART I - Professional Misconduct in relation to CAs in Practice (CAiP)

A CAiP is deemed to be guilty of professional misconduct if he:

Clause (1):

- allows any person to
- practice in his name as a CA
- unless such person is also a CAiP & is in partnership with or employed by him.

➢ Above clause is intended to safeguard public against unqualified accountant practicing under the cover of qualified accountants.

➢ It ensures that work of accountant will be carried out by a CA who may be his partner, or his employee and would work under his control and supervision.

Who can practice in name of CAiP? _____

Mr. C, CAiP allowed his brother-in-law Mr. P who is not a CA, to practice in name of CA. C. He also allowed Mr. T who is employee in his firm to practice in the name. Whether Mr. C is correct in allowing his brother-in-law Mr. P & Mr. T employee of his firm to practice in his name.

Clause (1) reference. In given situation Mr. CAiP allowed a non-CA his brother-in-law Mr. P to practice in name of CA. C is not correct. However, he can allow Mr. T who is employee in his firm to practice in his name.

Conclusion: Thus, CA. C will be held guilty of professional misconduct for allowing Mr. P who is not a CA to practice in his name as a CA as per Clause (1) of Part I to the First Schedule.

[Assumed that Mr T is a CAiP as Q. clearly mentions Mr. P isn't a CA]

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 the ICAI 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 purpose of rendering such professional services from time to time in or outside Indi

Reg. 53A: Professional bodies:

ICSI (CS), ICWAI (Cost a/c), Bar Council (Advocate), Inst of Architects (Architect), Inst of Actuaries (Actuary), Engineer (B. Tech/Engg), LLB(Lawyer), MBA

Sharing audit fees with SG: Registrars of various State Coop. Societies circular mention that certain amount of audit fee is payable to concerned SG & auditor has to deposit a percentage of his audit fee in state Treasury by prescribed challan within prescribed time of receipt of Audit fee.
Council considered the issue & while noting that Govt is asking auditors to deposit such percentage of audit fee for recovering administrative & other expenses incurred in process, Council decided that as such there is no bar in Code of Ethics to accept such assignment wherein a percentage of professional fee is deducted by Govt to meet the administrative and other expenditure.

Example: CA gave 50% of audit fees received by him to complainant, not a CA, under nomenclature of office allowance & such arrangement continued for no. of years, held by Council that in substance CA shared his profits & was guilty of professional misconduct.
It isn't nomenclature that is material, but substance of transaction, which is to be looked into.
Note: Paying % of profits to article as stipend not allowed even if financial condition weak

Share of Profit/Sale of Goodwill (Death Cases)

Partnership Firm: Legal representative (LR) will continue to receive share if Deed provides for it.
Sole Proprietorship(SP)Firm:

1. No sharing of fees between LR & purchaser of G/W on death of SP + payments in instalments allowed if agreement allows.
2. Goodwill can be transferred to other CA if:
   - Sale completed within 1 year of death (permission of council required)
   - If dispute of legal heir → inform ICAI within 1 year about dispute & name preserved for 1 year from dispute settlement.

CA Ravi, a CAiP, was proprietor of M/s Ravi & Associates. CA Ravi died on 15th Sep, 2023 due to cardiac arrest. Only family member left behind CA Ravi was his wife, Roohi. On 30th Sep, 2024, Roohi sold practice of her husband to CA Balwan for ₹ 25 Lacs along with right to use firm name i.e., M/s. Ravi & Associates and requested Institute to consider the effect of such sale. Give your comments on following issues with reference to CA Act, 1949 and Schedules thereto:

(i) Whether Roohi can sell practice to CA Balwan?

(ii) Can CA Balwan continue to practice as proprietor in name of M/s Ravi & Associates?

Sale of Goodwill:

With reference to Clause (2) of Part I to First Schedule to CA Act, 1949, Council of ICAI considered whether goodwill of a proprietary concern of CA can be sold to another member who is otherwise eligible, after death of proprietor.

- Legal heir of deceased member has to obtain permission of Council within a year of death of proprietor concerned.
- Sale is permitted subject to certain conditions like such a sale is completed/effected in all respects & ICAI's permission to practice in deceased's proprietary firm name is sought within a year of death of such proprietor concerned.
- In respect of these cases, name of proprietary firm would be kept in abeyance (i.e. not removed on receipt of info. about death of proprietor as is being done at present) only upto a period of one year from death of proprietor concerned as aforesaid.

In given case, Mrs. Roohi, widow of Mr. Ravi sold the practice along with right to use firm name after one year of his death for ₹ 25 lakhs. This sale is in effect sale of goodwill.

From the discussion given above it can be concluded that:

i) Mrs. Roohi cannot sell the practice of CA. Balwan with right to use the firm name.

ii) CA Balwan can't continue to practice in name of firm M/s. Ravi & Associates as a proprietor because name of firm M/s. Ravi & Associates would be kept in abeyance only up to a period of 1 year from death of proprietor.

Clause (3): accepts or agrees to accept any part of profits of professional work of person who is not member of ICAI.

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 member of such professional body or other person having qualifications, as is referred to in item (2) of this part.

Referral fees: Not prohibited for CAiP to charge Referral Fees, from another CAiP in relation to referring client to him.

Note: Accepting commission from regd valuer for referring valuation assignments → Guilty

Clause (4):

- enters into partnership, in or o/s India, with person other than
- CAiP or such other person who is 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 regd. as member under section 4(1)(v) or
- whose qualifications are recognized by CG or Council for purpose of permitting such partnerships.

Clause (5) Secures either through services of a person who is not an employee of such CA or who not his partner or by means which are not open to a CA, any professional business. Provided that nothing herein contained shall be construed as prohibiting any agreement permitted in terms of 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.

Provided that nothing herein contained shall be construed as preventing or prohibiting –

i) Any CA from applying/requesting/inviting/securing professional work from another CAiP or

ii) A member from responding to tenders or enquiries by users of professional services or organizations from time to time & securing professional work as a consequence.

Exception: As per Council guidelines, CAiP shall respond to tender in areas of services exclusively reserved for CAs, such as audit and attestation services only when minimum fees of assignment is prescribed in tender document

When can a CAiP respond to tender?

- Area exclusive for CA → Yes → Min. fees should be prescribed.
- If area not exclusive → All cases.

- ✓ Members should not adopt any indirect methods to adventure their professional practice with a view to gain publicity & thereby solicit clients or professional work.
- ✓ Such a restraint must be practiced so that members may maintain their independence of judgment & may be able to command respect of their prospective clients.

Advertisement of Coaching /teaching activities by member in practice: While advertising such teaching /coaching activities, comply with Regulation 190A of CA Regulations, 1988.

- Advertisement of Coaching /teaching activities by a CAiP may amount to indirect solicitation, as well as solicitation by any other means, & may therefore be violative of Clause 6/1/1.

- Such members are advised to abstain from advertising their association with Coaching /teaching activities through hoardings, posters, banners & by any other means, failing which they may be liable for disciplinary action, as per CA Act, 1949.
- Subject to above prohibition, such members may put, outside their Coaching/ teaching premises, sign board mentioning name of Coaching/teaching Institute, contact details & subjects taught.
- As regards size & type of sign board, Council Guidelines applicable to Firms of CAs would apply.

[MTP Nov-22]

- Advert/notes in press: Not circulate letters to possible clients.

Exceptions:

- May advertise changes in partnerships or dissolution of firm or change in address & telephone numbers.
- Bare statement of facts allowed & consideration given to appropriateness of area of distribution of newspaper or magazine & no. of insertions.
- Permitted to issue classified ad in journal/ newsletter of ICAI to give info for sharing professional work on assignment basis or seeking partnership or salaried employment of accountancy nature, provided it only contains accountant's name, address or telephone number, fax no, e-mail address & address(es) of social Networking sites of members.

  Mere factual position of experience & area of specialization, relevant to seek response to advertisement, are permissible.

- Application for empanelment for allotment of audit and other professional work: Govt Dept & many institutions maintain panel of CAs for allotment of professional work. Where existence of such panel known to CA, free to write to concerned org. Not proper to make roving enquiries. Permissible to quote fees on enquiries received from bodies, which maintain such panel.

- Publication of Books, Articles or Presentation: Not permissible to mention any professional attainment(s), whether of member or firm. May indicate the designation "CA" & name of firm.

- Issue of Greeting Cards or Invitations: Designation "CA" & name of firm may be used in greeting cards, invitations for marriages & religious ceremonies & for opening or inauguration of office of members, change in office premises & change in telephone numbers, provided invitations sent only to clients, relatives & friends of members concerned.

- Advertisement for Silver, Golden, Platinum or Centenary celebrations of CA Firms may be published in newspaper or newsletter. [What about opening ceremony? _____]
- Sponsoring Activities
  - A CAiP or Firm of CAs isn't permitted to sponsor an event. May sponsor event conducted by

a Programme Organizing Unit (PoU) of ICAI, provided it has prior approval of Continuing Professional Education (CPE) Directorate of ICAI.

- Members sponsoring activities relating to CSR may mention their name with prefix "CA". However, Firm name or CA Logo not permitted.

- Sharing Firm Profile with prospective Client: Not permitted to share Firm profile with prospective Client unless in response to a proposed client's specific query, & otherwise not prohibited to be used by client.

- Television or Movie Credits: Exhibition of name is not made differently as compared to other entries in the credits.

- Soliciting professional work by making roving enquiries: Not permissible to address letters, emails or circulars to persons likely to require services of CA since it would tantamount to advertisement.

- Seeking work from Professional Colleagues: Issue of advertisement or a circular by CA, seeking work from professional colleagues on any basis whatsoever except as provided above would be in violation

- Scope of representation which an auditor is entitled to make under Section 140(4) of the Companies Act, 2013: Opportunity not being abused to secure needless publicity. Letter should merely set out in dignified manner how he has been acting independently & conscientiously through the term of office & in addition, indicate his willingness to continue as auditor if reappointed by shareholders.

- Acceptance of original professional work by a member emanating from client introduced to him by another member: Member not accept original professional work emanating from client introduced to him by another member. If any professional work of such client comes directly, it should be his duty to ask client to come through other member dealing generally with his original work.

- Giving Public Interviews: Not result in publicity. Details about members or their firms not given in a manner highlighting professional attainments. Detail given as response to specific question, and factual nature only.

- Members and/or firms who publish advertisements under Box numbers: prohibited from inserting advertisements under box numbers in newspapers.



- Educational Videos: No reference made to CAs Firm wherein member is a partner/ proprietor. Not contain contact details or website address.

- CA sent letters to other CAs claimed to be pioneer in liasoning with govt depts as expertise for getting clearances → Guilty in this clause

Website of CA Firms (Council Guidelines)

- No format prescribed [free to add any colour]
- Should be on Pull model instead of Push model
- Info on website shouldn't be circulated own own or emails except on specific 'pull' request
- Not issue material to solicit users to visit their website
- Info that can be displayed:
  - ✓ Member/firm Name
  - ✓ Year of establishment
  - ✓ Address of firm/member(H.O./Branch office) + Tel/Fax nos + E-mail ids
  - ✓ Nature of services rendered (specific pull request)
  - ✓ Partners [Name, Year of qualification, Other qualification, Phone, email, Area of experience (pull request)]
  - ✓ Details of employees (like partners)
  - ✓ Job vacancies
  - ✓ No of article assistants (pull request)
  - ✓ Nature of assignments handled (pull request)
  - ✓ Name of clients & fees charged can't be given (Note)

Note: It can be given if required by regulator (whether or not constituted under a statute in India or o/s India) only to extent reqd & period reqd by regulator.
Where such disclosure of names of clients and/or fees charged is made on website, member/ firm shall ensure that its mentioned on website [in italics], below such disclosure itself, that "*This disclosure is in terms of requirement of [name of regulator] having jurisdiction in [name of country/ area where such regulator has jurisdiction] vide [Rule/ Directive etc. under which the disclosure is required by Regulator].*

- Display of Passport size pic permitted
- May include bulletin boards, articles, prof info, & relevant educational videos
- Chat rooms can be provided with confidentiality protocol
- Can provide Document Management Facility
- Can share link to Social Networking Site but not solicit to visit or like their pages
- Can provide online advice on specific request for free/payment

- Ensure adequate secrecy of matters of clients
- No ads on website of banner or any nature
- May provide link to website of ICAI, Regional councils, Branches & website of Govt/depts/Reg authorities/Professional bodies
- Website name should be similar to firm name & not amount to solicitation
- Mention info. which is not at material variance from ICAI's records

Online Third Party Platforms

- Some websites provide consultancy services of CAs or CA Firms
- Contact address of CA shouldn't be provided
- It should not advertise professional achievements or status of CAs just mention they are CAs
- Name of CA Firm with suffix "Chartered Accountants' not permitted

Publication of Name or Firm Name by CAs in Telephone or other Directories published by Telephone Authorities or Private Bodies

- Name under section 'Chartered Accountants'
- Member/firm should be from town/city of directory publication
- Order of entries should be alphabetical
- Entry shouldn't be made in differential or prominent manner giving impression of publicity /advertisement
- Entries shouldn't be restricted & open to all CAs of that town
- Members can also include their names in Trade/social directories

Application based Service provider Aggregators (Eg UrbanClap)

- Not permissible for CAs when other categories also listed

Specialised Directories for limited circulation (Who's Who)

- Name, description & address of member (or firm) may appear in any directory or list of members of a particular body in which names are listed alphabetically.
- Member shouldn't give name of clients
- May supply info for spl. directories on own discretion

Advertisement for following purpose allowed:

- ✓ For recruiting staff for own office
- ✓ Inserted on behalf of client for staff for their office or acquisition or disposition of property
- ✓ For sale of business or property by member acting in prof capacity as trustee, liquidator or receiver (litre)

Note: When advertising for staff its desirable to avoid saying "Well known firm".

Examples:

1. M/s XYZ, firm of CAs created website "www.xyzindia.com". Website besides containing details of firm and bio-data of partners also contains passport size photographs of all partners of firm.

Key Points:

CA firm can create its own website using any format subject to guidelines. However, website should be so designed that it does not solicit clients or professional work and should not amount to direct or indirect advertisement. Guidelines of ICAI allow a firm to put up the details of firm, bio-data of partners and display of a passport size photograph.

Conclusion: Not Guilty

2. M/s LMN, firm of CAs responded to tender from SG for computerization of land revenue records. For this purpose, firm also paid ₹ 50,000 as earnest deposit as part of terms of tender.

Key Points:

Matter relates to services other than audit, members can respond to any tender. Further, in respect of non-exclusive area, members are permitted to pay reasonable amount towards earnest money/security deposits.

Conclusion: Not Guilty

3. Mr. Honest, CAiP, wrote two letters to M/s XY CA firm requesting them to allot him some professional work. He also wrote letter to M/s ABC, CA firm for securing professional work. Mr. Clever, another CA, informed ICAI regarding Mr. Honest's approach to secure professional work. Is Mr. Honest wrong in soliciting professional work?

Key points:

a) Nothing shall be construed as preventing or prohibiting any CA from applying or requesting for or inviting or securing professional work from another CAiP.
b) Such restraint has been put so that members maintain their independence of judgment and may be able to command respect from their prospective clients.

Conclusion: Not guilty

Clause (7)

- Advertises his professional attainments or services, or
- uses any designation or expressions other than CA 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 CG or title indicating membership of ICAI or of any other institution that has been recognized by the CG or may be recognized by Council.

Member in practice may advertise through a write up, setting out service provided by him or firm and particulars of his firm subject to such guidelines as issued by Council.

- Not permitted → Income-tax Consultant, Cost Accountant, Company Secretary, Cost Consultant, Management Consultant or Corporate Lawyer
- Use of designation 'Member of Parliament', 'Municipal Councilor' not permitted.
- "Insolvency Professional" or "Registered Valuer" → Allowed on visiting card/letter head

- Date of setting-up practice/establishment of CA firm not be mentioned on letter heads & other professional documents [What about website? _____]

- Practice as Advocate : CAiP eligible to practise as advocates subject to permission of Bar Council but in such case, they should not use designation 'Chartered Accountant' in respect of matters involving practice as advocate. In respect of other matters they should use designation 'Chartered Accountant' but they should not use designation 'CA' and 'Advocate' simultaneously.

- Practice as Company Secretary/Cost Management Accountant: CAiP otherwise eligible may also practice as CS and/or CMA. Such members shall not use designation/s of aforesaid Institute/s simultaneously with designation "CA".
  Note: Its clarified that in event of permission being granted to a CAiP to also hold COP of sister Institute(s)/Bar Council, such a member be treated as a member in full-time practice.

- Notice in Press relating to Success in Examination: It should not contain any element of undesirable publicity. Candidate's name and address, school and local background, examination passed with details of any prize or place gained, name of principal, firm and town in which principal practices may be published

- Reports and Certificates: Manner of publication limited to enable report or certificate to serve its proper purpose. Members should use letterhead for issuing reports & certificates.

- Appearance of CAs on Electronic Media (including Internet): Members may appear on television, films, Internet & Radio or give lectures at forums and may give their names and describe themselves as CAs. Spl. qualifications or specialised knowledge directly relevant to subject matter of prog. may be given. Firm name may be mentioned; however, exaggerated claim or comparison is not permissible. It must not be promotional of him or his firm but must be an objective professional view of topic. Mention of membership of ICAI is desirable to achieve suitable publicity for ICAI.

- Members giving talks or lectures or attending conference may describe themselves as CAs only when they are acting in their capacity as CAs. Reference to professional firm of member should not be given.



- Organising Training Courses, Seminars etc. for his staff: CAiP may invite staff of other CAs and clients to attend. Undue prominence should not be given to name of CA in any booklet or document.
- Writing Articles or Letters to the Press: May give their names & use the description CAs.
- Size of Sign Board: Use of glow signs or lights on large-sized boards not permissible.

- Public Announcements with details of CA as Directors:
  - ✓ Prospectus or public announcements shouldn't publish descriptions about CA's expertise, specialisation & knowledge in any field. [Both 6 & 7 apply]
  - ✓ Member should invite attention of mgt to provisions and request that before communication, is issued, it should be approved by him.
  - ✓ Use of expression 'CA' is permissible. Directorships held by member in other Companies can be given, but name of firm in which member is partner, should not be given.

- Use of logo/monogram of any kind/form/ style/design/colour etc. is prohibited.
- Printing QR code on visiting card allowed giving name/address/contact details/firm name

Notes:

- Giving names of all firms in which CA is partner on letterhead is allowed
- When CA while delivering speech at Conference talks about his expertise & services of firm & requests audience to approach him → guilty under clause 6 & 7

Advertisements through write up

- ✓ Honest & truthful
- ✓ No exaggerated claims
- ✓ No disparaging references or unsubstantiated comparisons
- ✓ Not bring profession to disrepute
- ✓ Not contain testimonials
- ✓ Not contain info about achievements or awards (except awards by CG/SG/ Regulatory Bodies)
- ✓ Monogram of any sort not permissible
- ✓ Membership no/firm reg no to be mentioned
- ✓ Font size upto 14

Eg. Offer document of listed company in which Mr. D, practising CA is a director mentions name of Mr. D as a director along with his various professional attainments and spheres of specialisation. Council stated that if public Co, in which CAiP is director, issues prospectus or gives announcement that gives descriptions about CA's expertise, specialisation and knowledge in any particular field, it shall be a misconduct under Clauses (6) and (7) Part I First Schedule to CA Act, 1949.

Council further stated that in such cases member has to take necessary steps to ensure that such prospectus or public announcements don't advertise his professional attainments & don't directly or indirectly amount to solicitation of clients for professional work by the members.

Conclusion: Guilty of professional misconduct & liable for disciplinary action.

Clause (8) accepts a position as auditor previously held by another CA or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

✓ As a matter of professional courtesy & professional obligation it's necessary for new auditor appointed to communicate with such earlier auditor.

✓ Objective is to ascertain whether there are any circumstances which warrant him not to accept appointment.

Professional reasons for not accepting an audit would be:

(a) Non-compliance of Sec 139 and 140 of Companies Act, 2013

(b) Non-payment of undisputed Audit Fees by auditees other than in case of Sick Units

(c) Issuance of qualified report*

*may accept audit if satisfied that attitude of retiring auditor was not proper & justified. If he feels that retiring auditor qualified report for good & valid reasons, refuse to accept audit. There is no rule, written or unwritten, which would prevent auditor from accepting appointment offered to him in these circumstances. Before accepting audit, ascertain full facts of case.

What should be correct procedure to adopt when a prospective client tells you that he wants to change his auditor and wants you to take up his work?

Co. should be asked whether retiring auditor been informed of intention to change.

- If answer is 'Yes', then communication should be addressed to retiring auditor.
- If it is learnt that old auditor hasn't been informed & client is not willing to inform, it would be necessary to ask reason for proposed change.
- If no valid reason for change, it would be healthy practice to not accept audit.
- If he decides to accept audit he should address a communication to retiring auditor.

Members should retain positive evidence of delivery of communication to addressee.

In opinion of Council, following would provide such evidence: -

a) Communication by a letter sent through "Registered Acknowledgement due", or

b) By hand against a written acknowledgement, or

c) Acknowledgement of communication from retiring auditor's vide email address registered with ICAI or his last known official email address, or

d) Unique Identification Number (UDIN) generated on UDIN portal

*Letters posted under Certificate of Posting not considered valid (No positive evidence of delivery)

Special Cases:

- ✓ Premises found Locked : Deemed to be delivered to retiring auditor.
- ✓ Firm not found at the given Regd address : Address of communication is same as regd with ICAI on date of dispatch, letter will be deemed to be delivered, unless retiring auditor proves it was not really served and he was not responsible for such non-service.
- ✓ Joint audit with earlier auditor: It's necessary for new auditor appointed to act jointly with earlier auditor to communicate with such earlier auditor.
- ✓ Special Audit under Income Tax Act, 1961: It would be healthy practice if Tax Auditor conducting spl audit under Income Tax Act,1961 communicates with member who conducted Statutory Audit.

Council decisions:

- Requirement for communicating with previous auditor being CAiP would apply to all types of Audit viz., Statutory Audit, Tax Audit, Internal Audit, Concurrent Audit or any other kind of audit.
- Communication in case of Assignments done by other professionals: Communication is mandatorily for all types of Audit/Report where previous auditor is a CA. For assignments done by other professionals not being CAs, it would be a healthy practice to communicate.
- Lack of time in acceptance of Government Audits: No time to wait for reply from outgoing auditor, incoming auditor may give conditional acceptance of appointment and commence work.

In acceptance letter, make clear to client that acceptance is subject to professional objections, from previous auditors & that he'll decide about final acceptance after considering info. recd from previous auditor.

Mr. X, a CA accepted his appointment as tax auditor of a firm u/s 44AB, of Income-tax Act, & commenced tax audit within 2 days of appointment since client was in a hurry to file Return of Income before due date. After commencing audit, Mr. X realised his mistake of accepting this tax audit without sending any communication to previous tax auditor. To rectify his mistake, before signing tax audit report, he sent a registered post to previous auditor & obtained the postal acknowledgement. Will Mr. X be held guilty under CA Act?

As per Clause 8/1/1 to CA Act, 1949, Mr. X will be held guilty since he has accepted tax audit, without first communicating with previous auditor in writing.

Object is to ascertain whether there are any circumstances which warrant him to not accept appointment, for eg, whether previous auditor changed on account of having qualified report or expressed wish to not continue on account of something inherently wrong with administration of business.

Retiring auditor may even give out info. regarding condition of accounts of client or reason that impelled him to qualify his report.

Under all circumstances, it would be essential for incoming auditor to carefully consider the facts before deciding whether or not he should accept the audit.

As a matter of professional courtesy & professional obligation it's necessary for new auditor to communicate with earlier auditor.

Conclusion: Therefore, Mr. X will be held guilty of professional misconduct.

Clause (9) accepts appointment as auditor of a Co. without first ascertaining whether requirements of Sec 139 and 140 of Cos. Act, 2013, in respect of such appointment have been duly complied with.

- ✓ It's obligatory on incoming auditor to ascertain from Co. that appropriate procedure in the matter of his appointment been duly complied with so that no shareholder or retiring auditor may, at a later date, challenge validity of such appointment.
- ✓ Not sufficient for incoming auditor to accept certificate from mgt that provisions of above sections have been complied with.
- ✓ Necessary to verify relevant records of Co. & whether Co. has complied with above sections.
- ✓ If Co. not willing to allow incoming auditor to verify relevant records, should not accept audit assignment.

"Note: Do revise Sec 139 & 140"

Procedure if Co. doesn't want to reappoint retiring auditor:

- Members send special notice u/s 140(4) for resolution at AGM. Also required to remove auditor before expiry of term.
- Co. send a copy to retiring auditor. Also send to members at least 7 days before meeting.
- Retiring auditor shall submit representation to Co. to be sent to members.

Records to verify:

Case	Records
1. 1st Time Appointment	BOD resolution within 30 days of DOR. If BOD not appointed → Notice of GM + Resolution passed
2. Filling casual vacancy	BOD resolution Vacancy due to resignation → Resolution passed at GM Vacancy due to removal → Special resolution passed at GM + CG Approval prior to removal

ESB Guidelines in case of removal/resignation by Auditor

A. Auditor willing for reappointment but not reappointed → shall file with ICAI a copy of statement which is also sent to shareholders by mgt of Co (Obligatory for incoming auditor to obtain such copy from BOD & consider before accepting audit)

B. Auditor resigns → send communication to BOD + ICAI stating professional reasons (Obligatory for incoming auditor to obtain such copy from BOD & consider before accepting audit)

C. ESB can ask for add. info if required

D. Also applicable to removal of auditor by govt/other statutory bodies

CA Raja was appointed as Auditor of Castle Ltd for year 2022-23. Since he declined to accept appointment, BOD appointed CA Rani as auditor in place of Raja, which was also accepted by CA Rani. Board can appoint auditor in case of casual vacancy u/s 139(8) of Companies Act, 2013. Non-acceptance of appointment by CA. Raja does not constitute a casual vacancy to be filled by Board. In this case, it will be deemed that no auditor was appointed in the AGM.

Further, as per Sec 139(10) of Companies Act, 2013 when at any AGM, no auditor is appointed or re-appointed, existing auditor shall continue to be auditor of the Co.

Appointment of the auditor by Board is defective in law.

Conclusion: CA. Rani is guilty of professional misconduct since she accepted the appointment without verification of statutory requirements.

Clause (10)

- Charges or offers to charge,
- accepts or offers to accept
- in respect of professional employment
- fees based on percentage of profits or contingent upon findings, or results of such employment, except as permitted under any regulations made under this Act.

Exceptions: Regulation 192

a) Receiver or a liquidator, fees based on percentage of realization or disbursement of assets

b) Auditor of co-operative society, fees based on percentage of paid up capital or working capital or the gross or net income or profits

c) Valuer for purposes of direct taxes & duties, fees based on percentage of value of property valued

d) Mgt consultancy services, fees contingent upon findings, or results of such work

e) Fund raising services, fees based on percentage of fund raised

f) Debt recovery services, fees based on percentage of debt recovered

g) services related to cost optimisation, fees based on percentage of benefit derived and

h) any other service or audit as may be decided by Council.

[Following activities have been decided by Council under "h" above :-
(i) Acting as Insolvency Professional (ii) Non-Assurance Services to Non-Audit Clients]

Note: Members prohibited from accepting remuneration based on happening of contingency such as outcome of appeal in revenue proceedings.

Clause (11) Engages in business or occupation other than profession of chartered accountant unless permitted by Council so to engage.

Provided that nothing shall disentitle a CA from being a director of a Co. (Not being MD or a WTD*) unless he or any of his partners is interested in such Co. as auditor.
Exception: Ch-XVII of Council General Guidelines to be discussed later.

191. Part-time employment a CAiP may accept

Subject to control of Council, CAiP may act as liquidator, trustee, executor, administrator, arbitrator, receiver, adviser or representative for costing, financial or taxation matter, or may take up appointment that may be made by the CG or a State Government or a court of law or any other legal authority or may act as Secretary in his professional capacity, provided his employment is not on a salary-cum-full-time basis.

190A. CAiP not to engage in any other business or occupation EXCEPT for permissions given below
Permission granted generally–

- Employment under CAiP or firms of such CAs.
- Private tutorship.
- Authorship of books and articles.
- Holding of Life Insurance Agency License for purpose of getting renewal commission.
- Attending classes and appearing for any examination.
- Holding of public elective offices such as M.P., M.L.A. and M.L.C.
- Honorary office leadership of charitable-educational or other non-commercial organisations.
- Acting as Notary Public, Justice of the Peace, Special Executive Magistrate and the like.
- Part-time tutorship under coaching organisation of Institute.
- Valuation of papers, acting as paper-setter, head-examiner or a moderator, for any examination.
- Editorship of professional journals (Eg Company Audit Journal)
- Acting as Surveyor and Loss Assessor under the Insurance Act, 1938
- Acting as recovery consultant in banking sector
- Owning agricultural land and carrying out agricultural activity



Specific Resolution - Members in practice may engage in the following categories of business or occupations, after obtaining the specific and prior approval of the Council in each case:

- Employment in business concerns provided member and/or his relatives do not hold "substantial interest" in such concerns. (20% or more)
- Full-time or part-time employment in non-business concern.
- Office of MD or a WTD of body corporate provided member and/or any of his relatives don't hold substantial interest in such concern
- Interest in family business concerns (including such interest devolving on the members as a result of inheritance / succession / partition of family business) or concerns in which interest has been acquired as a result of relationships and in management of which no active part is taken.
- Interest in an educational institution.
- Part-time or full-time lectureship for courses other than relating to ICAI's exams conducted under auspices of ICAI or Regional councils or their branches.
- Part-time or full-time tutorship under any educational institution other than coaching organization of ICAI.
- Editorship of journals other than professional journals.
- Any other business/occupation for which Executive Committee considers permission may be granted.

Notes:

- No bar for member to be promoter / signatory to Memorandum and Articles of Association of Co.
- No bar for such promoter / signatory to be Director Simplicitor of that Co.
- Teaching hours shouldn't exceed 25 hrs a week to undertake attest functions.
- Trading in commodity derivates treated as business

Q. Whether auditor of a Subsidiary can be a Director of its Holding Company?
Ethical Standard Board (ESB) via a clarification, decided that auditor of a Subsidiary Co. can't be a Director of its Holding Company, as it will affect independence of an auditor.
Public conscience needs to be kept ahead of the law.

Member in practice in a HUF doing business

CAiP can acquire intt. in family business in any of following manner:

- Proprietary/partnership firm/ HUF as its Karta or a member
- Necessary for members to provide evidence that interest in family business devolved on him as a result of inheritance/succession/partition of family business.
- Also show that he was not actively engaged in business & family business concern in question not created by him.
- Furnish a declaration in prescribed format & documents to concerned Decentralized Office.

- CAiP engaged as Karta of HUF will be within limit prescribed by Council if he makes investments from funds of HUF only & not actively engaged in mgt of said business.

1. A CA holding COP and having 4 articled clerks registered under him accepts appointment as full-time lecturer in college. Also, becomes a partner with his brother in a business.
Key Points: Council had formulated Regulations 190A and 191 to CA Regulations, 1988 to provide a basis for considering applications of CAs seeking permission to engage in other business or occupation.
A member can accept full- time lecturer-ship in a college only after obtaining the specific & prior approval of Council as also becoming a partner in a business with his brother would require specific permission.
Conclusion: Guilty

2. Mr. A, a practicing CA, took over as the executive chairman of Software Co. on 1.4.2023. On 10.4.2023 he applied to Council for permission.
Key Points: Mr A was engaged in other occupation between the period 01.04.2019 and 10.04.2019, without permission of Council.
Conclusion: Guilty

3. C.A. Prabhu is leading income tax practitioner and consultant for derivative products. He does trading in commodity derivatives. Every day invests 50% of his time to settle commodity transactions. Is C.A. Prabhu liable for professional misconduct?
Key points: Council has granted general permission to members to engage in certain specific occupation. In respect of all other occupations specific permission of ICAI is necessary.
CA is engaged in occupation of trading in commodity derivatives which is not covered under general permission.
Conclusion: Guilty if no permission taken.

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 F.S.

Who can sign? _____

Exceptions:
Council has clarified that power to sign routine documents on which professional opinion or authentication is not required to be expressed may be delegated in following instances and such delegation will not attract provisions of this clause:

i) Issue of audit queries during course of audit.
ii) Asking for information or issue of questionnaire.
iii) Letter forwarding draft observations/financial statements.
iv) Initiating and stamping of vouchers and of schedules prepared for purpose of audit.
v) Acknowledging and carrying on routine correspondence with clients.
vi) Issue of memorandum of cash verification and other physical verification or recording results thereof in books of clients.
vii) Issuing acknowledgements for records produced.
viii) Raising of bills and issuing acknowledgements for money receipts.
ix) Attending to routine matters in tax practice, subject to provisions of Sec 288 of Income Tax Act.
x) Any other matter incidental to office administration and routine work involved in practice of accountancy.

Note:
Authority delegated by CA But Authority not used is not a defence for CA → Prof misconduct

1. S, a CAiP gives power of attorney to an employee CA to sign reports and F.S. on his behalf.
Key Points:

- Quote Clause 12/1/1
- This clause read in conjunction with Sec 26 of CA Act, 1949 stipulates that no person other than member of institute shall sign any document on behalf of a CAiP or a firm of CAs in his or its professional capacity.
- Term 'F.S.' for this purpose would cover an examination of accounts or F.S. given under a statutory enactment or otherwise.
- Further, Clause (1) of Part II of Second Schedule to CA Act, 1949 states that member of Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of provisions of this Act or regulations made there under or any guidelines issued by Council.
- Conclusion: Guilty under both clauses.

2. CA. Smart, a CAiP was on Europe tour between 15-9-23 and 25-9-23. On 18-9-23 a message was received from one of his clients requesting for stock certificate to be produced to bank on or before 20-9-23. Due to urgency, CA. Smart directed his assistant, who is also a CA, to sign and issue stock certificate after due verification, on his behalf.
Conclusion: Guilty

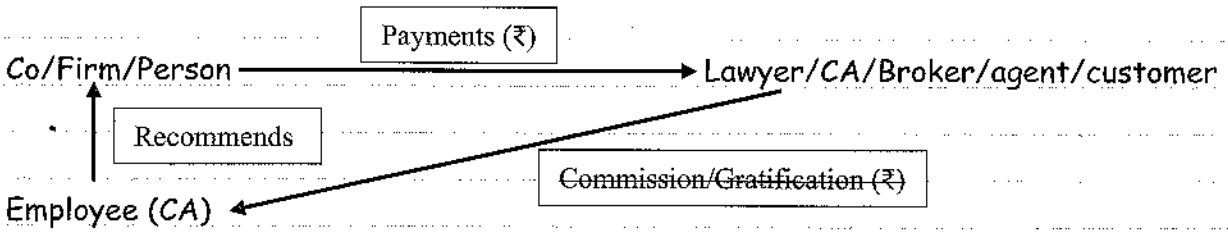
PART II – Professional misconduct in relation to members of the Institute inservice

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:

Clause (1) pays or allows or agrees to pay directly or indirectly to any person any share in emoluments of employment undertaken by him.

- Can share with relatives,dependents,friends etc. if it's not consideration for procuring or retaining a job.
- Job must be procured & retained with own professional capabilities & not by any financial deal impairing professional dignity.

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 Co., firm or person or agent or customer of such Co., firm or person by way of commission or gratification.



Member would be guilty of misconduct regardless of fact that he was in whole-time or part-time employment or holding COP along with his employment.

PART III - Professional misconduct in relation to members of the Institute generally

Clause (1) not being a fellow of the Institute, acts as a fellow of the Institute.

Clause (2) does not supply information called for, or does not comply with the requirements asked for, by Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority.

1. Mr. 'G', while applying for a COP, didn't fill in columns which solicit information about his engagement in other occupation or business, while he was indeed engaged in a business.
Key Points: Details of engg. in business need to be disclosed while applying for COP as it was the information called for in application, by ICAI.
Conclusion: Guilty
2. Mr. X, a CA, employed as a paid Assistant with CA firm, leaves services of firm on 31.12.22. Despite many reminders from ICAI he fails to reply regarding date of leaving services of firm.

Conclusion: Guilty

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 for in items (6) and (7) of Part I of this Schedule, gives information knowing it to be false.

PART IV- Other misconduct in relation to members of the Institute generally

Member of ICAI, 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 offence which is punishable with imprisonment for a term not exceeding six months [<= 6 months]

Clause (2) in opinion of Council,

- brings disrepute to the profession or the Institute
- as a result of his action whether or not related to his professional work.

CA is expected to maintain highest standards of integrity even in his personal affairs & any deviation from these standards, even in non-professional work, would expose him to disciplinary action.

Note: Before starting any ans. of this clause ICAI gives this line → Section 21 of the Chartered Accountants Act, 1949 provides that a member is liable for disciplinary action if he is guilty of any professional or "Other Misconduct."

Examples, where a member may be found guilty of "Other Misconduct":

- Retains books of a/c and documents of client & fails to return without reasonable cause.
- Makes material misrepresentation.
- Uses the services of his articled or audit assistant for purposes other than professional practice [Eg. Using them for election campaigning]
- Conviction by a competent court of law for any offence under Sec 8 (v) of the CAs Act 1949.
- Misappropriation of money by office-bearer of Regional Council of ICAI and utilisation for his personal use.
- Not replying within reasonable time and without good cause to letter of public authorities [Eg Police Station]
- Assessment records of IT Dept belonging to client of were found in almirah of bed-room of CA.
- Where CA had adopted coercive methods on a bank for having a loan sanctioned to him.

Cheque returned Unpaid with Remark "Refer to Drawer"

Negotiable Instruments Act 1881, where any cheque is returned by bank unpaid, either for insufficiency of funds or cheque amount exceeds arrangements made by drawer of cheque, drawer of such cheque shall be deemed to have committed an offence.

- Remark "refer to drawer" need not necessarily be only due to insufficiency of funds.
- If it is proved that cheques were dishonoured due to insufficiency of funds, then CA would be held guilty of "other misconduct".

The Second Schedule

Part I - Professional Misconduct in relation to CAiP

A CAiP shall be deemed to be guilty of professional misconduct, if he

Clause (1) Discloses Information acquired in course of his professional engg. 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.

Exceptions:

- Disclosure allowed only with consent of client or as part of professional duties (Eg submitting info to Exchange Control Authorities)
- No misconduct in case of legal compulsion as reqd by Evidence Act
- Sec 143(12) – Reporting of fraud

Eg. Mr. Parekh, a CA was invited by Chamber of Commerce to present a paper in a symposium on issues facing Indian Leather Industry. During course of his presentation he shared some of vital info. of client's business under impression that it will help Nation to compete with other countries at international level.

Clause 1/1/2

Key Points:

Code of Ethics further clarifies that such a duty continues even after completion of assignment. CA may however, disclose info. in case it is required as a part of performance of his professional duties.

Conclusion: Professional Misconduct

Note: When external party like Bank asks for info of your working papers → This clause + SA 200 Confidentiality is to be maintained + SA 230 Property of Auditor (discretion)



Clause (2) Certifies or submits in his name or in the name of his firm, a report of an examination of F.S. unless 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.

Clause (3) Permits his name or 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.

He can prepare profit forecast provided he indicates clearly in his report the

- the basis of forecasts and
- major assumptions made in arriving at the forecasts,
- sources of information,

so long as he does not vouch for the accuracy of the forecasts. [Reference in SAE 3400]

Clause (4) Expresses his opinion on FS of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

- ✓ CA can't certify FS of concern where he's employed
- ✓ Not audit a/c of college where he is part time lecturer
- ✓ Not audit trust if partner is either trustee or employee of trust
- ✓ Applicable to all types of Audit
- ✓ Client shouldn't be relative of member
- ✓ Not permitted to prepare books of a/cs for auditee clients
- ✓ Stat auditor can't be internal auditor
- ✓ Internal auditor can't be appointed as Tax/GST Auditor
- ✓ Cooling off period: Not accept Audit of Co for 2 years from date of completion of tenure/resignation as Director.

Note: Evaluating costs or other assignments of such nature → not covered in this clause

Clause (5) Fails to disclose a material fact known to him which is not disclosed in FS, but disclosure of which is necessary in making such FS not misleading where he's concerned with that FS in a professional capacity.

Mr. Joe, a CA during course of audit of M/s XYZ Ltd. came to know that the Co. has taken a loan of ₹ 10 lakhs from EPF. The said loan was not reflected in books of account. However, auditor ignored this information in his report.

Key Points: This is contravention of Rules and said loan has not been reflected in books of accounts. Further, this material fact has also to be disclosed in the F.S.
Conclusion: Guilty

Clause (6) Fails to report a material misstatement known to him to appear in a F.S. with which he is concerned in a professional capacity.

Note:
If CA appears before tax authorities on behalf of client → submits info or expln that's found false misleading → not guilty as data provided by mgt + acting on instructions of client

[Clause 5 & 6]

Clause (7) doesn't exercise due diligence, or is grossly negligent in conduct of his professional duties.

- It is a vital clause which gets attracted whenever it's necessary to judge whether accountant has honestly & reasonably discharged his duties.
- Expression negligence covers a wide field & extends from frontiers of fraud to collateral minor negligence.

Examples:

- ✓ Conducted Stock audit without visiting the site, relied on mgt reports
- ✓ Issued turnover certificate of betel nuts to firm for import license w/o checking books & docs but relying on article clerk → Guilty
- ✓ Issued certificate of consumption of Raw material based on minutes of BOD→ guilty clause 2 & 7 of this schedule
- ✓ Issued report subject to separate notes (No audit report is issued with Notes)
- ✓ Not submitted his report in due time to enable Co to comply with Statutory requirement
- ✓ Failed to check a forged signature which he could have checked
- ✓ Shared password of his digital signature certificate with client →Guilty
- ✓ Certified circulation figures of newspaper based on MIS report without examining books of a/c

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.

Examples:

- Transaction took place between ABC Firm & R developers but reported in books of ABC Construction. Loan amount was material. Guilty under clause 6, 7 & 8 of Part I of Second Schedule
- CA issued false certificates to several parties for past exports for monetary consideration without verifying any supporting records or documents which helped parties to make imports

free of duty. Held guilty under clauses (2), (7) & (8) of Part I of the second schedule

- CA audited books of A ltd that had investment of Rs 10L, later it was found real value was 25k → CA guilty under clause 2, 7, 8 of Part I of Second Schedule of CA Act,1949
- Certificate of circulation of Periodical w/o verifying underlying record bank statements, printer bills, sales records etc → Guilty under Clause 8 [can add (7) too]

Clause (9) Fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances

Generally accepted audit procedure => Engg. and Quality Control Standards, Statements, General Clarifications, Guidance Notes Technical Guides, Practice Manuals, Studies and Other Papers.

Special Points:

- Audit of listed cos : Done by Auditor subject to Peer Review process of ICAI & hold valid certificate issued by Peer Review Board of ICAI
- Firm Reg No & Membership No to be mentioned on reports pursuant to attestation engg.
- UDIN is mandatory to be generated for all kinds of certifications

Examples:

- CA didn't conduct sample checking of bank a/c of Co & didn't do vouching & depended on work of Article Assistant → guilty under clause 7,8,9
- CA didn't check bank column totals, didn't verify contra entries, test checked when no internal check present,didn't check Bank recos → guilty under clause 7,8,9

Clause (10) fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking a/c or to use such moneys for purposes for which they are intended within a reasonable time.

Spl points:

- Advance received against services excluded from scope
- Money recd for expenses to be incurred in reasonably short time not to be deposited in bank a/c
- Money recd in capacity of trustee, executor liquidator, etc keep in separate bank a/c

A charitable institution entrusted ₹10L with its auditors M/s R & Co., a CA firm, to invest in specified securities. Auditors deposited it in their Savings bank a/c & no investment was made in next 3 months.
If a CAiP fails to keep moneys of his clients in a separate bank a/c or fails to use such moneys for intended purposes then his action would amount to professional misconduct under Clause 10/1/2.

In course of his engagement as a professional accountant, a member may be entrusted with moneys belonging to his client. If he should receive such funds, it would be his duty to deposit them in a separate banking a/c, & to utilise such funds only as per instructions of client or for purposes intended by the client.

Conclusion: In given case by depositing client's money in their own savings bank a/c, auditors have committed a professional misconduct. Hence in given case, M/s R & Co. will be held guilty of professional misconduct.

PART II - Professional misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he -

Clause (1) contravenes any of provisions of this Act or regulations made there under or any guidelines issued by Council.

Examples:

- CA certified in Form K-2 audit clerk in service with him, article employed elsewhere 11-5 pm & then come to office work till 8 pm.
- Took article intern under him even when no vacancy was there, intern got to know Articleship deed not regd.
- Took loan from firm where article & his father were interested
- Didn't pay stipend as per Reg 48 to article, only paid when article left. Said he had agreement to pay fees annually → held guilty

Clause (2) being an employee of any Co., firm or person, discloses confidential info. acquired in course of his employment except as & when required by any law for time being in force or except as permitted by employer.

Clause (3) Includes in any information, statement, return or form to be submitted to ICAI, Council or its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or Appellate Authority any particulars knowing them to be false.

Examples:

- A CA manager in firm applied for admission as fellow to ICAI saying he's partner in firm→ made a statement that's false → Guilty
- In a hearing before Disciplinary Committee made a false statement on oath
- CA in full time employment in a Co while filling bank empanelment form gave declaration that he

was not in any occupation/business/vocation etc

- CA being manager of Co devoting 30 hrs. per week showed himself as CA in full time practice for employment for Bank branch Audit

Clause (4) Defalcates or embezzles money received in his professional capacity.
SA 240 → Defalcation & embezzlement of money recd in prof capacity → Fraud

Part III - Other misconduct in relation to members of the Institute generally

Member of Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if held guilty by any civil/criminal court for offence which is punishable with imprisonment for a term exceeding 6 months.

Council General Guidelines (Final Stage of Chapter)

Chapter I: Applicable to all Members of ICAI whether in practice or not.
Chapter II: A member of ICAI who is an employee shall exercise due diligence & shall not be grossly negligent in conduct of his duties.

Chapter V: Maintenance of books of account

Member or firm in practice shall maintain following books of a/c:

- Cash Book
- Ledger

Chapter VI: Tax Audit assignments under Section 44 AB of the Income-tax Act, 1961

CAiP shall not accept, in a financial year, more than 60 tax audit assignments u/s 44AB of the Income-tax Act, 1961.

- As per clarification, if there are 10 partners in a firm, then all partners of firm can collectively sign 600 tax audit reports. This max. limit of 600 tax audit assignments may be distributed between partners in any manner. For eg, 1 partner can sign 600 tax audit reports & remaining 9 partners not signing any tax audit report.
- Each year's audit would be taken as separate assignment.
- Mr A partner in ABC as well as ADE, then also only 60 allowed for A
- Mr A partner in ABC & also in a proprietorship, then also 60 allowed to A
- Audits u/s 44AD, 44ADA, & 44AE of IT Act 1961 not counted
- Audit of H.O. & Branch office counted as 1 assignment
- Audit of More than 1 branch of same concern = 1 assignment
- Part time practicing partner not allowed to accept tax audit assignments.
- Maintain record of tax audit assignments accepted in each AY in format prescribed by Council.

Mr. G is a partner in M/s. XYZ & Co., a CA firm with 6 partners. During AY 2022-23, Mr. G alone had signed 290 tax audit reports consisting of both corporate and non-corporate assesses.

- In given case, there are 6 partners in M/s XYZ & Co., accordingly, specified ceiling limit for the firm will be (60 tax audit assignments per partner X 6) = 360.
- All 6 partners can collectively sign 360 tax audit reports. This max. limit of 360 tax audit assignments may be distributed between partners in any manner whatsoever.
- Conclusion: Hence, Mr. G shall not be deemed to guilty of professional misconduct provided total no. of tax audit reports on behalf of firm do not exceeds 360.

Chapter VII: Appointment of an Auditor in case of non-payment of undisputed fees

- A CAiP shall not accept appointment as auditor of entity in case undisputed audit fee of another CA for carrying out statutory audit under Cos. Act, 2013 or various other statutes hasn't been paid.
- Undisputed audit fees include expense incurred by Auditor
- Exception: In case of sick unit, above prohibition of acceptance shall not apply.
- Sick unit means unit regd for 5 years or more & has accumulated loss >= Net worth

Mr. C accepted statutory audit of M/s PSU Ltd., whose net worth is negative for year 2022-23. Audit was to be conducted for year 2023-24. Audited accounts for year 2023-24 showed liability for payment of tax audit fees of ` 15,000 in favour of Mr. E, previous auditor.
(Mention Ch-VII & Exception of Sick unit)
In given case, though undisputed fees are unpaid, Mr. C would still not be guilty of professional misconduct since M/s PSU Ltd. is a sick unit having negative net worth for the year 2022-23.

Chapter VIII: Specified no of Audit assignments

CAiP shall not hold at any time appointment of more than "specified no. of audit assignments" of Companies under Section 141 of the Companies Act 2013.

- 30 audits per CA in full time practice allowed
- One Person Co & Dormant Co excluded from limit
- No. of partners on date of acceptance to be considered

Trivia: Max Audits
Small Co. _____, OPC & Dormant Co., Pvt ltd co. paid up share capital <100 Cr____, others _____

Chapter IX Appointment as Statutory auditor

- CAiP shall not accept appointment as statutory auditor of PSU(s)/ Govt/Listed Cos and
- other Public Company(s) having turnover of 50 Cr or more in a year
- where he accepts any other work(s) or assignment(s) or service(s) in regard to the same Undertaking(s)/ Company(s) on a
- remuneration which in total exceeds fee payable for carrying out stat audit of same Co.

Other work excludes:

- audit under any other statute.
- certification work required to be done by statutory auditors; and
- any representation before an authority

A is auditor of Z Ltd., turnover of ₹ 200 Cr. Audit fee for year is fixed at ₹ 50 lakhs. During year, Co. offers A an assignment of mgt consultancy within meaning of Section 2(2)(iv) of CA Act, 1949 for remuneration of ₹ 1 crore. A seeks your advice on accepting the assignment.
Conclusion: Misconduct on A's part if he accepts mgt consultancy assignment for a fee of ₹ 1 crore.

Chapter X Appointment of an auditor when he is indebted to a concern

CAiP or partner of firm in practice or firm or relative of such member or partner shall not accept appointment as auditor of concern while indebted to concern or given any guarantee or provided any security in connection with indebtedness of any 3rd person to concern, for limits fixed in statute and in other cases for amount exceeding 100,000/-.

Notes:

- Recovery of fees on progressive basis doesn't mean indebtness
- Limit as per Cos. Act for indebtness is 5L & for guarantee or security is 1L

D, who conducts tax audit u/s 44AB of Income Tax Act, 1961 of M/s ABC, a partnership firm, has received audit fees of ` 2,50,000 on progressive basis in respect of tax audit for year ended 31.3.2023. The audit report was, however, signed on 25.5.2023.
[Ch X & progressive basis exemption]
Conclusion: Mr. D will not be held guilty for misconduct.

Chapter XI Directions in case of unjustified removal of auditors

Incoming auditor(s) not to accept appointment as auditor(s), in case of unjustified removal of earlier auditor(s).

Chapter XV: Networking

Where larger structure is aimed at co-operation and entities within structure share significant part of professional resources, it is deemed to be a network.

Professional resources include:

- Common systems that enable firms to exchange info such as client data, billing & time records
- Partners and staff
- Technical departments that consult on technical or industry specific issues, transactions or

events for assurance engg.

- Audit methodology or audit manuals &
- Training courses & facilities

Different forms of Network can be as under:-

- Constituted as a mutual entity which will act as facilitator for constituents of Network. In such case Network itself will not carry out any professional practice.
- Network can be constituted as partnership firm with total no. of partners does not exceed 20.
- Network can be constituted as LLP subject to CA Act and Rules and such other laws applicable.
- Network can be constituted as Co. subject to guidelines prescribed by ICAI for corporate form of practice & formation of mgt consultancy services Co. (Chap xvii)
- Network Firms shall consist of sole Practitioner/proprietor, partnership or any such entity of professional accountants as may be permitted by the Act.
- Firm is allowed to join only one network.
- Firms having common partners shall join only one Network.

Naming of Network

1. Network may have distinct name which should be approved by ICAI. To distinguish a "Network" from a "firm" of CAs, words "& Affiliates" shall be used after name of network & words "& Co." /"& Associates" shall not be used. Prescribed format of application for approval of Name for Network is Form 'A'.
2. ICAI shall approve or reject name of Network and intimate to Network at its address mentioned in Form 'A' within 30 days from date of receipt of said Form.
3. Mere approval of name of Network shall not entitle Network to carry on practice in its own name.

Registration of Network with entities in India

1. After name of Network approved, Institute same shall reserve name for period of three (3) months from date of approval.
2. Network shall get itself registered with Institute by applying in Form B within period of 3 months, failing which name assigned shall stand cancelled on expiry of said period.
3. Registration of Network with Institute is mandatory.
4. If different Indian firms are networked with a common Multinational Accounting Firm, they shall be considered as part of network.

Listing of Network with entities outside India

1. Authorized representative of Indian Member firm (s)/Member constituting Network with entities outside India shall file declaration with ICAI in Form D for Listing such Network within 30 days from date of entering into Network arrangement.

2. Proprietary/individual members, partnership firms as well as members in LLP or any such other entity, shall be permitted to join such network with entities outside India provided that they can join only one network and firms having common partners shall join only one such network.

Framework of Internal Byelaws of Network:

Bye-laws may contain following clauses on which the affiliates of the network may enter into a written agreement among themselves:

i) Appointment of a Managing Committee
ii) Administration of network
iii) Contribution of membership fees to meet the cost of the administration of the network.
iv) Identifying a partner of any of member firms of network to be responsible for the assignment (engg. partner)
v) Dispute settlement procedures through arbitration and conciliation
vi) Development of training materials for members of the network
vii) Issue of News-letters for staff and clients
viii) Development of software for different types of assignments

(Manage >> Administer >> Fees >>EP >> Dispute settle >>Train >> Newsletters >> Softwares)

Ethical Compliance: It will be necessary for such network to comply with applicable ethical requirements prescribed by ICAI and following requirements in particular: -

1. If one firm of network is statutory auditor of entity then associate [including networked firm(s)] or said firm directly/indirectly not accept internal audit or book-keeping or other assignments prohibited for stat auditor firm.
2. Guidelines of ceiling on Non-audit fees is applicable in relation to Network as follows:
   i. For a Network firm who is doing statutory audit (including its associate concern and/or firm(s) having common partnership), it shall be same as mentioned in said notification &
   ii. For other firms of same Network collectively, it shall be 3 times of fee payable for carrying out statutory audit of same undertaking/ company.
3. In cases where rotation of firms prescribed by regulatory authority, no member firm of network can accept appointment as auditor in place of any member firm of network which is retiring.
4. Network may advertise to extent permitted by Advertisement Guidelines issued by ICAI. Firms constituting network are permitted to use words "Network Firms" on their professional stationery.
5. Constituent member firms of Network and Network shall comply with all Ethical Standards prescribed by Council from time to time.

Change in constitution of registered Network: In case of change in constitution of regd Network on account of entry or exit from Network, network shall communicate to ICAI by filing Form 'C' within 30 days from date of change in constitution.

Chapter XIV Unique Document Identification Number (UDIN) Guidelines

- To curb malpractice of false certification/ attestation by unauthorised persons & reduce bogus certificates.
- Mandatory for all certificates, Tax audit reports & other audit/assurance & attestation functions

Chapter XVI Logo Guidelines

Letters 'CA' in blue colour with a tri colour tick mark (upside down) with white background.

- Blue colour not only stands out on any background but also denotes creativity, innovativeness, knowledge, integrity, trust, truth, stability, & depth.
- Upside-down tick mark, typically used by CAs, symbolise wisdom & value of professional.
- 'India' is also added, as it epitomizes ICAI's connection to India First approach & commitment to serve Indian economy.
- No change in font, spacing, dimensions, design & colours.
- Refrain from rotating or tilting logo clockwise & anti-clockwise.
- Logo should not be shrunk or distorted.

Note: Transition time of 1 year provided to use existing stationary/signage replacement etc.

CA INDIA

Chapter XVII Guidelines for Corporate form of Practice

- Council has allowed members in practice to be MD/WTD/Manager of a Body Corporate that is exclusively engaged in providing Management Consultancy & Other Services permitted u/s 2(2)(iv) of CA Act 1949
- No restriction on equity holding in such Company
- Entitled to do attest functions & train article assistants
- Name of Mgt Consulting Co to be approved by ICAI & registered with it
- Compliances for Mgt Consulting Co:
  - ✓ Not to accept Internal audit or bookkeeping service or other assignments from entity where practitioner or firm is auditor
  - ✓ Ceiling of non-audit fees applicable to it
  - ✓ Mgt consulting co shall comply with clause 6 & 7 of Part 1 of First Schedule of CA Act 1949



Recommended Self-Regulatory Measures

- Branch Audits
  - ✓ Branch audit of Co shouldn't be conducted by Stat Auditors consisting 10 or more members
  - ✓ But by local firms of auditors less than 10 members
  - ✓ Restriction not apply in following cases:
    - o A/c records of branch at HO
    - o Significant operations carried out at Branch
- Joint Audit
  - ✓ Large Cos should have practice of having firms with < 5 members as Joint Auditors
  - ✓ Senior firms shouldn't object to such practice
- Ratio b/w Qualified & Unqualified Staff

  Atleast 1 member for every 5 non-members excluding articled/audit assistants, typists, peons, & others not engaged in professional work
- Disclosure of Interest by Auditors

  Disclose payments received for other services through medium of different firm or firms where he maybe a partner or proprietor
- Recommended minimum scale of fees

  Recommended Min. fees for professional services is to be charged

Public interest entity [PIE]

a) listed entity or

b) An entity:

i) Defined by regulation or legislation as PIE or

ii) For which audit is required by regulation or legislation to be conducted in compliance with same independence requirements that apply to audit of listed entities.

Note: Banks and Insurance Companies are to be considered as PIEs.

Summary: Listed Entities/Banks/Insurance Cos.

PIE Disclosure to ICAI:

Where for 2 consecutive years, total fees from audit client represent more than

- 20% [PIE]
- 40% [other entities]

of total fees received by firm expressing opinion on FS. Firm shall disclose this fact to ICAI.

Exemptions:

- Client fees upto ₹20 lakhs
- Audit of Govt Companies, public undertakings, nationalised banks, public financial institution, regulators or where appointments of auditors are made by Govt

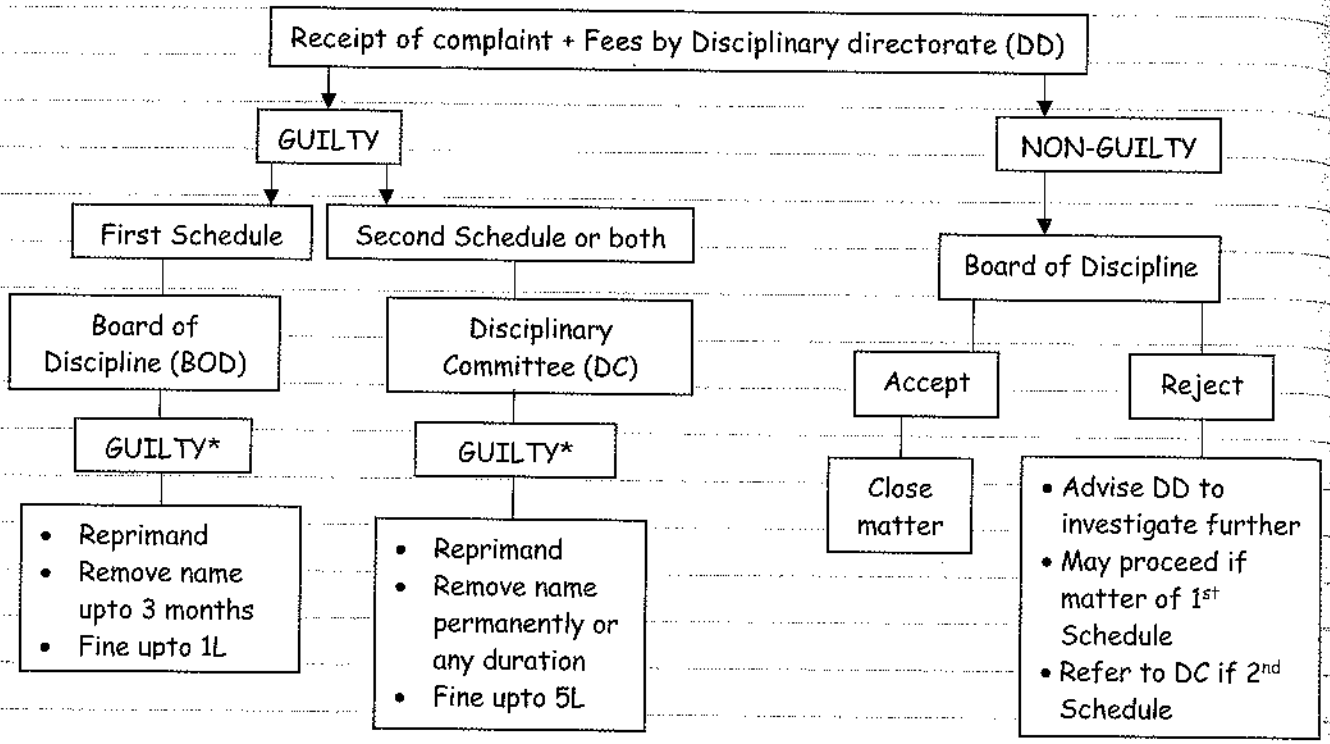
Recent Decisions of Ethical Standards Board (ESB)

- Not permissible for CAiP being statutory auditor to prepare Business Responsibility & Sustainability Reporting (BRSR) study for Audit Clients. However, may provide advisory services on the same. Permissible for statutory auditor to be "Assurance provider of BRSR core" for same client.
- Statutory auditor of entity not permitted to engage in compilation engg. of entity as per SRS 4410.
- CAiP can engage in services assessment/performance audit of centres of skill development council of Govt of India, permissible as Mgt Consultancy & other services u/s 2(2)(iv) of CA Act, 1949.
- CAiP can accept assignment of Mystery Audit.
- CAiP can mention position as promoter/Director on portal of Co. However, can't mention his professional attainments & firm name. Should not violate clause (6) & (7) of Part I of First Schedule to CA Act, 1949.
- CAiP can become professional director in Board of Mgt of a Co-operative Bank.
- Member can set up practice in IFSC/GIFT city.
- Member can render professional services to IFSC units from offices outside IFSC.
- Firm not permitted to publish vision or mission statement on letter head, visiting card or stationery etc. May be printed on firm profile & provided in response to a specific request.
- Statutory Auditor of Bank can't accept assignment of ASM of a customer of same Bank simultaneously. Can accept either of Assignments at one time.
- CAiP can't be appointed as Internal Auditor & Procurement officer simultaneously in an organization.
- CAiP can charge fees on percentage of utilization amount of educational Institute for certifying amount (utilization) spent by educational Institute out of grant.
- Statutory/tax auditor can't be valuer of unquoted equity shares of same entity if prohibited by law.
- CAiP may be Non-executive/independent director in a Co-op Bank, provided not involved into day to day activity of organization, nor he or any of his partners interested in Bank as auditor.
- CAiP can become a member of 'Board of Mgt' in Primary (Urban) Co-operative Banks. ESB noted that position of a member of 'Board of Mgt' in Primary (Urban) Co-op banks (UCBs) is similar to a Director-Simiplicitor i.e no involvement in day-to-day functioning/operations & not signatory etc. & only sitting fees provided.
- CAiP cannot act as Trademark or Patent Attorney. However, Professional advice in relation to Intellectual Property Rights (IPR) is a routine professional work & permissible under CA Act, 1949.
- CAIP can't accept statutory audit of society where immediate family member i.e., spouse or dependent, of member hold honorary position of one of the managing committee of institutes governed by the society.
- CA Firm may register itself on Udyog Aadhar, a web portal of Ministry Micro, Small and Medium (MSME) Enterprises.
- No prohibition for internal auditor of a Co. to acquire/purchase shares of said Co.
- Not permissible for member to use Messaging Applications to send messages to make people aware about his practice, & mention services.



- CAiP being Director Simplicitor in a Co. cannot sign ROC Forms of Co. as it's a direct conflict of role.
- CAiP can act as Authorized Representative of a Foreign Co, provided he isn't auditor of the Co..
- Permissible for 2 or more CAiP collectively to have joint training session for their clients on GST, & share fees collected from the clients thereof.
- CAiP can provide services through kiosk only if services provided are professional activities of a practicing CA, permitted under the Act.
- CA in service is allowed to take e-return registration if it doesn't conflict with employment obligation. However, he cannot certify the return.
- Where CAiP is a non-executive director in a Co., he or his Firm, should not accept appointment as statutory auditor of a Co. which is a joint venture of original Co., as it would impact independence.
- ESB while noting requirement for a Director to reside in India for a minimum period of 182 days in previous calendar year, such Director would be within scope of Director Simplicitor (which is generally permitted as per ICAI norms) , if he is non -executive director, required in Board Meetings only , & not paid any remuneration except for attending such Board Meetings (sitting fees).
- CA may be Equity research adviser but can't publish retail report as it'd be business or occupation
- No conflict of intt. in a CA, who is member of Trust, being auditor of said trust.
  Exception: Where a statute governing Trust prescribes prohibition on member of Trust to be its Auditor or otherwise where there is conflict of interest as per provisions of Code of Ethics.
- May engage himself as Registration Authority for obtaining Digital Signature Certificate for clients
- Can hold credit card of bank even if auditor of same bank but o/s balance shouldn't exceed 1L beyond prescribed credit period limit
- CA can act as mediator in Court
- Can't accept audit of bank if taken loan against FD
- CAiP can't become Financial Advisors & receive fees/commission from Financial Institutions such as Mutual Funds, Insurance cos, NBFCs
- Can't exercise lien over client docs for non-payment of fees
- Not permissible to print vision or values behind visiting cards as it'd result in solicitation & thus violative of Clause 6 of First Schedule of CA Act 1949
- Not permissible to take agencies of UTI, GIC & NSDL
- Permissible to be settlor of a trust (provides property to beneficiary)
- CAiP can't hold customs broker license
- CA in employment can appear as Tax representative before tax authorities on behalf of employer but not for other employees of that employer
- Stat auditor of bank can't do stock/inspection audit of such bank for same FY
- Internal auditor of PF trust of Govt Co. can't be stat auditor
- Concurrent auditor of bank X can't be stat auditor of bank Y which is sponsored by X
- CA/ CA firm can act as internal auditor of Co & stat auditor of its EPF [not vice-versa]

Disciplinary Proceedings



If not found guilty → Matter closed

Appeal: Can be made by member or Director (Discipline) within 90 days → Appellate Authority

Orders possible:

Confirm, modify or set aside order	Remit case to BOD/DC to reconsider
Impose, set aside, reduce or enhance penalty	Such order it thinks fit

Non-Compliance with Laws and Regulations (NOCLAR)

NOCLAR comprises acts of omission or commission, intentional or unintentional contrary to prevailing laws or regulations committed by:

- a client/professional accountant's employer
- or TCWG or Mgt of client/employer or
- other individuals working for or under direction of a client/ employing organization.

Examples of Laws & Regulations

Fraud, corruption and bribery.	Money laundering, terrorist financing and proceeds of crime.	Environmental protection.
Banking and other financial products and services.	Data protection.	Public health and safety.
Securities markets and trading.	Tax and pension liabilities and payments.	

Some important facts about NOCLAR are given below:

- Expertise of Laws not Required: Expected to apply knowledge & expertise & exercise professional judgment.
- Certain Matters Expressly out of Purview: Matters clearly insignificant, or relating to personal misconduct unrelated to business of client not covered.
- Disclosure, which is Contrary to Law not Required

Applicability of NOCLAR in India

- IESBA Code of Ethics makes NOCLAR applicable to all assignments (members in practice) and to all employers (members in service).
- ICAI Code has restricted applicability of NOCLAR to
  - CAiP: Audit engg. of entities listed on RSE in India having net worth >= 250 cr &
  - Members in service: Senior Professional Accountants (KMP) in service, being employees of listed entities.

Steps to be taken for responding

1. Obtain Understanding of Matter	5. Determining whether to disclose to Appropriate Authority
2. Addressing matter	
3. Seeking advice	6. Imminent Breach
4. Determining if further action needed	7. Documentation

Documentation Requirements in NOCLAR: Revised Code over and above require professional accountant to follow additional documents requirements as under:

- How management / TCWG responded to the matter.
- Course of action accountant considered, judgments made and decisions that were taken, having regard to reasonable and informed third party test.
- How accountant is satisfied that responsibility of public interest has been fulfilled.

NOCLAR vs. SA 250

Coverage of Laws

1. SA 250 is applicable only on Audit, & not on other Assurance engagements. However, NOCLAR is applicable on professional accountants in service, and in practice.
2. SA 250 talks of auditor's responsibilities for
   - ✓ laws having direct effect on determination of material amounts and disclosures in F.S. (such as tax and labour laws); and
   - ✓ other laws and regulations that don't have direct effect on determination of amounts and disclosures in F.S., but compliance with which may be fundamental to business.

NOCLAR, while being alike to SA 250 till this point, is further ahead of it in that it takes into account non-compliance that causes substantial harm resulting in serious consequences in financial or non-financial terms.

3. SA 250 doesn't define stakeholders. NOCLAR is related to affect of non-compliance on investors, creditors, employees as also the general public.

4. As per NOCLAR, in exceptional circumstances, professional accountant might become aware of imminent breach of a L/R that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with mgt or TCWG of Co., accountant shall exercise professional judgment & determine whether to disclose matter immediately to appropriate authority to prevent or mitigate consequences of such imminent breach. If disclosure is made, that disclosure is permitted. This provision is not existent in SA 250.

Summary ☺

First Schedule	
Part I	Professional misconduct in relation to Chartered Accountants in practice
	A CAiP is deemed to be guilty of professional misconductif he:
Clause (1)	allows any person to practice in his name as a CA unless such person is also a CAiP & 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 fees or profits of his professional business, to any person other than a member of Institute or partner or retired partner or legal representative ofa deceased partner, or member of any other professional body or with such other prescribed qualification, for purpose of rendering such professional services from time to time in or outside India
Clause (3)	accepts or agrees to accept any part of profits of professional work of a person who is not a member of Institute
Clause (4)	enters into partnership, in or outside India, with any person other then CAiP or such other person who is a member of any other professional body having such qualificationsas may be prescribed, including a resident who but for his residence abroad would beentitled to be registered as a member under clause (V) of sub-section (1) of section 4 or whose qualifications are recognized by CG or Council for purpose of permitting such partnerships
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 toa Chartered Accountant, any professional business. Provided that nothing herein contained shall be construed as prohibiting any agreement permitted in terms of 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. Provided that nothing herein contained shall be construed as preventing or prohibiting: (i) Any CA from applying or requesting for or inviting or securing professional work from another CAiP or (ii) A member from responding to tenders or enquiries issued by various users of professional services or organizations from time to time and securing professional work as a concequence. However, as per Council Guidelines, CAiP shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for CAs, such as audit and attestation services. [Exception: Minimum fees]
Clause (7)	➢ Advertises his professional attainments or services, or ➢ uses any designation or expressions other than CA on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a University est. by law in India or recognized by the CG or title indicating membership of ICAI or of any other institution that has been recognized by the CG or may be recognized by Council. CAiP may advertise through a write up, setting out service provided by him or firm and particulars of his firm subject to such guidelines as issued by Council.
Clause (8)	Accepts a position as auditor previously held by another CA or a certified auditor who has been Issued certificate under Restricted Certificate Rules, 1932 without first communicating with him in writing.
Clause (9)	accepts appointment as auditor of a Co. without first ascertaining whether requirements of Sec 139 and 140 of Cos. Act, 2013, in respect of such appointment have been duly complied with.
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 contingent upon findings, or results of such employment, except as permitted under Regulation 192 [CRV Fund Mgt Services + IP + Non-Non]
Clause (11)	Engages in any business or occupation other than profession of CA unless permitted by Council to engage. Provided that nothing contained herein shall disentitle a CA from being a director of a company (Not being managing director or a whole time director) unless he or any of his partners is interested in such company as auditor Trivia: CAiP can become MD of a Co. When?
Clause (12)	Allows a person not being a member of ICAI in practice or a member not being his partner to sign on his behalf or his firm, any BS, P&L a/c, report or F.S.
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 guiltyof professional misconduct, if he being an employee of any company, firm or person:

Clause (1)	pays or allows or agrees to pay directly or indirectly to any person any share in the emoluments of employment undertaken by him.
Clause(2)	accepts or agrees to accept any part of fees, profits or gains from a lawyer, a CA orbroker engaged by such Co, firm or person or agent or customer of such Co, firm or person by way of commission or gratification.
Part III	Professional misconduct in relation to members of the Institute generally
	A member of the Institute, whether in practice or not, shall be deemed to be guilty ofprofessional misconduct, if he:
Clause (1)	not being a fellow of Institute, acts as a fellow of the Institute.
Clause(2)	doesn't supply information called for, or does not comply with requirements asked for, by Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority.
Clause(3)	while inviting professional work from another CA or while responding to tenders or enquiries or while advertising through a write up, or anything as provided for in items (6) and (7) of Part I of this Schedule, gives info. knowing it to be false.
Part IV	Other misconduct in relation to members of the Institute generally
	A member of the Institute, whether in practice or not, shall be deemed to be guilty ofother 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 not exceeding six months.
Clause (2)	in opinion of Council, brings disrepute to profession or Institute as a result of his action whether or not related to his professional work.
	Second Schedule
Part I	Professional misconduct in relation to chartered Accountant in practice
Clause (1)	Discloses information acquired in course of his professional engagement to any person other than his client so engaging him without consent of his client or otherwise than as required by any law for time being in force.
Clause (2)	If he certifies or submits in his name or in name of his firm, a report of an examination of F.S. unless examination of such statements and related records has been made by him or by a partner or an employee in his firm or by another CAiP.
Clause (3)	Permits his name or name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in manner which may lead to belief that he vouches for the accuracy of forecast.
Clause (4)	Expresses his opinion on F.S. of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.
Clause (5)	Fails to disclose a material fact known to him which is not disclosed in a F.S., but disclosure of which is necessary in making such F.S. not misleading where he is concerned with that F.S. in a professional capacity.
Clause (6)	Fails to report a M.M. known to him to appear in a F.S. with which he is concerned in a professional capacity.

Clause (7)	Doesn't exercise due diligence, or is grossly negligent in conduct of professional duties.
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 opinion.
Clause (9)	Fails to invite attention to any material departure from generally accepted procedure of audit [GAPA] applicable to the circumstances.
Clause(10)	Fails to keep moneys of his client other than fees or remuneration or money meant to be expended in separate banking a/c or to use such moneys for purposes for which they are intended within a reasonable time.
Part II	Professional misconduct in relation to members of the Institute generally
	A member of the Institute, whether in practice or not, shall be deemed to be guilty ofprofessional misconduct, if he:
Clause (1)	contravenes any of provisions of this Act or regulations made there under or any guidelines issued by the Council.

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
Clause (4)	Defalcates or embezzles money received in his professional capacity.
Part III	Other misconduct in relation to members of the Institute generally
	A member of ICAI, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding 6 months.

"Positive thinking blesses us with positive results"

CHAPTER 03

Audit Planning



Benefits of Planning an Audit

i) Attention to Important areas
ii) Timely resolution of Potential Problems
iii) Proper Organisation and Management of Audit Engagement
iv) Proper Selection of Engagement Team
v) Direction and Supervision of Engagement Team
vi) Easy Coordination in work done by auditors of components and experts

Nature & Extent of Planning

i. Size & complexity of the auditee: If large, then more planning activities would be required as compared to entity whose size and complexity is small.
ii. Past experience & expertise: Also contributes towards variation in planning activities
iii. Change in circumstances

Reasons for → Changes to planning decisions

i) Result of unexpected events	ii) Changes in Conditions	iii) Audit evidence obtained from results of audit procedures

Auditor should revise NTE of F.A.P based on revised consideration of assessed Risk.

Planning - A Continuous Process

Planning is not discrete phase of audit but rather continual & iterative process. It begins shortly after completion of previous audit & continues until completion of current audit. It includes consideration of timing of certain activities & audit procedures. Also involves Audit Programming.

Planning includes need to consider such matters as:

- Analytical procedures to be applied as risk assessment procedures.
- Obtaining general understanding of legal and regulatory framework applicable to entity and how entity is complying with that framework.
- Determination of materiality.
- Involvement of experts.
- Performance of other risk assessment procedures.

Additional Matters for Initial Audit

As per SA 300, for initial audits, additional matters auditor may consider include following:

- Unless prohibited by law, arrangements with predecessor auditor, for eg, review of working papers.
- Any major issues (including application of a/c principles or auditing & reporting stds) discussed with mgt, TCWG & how these matters affect overall audit strategy & plan.
- Audit procedures necessary to obtain SAAE regarding opening balances (as per SA 510).

- Other procedures required by firm's system of quality control for initial audit engg (for eg, involvement of another partner or senior individual to review overall audit strategy prior to commencing significant audit procedures or review reports prior to their issuance).

Contents of Audit Plan

i. NTE of Risk Assessment Procedures (RAP) under SA 315
ii. NTE of Further Audit Procedures (FAP) under SA 330
iii. Other planned audit procedures to comply with SAs

- Audit plan is more detailed than overall strategy that includes NTE of audit procedures.
- Planning for procedures takes place over audit as plan for engagement develops.
  - ✓ Planning of auditor's RAP occurs early in audit process.
  - ✓ However, planning NTE of specific F.A.P depends on outcome of those R.A.P.
  - ✓ In addition, auditor may begin execution of F.A.P for some ABCD before planning remaining F.A.P.

Relationship between Overall Audit Strategy and Audit Plan

- Audit strategy is prepared before audit plan.
- Audit plan is more detailed than overall audit strategy.
- Audit strategy and audit plan are inter-related because change in one would result in change in other.
- Audit strategy provides guidelines for developing audit plan.
- It establishes scope & conduct of audit procedures & works as basis for developing detailed audit plan.
- Detailed audit plan would include NTE of audit procedures to obtain SAAE.

Overall audit strategy

a. Identify characteristics of engagement that define its scope
b. Ascertain reporting objectives of engagement to plan timing of audit and nature of communications required
c. Consider factors that, in auditor's professional judgment, are significant in directing engg. team's efforts
d. Consider results of preliminary engagement activities and, whether knowledge gained on other engagements performed by engagement partner for entity is relevant and
e. Ascertain NTE of resources necessary to perform engg.

Benefits of overall audit strategy

i. Employment of qualitative resources: Use of experienced team personnel for high risk areas & involvement of experts on complex matters
ii. Allocation of quantity of resources: Amount of resources allocated for each area
iii. Timing of deployment of resources: When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates

iv. Mgt of resources: how resources are managed, directed & supervised

Considerations in Establishing Overall Audit Strategy

Examples of matters that auditor may consider:

a. Characteristics of the engagement
- Financial Reporting Framework
- Industry specific reporting requirements
- Expected audit coverage (no. & locations of components)
- Nature of control relationships b/w parent & components
- Extent to which components audited by other auditors

b. Reporting Objectives, Timing of the Audit, and Nature of Communications
- Entity's timetable for reporting.
- Organization of meetings with mgt regarding audit work
- Discussion with mgt regarding type and timing of reports to be issued.
- Discussion with mgt regarding communications on status of audit work.
- Communication with auditors of components regarding types and timing of reports to be issued.
- Nature and timing of communications among engg team members.

c. Significant factors , Preliminary engagement acts & knowledge gained on other audits
- Determine materiality SA 320
- Areas with high ROMM
- Impact of assessed ROMM at F.S. level on direction, supervision & review (DSR)
- Evidence of mgt commitment to DIM of I.C.
- Volume of transactions that determine reliance on Internal Control
- Imp. Attached to IC

Documenting audit plan

Auditor shall document:

a. Record of key decisions (Audit strategy to plan audit & communicate significant matters to engg. team)

b. Record of NTE of R.AP. & additional audit procedures at assertion level in response to assessed risk (Audit plan)

c. Record of reasons of change in audit plans & audit strategy, explaining reasons for change & strategy & plan finally adopted.

Audit Programme (Allocate work to team members)

Important matters that need to be considered are:

a. Nature of business in which org. is engaged : Draw up audit programme after considering technical, financial and accounting set-up of Co.

b. Overall plan: Framework provided under overall plan should be strictly adhered to.

c. System of Internal controls & accounting procedures: Study and evaluation of internal control helps auditor to establish reliance he can place on internal controls in determining NTE of substantive auditing procedures.

d. Size of organisation & mgt structure: Increase in size of organisation enhances complexity of examination of it's a/c records.

e. Accounting & management policies: Check F.S. of PY to see of a/c policies have been followed consistently.

Circumstances requiring alteration of Audit Program (A/P)

- Audit procedures designed for certain level of turnover & volume increased substantially. Also, when significant changes in accounting organisation, procedures & personnel subsequent to audit procedure
- Internal Control not as effective as assumed when A/P framed
- Extraordinary increase in book debts or stock compared to PY
- Suspicion aroused in course of audit or info recd that Assets misappropriated

Key Phases in Audit execution

- Execution Planning : Auditors need to plan work to audit in effective, efficient and timely manner.
- Risk & Control Evaluation: For each segment of audit, conduct a detailed risk and control assessment i.e. list risks that must be reviewed, capture for each risk controls that exist and show for each control, work steps required to test effectiveness of controls.
- Testing: Test effectiveness of controls to determine whether controls are operating as designed.
- Reporting: Report as per SA 700. Auditor should review and assess conclusions drawn from audit evidence obtained as basis for expression of opinion on F.S.

Examples of Audit Programs

Movie Theatre Complex

i. Peruse the MOA and AOA of the entity.

ii. Ensure object clause permits entity to engage in this type of business.

iii. In case of income from sale of tickets:

- ✓ Verify control system as to how it is ensured that collections on sale of tickets of various shows are properly accounted.
- ✓ Verify system of online booking of various shows and the system of realization of money.



- ✓ Check that there is overall system of reconciliation of collections with no. of seats available for different shows on a day.

iv. Verify internal control system and its effectiveness relating to income from café, shops, pubs, game zone etc., located within the multiplex.

v. Verify system of control exercised relating to income receivable from advertisements exhibited within premises and inside the hall such as hoarding, banners, slides, short films etc.

vi. Verify the system of collection from parking areas in respect of vehicles parked by customers.

vii. Verify payment of salaries and other benefits to employees and compliance with statutory requirements.

viii. Verify payments effected in respect of maintenance of building and ensure same is in order.

ix. Verify insurance premium paid and ensure it covers entire assets.

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Identification & Verification of Plant & Machinery, tools & dies to check Obsolescence

i. Internal Control Aspects: Following should be checked in internal control aspects-

a. Maintaining separate register for hired, leased and jointly owned assets.
b. Maintaining register of fixed asset and reconciling to physical inspection and nominal ledger.
c. All movements of assets are accurately recorded.
d. Authorisation be obtained for -
   i. declaring a fixed asset scrapped.
   ii. selling a fixed asset.
e. Check whether additions to fixed asset register are verified and checked by authorised person.
f. Proper recording of all additions and disposal.

ii. Assets Register: To review registers & records of plant, machinery, etc. showing clearly date of purchase of assets, cost price, location, depreciation charged, etc.

iii. Cost Report and Journal Register: To review cost relating to each plant and machinery and verify items which have been capitalised.

iv. Code Register: To see that each item of plant and machinery has been given a distinct code number to facilitate identification and verify maintenance of Code Register.

v. Physical Verification: To see physical verification has been conducted at frequent intervals.

vi. Movement Register: To verify

a. whether Movement Register for movable equipments &
b. log books in case of vehicles, etc. are being maintained properly.

vii. Assets Disposal Register: To review whether assets have been disposed off after proper technical & financial advice & sales/disposaletc. of these assets governed by authorisation, sales memos etc

If M.O.M increase in Wastage ➔ Audit Plan to locate wastage of Raw Material

i. Procure list of raw materials, showing names & detailed characteristics of each raw material.

ii. Obtain standard consumption figures, and ascertain basis which normal wastage figures have been worked out. Examine break-up of normal wastage into process, storage and handling stages.

iii. Examine various records maintained for recording various lots purchased and identification of each lot with actual material consumption and ascertaining actual wastage figures therein.

iv. Obtain reports of Preventive Maintenance Programme of machinery to ensure that quality of goods manufactured is not of sub-standard nature or leads to high scrappage work.

v. Assess whether personnel employed are properly trained and working efficiently.

vi. See whether quality control techniques have been consistent or have undergone any change.

vii. Examine whether basis adopted for calculating wastage for the month is same as earlier months.

viii. Obtain a statement showing break up of wastage figures in storage, handling and process for months under reference & compare results of analysis for each of the months.

"If you can Dream it, you can Do it"

CHAPTER 04

Risk Assessment & Internal Control

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Audit risk components

1. Inherent Risk
   - Susceptibility of assertion to misstatement that could be material, assuming there are no related controls. Inherent risk is addressed at both F.S. level and assertion level.
   - For eg, technological developments making product obsolete, causing inventory susceptible to overstatement.
   - Arise from entity's size, operations, complexity, objectives & regulatory environment.

Risks of particular concern to auditor might include:



⇒ Complex calculations which could be misstated
⇒ High value inventory
⇒ Accounting estimates subject to significant measurement uncertainty
⇒ Lack of sufficient working capital to continue operations
⇒ A declining or volatile industry with many business failures

2. Control Risk (Do internal controls in place mitigate inherent risk)
   - Risk that entity's IC system will not prevent, or detect and correct on a timely basis, misstatement that could be material, individually or when aggregated with other misstatements.
   - Some control risk will always exist because of inherent limitations of any IC system.
   - Auditor reqd to understand entity's IC & perform procedures to assess RoMM at assertion level.

3. Detection Risk
   - Risk that auditor will not detect a misstatement that exists in an assertion that could be material, either individually or when aggregated with other misstatements.
   - Acceptable level of detection risk for given level of audit risk bears inverse relationship to ROMM at assertion level.

Audit Risk = RMM * Detection Risk
RMM = Risk that MM may exist in FS before start of audit i.e Inherent Risk * Control risk

Steps for Risk Identification

- Assess significance of assessed risk, impact of occurrence, & revise materiality for specific a/c balance
- Likelihood of occurrence and impact on audit procedures
- Document assertions affected
- Impact of risk on each of assertions Completeness, Existence, Accuracy, Valuation, Validity, Presentation relevant to a/c balance, COT & disclosure
- Consider Internal Control in place & effectiveness in mitigating risk involved.



Indicators of Possible Potential Misstatements

⇒ Completeness

- Transaction not identified
- Source doc not prepared/captured/represented

⇒ Existence

- Fictitious or unauthorised transactions entered
- Source document → duplicate or overstated
- Transactions duplicated

⇒ Recording

Inaccurate

- Capturing of source document
- Processing of transactions
- Adjustments in subsy ledger

⇒ Cut-off Procedures

Transactions that occur in a period are recorded in another period.

Audit Procedures in case Purchases are made without POs

During process of extracting exception reports, auditors noted numerous purchase entries without valid purchase orders.

Analysis: In terms of percentage, about 40% of purchases were made without valid POs and also few POs were validated after actual purchase. Also there was no reconciliation between goods received & goods ordered.

Assertions: Validity of purchases

Pervasive/Account Balance Level: Account Balance level

Account Balance(s) affected : (i) Purchases, (ii) Account Payable

Audit Procedures:

- Make a selection of purchases, review correspondence with vendors, purchase requisitions (internal document) and reconciliations of their accounts.
- Review Vendor listing along with ageing details. Follow up material amounts paid before normal credit period and analyse reasons for exceptions.
- Meet with company's Purchase officer and obtain responses to our inquiries regarding purchases made without POs.
- Discuss summary of such issues with client.

Steps in Conduct of Risk based Audit (3 key steps)

1. Assessing ROMM in the FS
2. Designing & performing FAP that respond to assessed risk & reduce it to acceptably low level
3. Issuing Audit report based on audit findings.

Explanation:

1. Risk Assessment: Assessing ROMM in F.S.
   - ✓ Performing client acceptance or continuance procedures
   - ✓ Planning the overall engagement
   - ✓ Performing risk assessment procedures (RAP) to understand the business and identify inherent and control risks
   - ✓ Identifying relevant internal control procedures and assessing their design and implementation (those controls that would prevent material misstatements from occurring or detect and correct misstatements after they have occurred)
   - ✓ Assessing the RoMM in the F.S.
   - ✓ Identifying significant risks that require spl consideration
   - ✓ Communicating material weakness in Design & Implementation of IC → TCWG + Mgt

2. Risk response: Designing and performing F.A.P that respond to assessed risks and reduce RoMM in F.S. to an acceptably low level

   Some of the matters auditor should consider when planning audit procedures include:

   - ✓ Assertions that cannot be addressed by substantive procedures alone. Eg. highly automated processing of transactions with little or no manual intervention. [Substantive not enough]
   - ✓ Existence of internal control that, if tested, could reduce need/scope for other substantive procedures. [Reduce substantive]
   - ✓ Potential for substantive analytical procedures that would reduce the need/scope for other types of procedures. [Analytics]
   - ✓ Need to incorporate an element of unpredictability in procedures performed. [Surprise checks]
   - ✓ Need to perform further audit procedures to address potential for management override of controls or other fraud scenarios. [FAPs]
   - ✓ Need to perform specific procedures to address "significant risks" that have been identified.

3. Reporting: Issuing an appropriate audit report based on the audit findings

Internal Control

Objectives of internal controls relating to accounting system are:

i. Transactions are executed through general or specific management authorization.

ii. All transactions are promptly recorded in an appropriate manner to permit the preparation of financial information and to maintain accountability of assets.

iii. Assets and records are safeguarded from unauthorized access, use or disposition.

iv. Assets are verified at reasonable intervals and appropriate action is taken with regard to the discrepancies.

Basic Accounting Control Objectives which are sought to be achieved by any a/c control system are:
Whether all transactions are:

- ✓ recorded
- ✓ real
- ✓ properly valued
- ✓ recorded timely
- ✓ properly posted
- ✓ properly classified and disclosed
- ✓ properly summarized

Limitations of Internal Control

- ✓ Mgt consideration that cost doesn't exceed benefit derived from it
- ✓ Most IC not directed at transactions of unusual nature. Also, there's potential of human error.
- ✓ Possibility of circumvention of IC through collusion with employees or 3rd parties
- ✓ Person responsible for exercising IC could abuse responsibility e.g. mgt override of IC
- ✓ Manipulation by mgt w.r.t transactions/estimates & judgements in preparation of F.S.

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Structure of Internal Control [Coverage of Policies & Procedures]

1. Segregation of Duties: Following functions are segregated:
   a) Authorisation of transactions
   b) Execution of transactions
   c) Physical custody of related assets
   d) Maintenance of records & documents

   Periodic rotation of duties is also desirable.

2. Authorisation of transactions: Establish procedures that authorizations are issued by persons acting within scope of authority and transactions confirm to terms of authorizations.

3. Adequacy of records & documents (same points as objectives of IC)

4. Accountability & safeguarding of assets
   - ✓ Assets like cash, inventories, investment scrips require frequent physical verification with books
   - ✓ Assets considered sensitive & susceptible to error need to be reconciled more frequently



- ✓ Only authorised personnel should be given access to asset
- ✓ Effective controls over physical custody of cash, inventories, investments & other fixed assets.

5. Independent checks by external auditor

Components of Internal control [Checking adequacy of Internal Control]

Control Environment >> Risk Assess Process >> Control Activities >> Info. System >> Monitoring

1. Control Environment Elements:

a. Communication & enforcement of integrity & ethical values: It includes mgt actions to eliminate or mitigate incentives that prompt personnel to engage in dishonest, illegal, or unethical acts. Communication of behavioural stds through policy statements & codes of conduct & by example.

b. Commitment to competence: Knowledge and skills to accomplish tasks that define individual's job

c. Participation by TCWG: Oversight of design & effective operation of whistle blower procedures and process for reviewing effectiveness of entity's IC.

d. Mgt philosophy & operating style: Mgt's attitudes & actions toward financial reporting is conveyed through conservative or aggressive selection from available alternative a/c principles, or conscientiousness and conservatism with which a/c estimates are developed.

e. Org structure: Includes considering key areas of authority and responsibility and appropriate lines of reporting. Appropriateness of org. structure depends on its size and nature of activities.

f. Assignment of authority & responsibility: Policies relating to appt. business practices, knowledge and experience of key personnel, and resources for carrying out duties. Ensuring all personnel understand entity's objectives, know how their actions interrelate & contribute to those objectives, & recognize how & for what they will be held accountable.

Integrity & ethics + Competence → TCWG + Mgt → Org Structure + Authority & Responsibility

2. Entity's Risk Assessment Procedures
   - i. Define business objectives & goals
   - ii. Identify events that may affect achievement of business objectives
   - iii. Assess likelihood & impact
   - iv. Respond & mitigate risk
   - v. Assess residual risk

Risk can arise or change due to certain circumstances

a) New technology: Incorporating new technologies into production processes or info. systems may change the risk associated with internal control.

b) New or revamped info. Systems: Significant and rapid changes in information systems can change the risk relating to internal control.

c) New personnel: New personnel may have a different focus on or understanding of internal control.

d) Rapid growth: Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.

e) Changes in operating environment: Can result in changes in competitive pressures and significantly different risks.

f) Corporate restructurings: Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may change the risk associated with internal control.

g) New a/c pronouncements: Adoption of new accounting principles or changing accounting principles may affect risks in preparing financial statements.

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Control Activities

a. Performance Reviews: Review & analysis of Actual performance vs budgets, forecasts and prior period performance.

b. Info. Processing: Two categories of info. system control activities are General IT Controls and Application controls

c. Physical Controls:
- ✓ Physical security of assets
- ✓ Authorisation for access to computer prog. & data files
- ✓ Periodic counting and comparison with amounts shown on control records. For eg. Comparing results of cash, inventory & security counts with a/c records)

d. Segregation of duties: Assigning different people responsibilities of authorising, recording and maintaining custody of assets.

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Internal Check System

Following are objectives of internal check system:

i. To detect error and frauds with ease.
ii. To avoid and minimize possibility of commission of errors and fraud by any staff.
iii. To locate responsibility area or stages where actual fraud and error occurs.
iv. To increase efficiency of the staff working within the organization.
v. To protect integrity of business by ensuring a/cs are always subject to proper scrutiny and check.
vi. To prevent and avoid misappropriation or embezzlement of cash and falsification of accounts.

Effectiveness of Internal Check depends on following considerations:

i. Clarity of responsibility: Resp of different ppl properly defined
ii. Division of work: Segregation of work to ensure free flow & job rotation
iii. Standardisation: Process of accounting should be standardised
iv. Appraisal: Periodic review of chain of operations & work flow.

Eg. BSF Limited is engaged in business of trading leather goods. You are internal auditor of company for year 2019-20. In order to review internal controls of the Sales Department of company, you visited and noticed work division as follows:

(1) An officer was handling the sales ledger and cash receipts.
(2) Another official was handling dispatch of goods and issuance of Delivery challans.
(3) One more officer was there to handle customer/ debtor accounts and issue of receipts.

As an internal auditor, you are required to briefly discuss the general condition pertaining to the internal check prevalent in internal control system. Do you think that there was proper division of work in BSF Limited? If not, why?

General condition pertaining to the internal check system may be summarized as under:

i. No complete control: no single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.
ii. Job rotation: Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.
iii. Leave once in a year: Every member of the staff should be encouraged to go on leave at least once a year.
iv. No access to books: Person with physical custody no access to books
v. A/c control for each class of asset: There should be accounting control for each class of asset, in addition, there should be periodical inspection so as to establish their physical condition.
vi. Budgetary controls: Budgetary control should be exercised and wide deviations observed should be reconciled.

vii. Mechanical devices to prevent misappropriation of cash

viii. Inventory counts, activities stopped & involve staff from different sections : For inventory taking, at close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of organization.

In given scenario, Co. has not done proper division of work as:

i) receipts of cash should not be handled by official handling sales ledger and

ii) delivery challans verified by authorised official other than officer handling despatch of goods.

Manual elements in internal control may be more suitable where judgment and discretion are required such as for following circumstances:

- ✓ Large, unusual or non-recurring transactions.
- ✓ Circumstances where errors are difficult to define, anticipate or predict.
- ✓ In changing circumstances that require control response outside the scope of an existing automated control.
- ✓ In monitoring the effectiveness of automated controls.

Standard Operating Procedures (SOPs)

1. Enterprise Risk Mgt: Org should have robust process to identify & mitigate risks
2. Segregation of Job Responsibilities: No 2 commercial activities be conducted by 1 person.
3. Job rotation in sensitive areas: A job carried by person for long may lead to complacency & misuse
4. Delegation of financial powers document: Document delegation of powers to allow controls to operate
5. IT based controls: Embed controls within system instead of being dependent on humans.

Basic Assumptions about a Good Internal Control Questionnaire

In use of standardized internal control questionnaire, certain basic assumptions about elements of good control are taken into account.

These are -

i. Certain procedures in general used by most business concerns are essential in achieving reliable internal control. Eg daily banking of receipts or balancing of cash book or periodic reconciliations

ii. Division of duties & responsibilities

iii. Employees with custodian function not assigned accounting function

iv. No single person thrust of completing a transaction all by himself

v. Work performed by one reviewed by another

vi. Proper documentation & recording of transactions

Flow chart depiction of flow of documents:

i. at what point a document is raised internally or received from external sources
ii. no. of copies in which a document is raised or received
iii. intermediate stages set sequentially through which the document and the activity pass
iv. distribution of the documents to various sections, department or operations
v. checking authorisation and matching at relevant stages
vi. filing of the documents and
vii. final disposal by sending out or destruction.

Material Weakness

Material weaknesses are defined as absence of adequate controls on flow of transactions that increases possibility of errors and frauds in F.S. of entity.

Important points with regard to such a letter are as follows:

a. Letter lists down areas of weaknesses in system and offers suggestions for improvement.
b. It should clearly indicate that it discusses only weaknesses which have come to attention of auditor as a result of his audit and examination has not been designed to determine adequacy of IC for mgt.
c. This letter serves as a valuable reference document for mgt for purpose of revising system and insisting on its strict implementation.
d. Letter may also serve to minimize legal liability in event of a major defalcation or other loss resulting from a weakness in IC.

Areas of weakness >> Attention >> Valuable ref. doc >> Min legal liability

Case Study on Internal Control: Entertainment Centres

Y Co. Ltd. has 5 entertainment centres to provide recreational facilities for public especially for children and youngsters at 5 different locations in peripheral of 200 km. Collections are made in cash. Specify the adequate system towards collection of money.

To achieve proper control over sale of tickets and collection, following system should be adopted -

a. Printing of tickets: Serially numbered pre-printed tickets should be used & designed in such a way that any type of ticket used cannot be duplicated by others in order to avoid forgery.
b. Ticket sales: Sale of tickets from Central ticket office at each of 5 centres, preferably through machines. There should be proper control over the keys of the machines.
c. Daily cash reconciliation: Cash collected at each office should be reconciled with no. of tkts sold.
d. Daily banking: Each day's collection should be deposited in bank on next working day of bank. Cash should be in custody of properly authorized person preferably in joint custody.
e. Entrance ticket: Entrance tkts should be cancelled at entrance gate when public enters centre.
f. Advance booking: If advance booking facility is available, system should ensure all advance booked tkts are paid for.



g. Discounts and free pass: Discount policy such that concessional rates, say, for group booking should be properly authorized and signed forms for such authorization should be preserved.
h. Surprise checks: Internal audit system should carry out periodic surprise checks for cash counts, daily banking, reconciliation and stock of unsold tickets etc.

International Internal Control Frameworks

COSO Framework [Internal Control - Integrated Framework issued by Committee of Sponsoring Organisations of the Treadway Commission]

Components of Internal Control: Control Environment, Risk Assessment, Control Activities, Information & Communication, Monitoring

3 categories of objectives:

a. Operating objectives: effectiveness & efficiency of operations
b. Reporting objectives: internal & external financial & non-financial reporting to stakeholders
c. Compliance objectives: compliance with laws & regulations

CoCo Framework (Issued by Canadian Institute of Chartered Accountants)

It outlines criteria for effective control in the following 4 areas:

1.Purpose 2. Commitment 3. Capability 4.Monitoring and Learning

COBIT Framework (Control Objectives for Information and Related Technology)

- ✓ COBIT has 34 high-level processes that cover 210 control objectives
- ✓ COBIT is used globally by all managers who are responsible for IT business processes.
- ✓ COBIT ensures quality, control and reliability (QCR) of information systems in organization, which is also most important aspect of every modern business.
- ✓ This framework guides an organization on how to use IT resources.
- ✓ Well-governed IT practices can assist businesses in complying with laws, regulations, and contractual arrangements.

Sarbanes Oxley Section 404

SEC rules and PCAOB standard require that:

- ✓ Mgt perform a formal assessment of its controls over financial reporting including tests that confirm design and operating effectiveness of controls.
- ✓ Mgt include in its annual report an assessment of ICFR.
- ✓ External auditors provide two opinions as part of a single integrated audit of Co:
- ✓ Independent opinion on effectiveness of system of ICFR.
- ✓ Traditional opinion on F.S.

"It's going to be hard, but Not impossible"

CHAPTER

05 Group Audits

Mandatory under Companies Act,2013

- Sec 129(3) → where Co. has one or more subsidiaries, including JVs & associates, its shall in addition to own FS prepare CFS of Co. & all its subsidiaries
- Sec 129(4) → Provisions relating to preparation, adoption & audit of FS of Holding Co. shall apply mutatis mutandis to CFS
- CFS shall be made as per Sched III & A/c standards
- CFS shall also be approved by BODs before signed on behalf of Board, along with its SFS & shall be laid before AGM of Co. with SFS.
- Co. shall also attach along with its FS, a separate statement containing salient features of FS of its subsidiary(ies) in Form AOC-1.
- Consolidation of FS of Co. shall be made as per provisions of Schedule III & applicable a/c standards.
- Co. which isn't required to prepare CFS as per a/c std, it shall be sufficient if it complies with provisions of CFS under Sched III

Requirement to prepare CFS doesn't apply if ALL following conditions met:

- Wholly or partially owned subsy & all its other members have been intimated in writing & for which Proof of Delivery is available with Co. & they don't object to Co. not presenting CFS
- Co. whose securities aren't listed or not in process of listing in any stock exchange (in or o/s India)
- Ultimate or intermediary holding Co. files CFS with Registrar in compliance with A/c stds

Note: An investment entity need not present CFS if it measures all its subsidiaries at Fair value through P&L [Ind AS 110]

Investment Entity is an entity that:

a. obtains funds from one or more investors for purpose of providing them with investment management services;

b. commits to its investor(s) that business purpose is to invest funds solely for returns from capital appreciation, investment income, or both and

c. measures and evaluates performance of substantially all of investments on fair value basis.

Note: Parent of Investment entity shall prepare CFS unless it's also an Investment entity.

Example: Parent Ltd acquired 51% shares of Child Ltd during year ended 31.3.24. During FY 2024-25, 20% shares of Child Ltd were sold by Parent Ltd. Parent Ltd while preparing F.S. for year ended 31-3-24 and 31-3-25 did not consider F.S. of Child Ltd for consolidation. As a statutory auditor how would you deal with it?

As per Ind AS 110, there is no such exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant F.S.

However, as per sec 129(3) of Companies Act, 2013 where a Co. having subsidiary, which is not required to prepare CFS under applicable AS. It shall be sufficient if Co. complies with provisions of CFS provided in Schedule III to the Act.

Conclusion: In given case, Parent Ltd acquired 51% shares of Child Ltd during the year ended 31.03.23 and sold 20% shares during the year ended 31.03.24. Parent Ltd did not consolidate F.S. of Child Ltd for year ended 31.03.23 and 31.03.24. Intention of Parent Ltd is quite clear that control in Child Ltd is temporary as it disposed off acquired shares in next year of its purchase.
Parent Ltd is required to prepare CFS as per Ind AS 110 as exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" is not available under Ind AS 110. It states that "Consolidation of an investee shall begin from date investor obtains control of investee and cease when investor loses control of investee".

Responsibility of Parent

Preparation & presentation of CFS is responsibility of mgt of Parent.

a. identifying components, and including financial information of components to be included in the CFS
b. where appropriate, identifying reportable segments for segmental reporting
c. identifying related parties and related party transactions for reporting
d. obtaining accurate and complete financial information from components
e. making appropriate consolidation adjustments
f. harmonization of accounting policies and accounting framework &
g. GAAP conversion, where applicable

Identify components >> Consol Adj (Harmonisation + GAAP Conv.) >> Ind AS 24 +108

Auditor's objectives in audit of CFS

a. to satisfy that CFS have been prepared as per requirements of applicable FRF
b. to enable himself to express opinion on true and fair view presented by CFS
c. to enquire into matters specified in section 143(1) of Companies Act, 2013 and.
d. to report on matters given in clauses (a) to (i) of section 143(3) of Companies Act, 2013 for other matters under section 143(3)(j) read with rule 11 of the Companies (Audit and Auditors) Rules, 2014, to comment on the matters specified in sub-rule (a),(b),(c),(d), (e), (f) & (g) to extent applicable
e. Auditor should also validate requirement of preparation of CFS for company as per applicable FRF.

Auditor's considerations about Materiality in Audit of CFS

- Auditor is required to compute materiality for group as a whole. This materiality should be used to assess appropriateness of consolidation adjustments (i.e. permanent and current period consolidation adjustments) made by mgt in preparation of CFS.

- Parent auditor can also use group level materiality to determine whether component's FS are material to group to determine whether they should scope in additional components & consider using work of other auditors as applicable.
- Principal auditor also computes materiality for each component and communicates to component auditor, if he believes is required for true and fair view on CFS.
- Principal auditor also obtains certain confirmations from component auditor like independence, code of ethics, certain info required for consolidation and disclosure requirements etc.

Group Materiality → Audit CFS
Group Materiality → Determine material Components → Individual Components Materiality

Note: While considering observations i.e. Modification/EOM/OM para of component auditor in his report on SFS, concept of materiality will be considered. This is as per principles of SA 600.

Planning Audit of CFS

a. Understanding of group structure and group-wide controls including assessment of IT system & related general & applications IT related controls (manual and automated) for consolidation process
b. Understanding of accounting policies of parent and its components as well as of consolidation process including process of translation of F.S. of foreign components
c. Determining and programming NTE of audit procedures to be performed based on assessment of ROMM in consolidation process
d. Determining extent of use of other auditor's work in audit and
e. coordinating work to be performed.

Understanding [Group structure + A/c policies] → NTE of Audit Procedures → Use other auditor's Work → Coordinate

How Auditor ensures completeness of Components included in CFS?

a. review his working papers for prior years for known components
b. review parent's procedures for identification of various components
c. make inquiries of management to identify any new components or any component which goes out of consolidated financial statements
d. review investments of parent as well as its components to determine shareholding in other entities
e. review joint ventures and joint arrangements as applicable (JVs)
f. review other arrangements entered by parent that have not been included in CFS
g. Identify changes in shareholding that might have taken place during reporting period

PY w/p + Parent's Proc. >> Inquiry + Invest + JVs + Other Arrangements >> Changes in Shareholding

Permanent Consolidation Adjustments

- Adjustments are made on first occasion, or subsequently when there's change shareholding of entity which is consolidated.
- These are:
  - ✓ Determination of Goodwill or capital reserve as per AS
  - ✓ Determining equity attributable to Minority /Non-Controlling intt
- Auditor should verify above calculations:
  - ✓ Particular attention to determine pre-acquisition reserves of components. Date of investment is imp. in this regard.
  - ✓ Also check pre-acquisition reserves properly allocated between parent & minority/NCI
  - ✓ Also verify changes in permanent consolidation adj on account of subsequent acquisition or disposal of shares in components

Note: It may happen, in case of one subsy, its goodwill & in case of other Capital Reserve, parent may net off both & show single amt in B/Sheet as per FRF. Auditor should verify if gross amt of g/w & capital reserve shown in notes to CFS.

Current Period Consolidation Adjustment

These adjustments made in accounting period for which consolidation of F.S. is to be done.

These primarily relate to intra group transactions & a/c balances including:

i. Intra-group intt paid or recd
ii. Unrealized intra group profit on assets acquired/ trfd from /to other subsidiaries
iii. Record deferred tax on unrealized inter Co. profits elimination as per Ind AS 12
iv. Intra-group indebtness
v. Adj. to harmonizing different accounting policies being followed by Parent & its components
vi. Adjustments to recognize subsequent events or transactions that occur between balance sheet date & date of auditor's report on CFS of the Group
vii. Adj. for effects of significant transactions or events b/w date of component's balance sheet (not already recognized) & auditor's report on Group's CFS when components F.S. not drawn upto same B.S. date as parent
viii. Foreign component, adjustments to convert from Component's local GAAP to GAAP under which CFS are prepared

Note:
Difference between reporting dates of component f.s. & date of CFS should not be more than 6 months in case of F.S. under AS and 3 months in case of financial statements under Ind AS.

Following information is also reqd to be disclosed in CFS separately for parent and each of its components (including foreign component) which has been consolidated:
(i) amt of net assets and net assets as a percentage of consolidated net assets
(ii) amt of share in P&L and percentage of P&L as percentage of consolidated P&L
(iii) amount in OCI and percentage of OCI as a percentage of Consolidated OCI

Examples of info. which is given in SFS of parent or subsidiaries, need not be given in CFS

i. Source from which bonus shares are issued eg. Capitalization of profits or reserves or securities premium a/c
ii. Disclosure of unutilized monies out of issue indicating form in which they have been invested
iii. Disclosure under MSME Development Act 2006
iv. Value of imports on CIF basis by Co. during FY in respect of: [CIF → Cost Insurance Freight]
   a) Raw material
   b) Components & spare parts
   c) Capital Goods
v. Expenditure in forex during FY on account of Royalty, know how etc
vi. Value of imported Raw material, spare parts & components consumed & value of indigenous Raw Material, Spare Parts & Components consumed & percentage of each to total consumption.

Management Representations regarding CFS

a. Completeness of components included in the CFS
b. Identification of reportable segments for segmental reporting
c. Identification of related parties and related party transactions for reporting
d. Appropriateness and completeness of permanent and current period consolidation adjustments, including elimination of intra-group transactions.

Reporting

1. When Parent's Auditor is also Auditor of all its Components

- Auditor should report whether principles & procedures for preparation & presentation of CFS as per AS have been followed.
- In case of any departure or deviation, consider requirements given in SA 705 in audit report so that users are aware of such deviation.
- Auditor should issue an A/R expressing opinion whether CFS give true & fair view of state of affairs of Group as on BS date & whether consol. P&L gives true & fair view of results of consolidated P&L of Group for period under audit.
- Where CFS also include cash flow statement, auditor should also give his opinion on true & fair view of cash flows presented by consol. cash flow statements.

2. When the Parent's Auditor is not the Auditor of all its Components

- Auditor should consider requirement of SA 600.
- As per SA 706, if auditor makes reference to work of other auditor in his audit report on CFS, disclose clearly magnitude of portion of FS audited by other auditor.
- This may be done by stating aggregate amts, or percentage of total assets, revenues & cash flows included in CFS not audited by parent's auditor.
- Total assets, revenues and cash flows not audited by the parent's auditor should be presented before giving effect to permanent and current period consolidation adjustments.
- Reference in A/R that part of audit of group was made by other auditor(s) is not to be construed as qualification of opinion rather indication of divided responsibility between auditors of parent & its subsidiaries.

3. When Component(s) Auditor Reports on F.S. under an Accounting Framework Different than Parent

- Parent may have components located in multiple geographies o/s India applying a/c framework (GAAP) different from parent in preparing its FS.
- Foreign components prepare FS under different FRFs, which may be a well-known framework (Eg. US GAAP or IFRS) or local GAAP of jurisdiction of component. Local component auditors may be unable to report on FS prepared using parent's GAAP because of unfamiliarity with such GAAP.
- Parent's mgt performs conversion of component's audited F.S. to FRF for CFS.
- Conversion adjustments are audited by Principal Auditor.
- Component might prepare FS as per parent's a/c polices based on Group Accounting Manual
- Local component auditor can audit & issue report on component FS prepared as per Group a/c policies
- Parent auditor shall check if group a/c policies comply with GAAP applicable to Parent

4. Components not audited

- Generally, FS of all components included in CFS should be audited or subjected to audit procedures in context of a multi-location group audit. Such audits and audit procedures can be performed by auditor reporting on C.F.S or by components' auditor.
- Where FS of one or more components remain unaudited, auditor reporting on CFS should consider unaudited components in evaluating a possible modification to his report on CFS. The evaluation is necessary because the auditor has not been able to obtain SAAE in relation to such consolidated amounts/balances.
- In such cases, auditor should evaluate both qualitative and quantitative factors on possible effect of such amounts remaining unaudited when reporting on CFS using guidance provided in SA 705, "Modifications to Opinion in Independent Auditor's Report".

5. When Component(s) Auditor Reports under an Auditing Framework Different from Parent:

- Audits of FS, including CFS performed as per audit stds generally accepted in India (Indian GAAS).

- To maintain consistency of auditing framework & enable parent auditor to rely & refer to other auditor's audit report in their audit report on CFS, components' FS should also be audited under a framework that corresponds to Indian GAAS.

Consolidation Process as per AS/Ind AS

CFS as per AS

Subsidiaries	FS of parent & subsidiaries are combined on line-by-line basis by ✓ adding together like items of assets, liabilities, income, expenses & cash flows & ✓ then determine goodwill or capital reserve, ✓ minorities interest & ✓ adjustments like elimination of intra group transactions, balances & unrealised profits etc. are made as per AS 21, "CFS".
Associates	Use Equity Method in AS 23, "Accounting for Investments in Associates in CFS".
Joint Venture	Parent that has intt. in jointly controlled entity, reports its interest in CFS using proportionate consolidation method as per AS 27, "Financial Reporting of Interests in JVs".

CFS as per Ind AS

Subsidiaries	• FS of parent & its subsidiaries are combined as per Ind AS 110, "CFS" on a line-by-line basis by adding together like items of assets, liabilities, income, expenses and cash flows • related goodwill/ capital reserve (or gain on bargain purchase) & NCI is determined as per Ind AS 103 • adjustments like elimination of intra-group transactions, balances, unrealised profits & deferred tax etc. made as per Ind AS 110
Associates & JVs	Accounted using Equity Method prescribed in Ind AS 28, "Investments in Associates & Joint Ventures".
Joint Operation	Interests in assets, liabilities, revenues & expenses in a joint operation are accounted for as part of separate FS of entity as per Ind AS 111, "Joint Arrangements"
Common Control	Accounted using pooling of interest method as per Ind AS 103
In Stages	In a business combination achieved in stages, acquirer shall remeasure its previously held equity interest in acquiree at its acquisition-date fair value & recognise resulting gain or loss, if any, in P&L or OCI, as per Ind AS 103

"Push harder than Yesterday, if you want a Better Tomorrow"

CHAPTER 06

Bank Audit



Special Audit Considerations

Special audit considerations arise in audit of banks because of:

- Particular nature of risks associated with the transactions undertaken
- Scale of banking operations & resultant significant exposures which can arise in short period of time
- Extensive dependence on IT to process transactions
- Effect of the statutory and regulatory requirements
- Continuing development of new products & services & banking practices which may not be matched by concurrent development of a/c principles & auditing practices.
- Evolution of technology and providing services through Net Banking & Mobiles has exposed banks to huge operational & financial risk.

Legal Framework

Principal enactments governing functioning of bank are:

- ✓ Companies Act,2013,
- ✓ Banking Regulation Act, 1955,
- ✓ Prevention of Money Laundering Act, 2002,
- ✓ RBI Act 1934,
- ✓ SBI Act 1955,
- ✓ IT Act, 2000 etc.

Contents of Appointment Letter

Most banks appoint 4 or more CA firms as Statutory Central Auditors.

Appointment letter contains following:

- Period of appointment.
- Particulars of other central auditors
- Particulars of previous auditors.
- Procedural requirements to be complied with in accepting the assignment
- Statement of division of work & review & reporting amongst joint auditors for nationalised banks
- Scope of assignment which included spl certificates or reports to be given by CSAs
- Basis of computation of audit fee & scale of travel, related allowances & other expense reimbursement, if any.

Authority appointing the auditor:

- Banking Co. → Appointed at the AGM of the shareholders
- Nationalised bank → appointed by concerned bank acting through its BOD
- In either case, approval of RBI is required before appointment is made
- SBI → appointed by C&AG in consultation with CG
- Regional rural banks are to be appointed by concerned bank with approval of CG

Conduct of Audit

1. Initial Considerations
   - Acceptance & Continuance: Assessing engagement risk prior to acceptance.
   - Declaration of Indebtness: Written confirmation that credit facilities obtained by auditors & their family members have not been declared wilful defaulters by any bank/financial indebtness.
   - Internal Assignments: Not take stat audit if associated with internal audit assignment
   - Terms of Audit Engagements: As per SA 210, agree terms of engg before beginning fieldwork
   - Communication with Previous Auditor: As per Clause 8 of Part I of First Schedule of CA Act 1949
   - Planning: Documenting NTE of audit procedures & flexible to make changes
   - Establish Engagement Team: Qualified & experienced professionals to manage engg. risk

2. Understanding
   - Understanding the Bank and Its Environment including Internal Control
   - Understand Bank's Accounting Process
   - Understanding Risk Management Process
     - ✓ Oversight by TCWG: They should approve risk mgt policies consistent with bank's objectives, strategies, regulatory requirement etc
     - ✓ Identification, Measurement and Monitoring of Risks: Risks should be identified, measured & monitored against pre-approved limits & criteria
     - ✓ Control Activities: Segregation of duties, verification & approval of transns, physical security
     - ✓ Monitoring Activities: Conducted by independent risk mgt unit
     - ✓ Reliable information systems: That provide adequate compliance, financial & operational info

3. Risk Assessment
   - Identifying and assessing ROMM: As per SA 315, Identifying & assessing ROMM at F.S. level & assertion level for ABCD
   - Assess the risk of fraud including Money Laundering: As per SA 240, assess risk due to fraud
   - Assess specific risk: ROMM at F level relating to banking industry & use of IT
   - Risk of outsourcing activities: Used for reducing costs as well as making use of services of expert not available internally but risk associated with it.

4. Execution: Engagement team discussion, Response to assessed risks, Establishing Audit strategy, Determining audit materiality, Consider Going concern

5. Reporting (discussed later in this chap)



Special considerations in IT Environment

Considering importance of IT systems in PPFS, it is imperative that bank should share detailed information with auditors like: -

- Overall IT policy, structure and environment of Bank's IT system
- Data processing and data interface under various systems
- Data integrity and data security
- Controls over key aspects, use of various a/c heads, expense booking, overdue identification etc.
- Controls on recording of various e-banking and internet banking products and channels
- MIS reports being generated and their periodicity
- Major exception reports and process of generation including embedded logic

Note:

- Overall review of IT environment and computerized a/c system has to be taken at HO level.
- Branch auditors don't have access to IT policy & processes implemented by bank.
- Based upon guidance and info received from SCAs, branch auditors need to ensure that data review and analysis through CBS is carried out & TOCs & substantive checking of sample transactions is carried out at branch level & results are shared with SCAs.

Key control aspects that auditor needs to address while undertaking audit in a Computerised bank.

- Ensure authorised , accurate and complete data available for processing
- Ensure in case of power failure → system restarts without affecting completion of entries/records
- Verify access controls of staff working match with responsibilities as per manual.
- Verify segregation of duties ensured while granting system access to users
- Ensure system prevents unauthorised amendments to programme

Data → power failure → access controls → SOD → Prevent unauth. amend + Changes authenticated

Risk-based Internal audit is conducted based upon risk assessment of business & control risks of branches.

Risk assessment process includes: -

- Identification of inherent business risks in various activities undertaken by branches (Business risk)
- Assessment of effectiveness of control systems for monitoring inherent risks of business activities of branch (Control risk)
- Making an assessment of level and direction of various risk areas and assess level and direction of overall business risk and control risk
- Drawing up of risk matrix taking into account factors viz. Risk of branch

Internal Controls

General:

- Staff of bank shifted from one position to another frequently & without prior notice.
- Work of one person should always be checked by another person (Internal check)
- Arithmetical accuracy of books should be proved independently every day.
- All bank forms (e.g. Cheque books, demand draft, travelers' cheques, etc) should be in possession of an officer & another officer should verify issuance & stock of such stationery.
- Mail opened by responsible officer. Signatures on all letters & advices received from other branches of bank should be checked by officer with signature book.
- Signature & telegraphic code book kept with resp. officers & access only to authorised officers.
- Insurance policies against loss due to fire, natural calamities, theft & employees' infidelity.
- Surprise inspection of HO & Branches by Internal Audit Dept

Shift/Check/Accuracy → Forms →Mail → Sign/Code → Surprise → Insurance Policies

Cash:

- Cash should be kept in joint custody of 2 responsible officers.
- Test-checked daily & counted in full occasionally by responsible officer other than one handling cash.
- Cashier should have no access to customer's ledger accounts and Day Book.
- Payments made only after vouchers (e.g. cheques, demand drafts etc) have been passed for payment
- High value cash receipts & payments should be verified by a higher officer/ branch manager

Joint custody → check → SOD → Payments

Clearings

- Cheque Truncation System (CTS) implemented by RBI, electronic image of cheque is transmitted to paying branch through clearing house, with relevant info. like data on MICR band, date of presentation, presenting bank, etc. This eliminates associated cost of movement of physical cheques, reduces time reqd for their collection.
- As per RBI guidelines, branch is required to either call customer or email him for any cheque recd for 5L & above in respect of inward clearings. Auditor may verify compliance on test check basis.
- Auditor is to check whether sign of drawer of cheque is being verified by staff or not as else there will be liability of paying bank under all circumstances.
- Unpaid cheques received in outward clearing should be either sent to customers at their recorded address or customers be informed to collect the same from bank branch.

CTS → Call/E-mail 5L or above → Sign verify → Unpaid Cheques



Bill for collection

- Docs received & entered in register by responsible officer.
- At time of dispatch make sure documents sent with Bills.
- A/cs credited only after bill collected or advice received from bank branch or agent to which they were sent for collection
- Ensure → Bill sent by 1 branch to another not taken in bills for collection twice in amalgamated B.S. of Bank. So, receiving branch needs to reverse entries at end of year for closing purpose.

Recd docs register → A/c credit → twice?

Bills Purchased

- All documents of title should be assigned to bank
- Sufficient margin to cover decline in value of security
- Unable to collect bill on due date take immediate steps to recover amt.
- Irregular a/c report to H.O.
- Bill purchased o/s at year end, discount is apportioned between 2 years

Docs of title → margin → unable to collect → irregular → discount in 2 yrs

Loans & Advances

- Advance only after verifying Creditworthiness & obtaining sanction from proper authority
- Necessary documents (agreements, letter of hypothecation etc) executed before advance made
- Sufficent margin to cover against decline in security value & comply with RBI Directives
- Securities recd and return by responsible officer only + kept in joint custody
- Securities registered in name of bank only
- A/c kept within drawing power & sanctioned limit as per norms. Add. temporary limit maybe sanctioned, max 20% of existing limit & 90 days max tenure.
- Operation in each advance a/c should be reviewed atleast once every year.
- Irregular a/c report to Management/H.O. regularly

Creditworthiness → Docs → Security [Margin/recd/regd] → A/c within DP/SL → review →irregular

Demand Drafts

- Check signature with signature book
- DD sold/ issued confirmed by advice to paying branch
- Paying branch not receive confirmation or credit in account → steps to ascertain reasons

Credit Card Operations

- Effective screening of applications with reasonably good credit assessments.

- Strict control over storage & issue of cards.
- Prompt reporting by merchants of all settlements accepted through cr. cards.
- Reimbursement to merchants only after verification of validity of merchant's acceptance of cards.
- All reimbursement (gross of commission) should be immediately charged to customer's a/c.
- System to ensure that statements are sent regularly and promptly to customer.
- System to monitor & follow-up customers' payments.

Screening → Storage/Issue → Reporting → Reimbursement → Charge → Statement → Follow up

SLR/CRR Requirements

Cash Reserve Ratio: Min. fraction of deposits in cash/ deposits with RBI. Check master circular of RBI to check compliance.

Statutory Liquidity Ratio: Required to maintain gold/cash/govt approved securities/other liquid assets. Report submitted to top mgt & RBI.

Correctness of compilation of DTL — Maintenance of liquid Assets

- Verify compliance on 12 odd dates, not being Fridays
- Audit procedure:
  - ✓ Understand circular/direction of RBI
  - ✓ Request branch auditor → weekly trial balance on Friday for consolidation at H.O. Also on dates selected by auditor. Specific request examine cash balance on selected dates.
  - ✓ Test basis examine consolidation Demand Time Liability position w.r.t branch returns
  - ✓ Exclusions from liabilities:
    - Paid up capital, reserve, any cr. balance in P&L a/c of bank, loan taken from RBI & refinance taken from EXIM bank, NHB, SIDBI and NABARD
    - Part amounts of recoveries from borrowers in respect of debts considered bad & doubtful.
    - Amounts recd in Indian currency against import bills & held in sundry deposits pending receipts of final rates.
    - Un-adjusted deposits/balances lying in link branches for agency business like dividend, interest warrants etc. to the extent of payment by other branches but not adjusted by link branched
    - Margins held & kept in sundry deposits for funded facilities
    - Bills discounted by a bank with eligible financial institutions as approved by RBI.
    - Net Income tax provision.
    - Amount received from
      - ✓ DICGC towards claims held by banks pending adjustments thereof.
      - ✓ ECGC by invoking the guarantee.
      - ✓ insurance cos. for ad hoc settlement of claims pending judgement of court.
      - ✓ Court receiver.

- Net unrealized gain/loss arising from derivatives transactions under trading portfolio.
- Income flows received in advance such as annual fees & other charges which are not refundable.
- Liabilities arising on account of utilisation of limit under 'Bankers' Acceptance Facility' (BAF).

✓ Inclusions in liabilities:

- Net credit balance in branch adjustment a/cs. Credit entries in branch adjustment a/c which are outstanding for > 5 years to be considered at gross.
- Interest accrued on deposits should be calculated on each reporting fortnight, whether or not accounted, so that bank's liability is reflected in total NDTL of the same fortnightly return.
- Cash collaterals received under collateralized derivative transactions are in nature of 'outside liabilities'.
- Borrowings from abroad by banks in India to be considered as 'liabilities to other' & considered at gross level unlike 'liabilities towards banking system in India', which are permitted to be netted off against 'assets towards banking system in India'.
  Thus, adverse balances in Nostro Mirror a/c to be considered as 'Liabilities to other'.
- Reconciliation of Nostro a/c (with Nostro Mirror a/cs) needs to be scrutinized carefully for any inwards remittances received on behalf of customers / constituents of bank &/or any other debit (inward) entries unaccounted & liabilities for the bank.

Exempted Categories: While examining computation of DTL, auditor may specifically examine details of exempted categories of following items:

✓ Minimum Eligible Credit (EC) & outstanding Long-Term Bonds (LB) to finance Infrastructure loans & affordable housing loan, as per RBI Circular.

✓ Eligible amount of incremental FCNR(B) & NRE deposits of maturities of 3 years & above.

Also verify loans out of FCNR(B) deposits & inter- bank Foreign Currency (IBFC) deposits for reporting in Form A return. Banks should convert their forex assets/liabilities (including borrowings) in USD, GBP, JPY & Euro into INR at RBI reference rate. For other currencies consider New York rate for conversion into USD.

✓ RBI Circular on "Maintenance of CRR/SLR on Foreign Currency Assets/Liabilities: Reference rate for INR/USD & other major currencies",

- For conversion of foreign currency Assets/ Liabilities reference rate from FBIL be taken.
- If reference rate not available from FBIL, banks may use New York closing rate for conversion of such currency into USD.

Other Points:

- Examine whether consolidations prepared by bank include relevant info of all branches.
- Also examine whether balances in Branch Adjustment a/c of foreign branches considered in arriving at net balance in Branch Adjustment a/c.
- Examine correctness of data in Form A return for CRR & Form VIII for SLR on sample basis.

Verification of Assets (Selective items)

Cash

- Carry out physical verification of cash (including foreign currency, if any, cash at ATM & cash at cash deposit machines) as close to BS date as possible.
- Cash balance as physically verified should be agreed with cash register/balance in CBS.

Balance with RBI

- Verify ledger balance w.r.t confirmation certificates and reconciliations.
- Review reconciliation statements with spl. attention to:
  - ✓ Cash transactions remaining unresponded
  - ✓ Revenue items requiring adjustment/write off &
  - ✓ Other cr. and debit entries originated in RBI Statement remaining unresponded for > 15 days.

Money at call/short notice

- Examine-proper system of authorization & compliance with HO instructions
- Verify call loans wrt to certificates of borrowers & call loan receipts held by bank
- Examine-balance in registers tally with general ledger
- Examine subsequent repayments from borrowing banks to verify balance at year end. Call loans made can't net off with loans recd.
- Verify-interest accrued & accounted year end

Authorised → Certificates/receipts → Register → Subs. Receipts → Intt.

Spl purpose certificates relating to investments

- Examine-bank maintain separate accounts for investments
  - ✓ Own a/c
  - ✓ PMS clients
  - ✓ Other constituents (including brokers)
- RBI Guidelines-separate audit of investments under PMS-external auditor

Note: There should be half yearly reviews of Investment portfolios (30th Sept & 31st Mar)

Advances

Audit Approach: Auditor is concerned with obtaining evidence about following:-

- Amounts included in B.S. in respect of advances are o/s at date of B.S.
- Advances represent amounts due to bank
- Amounts due to the bank are appropriately supported by loan documents
- There are no unrecorded advances

- Stated basis of valuation of advances is appropriate and properly applied and recoverability of advances is recognized in their valuation.
- Appropriate provisions towards advances are made as per RBI norms, a/c standards and GAAP

Substantive Audit Procedures

- Verify correctness of master data of loan a/cs updated in CBS. Check parameters like instalments, EMI, rate of intt, tenure of loans etc.
- Verify that each customer of bank is tagged under single customer id in respect of all it's a/cs including those in which cr. facilities are granted.
- Examine a/cs identified to be problem a/cs but which have not yet slipped into NPA category. This can be done by obtaining list of SMA1 and SMA2 borrowers from bank and same can be considered for selection of problematic accounts.
- Examine those a/cs → adversely commented upon by concurrent auditors/bank's internal inspection/RBI inspection team.
- Examine list of restructured a/cs to ensure that restructure is as per RBI guidelines. Remember restructured a/c portfolio requires additional provisioning.
- Examine quick/early mortality accounts. Any advance slippage to NPA within 12 months of its sanction is called as quick/early mortality case.
- Examine all large advances & others on sample basis
- Completeness & accuracy of interest charged

Recoverability of advances

- Review periodic statements submitted by borrower indicating extent of compliance with T&Cs
- Latest financial statements of borrower
- Reports on inspection of security
- Review audit report for borrowers having cr. facilities beyond cut-off limit fixed by BOD of bank.

Provisioning of NPA

Classification & Provision

- Verify whether bank has a system of ongoing identification and classification of advances through CBS without manual intervention & its accuracy in crystallising date of NPA.
- Examine classification appropriate → particularly those advances with threat to recovery
- Examine secured & unsecured portion segregated correctly & calculation of provision
- Review & compare date of NPA of loan a/cs mentioned in CY statements with PY. Reasons for any change should be ascertained.

Accounts Regularised near B.S. Date

- A/c regularised before B.S. date by payment from genuine sources need not be classified as NPA
- If subsequently, branch lends funds to borrower → auditor assess genuineness of source of payment
- Indicates Inherent weakness in a/c based on available data → deemed NPA
- Classification as per position as on date & review of all std accounts on B.S. date
- Recognition on basis of Past Due/Overdue Concept & not based on balance sheet date.

Drawing power calculation (DP)

- Ensure calculation as per extant guidelines i.e. credit policy of bank formulated by Board & agreed by stat auditors reflected in respective sanction letters
- Spl consideration to proper reporting of sundry creditors & stocks covered under LCs/guarantees for purposes of calculating drawing power.
- Calculated carefully for working capital advances to Cos. in construction business. Valuation of WIP proper & consistent manner. Mobilisation advance reduced to calculate DP.
- Stock audit for a/c funded exposure > stipulated limits. Review report of stock auditor with spl. focus to comments on valuation of security & calculation of DP

Extant guidelines >> Proper reporting [Crs & stocks] >> Construction >> Stock audit

Accounts with temporary deficiencies

- Banks shouldn't classify as NPA merely due to existence of some temporary deficiencies such as non-availability of DP based on latest available stock statement, balance o/s exceeding limit temporarily & non-renewal of limits on due date.
- Stock statements for determining DP shouldn't be older than 3 months.
- o/s in account based on DP calculated from stock statements older than 3 months are considered as irregular. Ensure adherence to these guidelines.

Limits not reviewed

Where ad hoc/ regular limit not reviewed within 180 days from due date, consider as NPA. Also ensure review not done on repetitive basis.

Asset classification → Borrower wise & not facility wise

It is to be ensured that all facilities granted by a bank to borrower will have to be treated as NPA and not particular facility which has become irregular.

Govt Guaranteed Advances

- If it becomes NPA, income recognition on realisation basis

Asset classification [Advance overdue > 90 days]

- CG guarantee: treat NPA only if CG repudiates guarantee when invoked

- SG guarantee: no such exception, i.e. NPA if overdue > 90 days
- If CG guarantee not invoked for long → report in LFAR

Agricultural Advance

As per norms, Agri. advances are of 2 types:

a. Long Duration Crops (crop season > 1 year)

b. Short Duration Crops (crop season <= 1 year)

NPA Provisions:

LDC → Principal or intt overdue for 1 crop season

SDC → Principal or intt overdue for 2 crop seasons

- NPA norms applied as per crop season determined by State Level Bankers' Committee in each State.
- Also ensure that these norms are made applicable to all direct agricultural advances listed in Master Circular on lending to priority sector.
- In respect of agricultural loans, other than those specified in circular, ensure that identification of NPAs has been done on the same basis as non-agricultural advances.

Restructured Advance

- Restructuring is an act in which lender for economic or legal reasons relating to borrower's financial difficulty, grants concessions to borrower.
- It may involve modification of terms of advances including alteration of amt of instalments/alteration of repayment period/rate of intt/sanction of additional cr. facilities etc. to help in curing of default.
- Auditor should verify compliance with requirements of circular issued in this regard.
- Banks may restructure a/cs classified under std, substandard or doubtful categories. Banks can't restructure a/cs with retrospective effect.
- Once bank receives an application in respect of an a/c for restructuring, it implies that account is intrinsically weak. During the time a/c remains pending for restructuring, auditors need to take a view whether provision needs to be made in respect of such a/cs, pending approval for restructuring.
- On restructuring, a/c will be downgraded from Std to sub-std. NPAs remain in same category.

Upgradation of Account

- Examine all accounts upgraded from NPA to std. category during year as per RBI guidelines.
- There can be a possibility of incorrect upgradation of a/c on basis of partial recoveries made in the a/c & overdue portion might not have wiped out completely.
- There can also be a possibility of recoveries being made in account after cut-off date and a/c being upgraded as on date of B.S.

Sale/ Purchase of NPAs

General points:

- Policy of BOD relating to procedures, delegation of power and valuation
- Only such NPA can be sold that remained in books for atleast 2 years
- Sale/purchase without recourse only i.e. entire cr. risk related to NPA trfd to purchasing bank
- Subsequent to sale bank doesn't assume 'any risk'
- NPA sold at cash basis only. Can't be sold at contingent price.
- Bank don't purchase NPA already sold

Spl. Points for Sale of NPA

- Removed from books after sale
- Shortfall on sale charge to p&l i.e. Sale below Net Book Value
- Sale > Net book value, excess retained to meet loss on sale of other NPA (don't recognize profits)

Spl points for purchase of NPA

- Provision as per classification status in books of purchaser
- Any recovery first adjust against acquisition cost & excess as profit
- Capital adequacy → 100% risk weight to NPAs purchased from other banks

Stationery & Stamps

- Ensure it includes only exceptional items of expenditure on stationery like bulk purchase of security paper to be written off over period of time. Such items valued at cost. Normal expenditure on stationery is charged to p&l a/c. This item may not appear at branch level as considerable part of stationery is supplied to branches by head office.
- Check Internal Controls. Specific reporting in LFAR.
- Physical verification at year end. Shortage to be inquired into.
- Check cost charged to p&l

Non-Banking assets acquired in satisfaction of claims

- Ensure it includes those immovable properties/tangible assets which bank has acquired in satisfaction of debts due or its other claims and these are being held with intention of being disposed off.
- Verify with ref. to documentary evidence, eg. order of court, or award of arbitration
- Check ownership legally vested with bank. If dispute, check if recording as asset appropriate. If dispute arise later on, check if provision reqd as per AS 29.
- Ensure compliance with Sec 9 of Banking Regulation Act
  [Prohibits banking Co. from holding any immovable property, howsoever acquired, for period exceeding 7 years from date of acquisition, except required for own use]

- Ensure that as at date of acquisition, assets should be recorded at lower of net book value of advance or NRV of asset acquired.

Verification of capital:

- Capital Risk Adequacy Ratio = (Eligible total capital funds/Risk weighted assets & off balance sheet items) * 100
- RBI requires banks to maintain minimum 9% CRAR.

Stress Testing: Designed to understand whether bank has enough capital to survive plausible adverse economic conditions and to maintain enough buffer to stay afloat under extreme scenarios.

BASEL III framework :Basel III norms relate to Capital Adequacy requirement compliance which Bank has to achieve as contained in BASEL III accord. Basel capital adequacy norms are meant for protection of depositors & shareholders.

Aim:

a) improving the banking sector's ability to absorb shocks arising from financial and economic stress
b) improving risk management and governance practices
c) strengthening banks' transparency and disclosure standards.

Verification of Liabilities (selected items)

Current and saving accounts

- Verify on a sample basis current and saving a/c opened during year for adherence to KYC norms. Verify saving a/c opened in name of individuals, HUF, trusts, educational institutes etc. Saving a/c aren't opened for business/professional concern. Business transactions are carried in current a/c which can be opened for all kind of customers like companies, individuals, partnership firms etc.
- Verify balances in individual accounts on a sample basis.
- Check calculations of intt. on test check basis. No intt. paid generally on current a/c by banks.
- Examine whether procedure for obtaining balance confirmation periodically has been followed consistently. Examine, on sampling basis, confirmations received.
- Ensure debit balances in current a/c not netted out on liabilities side but included under 'advances'.

Inoperative A/cs

- Inoperative a/cs (both current and saving) are high-risk area of frauds in banks. As per RBI, a savings/current a/c treated as inoperative/dormant if no transactions for over a period of 2 years.
- Verify on a sample basis some of inoperative a/c revived/closed during year.
- Ensure that inoperative a/c revived only with proper authority. Cases where there is significant reduction in balances of such a/c compared to previous year, examine authorisation for withdrawals.

Opened >> balances >> interest >> confirmation >> dr. balance >> Inoperative a/c

Case Study: During audit you notice that large no. of cash credit a/c in branch are only partially utilized during substantial part of year. However, in month of March, accounts are fully utilized. On further scrutiny, it is observed that these a/c holders made FDs from these utilized amounts at end of year. These deposits have been liquidated in first week of April of next financial year. Comment upon how this situation would be dealt by you as a statutory branch auditor?

Many of cash credit a/c are only partially utilized during substantial part of year. However, in March, accounts are fully utilized. Further, its observed that these a/c holders have made FDs from these utilized amounts at end of year. These deposits have been liquidated in 1st week of April of next FY.

- This is eg. of window dressing. Branch is resorting to window dressing by artificially boosting its advances and deposits. To inflate its advances as well as deposits artificially.
- Relevant regulatory guidelines also prohibit such type of practices & these might involve penal action in terms of Banking Regulation Act, 1949.
- Same needs to be suitably reported in audit report and commented in LFAR also.

In appropriate cases, making a suitable qualification in main audit report has also to be considered.

Term Deposits

- Verify on sample basis some of recurring deposit a/cs opened during year.
- Examine whether deposit receipts & cash certificates are issued serially & all of them are accounted in registers.
- In case of closure, test check whether required foreclosure penalty deducted from applicable rate of intt. payable.
- Verify correctness of rate of intt. on term deposits on sample basis.
- Verify in case of bulk deposits (₹2 crore & above for scheduled commercial banks presently), correct rate of intt been offered.

Deposits designated in foreign currencies

- Verify FCNR a/cs opened during year on sample basis & ensure these conform to RBI directions.
- Verify on sample basis permissible credits & debits in FCNR a/cs as per RBI directions.
- In case of FCNR a/cs, examine whether these have been converted into Indian Rupees at rate notified by HO.
- Examine whether any resultant increase or decrease taken to p&l a/c.
- Verify that intt. on deposits has been paid on basis of 360 days in a year.

Notes: In case of NRE & NRO a/cs, verify on sample basis credits & debits as per RBI guidelines. Also check repatriablity. NRE a/cs are repatriable whereas NRO a/cs aren't repatriable.

- Intt. accrued but not due on deposits isn't included under deposits but shown under head 'other liabilities and provisions'.

- Ensure that framework relating to 'Know Your Customer' & Anti-Money Laundering measures is formulated and put in place by the bank.

Borrowings

- Obtain & verify confirmation certificates & other docs
- SA 505, "External Confirmation" -audit evidence to respond to significant risks
- Examine- clear distinction b/w rediscount and refinance, as rediscount doesn't appear in this head
- Examine borrowing at call & short notice should be authorised

Bills payable

- Evaluate the existence, effectiveness and continuity of internal controls over bills payable.

Controls should usually include the following-

- Drafts, mail transfers,etc. made out in std printed forms.
- Unused forms of drafts, traveller's cheques, etc. kept under custody of responsible officer.
- Bank should have a reliable private code known only to responsible officers of branches, coding and decoding of telegrams should be done only by such officers.
- The signatures on demand draft, checked by officer with specimen signature book.
- All TTs and DDs issued by a branch should be immediately confirmed by advices to the branches concerned. On payment, paying branch should send a debit advice to originating branch

- Examine sample of outstanding items comprised in bills payable accounts with relevant registers. Reasons for old outstanding debits in respect of drafts or other similar instruments paid without advice should be ascertained.
- Correspondence with other branches after year-end should be examined specially for large value items outstanding on balance sheet date.

Contingent Liabilities

Management Representation:

Auditor should obtain representation from mgt that:-

i) all off-balance sheet transactions have been accounted in books of a/cs as and when such transaction has taken place
ii) all off balance sheet transactions have been entered into after following due procedure laid down
iii) all off balance sheet transactions are supported by the underlying documents
iv) all year end contingent liabilities have been disclosed
v) disclosed contingent liabilities don't include any crystallised liabilities which are of nature of loss/ expense and which require creation of a provision/adjustment in F.S.
vi) estimated amounts of financial effect of contingent liabilities are based on best estimates in terms of AS 29, including consideration of possibility of any reimbursement

Contingent Liabilities (Presentation)

- Claims against the bank not acknowledged as debts
- Liability for partly paid investments
- Liability on account of outstanding forward exchange contracts.
- Guarantees given on behalf of constituents (within India; outside India)
- Acceptances, endorsements and other obligations
- Other items for which the bank is contingently liable

Audit procedures:

Contingent Liability (CL)

- Adequte Internal Controls ensure transactions executed by persons authorised
- Verify in case of Letter of Credits for import of goods, payments made in terms of LC
- Test completeness of recorded obligations
- Review reasonableness of year end CL in light of previous experience & current year activities
- Review whether comfort letters issued included in CL

Claims against bank not acknowledged as debt

- Examine relevant evidence, e.g. correspondence with lawyers, workers, officers etc.
- Review minutes of meetings of BOD/committees of BOD, contracts, agreements & arrangements
- Ascertain from mgt the status of claims o/s at year end
- Review of subsequent events for evidence about completeness & valuation

Guarantees given on behalf of constituents

- Check Internal Controls over issue of guarantees
- Controls over unused guarantee forms e.g. under custody of responsible officers
- Examine guarantee register- procedure of marking off expired guarantees
- Check guarantee register- ensure all included in disclosures
- If claim risen, provision as per AS 29

Auditor's Reports

In case of nationalized bank, report is issued to Central Govt. stating following:

- Whether, in auditor's opinion, balance sheet is full and fair balance sheet containing all necessary particulars & properly drawn up to exhibit true & fair view of affairs of bank.
- In case auditor called for any explanation or information, whether it has been given & satisfactory.
- Whether or not transactions of bank, which have come to auditor's notice, within powers of bank.
- Whether or not returns recd. from offices & branches found adequate for purpose of audit.
- Whether P&L a/c shows true balance of profit or loss for period covered by such a/c.
- Any other matter which auditor considers should be brought to notice of CG.

Long Form Audit Report (LFAR)

- LFAR is to be given by SBAs as well as SCAs.
- LFAR for branch is in form of questionnaire where observations/comments must be provided on matters including cash, balance with banks, investments, advances, deposits etc.
- These are submitted by SBAs to SCAs.

Consolidation is done at HO level & LFAR for bank is submitted by SCAs to mgt. LFAR after due examination, should be placed before ACB of bank indicating action taken/proposed to be taken for rectification of irregularities, if any, mentioned therein; & a copy of LFAR and relative agenda note, together with Board's views or directions, is submitted to RBI within 60 days of submission of LFAR by statutory auditors.

In case of fraud report to:

- RBI
- Chairman/MD/CEO of bank
- CG u/s 143(12)

SCAs have to furnish following reports in addition to main report:

- Report on ICFR as per Sec 143(3)(i) of Cos Act 2013
- Long Form Audit Report (LFAR)
- Report on compliance with SLR Requirements
- Report on income recognition, asset classification & provisioning as per RBI Guidelines
- Report on whether any serious irregularity was noticed in working of bank which requires immediate attention (as per sec 143(12) of Companies Act, 2013.)
- Report on whether treasury operations conducted as per RBI instructions
- Report on status of compliance by bank with regard to implementation of recommendations of Ghosh Committee relating to frauds and malpractices and Jilani Committee on internal control and inspection/credit system.

Concurrent Audit

Scope of Concurrent Audit in Banks

Cash + Deposits + Advances + Investments + Foreign Exchange + House Keeping + Other Items

Coverage of Business/Branches for concurrent Audit

Scope of work to be entrusted to concurrent auditor, coverage etc is discretion of head of Internal Audit with due approval of Audit Committee of Board of Directors (ACB)

Areas of focus in Concurrent Audit

Cash

- Daily cash transactions with reference to any abnormal/high value receipts and payments.
- Proper accounting of inward and outward cash remittances.
- Proper accounting of currency chest transactions, its prompt reporting to the RBI.
- Expenses incurred by cash payment involving sizeable amount.

Investments

- Purchase/sale of securities should as per:
  - HO instructions
  - Rates beneficial to bank
- Securities in books → should be physically held by it
- Compliance with RBI/HO guidelines

Advances

- Ensure proper sanction of advances
- Securities properly recd and regd in name of bank.
- Proper post disbursement supervision & follow-up
- LC issued within delegated power
- BG issued, properly worded & recorded in register
- Classification as per RBI guidelines
- Claims to ECGC & DICGC submitted in time

Foreign Exchange

- Check foreign bills negotiated under letters of credit.
- Examine extension and cancellation of forward contracts for purchase and sale of foreign currency. Ensure that they are duly authorised and necessary charges have been recovered.
- Ensure that balances in Nostro accounts in different foreign currencies are within prescribed limit.
- Ensure verification/reconciliation of Nostro and Vostro a/c transactions/balances.
- Check FCNR and other non-resident a/c whether debits and credits are permissible under rules.
- Check whether inward/outward remittance have been properly accounted for.
- Ensure adherence to guidelines issued by RBI/HO of bank about dealing room operations.

Appointment of concurrent auditor

- Option: own staff or external auditor → discretion of bank
- If own official: experienced, trained & senior + independent of branch where audit is conducted
- ACB of bank shall decide max. tenure of external concurrent auditor. Generally, it'll not be more than 5 years. No auditor will continue with a branch/Business unit for more than 3 years.



- If omission/commission by auditor report to RBI & ICAI & appointment maybe cancelled.

Reporting Systems in case of concurrent audit

- Proper reporting of findings of concurrent auditors. For this purpose, each bank should prepare a structured format.
- Zone-wise reporting of findings of concurrent audit to ACB & annual appraisal/report of audit system should be placed before ACB.
- Before submission of report auditor discuss important issues with branch manager & concerned officers. This will enable auditor to consider opposite view point and clarify any doubts.
- Minor irregularities pointed out by concurrent auditors are to be rectified in timely manner. Serious irregularities should be reported to controlling offices/ Head Offices for immediate action.
- Whenever fraudulent transactions are detected, they should immediately be reported to Inspection & Audit Department (HO) + Chief Vigilance Officer + Branch Managers concerned (unless branch manager is involved).
- Follow-up action on concurrent audit reports should be given high priority by controlling office/Inspection and Audit Department and rectification of features done without any loss of time.

"Once you become Fearless, life becomes Limitless"

CHAPTER 07

NBFC Audit

Learn with Fun

Definition

- A Financial Institution which is a Co.
- A non-banking institution (NBI) which is a Co. & principal business receiving deposits & lending
- Such other institution as RBI may with approval of CG & notification in official gazette specify

Co.= NBFC, if [50:50 Test]

✓ Financial Assets > 50% of total assets [excluding Intangible assets] &

✓ Income from FA > 50% of gross income

If both criteria fulfilled, qualify as NBFC & regd. with RBI.

Section 45-IA of RBI Act, 1934, No NBFC can do business of Non-Banking F.I. without

- Certificate of Reg. issued by RBI &
- Minimum Net owned Funds of ₹10 Cr for certain categories of Cos. currently applying for registration as NBFC (previously it was INR 2 Crore)

What about existing NBFCs?

RBI has prescribed timeline to meet NOF of ₹10 Crore in a phased manner for certain categories of existing NBFCs by 31.3.27.

NBFCs	Current NOF	By 31.3.25	By 31.3.27
NBFC-ICC	₹2 Cr	₹5 Cr	₹10 Cr
NBFC-MFI	₹5 Cr	₹7 Cr	₹10 Cr
NBFC-Factor	₹5 Cr	₹7 Cr	₹10 Cr

Exceptions:

- For NBFC-P2P, NBFC-AA & NBFCs with no public funds & customer interface, NOF shall be ₹2 Cr.
- For NBFC-IFC & IDF-NBFC, NOF shall be ₹300 Cr.

NBFCs regd. with RBI are categorized as follows:

a. in terms deposit acceptance or otherwise into Deposit and Non-Deposit accepting NBFCs

b. non deposit taking NBFCs by their size into systemically important & non-systemically important (NBFC-NDSI and NBFC-ND)

Cos exempt from RBI registration (Doing financial business but regulated by other regulators)

Mutual Benefit Cos.	Nidhi Cos. (MCA, GOI)
Merchant banking cos. (SEBI)	Insurance (IRDA)
Stock ex. (SEBI)	Chit (Chit fund Act)
Stock broking/sub-broking (SEBI)	Alternate Investment Fund Cos.
Venture cap fund (SEBI)	Mortgage Guarantee Cos.
Housing Fin Institution (regulated by National Housing Board)	Core investment Cos with asset size <100 Cr & if >=100 cr but not accessing public funds

NBFC Classification

NBFC classification based on 4 layers based on their size, activity and perceived riskiness.

Base Layer

Base Layer shall comprise of

a. non-deposit taking NBFCs below asset size of ₹1000 cr &

b. NBFCs undertaking following activities-

i. NBFC-Peer to Peer Lending Platform (NBFC-P2P),

ii. NBFC-Account Aggregator (NBFC-AA),

iii. Non-Operative Financial Holding Company (NOFHC) &

iv. NBFCs not availing public funds and not having any customer interface.



Middle Layer

Middle Layer shall consist of

a. all deposit taking NBFCs (NBFC-Ds), irrespective of asset size,

b. non-deposit taking NBFCs with asset size of ₹1000 crore & above &

c. NBFCs undertaking following activities

(i) Standalone Primary Dealers (SPDs),

(ii) Infrastructure Debt Fund - Non-Banking Financial Companies (IDF-NBFCs),

(iii) Core Investment Companies (CICs),

(iv) Housing Finance Companies (HFCs) and

(v) Infrastructure Finance Companies (NBFC-IFCs).

Standalone >> Core >> Housing >> Infrastructure [Debt fund/finance cos]

Eg. if Housing finance Co. has asset size of ₹800 Cr, then also it shall be covered in middle layer. Asset size doesn't matter in such case.

Upper Layer

NBFCs which are specifically identified by RBI warranting enhanced regulatory requirement based on a set of parameters & scoring methodology as provided in Appendix to this circular. Top 10 eligible NBFCs in terms of asset size shall always reside in upper layer, irrespective of any other factor.

Top Layer

It'll ideally remain empty. This layer can get populated if RBI is of opinion that there is substantial increase in potential systemic risk from specific NBFCs in Upper Layer. Such NBFCs shall move to Top Layer from Upper Layer.



Categorisation of NBFCs carrying out specific activity

a. NBFC-P2P, NBFC-AA, NOFHC and NBFCs w/o public funds & customer interface will always remain in Base Layer.

b. NBFC-D, CIC, IFC and HFC will be included in Middle Layer or Upper Layer (not in Base layer), as case may be. SPD and IDF-NBFC will always remain in Middle Layer.

c. Remaining NBFCs,
- Investment and Credit Companies (NBFC-ICC),
- Micro Finance Institution (NBFC-MFI), NBFC-Factors and
- Mortgage Guarantee Companies (NBFC-MGC)

could lie in any of layers of regulatory structure depending on parameters.

d. Government owned NBFCs in Base Layer or Middle Layer. Not in Upper Layer till further notice.

Diff b/w Bank & NBFC

a. NBFC can't accept DD, but some NBFC can accept Term Deposits

b. NBFCs don't form part of payment & settlement system & can't issue cheques drawn on itself

c. Deposit insurance facility of DICGC not available to depositors of NBFC unlike banks

d. No min. exposure to priority sector in case of NBFC

Prudential Norms

Capital Adequacy Ratio

- Min capital ratio consisting of tier I & II capital not less than 15% of agg. Risk weighted assets & risk adjusted value of off balance sheet items.
- Tier I not less than 10% at any point of time (except NBFC-MFI & lending against gold)
  If lending against Gold jewellery (such loans >= 50% of financial assets) → min tier I cap 12%.

"Tier 1 capital" for NBFCs (except NBFCs-BL) is sum of

i) Owned fund as reduced by investment in shares of other NBFCs & shares, debentures, bonds, o/s loans & advances including hire purchase & lease finance made to & deposits with subsidiaries & Cos. in the same group exceeding, in aggregate, 10% of owned fund &

ii) Perpetual debt instruments issued by a non-deposit taking NBFCs in each year to extent it is not > 15 % of aggregate Tier 1 capital of such Co. as on March 31 of previous a/c year.

"Tier 2 capital" for NBFCs (except NBFCs-BL) is sum of

i) Preference shares other than compulsorily convertible into equity

ii) Revaluation reserves at discounted rate of 55 %

iii) General provisions (including for Standard Assets) & loss reserves to the extent not attributable to actual diminution in value or identifiable potential loss in any specific asset & available to meet unexpected losses, to extent of 1.25 % of risk weighted assets

iv) Hybrid debt capital instruments
v) Subordinated debt &
vi) Perpetual debt instruments issued by non-deposit taking NBFC not covered in Tier 1 capital to the extent aggregate does not exceed Tier 1 capital

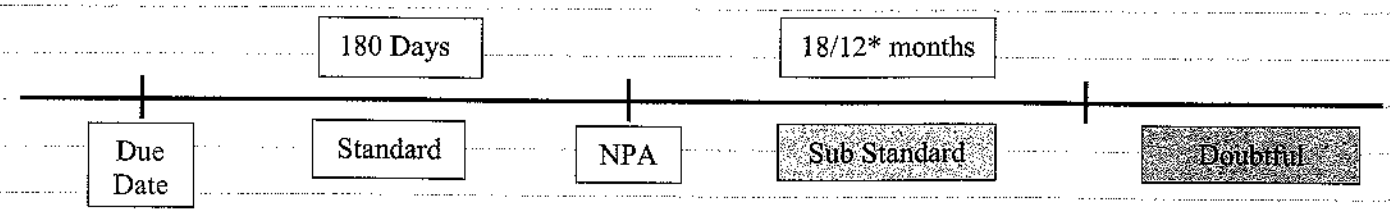
Note: NBFCs-BL are not eligible to include perpetual debt instruments in Tier 1 & 2 capital.

Risk Weights

Nos	Head	Weight
1	Cash Bank	0
2	Approved securities	0
3	Loan & advances fully secured + loans to employees	0
4	TDS Deducted/Advance tax	0
5	Intt on Govt security	0
6	Fund based claims on CG	0
7	CG Guarantee claims	0
8	SG securities	0
9	SG guarantee claims, not in default > 90 days	20
10	Bonds of Public Sector Banks	20
11	PPP & Post commercial operations date infrastructure projects exist over 1 yr operation	50
12	(i) Consumer credit exposure (outstanding as well as new) categorised as retail loans, excluding housing loans, educational loans, vehicle loans, loans against gold jewellery & microfinance/SHG loans (ii) Credit Card Receivables	125
13	Others	100

Income Recognition: Income on NPA recognised only when actually realised. Any such income recognised before asset became NPA & unrealised shall be reversed.

Asset Classification (Applicable to all NBFCs except MFI)



*12 months in case of NBFC-ML & above

Standard asset: Asset in which, no default in repayment of principal/interest perceived & does not disclose any problem or carry more than normal risk.

Sub-Standard Asset:

a. NBFC BL: Asset classified as NPA for period <= 18 months
b. NBFC ML & above: Asset classified as NPA for period <= 12 months
c. Asset where agreed terms of interest &/or principal renegotiated/rescheduled/restructured, until expiry of 1 year of satisfactory performance under revised terms.

Doubtful Asset:

NBFC BL: Sub-standard asset for a period > 18 months

NBFC ML & above: Sub-standard asset for a period > 12 months

NPA Glide Path for applicable NBFCs to adhere to 90 days NPA norm as under:

NPA Norms	Timeline
>150 days overdue	By March 31, 2024
>120 days overdue	By March 31, 2025
> 90 days	By March 31, 2026

Note: Glide path not applicable to NBFCs already required to follow 90-days NPA norm.

Provisioning (%) (Applicable to all NBFCs except MFI)

Loss Assets: 100%

Doubtful Assets: Unsecured 100%

Period for which Secured Asset has been considered as doubtful	% of Provision
Up to 1 year	20
1-3 years	30
More than 3 years	50

Sub std asset: 10%

Std asset: 0.40% (NBFC ML & above) & 0.25% for NBFC-BL

Note: Provision towards standard assets not netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' in BS.

Audit Procedures

1. Ascertaining business of Co
   - ✓ Check MOA & AOA
   - ✓ Check business policy → ascertain main business of co.
   - ✓ Minutes of Board Meeting & discuss with top level mgt

2. Evaluation of Internal Control System
   - ✓ Understand a/c system & related internal controls
   - ✓ Review effectiveness of system of recovery
   - ✓ Periodical review of advances facilitate monitoring & follow up

3. Registration with RBI
   - ✓ Sec 45 IA, min Net owned fund of 10 Cr/2 cr
   - ✓ Obtain copy of Certificate of Reg, or copy of application
   - ✓ If NBFC holds Public Deposits → invest % in liquid assets as per RBI
   - ✓ Qtr return filed with RBI about maintenance of liquid assets

4. NBFC Acceptance of Public Deposit Directions

(NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 2016)

i) Check NBFC appropriately classified

ii) Ceiling on quantum of deposits as per credit rating by approved credit rating agency
   - ✓ Obtain copy of cr. Rating & check Public Deposits as per the rating assigned
   - ✓ In event of up/downgrading → increase/decrease deposits → inform RBI
   - ✓ If downgraded below min investment grade, regularise excess deposits as under:
     - ➢ Not accept fresh deposits & not renew existing ones
     - ➢ Existing deposits run off till maturity
     - ➢ Report within 15 working days to Regional office RBI where its regd.
     - ➢ no matured public deposit renewed without express and voluntary consent of depositor

iii) test check intt calculations, to check no excess intt paid

iv) Acceptance/renewal only after written application from depositor on form supplied by NBFC

v) Verify deposit register & test check particulars with supporting receipts

vi) Check investments in liquid assets in safe custody with scheduled comm. Bank

vii) Check filed returns in timely manner

viii) NBFC not accepting/holding PD → BR passed

5. NBFC Prudential Norms

i) Check compliance with prudential norms (income recog, a/c stds, asset classification, PDD, capital adequacy norms, prohibition of grant in loans against own shares)

ii) Ensure BOD granting/ intending to grant demand/call loans shall frame & implement policy for Co.

iii) Assess compliance with prudential norms. Verify advance properly classified as std, sub std, doubtful & loss assets & proper provisions made

iv) In case of NPA, unrealised income not taken to p&l on accrual basis. Recognised on realisation only.

v) A/cs classified as NPA in prev. year continue shown as such in CY also. If made regular, check with directions.

Classification of Frauds by NBFC

a) Misappropriation & criminal breach of trust

b) Fraudulent encashment through forged instruments, manipulation of Books of a/c or fictitious a/cs

c) Unauthorised cr. Facilities extended for reward or illegal gratification

d) Negligence & cash shortages

e) Cheating & forgery

f) Irregularities in forex transaction

g) Any other type of fraud

Case of (d) & (f) to be reported as fraud if intention proved/suspected

In following cases it'll be fraud:

- Cash shortage > 10,000 &
- Cash shortage > 5,000 if detected by mgt/auditor/inspector & not reported by cashier.

Audit Check list -- NBFC - Investment and Credit Company (NBFC-ICC)

i. Physically verify all shares & securities held by NBFC.

ii. Verify no loan advanced against security of its own shares.

iii. Verify dividend income wherever declared recd by NBFC & intt due (except NPA) is accounted.

iv. Dividend income on shares & units of MF recog. on cash basis.

v. Test check bills/contract notes recd from brokers w.r.t prices vis-à-vis stock mkt quotations on respective dates.

vi. Verify Board minutes for purchase & sale of investments. Ascertain from BR, long term/short term.

vii. In respect of shares/securities held through a depository, obtain a confirmation from the depository regarding the shares/securities held by it on behalf of the NBFC.

viii. Check whether requirements of AS 13 "Accounting for Investments" have been complied with.

ix. Check the classification of loans and advances (including bills purchased and discounted) made by a NBFC into Standard Assets, Sub-Standard Assets, Doubtful Assets and Loss Assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms.

Auditor's duty to Report to BOD [Para 3]

(A) In case of all NBFCs

i) Examine whether Co. obtained CoR (Certificate of Registration)

ii) In case Co. holding CoR whether its entitled as per principal business criteria as on 31st March of year

iii) Whether its meeting NOF criteria laid down in master direction

Certificate from Statutory Auditor in this regard w.r.t. position of Co. as at end of FY ended March 31st 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 A/R u/s 134 of Companies Act, 2013, but not later than 31st December of same year, in any case.

(B) NBFC holding/accepting public deposits (PD)

i) Whether PD held by it with other borrowings within limits of provisions of NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 2016

ii) Where PD in excess of quantum → regularised in manner provided in Directions

iii) Whether accepting PD w/o min investment grade rating from approved institution as per Directions

iv) Whether Cap Adequacy Ratio(CAR) correctly determined & compliance with min CRAR prescribed

v) For NBFCs referred in clause (iii) above,

a. whether credit rating, for FDs schemes assigned by Credit Rating Agencies listed in NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 2016 in force &

b. whether aggregate amount of o/s deposits at any point during year exceeded limit specified by such Credit Rating Agency

vi) Whether Co. has violated any restriction on acceptance of public deposit as per directions

vii) Whether Co has made default in paying interest/principal after they became due

viii) Whether Co. complied with prudential norms on income recognition, accounting standards, asset classification, provisioning for bad & doubtful debts, & concentration of credit/investments as specified in Directions issued by Bank in terms of Master Direction - RBI (NBFC - Scale Based Regulation) Directions, 2023

ix) Whether Co. complied with liquid assets requirement & whether details of bank in which approved securities held communicated to RBI in NBS 3, NBFC Returns (Reserve Bank) Directions, 2016

x) Whether Co. has furnished to RBI within stipulated period return on deposits as specified in DNBS 01 to Master Direction - RBI (Filing of Supervisory Returns) Directions, 2024

xi) Whether Co. has furnished to RBI within stipulated period quarterly return on prudential norms as specified in Master Direction - RBI (Filing of Supervisory Returns) Directions, 2024

xii) Whether, in case of

- ✓ opening of new branches or offices to collect deposits or
- ✓ closure of existing branches/offices or appointment of agent,

Co. has complied with requirements contained in directions.

(Directions → NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 2016)

(C) NBFC not accepting deposits

i) BOD passed Board Resolution for non-accept of deposits

ii) Whether Co accepted any deposits during year

iii) Whether Co. complied with prudential norms (I/R, a/c std, Asset classification, PDD)

iv) In respect of NBFC- NDSI

a. Whether CRAR disclosed in NBS-7 correctly arrived & compliant with minimum CRAR

b. Whether Co has furnished to RBI, annual statement of capital funds, risk asset ratio in NBS 7

v) Whether NBFC correctly classified as NBFC Micro Finance Institution (MFI)

Reasons for Unfavourable/ Qualified statements

Where, in auditor's report, statement regarding any of items referred to in para 3 is unfavourable or qualified, auditor's report shall also state reasons for such unfavourable or qualified statement, as case may be. Where auditor is unable to express opinion on any of items referred to in para 3, report shall indicate such fact together with reasons therefor.

Obligation of auditor to submit an exception report to the RBI

I. Where, in case of NBFC, statement regarding any of items referred in para 3 above, is unfavourable or qualified, or in opinion of auditor company has not complied with:

a) provisions of Chapter III B of RBI Act (Act 2 of 1934) or

b) NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 2016 or

c) Master Direction - RBI (NBFC - Scale Based Regulation) Directions, 2023

It shall be obligation of auditor to make report containing details of unfavourable or qualified statements and/or about non-compliance in respect of Co. to Regional Office of Deptt. of Non-Banking Supervision of RBI under whose jurisdiction regd office of Co. is located as per first Schedule to NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

II. Duty of Auditor under sub-para (I) shall be to report only contraventions of provisions of RBI Act, 1934, & Directions, Guidelines, instructions referred to in sub-para (1) & such report shall not contain any statement with respect to compliance of any of provisions.

Difference b/w Division II (Ind AS- Other than NBFC) &
Division III (Ind AS NBFC) of Schedule III

a) NBFC allowed to present items of B.S. in order of liquidity

b) NBFC to disclose by way of note item of 'other income/expense' > 1% of total income. Div II requires disclosure of item > 1% of Revenue or 10 L (whichever is higher)

c) NBFC separately disclose under receivables debt due from LLP where Director is partner/member

d) Disclose items comprising 'Revenue from operations' & 'OCI' on face of P&L instead of only notes

e) Separate disclosure of Trade Receivables with significant increase in cr risk & cr impaired
f) Conditions or restrictions for distribution attached to stat. reserves separately disclosed.

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Note: NBFCs required to comply with Ind AS as per Rule 4 (1)(iv) of Companies (Ind AS) Rules, 2015 & as amended by Companies (Ind AS) (Amendment) Rules, 2023.

CARO 2020 Reporting

As per CARO 2020, auditor is required to report that -

I. Whether during year company has made investments in, provided any guarantee or security or granted any loans or advances in nature of loans, secured or unsecured, to companies, firms, LLPs or other parties,

If so,

(b) whether investments made, guarantees provided, security given and terms and conditions of grant of all loans and advances in nature of loans and guarantees provided are not prejudicial to company's interest;

(c) in respect of loans and advances in nature of loans, whether schedule of repayment of principal and payment of interest has been stipulated and whether repayments or receipts are regular;

(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 of principal and interest;

(f) whether company has granted any loans or advances in nature of loans either repayable on demand or without specifying any terms or period of repayment, if so, specify aggregate amount, percentage thereof to total loans granted, aggregate amount of loans granted to Promoters, related parties; [Paragraph 3(iii)]

(II) (a) Whether company is required to be registered under section 45-IA of RBI Act, 1934 and if so, whether registration has been obtained.

(b) Whether company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from RBI as per the RBI Act, 1934;

(c) Whether company is a Core Investment Company (CIC) as defined in regulations made by RBI, if so, whether it continues to fulfil criteria of a CIC, and in case company is an exempted or unregistered CIC, whether it continues to fulfil such criteria;

(d) Whether Group has more than one CIC as part of Group, if yes, indicate number of CICs which are part of the Group; [Paragraph 3(xvi)]

Eg. AF Ltd. is a NBFC & in business of accepting public deposits & giving loans since 2015. Co. was having net owned funds of ₹1.5 Cr & not having registration certificate from RBI & applied for it on 30.03.24. Co. appointed Mr. Kabra as its statutory auditors for year 2023-24. Advise auditor with reference to auditor procedures to be taken and reporting requirements in view of CARO 2020 ?

As per Clause (xvi) of Para 3 of CARO 2020, auditor is required to report that "whether Co. is required to be regd. u/s 45-IA of RBI Act, 1934 and if so, whether registration has been obtained." Auditor is reqd to examine whether Co. is engaged in the business which attract the requirements of registration. Registration is required where financing activity is a principal business of Co. RBI restrict Cos. from carrying on business of a NBFI without obtaining certificate of registration.

Audit Procedures and Reporting:

i) Auditor should examine transactions of Co. with relation to activities covered under RBI Act and directions related to NBFCs.
ii) F.S. should be examined to ascertain whether Co's financial assets constitute more than 50% of total assets and income from financial assets constitute > 50 % of gross income.
iii) Whether Co. has net owned funds as required for registration as NBFC.
iv) Whether Co. has obtained reg. as NBFC, if not, reasons should be sought from mgt & documented.
v) Auditor report incorporating following:-
   a. Whether the registration is required u/s 45-IA of the RBI Act, 1934.
   b. If so, whether it has obtained the registration.
   c. If registration not obtained, reasons thereof.

In given case AF Ltd. is a NBFC & in business of accepting public deposits & giving loans since 2015. Co. was having net owned funds of ₹1.5 Cr which is less than prescribed limit i.e. 2 Cr & also not having registration certificate from RBI (though applied for it on 30.03.24). Auditor is required to report as per Clause (xvi) of Para 3 of CARO 2020.

"Be a Warrior, not a Worrier"

CHAPTER 08

PSU Audit



In India, Govt. audit is performed by C&AG through Indian Audit & Accounts Deptt.

Articles of Constitution

Article 148	o Appointment of C&AG by President o Spl. procedure for removal of C&AG only on proven misbehavior or incapacity. o Salary & other conditions of service to be determined by Parliament.
Article 149	C&AG's (Duties, Powers & Conditions of Service) Act, 1971 defines functions & powers of C&G.
Article 150	On advice of C&AG, President to prescribe such form in which a/cs of Union & States shall be kept.
Article 151	Audit Report of C&AG on a/cs of CG/SG submitted to President/Governor of State to be laid before Parliament/State Legislative Assemblies.

C&AG shall hold office for term of six years or upto age of 65 years, whichever is earlier.

Organizations subject to C&AG Audit

- All Union and State Govt. deptts & offices including Indian Railways & Posts & Telecom.
- Public commercial enterprises controlled by Union & State govts, i.e. govt cos and corporations.
- Non-commercial autonomous bodies & authorities owned or controlled by Union or States.
- Authorities and bodies substantially financed from Union or State revenues.

Dept & Offices >> Commercial + Non Commercial >> Substantially financed

Audit of a/c by C&AG → Submission of a/cs & reports → 3 committees

[Constituted by Parliament & State Legislature]

3 Committees that Consider Audit Reports of C&AG

1. Public Accounts Committee: Duty to satisfy itself that:
   - ✓ that moneys were disbursed legally on service or purpose to which they were applied
   - ✓ that expenditure incurred was authorised
   - ✓ that re-appropriation has been made in accordance with provisions made (i.e.distribution of funds).
   - ✓ to examine statement of a/c of autonomous & semi - autonomous bodies, audited by C&AG

2. Estimates Committee: Examines estimates with a view to:
   - ✓ report what economies, improvements in organization, efficiency, consistent with policy underlying estimates may be effected
   - ✓ suggest alternative policies
   - ✓ examine whether money is well laid out within limit &
   - ✓ suggest form in which estimates shall be presented to Parliament

3. Committee on Public Undertakings (COPU)

- ✓ to examine reports & accounts of PSUs
- ✓ to examine reports of C&AG on public undertakings
- ✓ to examine autonomy & efficiency of PSU & whether they are managed as per sound business principles & prudent commercial practices
- ✓ to exercise such other functions vested in PAC & Estimates Committee not covered above & may be allotted by Speaker from time to time

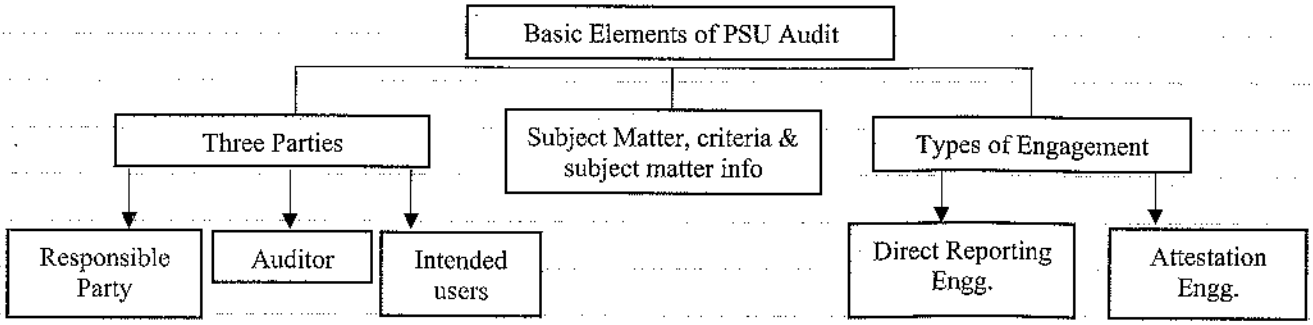
Note: COPU exercises same financial control on PSUs as PAC exercises over Govt depts.

C&AGs Role as Friend, Philosopher & Guide to committees

- His report forms basis of committee's working, they aren't precluded from examining other issues.
- Scrutinises notes submitted by ministries to committees to check correctness of submissions & facts & figures in their draft reports
- Financial Committees present Report to Parliament/ State Legislature with their observations & recommendations
  Ministries / Dept. of Govt reqd. to inform Committees of action taken by them on recommendations of Committees (which are generally accepted) & Committees present Action Taken Reports to Parliament / Legislature
- If A/R couldn't be discussed in detail, written ans. obtained from dept/ministries to ensure A/R not taken lightly by Govt even if entire report not deliberated by committee.

Objective & Scope of PSU Audit

1. Audit of PSU not constrained to Financial & Compliance audit: Also covers performance audit
2. Propriety audit
3. Comprehensive audit
4. Organisations decisions to be taken up by competent authority
5. Helping govt
6. Highlight issues of efficient & economic operations
7. Fiscal Accountability: Audit of provision of funds, sanctions, compliances & propriety
   Managerial Accountability: Efficiency, Economy & effectiveness





- ✓ Auditor: Its SAI (Supreme Audit Institution), India & person delegated by it for audit [SAI= C&AG + Indian Audit & Accounts Department]
- ✓ Subject matter: This refers to info., condition or activity measured or evaluated against criteria.
- ✓ Criteria: These are benchmarks used to evaluate subject matter.
- ✓ Subject matter info: Refers to outcome of evaluating or measuring subject matter against criteria.
- ✓ Attestation Engg.: Responsible party measures subject matter against criteria & presents subject matter info, on which auditor gathers SAAE to provide reasonable basis for expressing conclusion.
- ✓ Direct Reporting Engg.: Auditor measures or evaluates subject matter against criteria.

Financial audits are attestation engg, as they are based on financial info. presented by responsible party. Performance & compliance audits are generally direct reporting engagements.

Principles of PSU Audit

General Principles	Principles relating to Audit process
○ Ethics & Independence ○ Professional Judgement, due care and skepticism ○ Quality Control ○ Audit Team Mgt & Skill ○ Audit Risk ○ Materiality ○ Documentation ○ Communication	○ Planning the audit (Agreeing terms of engg, understanding entity, developing audit plan) ○ Conducting the Audit (Performing audit procedures, evaluating evidence & drawing conclusions) ○ Reporting & follow up (Reporting based on conclusions & following up on reported matters)

Compliance Audit

Independent assessment of whether given subject matter is in compliance with applicable criteria.

Compliance audit is concerned with:

a. Regularity- adherence of subject matter to formal criteria emanating from relevant laws, regulations & agreements applicable to entity.

b. Propriety- observance of general principles governing sound financial mgt & ethical conduct of public officials.

Perspective of Compliance Audit: Compliance auditing is generally conducted either

i) in relation with audit of F.S, or

ii) separately as individual compliance audits, or

iii) in combination with performance auditing.

Performance Audit

Objective & systematic examination of evidence for providing an independent assessment of performance of govt organization, program, activity, or function in order to

- ✓ provide info. to improve public accountability &
- ✓ facilitate decision making by parties with responsibility to oversee or initiate corrective action.

Conducted by? C&AG through subordinate offices of IAAD.

Auditing process adheres to manuals & standards set by C&AG, guiding subordinate offices in evaluating EEE of policies, programs, organizations & mgt.

(i) Economy: Minimize cost of resources used for an activity, having regard to qty, quality andbest price.

(ii) Efficiency: Input-output ratio. Max output with min input. or min input for given quality & qty of output

Check:

- Sound procurement policies followed
- Resources are properly protected & maintained
- Efficient utilization of physical, financial & HR
- Public sector prog/entities/ activities efficiently managed, regulated & organised
- Efficient operating procedures used

(iii) Effectiveness: Extent to which objectives achieved & relation b/w intended & actual impact of activity

Check:

- Objectives & means provided (legal, financial etc) for public sector prog. are proper, suitable & consistent with policy
- Determine extent to which results achieved
- Assess & establish with evidence that whether social & economic impact due to policy or other causes
- Assess effectiveness of program &/or individual components
- identify ways of making programmes work more effectively

Case study by ICAI

Performance audit of enforcement mechanism administering provisions of Minimum Wages Act

- ➢ Auditor possess knowledge of industries or labour contracts where provisions applicable
- ➢ Evaluate std of living before and after implementation of the Act
- ➢ Also evaluate EEE in welfare system to be audited
- ➢ Study shortcomings in coordination b/w different agencies like labor dept, ESI , EPF organisations
- ➢ Shall also point out lacuna in existing legal framework to strengthen objective of legislation.

Planning for performance Audit

- Understanding entity/programme

Sources of understanding the entity

Documents of entity	Legislative documents	Policy documents	Academic or spl research	Past Audits	Media Coverage

i) Documents of entity: Documents on administration & functions of entity, policy files, annual reports, budget docs, accounts, minutes of meetings, info. on website, internal audit reports, etc.

ii) Legislative documents: Legislation, parliamentary questions & debates, reports of PAC, COPU, Estimates Committee & letters from MP.

iii) Policy documents: Documents of Planning Commission, Ministry of Finance etc.

iv) Academic or special research: Independent evaluations on entity, academic research & similar work done by other govts and other SAIs.

v) Past audits: Past financial & performance audits of entity provide major source of info. & understanding.

vi) Media coverage: Print and electronic media - documentation on regular basis in a transparent manner.

- Defining objectives & scope of audit: Mainly focus on NTE of audit

- Determining audit criteria: Standards to determine if program meets expectations.

Audit criteria can be obtained from following sources:

- Procedure manuals of entity
- Policies, standards, directives, & guidelines
- Criteria used by same entity or others in similar activities or programs
- Independent expert opinion or know how
- New or established Scientific knowledge or other reliable info
- General mgt & subject matter literature & research papers

- Deciding audit approach: Determining methods & means to conduct performance audit.

Methods & means for conducting Performance audit

i. Analysis of procedures: It involves review of systems in place for planning, conducting, checking & monitoring the activity.

ii. Case studies: It's a descriptive analysis of entity, scheme or programme. Involves analysis of a particular issue within context of whole area under review.

iii. Use of existing data: Audit staff should investigate data held by entity & other relevant sources.

iv. Surveys: Method of collecting info. from population to assess interrelation of events & conditions.

v. Analysis of results: Carry out actual output-input analysis to determine efficiency of programme.

vi. Quantitative analysis: Examination of available data relating to financials like earnings, revenue, or data relating to programme implementation like details of beneficiaries etc.

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- Developing audit questions
- Assessing audit team skills and whether outside expertise required
- Preparing Audit Design Matrix
- Establishing time table and resources
- Intimation of Audit programme to audit entities

Read from ICAI SM

Objectives of audit in connection with a State Electricity Distribution Co. were to ascertain whether:

i) total cost of providing electricity is recovered by timely submissions to State Electricity Regulatory Commission

ii) tariff orders, sales circulars & sales instructions were issued timely, without any ambiguity. They were implemented in time

iii) metering, billing and collection was managed efficiently and effectively

iv) monitoring and internal controls were efficient.

What kind of audit is this? Prepare 2 sample observations which could be part of audit report.

This is a performance audit.

Sample observations could be:

i) Non replacement of defective/ burnt meters: Large no. of meters, in excess of permitted limit of 1% of total meters were defective & their replacement wasn't completed within stipulated time of 1 month. This resulted in billing on avg basis for several months. This could result in losses & administrative hassles & disputes with consumers.

ii) Under charging of meter rent: As per Schedule of Charges, Co. is required to charge meter rent of ₹30 per month for a single phase meter & ₹40 per month for 3 phase meter. It was observed that Co. had short charged meter rent of ₹60 lakh from 3 lakh consumers in 5 lakh bills during the period.



Comprehensive Audit

Efficiency cum performance audit. Locate area of weakness and extravagance for mgt info.

Some of issues examined in comprehensive audit are:

- Overall cost of capital compared with approved planned cost? Is there a substantial increase? If yes any extravagance or unnecessary expenditure?
- Has planned production or operational output achieved? Has there been Underutilisation of installed capacity or shortfall in performance & if so what caused it?
- Has Planned rate of return achieved?
- Are Systems of project formulation and implementation sound? Are there inadequacies?
- Are cost control measures adequate? Wastages in raw material consumption etc?
- Does enterprise have Research & Development program?
- Does enterprise have adequate system of Repair & Maintenance?

Propriety Audit

Verification of transaction under test of public propriety, commonly accepted customs & stds of conduct.

Principles of Propriety

- Expenditure not prima facie more than what occasion demands & official exercises same degree of vigilance as person of ordinary prudence would do with his own money
- Authority utilising power to sanction expenditure not accruing to its own benefit
- Funds not to be utilised to benefit particular person(s)
- Apart from agreed remuneration & reward no other indirect benefit to mgt or employees

Functions of Auditor in context of Propriety Audit may be specified as under as to :

- see that expenditure incurred are properly planned.
- see that size of expenditure are rightful & expected to give maximum results.
- appraise whether those expenditure are likely to give optimum result.
- see that any substitute plan of action can bring improvement & return from capital expenditure.
- examine that actions & decisions of mgt conductive to public interests & meet standards of conduct.

Parts of Audit Report of C&AG

- Introduction containing general review of working results of Govt Co/ deemed Govt Cos.
- Results of comprehensive appraisals of selected undertakings conducted by Audit board
- Resume of Co. Auditor's reports submitted under directions of C&AG & comments on a/cs of Govt cos.
- Significant results of audit of undertakings not taken up for appraisal by audit board.

Role of C&AG is prescribed u/s 143(5)/(6)/(7) of the Companies Act, 2013.

(1) Power to appoint Government Company Auditor :-

Section 143(5) → Govt Co. or any other Co. owned/controlled, by CG/SG(s)/partly by CG & one or more SGs, C&AG shall appoint auditor u/s 139(5)/(7) and direct such auditor manner in which a/cs to be audited and auditor shall submit a copy of A/R to C&AG which include

⇒ directions, if any, issued by C&AG,

⇒ action taken thereon and

⇒ its impact on a/cs and FS of Co.

(2) Power to conduct Supplementary Audit & comment thereupon :-

C&AG shall within 60 days from receipt of A/R have a right to,

a. conduct supplementary audit u/s 143(6)(a), of FS of Co. by such person(s) as he may authorize in this behalf & for purposes of such audit, require info or add. info to be furnished to any person(s) so authorised, on such matters, by such person(s), & in such form, as C&AG may direct

b. comment upon or supplement such A/R u/s 143(6)(b).
Comments given by C&AG upon, or supplement to, A/R → sent by Co. to every person entitled to copies of audited FS & also placed before AGM at same time & manner as A/R.

(3) Test Audit u/s 143(7): C&AG may by order, cause test audit be conducted and provisions of Sec 19A of C&AG's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to such test audit.

"Discipline is the Bridge between Goals & Accomplishment"

Independent assurance

- on effectiveness of internal controls & risk mgt processes
- to enhance governance & achieve organisational objectives

Indicative Objectives and scope of Internal Audit

- Monitoring of internal controls : Performing 3 way matching of PO, receipt of material (GRN) and vendor invoices before approving vendor payment
- Examination of financial & operating information: Internal Audit of sales records, delivery records, sales commission for identifying correctness of revenue recorded
- Review of operating activities: Reviewing Inventory mgt activities & appropriate handling to prevent damages
- Review of compliance with laws and regulations: Compliance with newly applicable Tax Regime.
- Risk management: Evaluation & mgt of Risk Exposure for complex financial instruments transactions
- Governance: Assessment of Governance Process in achieving objectives on ethics & values.

Applicability of Internal Audit

Sec 138 of Companies Act, 2013 read with Rule 13 of Companies (Accounts) Rules 2014

- Listed Cos
- Unlisted public Companies
  - Deposits >= 25 Cr (anytime) or
  - PUSC >= 50 Cr or
  - Borrowings (Bank/FI) > 100 Cr (anytime) or
  - T/o >= 200 Cr
- Pvt Co.
  - Borrowings > 100 Cr (anytime) or
  - T/o >= 200 Cr

} [during preceding FY]

Note: Co. which gets covered under any of above criteria shall comply with requirements within 6 months of commencement of such applicability.

JKT Pvt. Ltd. having ₹ 40 lacs paid-up capital, ₹9.50 crores reserves and turnover of last 3 consecutive FY, immediately preceding FY being ₹ 49 cr, ₹ 145 cr and ₹ 260 cr, but doesn't have any internal audit system. In view of mgt, internal audit system is not mandatory. Comment.

In given case, JKT Pvt. Ltd. is having a t/o of ₹ 260 crores during preceding FY which is more than 200 cr. Hence, co. has statutory requirement to appoint Internal Auditor and conduct internal audit.

Who can be Internal Auditor?

- Individual/firm/body corporate
- CA/Cost a/c /any other professional whether in practice or not
- May or may not be employee of Co.

AB Pvt. Ltd. Co, having o/s loans & borrowings from banks > ₹100 Cr, wants to appoint Mr. X, a practicing cost accountant, as an internal auditor. Is appointment of Mr. X valid?

Internal auditor shall either be a CA or cost accountant (whether engaged in practice or not), or such other professional as may be decided by Board to conduct an internal audit of companies.

Thus, Appointment of Mr. X as internal auditor of AB Pvt. Ltd is valid.

Critical Activities performed by Internal Audit Function

- Define overall plan, scope & methodology of Internal Audit Function on a periodic basis.
- Oversee & monitor various audit assignments, their proper planning, execution, reporting of findings & subsequent closure of reported observations.
- Plan, acquire, engage & review performance, training & development of professional staff, talent & other resources to achieve its objectives.
- Identify, source, engage & manage external experts & technical solutions, if required.
- Communicate & engage with all key stakeholders regarding progress & achievement of objectives.

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Main Responsibilities of Internal Auditor [A/c function & financial records]

- Maintain adequate system of Internal Control by continuous examination of accounting procedures
- To operate independently of a/c staff & not divert from his responsibilities
- Not involve himself in performance of executive functions to maintain objective outlook
- Observe facts & situations, bring them to notice of authorities who would otherwise never know them
- Associate closely with mgt & keep knowledge upto date about business
- At all times, must enjoy independent status

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Scope of Internal Auditor's work includes review of:

1. Internal control systems & procedures
   - Assess design & operating efficiency & effectiveness of IC
   - To minimize overall internal audit risk i.e. inherent risk, control risk & detection risk
   - Controls should be inbuilt in operating functions → cost effective
   - Review should consider limitations of Internal Control → cost benefit, human errors, collusion & abuse by process owner
2. Custodianship & Safeguarding of Assets
   - Verify existence of assets
   - Review Segregation of Duties is in place
   - Ensure all assets accounted fully
   - Review control systems for intangible assets e.g. procedures related to credit control
3. Compliance with Policies, Plans, Procedures & Regulation

   Point out specific weakness & suggest remedial action
4. Relevance & Reliability of Information
   - Review information systems
   - Examine whether reporting by exception i.e reports highlight significant & distinctive features
5. Review of Organisation structure
   - Review Manner in which activities of organisation are grouped for managerial control.
   - Examine organisation chart to check structure is simple & economical & no function enjoys undue dominance over others
   - Responsibilities of managerial staff at headquarter shouldn't overlap with chief executives of operating units
   - Examine reasonableness of Span of control of each executive (no. of subordinates that executive controls). There should be Unity of Command i.e. each person report to one 1 superior.
   - Where dual responsibilities can't be avoided, primary one should be specified
   - Evaluate process for managerial development in enterprise.

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6. Review of utilisation of Resources
   - Check proper operating std & norms established for economic & efficient use of resources
   - Whether detailed enough to be identified with specific operating responsibilities
   - Review method of establishing operating standards & norms. Examine the assumptions.

- Where there is wide divergence between actual performance & std, reasons maybe considered

7. Accomplishment of Goals & Objectives
   - Objectives clearly stated & attainable
   - Expressed in quantifiable terms
   - Sufficient flexibility in plan to permit improvements

Qualities of Internal Auditor

1. Special expertise for evaluating management control system esp. financial & accounting controls
2. Must have Accounting & financial expertise to discharge his duties
3. Expected to evaluate operational performance & non-monetary controls. Requires basic knowledge of technology & commercial practices of entity
4. Basic knowledge of commerce, laws, taxation, cost accounting, tax, economics, EDP systems.
5. Understanding of mgt principles & techniques & ability to deal with people.
6. By conduct his provide assurance to mgt that confidentiality will be maintained

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Performing Internal Audit Engg.

Step 1 – Obtain knowledge of Business and its Environment

- Conduct meetings with key stakeholders, BOD and KMP to obtain understanding of organization's business environment, its operations, vision, mission and top mgt's expectations from audit functions.
- Obtain understanding of various business documents - SOPs & F.S Etc.
- Also obtain understanding of underlying IT landscape, various applications & ERP systems & MIS of organization.

Step 2 - Perform Audit Planning

- Audit scope must be approved by Audit Committee & BOD.
- Once approved, IA must share detailed Audit Plan with KMPs & plan in advance detailed schedule of Audit to be conducted.
- Conduct opening meeting with key stakeholders before start of audit engg. & share details of Information & System Access required to perform audit.
- Detailed work plan prepared by audit managers & approved by Head of IA / Chief Internal Auditor.
- Plan prepared after performing evaluation of all major risks in process being reviewed & audit checks to be performed to assess adequacy of control environment to mitigate such risks.

Step 3 – Gather required information

- Obtain reqd info. & perform checks to ensure correctness & integrity of info. received.
- Obtain info. directly from source.
- Adequate planning should be done & advance intimation should be made for any interim info. needed for performing audit checks.

Step 4 – Perform audit checks

- Analytical Procedures: Collate all data & perform analytical procedures to identify key trends & outliers.. Relevant analytical tools may be used to review complete data for audit period.
- Sampling: Select sample. Detailed audit testing performed as per audit work plan.
- Evidence: Adequate evidences must be collected and stored as. Prepare lists of audit issues & controls gaps.
- Reporting: Interim reports may be issued after proper review of work performed.
- Documentation :Adequate document of work papers to be ensured.

Step 5 – Reporting of Internal Audit Issues

- Prepare draft report of Internal Audit comprising of
  - ✓ business process/ function reviewed as per scope,
  - ✓ detailed audit coverage and exclusions,
  - ✓ audit period covered,
  - ✓ summary along with detailed issues over gaps noted with implication on business &
  - ✓ recommendation to mitigate identified gaps.
- Mgt Action Plan should be agreed with responsibility of action & timelines for actions.
- Also review status of actions taken by mgt against actions agreed during previous audits & report status of such follow up in audit report.
- Thereafter circulate Final Report & present findings to Audit Committee.

2 Stages Reporting

SIA 370 Reporting by IA in 2 stages:

1) At end of assignment report covering specific area or function of entity is prepared highlighting key observations. Details of manner of conducting assignment & key findings from audit. Issued to Auditee with copies to local mgt agreed in planning phase.
2) On periodic basis, at close of plan period, report on IA activities covering Entity & plan period is prepared by Chief Internal Auditor (or EP in case of external service provider). Normally done on Quarterly basis & submitted to Audit Committee.

This SIA pertains to responsibility to issue only IA report pertaining to specific assignments.

Typical internal audit report should include the following:

- Audit Scope performed
- Audit period Covered
- Executive Summary
- Summary of critical findings
- Detailed audit findings with elaboration on business impact & root cause of such issues
- Rating of highlighted issues (Eg High/Medium/Low) as per criteria approved by Audit Committee
- Audit recommendation to improve control environment & address the highlighted finding
- Response received from responsible functional authority containing action plan &
- Target timelines for action

Key Elements of Internal Audit Report

a) Overview of scope, objective & approach of audit assignments
b) Fact that Internal audit completed as per Standard on Internal Audit
c) Executive summary of key observations covering important aspects & specific to scope of assignment
d) Summary of corrective actions required(or agreed by mgt) for each observation
e) Nature of assurance, if any, which can be derived from observations.

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Follow Up

- As per SIA 390 Monitoring & Reporting of Prior Audit Issues (PAI), ChIA is responsible for continuously monitoring closure of PAI through timely implementation of action plans.
- Responsibility to implement action plans stays with mgt.
- IA review follow up action taken by mgt based on his observations.
- If no action taken in reasonable time, draw mgt attention to it.
- Where mgt not acted on his suggestions or implemented recommendations → IA ascertain reasons
- Where mgt accepted recommendations & initiated necessary action, IA review manner & extent of implementation of recommendations & report recommendations not implemented fully/partly.

Typical Action Taken Report may include the following:

- Reference to previous audit reporting containing the reported issues
- Implementation Action agreed by mgt along with target implementation date
- Status of action taken by mgt. The same may be classified under Implemented / Not Implemented
- Residual risk and rating for any unimplemented action
- Audit findings not implemented for long period of time

- Any critical audit finding that require immediate action for action or implementation

Relationship b/w Internal Auditor(IA) & External Auditors(EA)

- Scope & objective of Internal audit dependent on size & structure of entity & requirements of mgt.
- IA reviews a/c systems & internal control, examines financial & operating info for mgt, there's a lot of overlap b/w work of IA & EA.
- Work done by IA has important bearing on work of EA. Fn. of IA is integral part of system of IC.
- As per sec 138, Audit committee in consultation with IA formulate scope, functioning, methodology, & periodicity (SFMPE) for conducting Internal audit.
- Obligatory for stat auditor (EA) to examine scope & effectiveness of work carried out by IA.
- He should examine internal audit dept, strength of staff & qualification & powers.
- Extent of independence exhibited by IA & status in organisation, determine effectiveness of audit.
- EA should evaluate internal audit function to determine NTE of compliance & substantive procedures.

Difference between Internal & External Audit

Basis	Internal Audit	External Audit
Meaning	Ongoing audit function performed within an organisation by separate internal audit dept	Audit function performed by independent body not part of organisation
Examination	Examines operational efficiency of organisation	Examines accuracy & validity of F.S.
Appointment	By mgt	By members
Users of Report	Management	Stakeholders
Period	Continuous process throughout year	Done once in a year
Opinion	On the effectiveness of operational acts of organisation	On truthness & fairness of F.S.
Status of Auditor	Could be employee	Can't be employee

Factors responsible for high employee attrition rate are as under:

i. Job Stress & work life imbalance
ii. Wrong policies of the 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.

Miscellaneous Topics

Internal Audit as a Mgt Function

Management

- Mgt is a process by which affairs of entity are conducted so that goals & objectives are attained through optimum utilisation of all available resources, within legal, social, economic & environmental constraints.
- Mgt is a set of 5 general functions: planning, organizing, staffing, directing and controlling.
- While functions of planning, organizing, staffing & leading are critical attributes to create & grow stakeholder's wealth while controlling is to preserve stakeholder's wealth.

Internal Audit

- *"Internal audit provides independent assurance on effectiveness of internal controls & risk mgt processes to enhance governance & achieve organisational objectives".*
- IA is expected to evaluate mgt activities & advise on areas of improving internal controls and manage business and operational risks effectively by recommending appropriate mitigating controls.
- IA is important element of mgt controlling function
  - ✓ Helps mgt to set up appropriate systems & processes to mitigate risk while remaining independent to operations.
  - ✓ IA report on identified gaps & areas of weak internal control
  - ✓ Identify root cause of problems & suggest appropriate mitigating steps & strengthen internal controls of org.

Conclusion:

IA is seen as important function that helps mgt to achieve org. goals & work in an orderly manner.

Audit Trail

- Audit Trail (or Edit Log) is a visible trail of evidence enabling one to trace info. contained in statements or reports back to original input source.
- Audit trails are a chronological record of changes made to data. Any change to data including creating new data, updating or deleting data that must be recorded.

Records maintained as audit trail may include following info.:

- when changes were made i.e., date and time (timestamp)
- who made the change i.e., User Id
- what data was changed i.e., data/transaction reference; success/failure

In order to demonstrate that the audit trail feature was functional, operated and was not disabled, a Co. would have to design & implement specific internal controls (predominantly IT controls) which would be evaluated by auditors, as appropriate. Explain.

An illustrative list of internal controls reqd to be implemented & operated are given below:

Controls to ensure that:

- ✓ audit trail feature hasn't been disabled or deactivated
- ✓ access to audit trail (and backups) is disabled or restricted & access logs, whenever audit trails have been accessed, are maintained.
- ✓ changes to configurations of audit trail are authorized & logs of such changes are maintained.
- ✓ User IDs are assigned to each individual and User IDs are not shared
- ✓ periodic backups of audit trails taken & archived as per statutory period specified under provisions of Act.

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Approach to develop Internal Audit Plan

It should be developed in a manner that all business processes covering both financial & operational activities are reviewed by IA function within a defined time cycle.

Also, ensuring appropriate consideration is made and adequate balance is ensured to the following:

- ✓ Coverage of all auditable areas within defined time range
- ✓ Value that the internal audit can provide to the organization
- ✓ Effort involved in conducting the internal audit for a particular business process
- ✓ Risk underlying business process
- ✓ Risk Appetite of organization

SA 610: Using the work of Internal Auditor (IA)

- Sole responsibility of audit opinion → External Auditor (EA)
- EA has to obtain SAAE that work of IA Function or Internal auditor providing direct assistance is adequate for purpose of audit

  Internal Audit Function: Fn. of entity that performs assurance & consulting activities to evaluate and improve effectiveness of entity's governance, risk mgt and internal control processes (GRC).

  Direct Assistance: Use of internal auditors to perform audit procedures under direction, supervision and review (DSR) of external auditor.
- Scope of SA:
  a) Using work of IA Function in obtaining audit evidence &
  b) Using IA to provide direct assistance under direction, supervision and review (DSR) of EA
- This SA doesn't apply if entity doesn't have IA function/I.A.

Internal Audit Function

Objectives of Auditor where entity has internal audit function:

- To determine if work of IA function or direct assistance of Internal auditor can be used
- If using work of IA Function, determine whether work is adequate for Audit purpose
- If using Internal Auditor to provide Direct Asst, to DSR their work

Evaluating whether work of Internal Audit Function can be used for Audit Purpose

a. Extent to which IA function's organizational status & relevant P&P support objectivity of IA
b. Level of competence of IA function &
c. Whether IA function applies a systematic and disciplined approach, including quality control.

Determining Nature & Extent of work of Internal Audit Function that can be used

Types of Work of IA function that can be used by external auditor include following:

- Testing of operating effectiveness of controls.
- Substantive procedures involving limited judgment.
- Observations of inventory counts.
- Tracing transactions through the information system relevant to financial reporting.
- Testing of compliance with regulatory requirements.
- In some circumstances, audits or reviews of financial info. of subsidiaries that aren't significant components to group (where this does not conflict with requirements of SA 600).

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External auditor shall make all significant judgments in audit & prevent undue use of work of IA function, shall plan to use less of work of function & perform more of work directly:

a) More judgment is involved in:
(i) Planning & performing relevant audit procedures &
(ii) Evaluating audit evidence gathered;
b) Higher the assessed RoMM at assertion level, with special consideration given to significant risks
c) Less the IA function's organizational status & relevant P&P adequately support objectivity of IA &
d) Lower the level of competence of IA function.

Notes:

- Extent of involvement of external auditor: Be sufficiently involved in audit
- Communicate with TCWG how external auditor planned to use work of IA function, while sharing planned scope & timing of the audit.

Using Work of Internal Audit Function

1. Discussion & Coordination with IA Function: Discuss the planned use of its work with function as a basis for coordinating their respective activities.
2. Read reports of IA function relating to the work that external auditor plans to use to obtain understanding of nature & extent of audit procedures it performed & related findings.
3. External auditor shall perform sufficient audit procedures to determine adequacy of IA function for purposes of audit, including evaluating whether:
   a. Work of IA function been properly planned, performed, supervised, reviewed & documented;
   b. SAAE obtained to enable the function to draw reasonable conclusions &
   c. Conclusions reached are appropriate in circumstances & reports prepared are consistent with results of work performed.
4. Nature & extent of external auditor's audit procedures shall be depend on evaluation of:
   a. Amount of judgment involved
   b. Assessed RoMM
   c. Extent to which IA function supports objectivity of internal auditors &
   d. Level of competence of function.
5. Also evaluate whether external auditor's conclusions regarding IA function & determination of nature & extent of use of work of IA function for audit remain appropriate.

To determine adequacy of specific work performed by internal auditors for external auditor's purposes, external auditor shall evaluate whether:

i. Work was performed by internal auditors having adequate technical training and proficiency
ii. Work was properly supervised, reviewed and documented

iii. Adequate audit evidence has been obtained to enable internal auditors to draw reasonable conclusions

iv. Conclusions reached are appropriate in circumstances and any reports prepared by internal auditors are consistent with results of work performed and

v. Any exceptions or unusual matters disclosed by internal auditors are properly resolved.

Direct Assistance

Using internal auditors to provide direct assistance is not prohibited

a. Evaluation of existence & significance of threats to objectivity & level of competence of IA.

b. Evaluation of existence & significance of threats shall include inquiry of internal auditors regarding interests & relationships that may create a threat to their objectivity.

Factors to be considered while evaluating existence & significance of threats to objectivity of Internal Auditor

- Extent to which IA function's organisation status & relevant P&P support objectivity of IA
- Family & personal relationships with individual responsible for aspect of entity to which work relates.
- Association with division or department in entity to which work relates.
- Significant financial interests in entity other than remuneration on terms consistent with those applicable to other employees.

External auditor shall not use an internal auditor to provide direct assistance if:

a. There are significant threats to objectivity of internal auditor or

b. Internal auditor lacks sufficient competence to perform proposed work. This amounts to weaknesses in Internal Control System if internal auditor does not apply required test procedures considering Materiality. This would result in Higher Audit Risks.

Written Agreements: Prior to using IA to provide direct assistance for purposes of audit

a. From authorized representative of entity that IA will be allowed to follow external auditor's instructions, & entity will not intervene in work IA performs for external auditor and

b. From internal auditors that they will keep confidential specific matters instructed by external auditor and inform about any threat to their objectivity.

Areas where Internal auditor can't provide Direct Assistance

a. Involve making significant judgments in audit

b. Relate to higher assessed ROMM where judgment required in performing relevant audit procedures or evaluating audit evidence gathered is more than limited

c. Relate to work with which internal auditors have been involved and which has already been, or will be, reported to Mgt or TCWG by internal audit function or



d. Relate to decisions external auditor makes as per this SA regarding internal audit function and use of its work or direct assistance.

Significant judgments include following:

- Evaluating Sufficiency of tests performed
- Evaluating adequacy of disclosures in F.S, and other matters affecting auditor's report.
- Evaluating appropriateness of management's use of going concern assumption
- Assessing RoMM
- Evaluating significant accounting estimates

Documentation: External auditor uses IA to provide direct assistance

a. Evaluation of existence & significance of threats to objectivity & level of competence of internal auditors used to provide direct assistance
b. Basis for decision regarding nature & extent of work performed by internal auditors
c. Who reviewed work performed and date and extent of that review in accordance with SA 230
d. Written agreements obtained from authorized representative of entity and the internal auditors
e. Working papers prepared by internal auditors who provided direct assistance on audit engagement.

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Review of work performed by Internal Auditors

External auditor shall direct, supervise & review work performed by IA as per SA 220.

a. NTE of direction, supervision & review shall recognize that internal auditors are not independent of entity &
b. Review procedures shall include external auditor checking back to underlying audit evidence for some of the work performed by internal auditors.

"If you want to fly, give up everything that Weighs you down"

CHAPTER 10

Due Diligence



It is process of investigation,

- performed by investors,
- into details of a potential investment
- such as examination of operations & management & verification of material facts.

- It includes conducting inquiries for disclosure of all material info, which may influence outcome of transaction.
- Involves study of financial as well as non-financial possibilities for successful implementation of restructuring plans.
- Involves an analysis carried out before acquiring a controlling interest in a Co. to determine that conditions of business conform with what has been presented about target business.
- Also, it can apply to recommendation for investment or advancing a loan/credit.

Who can do DD? Any person.

Areas where due diligence may be undertaken are: - Corporate restructuring, Venture capital financing, Public offerings

Importance of D.D. [Main Reasons]

- To confirm that the business is what it appears to be
- To gain information that will be useful for valuing assets, defining representations and warranties, and/or negotiating price concessions; and
- To identify potential 'deal killer' defects in target Co. & avoid bad business transaction
- To verify that transaction complies with investment or acquisition criteria.

Identify → Verify → Confirm → Gain info.

Classification of Due Diligence

- Commercial/Operational: Performed by acquirer for evaluation from commercial, strategic and operational perspectives. For eg, whether proposed merger would create operational synergies.
- Financial: Analysis of books of a/c and other info pertaining to financial matters of entity.
- Tax: Looking at tax effect of merger or acquisition.
- Information system: It pertains to all computer systems & related matter of entity.
- Legal: Legal aspects of functioning of Entity are reviewed.
- Environmental DD: Study entity's environment, its flexibility & adaptiblity to acquirer entity.
- Personnel: Ascertain that entity's personnel policies are in line or can be changed to suit requirements of restructuring.

Scope of Financial Due Diligence

a) Brief history of target Co. & background of promoter

b) Accounting policies : Check if appropriate & see if changed in recent past

c) Review of F.S. : FS prepared as per a/c std, statute, Framework for PPFS + Extraordinary items + Trading results of past 4/5 years to arrive at normal profit

d) Taxation: Tax implications of merger

e) Cash flow: It is important to know if company is able to meet its cash requirements.

It is necessary to check that:

a. Is Co. able to honor its commitments to trade payables, banks, govt & other stakeholders?
b. How well is Co. able to turn its trade receivables and inventories?
c. How well does it deploy its funds?
d. Are there any funds lying idle or is the Co. able to reap maximum benefits out of available funds?
e. What is investment pattern of Co. & are they easily realisable?

f) Financial projection: For next 5 years with assumptions & workings

g) Management & employees: Retention, impact of labour litigations, ESOPs, Sales incentives promised

h) Statutory compliance: If not legally compliant may have to pay penalty

Hidden Liabilities

- Co. may not show any show cause notice which have not matured into demand as contingent liabilities. These maybe material & important.
- Co. may have given Letters of comfort to Banks & Financial Institutions. Since these aren't guarantees may not be shown in BS of target Co.
- Tax liabilities under direct & indirect taxes.
- Long pending sales tax assessments.
- Pending final assessment of custom duty where only provisional assessment has been completed.
- Agreement to buy-back shares at stated price
- Future lease liability
- Unresolved labour litigations

Over-Valued Assets

- Uncollected/uncollectable receivables.
- Obsolete, slow non-moving inventories or inventories valued above NRV.
- Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
- Intangible assets of no value



- Litigated assets and property.
- Investments carried at cost though realizable value is much lower.
- Investments carrying a very low rate of income / return.
- Infructuous project expenditure/deferred revenue expenditure etc.

Work approach to DD

→ Reviewing and reporting on financials submitted by target Co.
→ Assessing business first hand by a site visit (if applicable).
→ Working through due diligence process with acquisitioning Co. or investor by defining key areas.
→ Helping prepare an offer based on completion of due diligence

Review & Report + Site visit → Acquirer → Offer (₹)

How to conduct DD?

✓ Start with open mind. Identify trouble spots & ask for explanation.
✓ Get best team of people. You may hire DD experts after checking experience record.
✓ Get help in all areas to get 360-degree view of the acquisition candidate.
✓ Talk to customers, suppliers, business partners, and employees are great resources.
✓ Take a risk mgt. approach.
✓ Prepare comprehensive report detailing compliances & substantive risks/issues

Contents of DD Report

- Executive summary
- Intro.
- Background of Co.
- Brief history of Co.
- Objective of DD
- Terms of reference & scope of verification
- Assessment of Financial Liabilities
- Assessment of valuation of assets
- Assessment of Net Worth
- SWOT Analysis

CHAPTER

11 Forensic Accounting

Particulars	Other Audits	Forensic Accounting
Objectives	Express an opinion as to 'True & fair' presentation	Whether fraud has actually taken place in books
Techniques	Substantive & compliance. Sample based.	Investigative, substantive & in-depth checking
Period	Accounting period	No such limitation
Verification of stock, estimation realizable value of assets, provisions, liability etc	Relies on mgt certificate/representation	Independent Verification of suspected/selected items where misappropriation expected
Off balance sheet items (like contracts etc)	Used to Vouch arithmetic accuracy & compliance with procedures	Regulatory & propriety of these transactions/contracts examined
Adverse findings if any	Negative or qualified opinion expressed with/without qualification	Legal determination of fraud impact & identification of perpetrators depending on scope

Forensic Accounting Services

Indicative list of services that can be provided by Professional in this area are as follows:

- ✓ Financial Statement manipulations
- ✓ Related party transactions/valuations
- ✓ Valuations/Estimations of loss/damage
- ✓ Fund diversions/Asset tracing
- ✓ Anti-Money laundering
- ✓ Suspicious transactions under IBC (Insolvency and Bankruptcy Code)
- ✓ Licence Fees/Dues/Tax Evasion

Need for forensic Accounting

Forensic auditor is often involved in:

1. Fraud Detection: Investigating and analyzing financial evidence, detecting financial frauds and tracing misappropriated funds.
2. Computer Forensics: Developing computerized applications to assist in recovery, analysis and presentation of financial evidence.
3. Fraud Prevention: Either reviewing internal controls to verify their adequacy or providing consultation in development & implementation of internal control framework aligned to organization's risk profile.
4. Providing Expert Testimony: Assisting in legal proceedings, including testifying in court as expert witness and preparing visual aids to support trial evidence.

Process of Forensic Accounting

1. Initialization:
   - ➢ Clarify and remove all doubts as to real motive, purpose & utility of assignment.
   - ➢ Helpful to meet client to obtain understanding of important facts, players & issues at hand.
   - ➢ Conflict check should be carried out as soon as relevant parties are established.
   - ➢ Preliminary investigation prior to development of plan allows planning to be based upon a more complete understanding of issues.

2. Develop Plan: Consider knowledge gained by meeting with client & initial investigation. Now set out objectives to be achieved & methodology to be utilized to accomplish them.

3. Obtain relevant evidence: Evidence should be sufficient to ultimately prove identity of fraudster(s), mechanics of fraud scheme, and amount of financial loss suffered.
   - ➢ It's important that investigating team is skilled in collecting evidence to be used in a court case within stipulated time & keeping a clear chain of custody until evidence is presented in court.
   - ➢ If evidence is inconclusive or there are gaps in chain of custody, then evidence may be challenged in court or become inadmissible.
   - ➢ Be alert to documents being falsified, damaged or destroyed by the suspect(s).

4. Perform the analysis:
   Actual analysis performed will be dependent upon nature of assignment and may involve:
   - ✓ calculating economic damages
   - ✓ performing present value calculations utilizing appropriate discount rates
   - ✓ summarizing a large number of transactions
   - ✓ utilizing charts and graphics to explain the analysis
   - ✓ utilizing a computerized application such as a spread sheet, data base or computer model
   - ✓ performing a regression or sensitivity analysis

5. Reporting
   - ○ Final step of forensic accounting. Auditors will include info. detailing fraudulent activity, if any found.
   - ○ Client will expect report containing findings of investigation, including summary of evidence, conclusion as to amount of loss suffered as result of fraud and identify those involved in fraud.
   - ○ Report may include sections on nature of assignment, scope of investigation, approach utilized, limitations of scope & findings and/or opinions.
   - ○ Include schedules and graphics necessary to properly support and explain findings.
   - ○ Report will also discuss how fraudster set up fraud scheme & controls, if any, were circumvented.
   - ○ Likely that investigative team will recommend improvements to controls within organization to prevent any similar frauds occurring in future.

- Forensic auditor should have active listening skills enabling him to summarize facts in report.
- Should be kept in mind that report should be based on facts assimilated during process & not on opinion of person writing report.

6. Court Proceedings: Evidence gathered will be presented in court proceedings & team members may be called.

Forensic accounting & Investigation Report

One engg. may include multiple assignments, multiple reports may have to be issued; one for each assignment.

1. Written Report which conveys results of assignment clearly & accurately. Findings reported shall be based on evidence gathered which are reliable and relevant. Thus, Professional shall issue a written report which is precise & unambiguous.

2. Report addressee and distribution: Addressed to Primary Stakeholders & shared with other stakeholder(s) if required or otherwise permissible

3. Format or Content of Report: No fixed format mandated by this Standard, report shall include certain key elements to enable recipient to understand purpose of assignment, extent & scope of work performed by Professional, limitations, assumptions or disclaimers, facts & evidence gathered & conclusions drawn. Where form & content of report is mandated by stakeholders, or specified by statutory or regulatory requirements, report in line with those requirements including key elements.

Key Elements of Report

Consider inclusion of following key elements in report (indicative list):

- ✓ Title, addressee and distribution list (if any)
- ✓ Scope and objectives of assignment
- ✓ Approach & broad work procedures undertaken
- ✓ Executive Summary of results, covering all important aspects and the essence of the findings
- ✓ Reference to use of an expert, where applicable
- ✓ Fact that assignment conducted in accordance with FAIS, or any material departures therefrom
- ✓ List of findings supported by key evidences, sources of evidences, and other relevant matter
- ✓ Assumptions, limitations and disclaimers of assignment
- ✓ Conclusions (if any) drawn from assessment undertaken.

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4. Discussion of Draft report: Where mandate of engg. requires discussion of findings with subject party (chor) prior to finalisation, summary of responses recd. from them shall be included in report.
   - → Further, Principles of Natural Justice requires discussion of observations with subject party.
   - → In some cases, this is done by Primary Stakeholders through their own internal processes (e.g., disciplinary committee, show-cause notice, etc.).
   - → At times, Professional is requested to incorporate discussion of draft findings as part of interview process with subject.
   - → Where engg. mandate requires discussion of draft findings with subject party, any response received shall be included in written report issued by Professional.

5. Assumptions and Limitations: List relevant assumptions made during assignment having a significant bearing on subject matter.
   - → In addition, Professional may encounter limitations that restrict methodologies or procedures applied in carrying out assignment.
   - → Such limitations can be in form of lack of mgt support, restricted (or denied) access to reqd. records, info. or people, due to any reason such as court orders, short timelines, etc.
   - → These disclaimers would be covered in report as a key element of report.

Report shall not express an opinion or pass any judgement on guilt or innnocence. Determination of culpability is either a disciplinary process internal to organization under review, or a judicial process depending on specific situation under review. Report can at best, highlight circumstances & facts that may aid a stakeholder decision or further a civil or criminal investigation.

6. Reporting Timelines: Report shall be issued within reasonable time frame as per engg. terms. Professional may be required to provide interim reports as per engg. terms which can be given to extent practicable without compromising progress of investigation.

"The secret of getting things done is to ACT"

CHAPTER 12

Investigation



Audit vs Investigation

Basis	Investigation	Audit
Nature	Voluntary	Mandatory
Observance of a/c principles	Analytical, involves application of mind	Compliance with GAAP, Audit procedures & disclosure requirements
Objective	Aims at establishing a fact or happening or assessing particular situation.	Verify whether F.S. give a true & fair view of state of affairs of entity.
Periodicity	Not limited by rigid time frame	Qtrly, half yearly or annually
Reporting	To person on whose behalf investigation carried out	To owners of business entity
Scope	Maybe Governed by statute/non statutory	Scope is wide, for statutory audit governed by law

Steps in Investigation

1. Determination of objectives & establishment of scope of investigation
2. Formulation of the Investigation programme.
   Investigation programme should be drawn up having regard to:
   a. Nature of business
   b. Structure of business organization
   c. Instructions from client embodying objectives & scope of work
   d. Consequent scope & depth of investigation
   e. Necessity to extend investigation into books & records of others.
   f. Concentrate on relevant areas rather than undertaking wide-ranging verification.
3. Examination & study of various records by reference to appropriate evidence.
4. Analysis, processing & interpretation of findings.
5. Preparation of report & drawing up of conclusions.

Important issues in mind by Investigator while preparing his report

- Report not contain anything which isn't relevant to highlight nature of investigation or final outcome.
- Every word/expression to be used properly to minimize possibility of different meaning/ interpretation.
- Facts & conclusions should be properly linked with evidence
- Basis & assumptions to be explicitly stated. Should be reasonable & not in conflict with objectives

of investigation.

- Report should clearly spell out nature & objective of assignment, its scope & limitations
- Report should be made in paragraph form with headings for the paragraphs
- Opinion of investigator in final paragraph of report.

Spl issues in investigation

- Whether to adopt cent percent verification approach or adopt selective verification

Depends on circumstances

- Amount of Cash defalcation → examine all cash vouchers
- Profitability of concern → adopt selective approach → statistical sampling

- Whether rely on already audited statement of a/c
  - Doubt on audited statement of a/c → no Question of reliance
  - Value of business/share/Goodwill → rely on audited materials

What if a/cs not audited?

- Natural duty to get figures in a/cs properly checked & verified.
- However, when accounts have been specially prepared by a professional accountant for purposes of investigation, he could accept them as correct relying on principle of liability to 3rd parties.
- Prudent to check that such a/cs prepared with objectivity & no bias crept in to give advantage to person on whose behalf these were prepared.

- Assistance of expert? May feel necessity of obtaining views & opinions of experts. Get written consent of client at beginning of investigation & settle question of costs for obtaining views

- Investigation out of disputes & conflicting claims
  - Remain above disputes
  - Alert of possibilities of info. available to be prejudiced
  - Be professional & keep the interest of all involved parties in view
  - Requires maturity & experience

- Basis of opinion
  - Refrain from issuing speculative opinion
  - Confine opinion to established facts, nothing more

- Futuristic Statements? Not allowed. may assume that established trend will continue in near future, in absence of contrary evidence, in arriving at present value of business. However, shouldn't project trend into future years to establish a value.

- Retain working papers or not?
  - Retain in his files full notes of work carried out, copies of schedules & annexures, facts, figures, record of conversations etc.
  - Should link up figures of books produced by client with his final figures
  - Take representation letter from appointing authority
  - Help in correlating facts & events while drafting report

Factors to consider for studying economic & financial position of business:

- Adequacy of fixed & working capital
- Trend of sales & profits in future?
- Whether profit maintained in future would yield adequate return on capital employed?
- Whether business operating at 100% capacity or improvements can be made?

Factors- future maintainability of turnover

- Trend: Whether in past sales increasing consistently or fluctuating.
- Marketability: Is it possible to extend sales to new market or they have been fully exploited?
- Political & economic considerations: Are policies of govt likely to extend market of goods to other countries?
- Competition: Is demand for competitor's products increasing? Is the Co's share in total trade constant or fluctuating?

Investigation on behalf of Incoming Partner

a. Ascertainment of History of inception & growth of firm.
b. Study provisions of partnership deed, composition of partners, capital contribution, drawing rights, job allocation etc.
c. Scrutiny of Record of profitability of firm's business over suitable no. of years.
d. Examination of asset & liability position to determine tangible asset backing for partner's investment, appraisal of value of intangibles like Goodwill, know how, patents etc.
e. Position of Orders in hand & quality of clientele should be thoroughly examined.
f. Study composition & quality of key personnel employed by the firm & their likelihood of leaving organisation in near future.
g. Reasons for offer of admission to new partner & whether any senior partner is retiring at same time.
h. Appraisal of Record of capital employed & rate of return.
i. Manner of Computation of goodwill on admission & retirement should be ascertained.

Investigation in Valuation of Shares of Pvt Co.

For equity shares, there are 2 main methods of valuation.

1st method: Value is determined on the basis of net worth of Co.
Net worth is divided by no. of shares comprising equity capital to arrive at value for one share.
When this method is followed, goodwill of business, and non-trading assets (like investments) based on estimated future maintainable profit, included in assets to arrive at amount of net worth.

2nd method: Capitalisation of Avg Profits

- Avg profit earned by business during preceding 5 to 7 years is computed.
- On the assumption that same would continue to be earned in future, value of business is calculated by capitalising it at reasonable rate of interest.
- If rate assumed is high, value of business would be smaller.
- Correspondingly, it would be high if rate of interest applied is low. A provision of risk factor and restriction on transfers in value of shares is made by varying rate of interest applied.
- Rate of return that investor expects to earn in a business of the type in which Co. is engaged, is ascertained from prices of shares of cos. engaged in similar business quoted on stock exchange.

Investigation on behalf of a Bank/ FI Proposing to Advance Loan to a Company

- ✓ Purpose for which loan is required & manner in which borrower proposed to invest the proceeds.
- ✓ Schedule of repayment submitted by borrower including assumptions of cash profits & cash available for repayment.
- ✓ Financial standing & reputation of business integrity enjoyed by directors & officers.
- ✓ Whether Co. is authorised by Memorandum or Articles of Association to borrow money for purpose for which loan shall be used.
- ✓ History of growth & development & performance in past 5 years.
- ✓ Whether any loan application made to other bank & if so reasons for rejection.

To investigate profitability of business to judge accuracy of schedule of repayment furnished by borrower & value of security in form of assets of business and those which will be created out of loan, investigating accountant should take under-mentioned steps:

a. Prepare condensed income statement from Statement of P&L for prev. 5 years, showing items of income, expenses, gross & net profits earned and taxes paid annually during each of 5 years. Amt of maintainable profits determined should be increased by returns on investment of borrowed funds.
b. Compute under-mentioned ratios separately to show trend as well as changes that have taken place in financial position of Co:
   i. Sales to Average Inventories held.

ii. Sales to Fixed Assets.
iii. Equity to Fixed Assets.
iv. Current Assets to Current Liabilities.
v. Quick Assets (the current assets that are readily realisable) to Quick Liabilities.
vi. Equity to Long Term Loans.
vii. Sales to Book Debts.
viii. Return on Capital Employed.

c. Enter in separate part of statement break-up of annual sales product-wise to show their trend.

Steps involved in verification of assets and liabilities included in B.S. of borrower Co.

a. Fixed Assets: Gross value, Rate of Depreciation, Total depreciation, Charge on asset, Revaluation Increase or decrease & comment on basis of revaluation

b. Inventory : Nature & types (RM,WIP,FG) + Basis of valuation. If pledged for loan, disclose loan

c. Trade Receivables:
- Debts where credit period not expired
- Debts due within 6 months
- Debts due but not recovered for over 6 months

Debts due from director/officere/employees. Recoveries after B.S. date.

d. Investments: Date of purchase, cost, nominal & market value. If pledged for loan, disclose loan.

e. Secured & unsecured loans: Debentures & secured loans. Details of assets pledged to be disclosed.

f. Provision for tax: PY up to which tax assessed. If provision inadequate, state fact with shortfall.

g. Insurance: Schedule of insurance policies, date of last premium etc.

h. Contingent liabilities: Ensure completeness of disclosure.

Fraud at operational level employees

(i) Tampering of Cheques/Drafts/On-line payments/receipts: On-line payments generally are considered a transparent mechanism to prevent the above frauds.

(ii) Off Book Frauds: Fraud perpetrator misappropriates cash before these are recorded in books or before sale is recorded in books.

(iii) Cash Misappropriation: Cash is misappropriated after a/c entries are passed in books.

(iv) Teeming and Lading: Cash deposits or cheques collected from customers being overlapped with collections from subsequent customers & amount collected is diverted to personal A/c. Reconciliation of customer a/cs at single point of time & confirmation for amounts outstanding in their accounts helps in identifying leakage in collections.

(v) Fraudulent Disbursements: Issuing or submission of false bills, or personal expense bills being converted into official expenses bills.

(vi) Expense Reimbursement Schemes: Expense claims based on duplicate bills or photostat copies.

(vii) Payroll Fraud: Payment to non-existent employees or in a contractual arrangement inflating of manpower resources than actually deployed while billing client.

(viii) Commission Schemes: Salesman exaggerates sales through fictitious billings to earn higher commission or alter sales prices of products sold from those stipulated by Co. or share sales volumes achieved with other employees to share higher commission.

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Situations in which frauds can occur

A. Cash Receipts

i) Issuing a receipt to payee for full amount collected and entering only part of amount on counterfoil.

ii) Showing larger cash discount than actually allowed.

iii) Adjusting cash sale as credit sale, and raising debit in account of customer.

iv) Writing off good debt as bad & irrecoverable to cover up amt collected which was misappropriated.

v) Short-debiting customer's account in ledger with intention to withdraw difference when full amount payable by him is collected.

Audit procedures:

✓ Carbon copies of receipts marked 'duplicate' checked to confirm they are copies of receipts issued earlier.

✓ Cash sales should be vouched in detail.

✓ Recoveries from customers should be checked with copies of receipts issued to them; deductions on account of cash discounts should be reviewed.

✓ Record of sales of scrap of waste paper, collection of rents from labourers accommodated in Co's quarters, etc should be examined for finding if any of these amts have been misappropriated.

✓ All withdrawals from bank checked by reference to bank pass book.

B. Inflating cash payment – Cash payment frauds may be in the form of:

i) Making double payment of invoice or paying false invoice.

ii) Paying personal expenses out of business by falsifying details. eg, showing betting losses as advertisement charges.

iii) Withdrawing unclaimed credit balances of customers or amounts falsely credited in a/c of parties.

iv) Falsely adjusting refund in a/c of customer & withdrawing credit balance.

v) Wrong totalling of wage sheets & misappropriating excess amount withdrawn from bank for payment of wages.

Audit procedures:

✓ All evidence about cash payments, including acknowledgement by parties, carefully scrutinised.

✓ Where a figure appears to have been erased or altered on receipts issued by party, actual amount paid to him should be confirmed.

✓ All payments by bearer cheques should be examined.

✓ System of recording of wages should be reviewed, for possible over-totalling of wage sheets, & entries in them of dummy workmen.

✓ System of ordering & receiving goods reviewed to confirm no payment made for supplies not recd.

✓ Confirmations obtained from partners or Directors for amounts shown to have been paid to them.

C. Frauds through suppliers' ledger –

i) Adjusting fictitious or duplicate invoices as purchases in a/c of suppliers & subsequently misappropriating amts when payments made to suppliers for these invoices.

ii) Suppressing Cr. Notes issued by suppliers & withdrawing amounts not claimed by them.

iii) Withdrawing amts unclaimed by suppliers, for one reason or another by showing same have been paid.

iv) Accepting purchase invoices at prices considerably higher than market prices & collecting excess amt paid, in cash, from suppliers.

Audit procedures

- ✓ Purchase Journal vouched by reference to entries in Goods Inward Book & suppliers' invoices to confirm that amts credited to suppliers in respect of goods duly recd & suppliers' a/cs credited correctly.
- ✓ All suppliers requested to furnish statements of their a/cs to see whether or not any balance is outstanding or due to confirm that allowances & rebates given by them have been correctly adjusted and duly authorized by authorized person/ officer.
- ✓ Examine system of internal control w.r.t purchase orders & possibilities of collusion with suppliers.

D. Customers Ledger

i) Teeming & lading

ii) Misappropriating amount collected from customer and subsequently adjusting his account by crediting amount on account of allowance or a rebate for excess price charged.

iii) Crediting amount received from a customer to account of another customer and subsequently withdrawing amount wrongly credited.

Audit procedures:

- ✓ Spl attention should be paid to allowances adjusted on account of goods returned or difference in price
- ✓ To confirm that accounts of customers have been debited in respect of goods supplied to them, entries in Order Book should be cross-checked with those in Sales Day Book where the same is kept.
- ✓ The accountant should obtain confirmation of customers in respect of amounts standing in accounts.
- ✓ Those of them who have no balance in accounts should be requested to confirm statement of their account (which should be sent to them) for ascertaining that the entries shown therein were genuine.

E. Inventory Fraud

- Employees remove goods from premises
- Theft of goods concealed by writing them off
- Inventory records manipulated by employees
- Inflating quantities issued for production for defalcating raw material



Verification Procedure for Defalcation of inventory

Such thefts are possible through collusion among no. of persons. Therefore, for detection, entire system of receipts, storage & despatch of goods should be reviewed to localise weakness in system.

Determining factors responsible for theft & establishment of guilt will be difficult in absence of:
(a) a system of inventory control & existence of detailed record of movement of inventory, or
(b) availability of sufficient data from which such a record can be constructed.

- ✓ First step is to establish different items of inventory defalcated & their quantities by checking physically quantities & those shown by Inventory Book.
- ✓ Defalcations of inventory also are committed by mgt, by diverting part of production & shortages in production adjusted by inflating wastage in production.
- ✓ For detecting such shortages, take assistance of engineer who shall be more conversant with factors responsible for shortage in production & determine extent to which shortage has been inflated.
- ✓ Guidance can also be taken from past records showing extent of wastage in production in past. He would be able to judge whether material issued was excessive and, if so to what extent.
- ✓ Per hour capacity of machine & time it took to complete one cycle of production, also would show whether issues have been larger than those required.

Indicators of Fraud

Several indications of possible frauds can be listed as follows :-

i) Discrepancies in Accounting Records including non-recording or partial recording or incorrect recording of amounts, misclassifications, etc.

ii) Conflicting or missing evidence including missing docs, altered docs, significant unexplained items in reconciliations, discrepancies between entity's records & confirmations received etc.

iii) Unacceptable management responses such as - denial of access to records/facilities/employees, undue time pressure to resolve complex issues, unusual delays in providing requested info., unwillingness to address identified deficiencies in internal control etc.

iv) Other indications such as - Accounting Policies in variance with Industry Norms, Frequent changes in a/c estimates etc.

Fraud Diamond: Four Elements of Fraud

- o Incentive: I want to, or have a need to, commit fraud.
- o Opportunity : There is a weakness in system that right person could exploit. Fraud is possible.
- o Rationalization: I have convinced myself that this fraudulent behavior is worth the risks.
- o Capability: I have necessary traits and abilities to be right person to pull it off. I have recognized this particular fraud opportunity and can turn it into reality.

Will Auditor be able to Detect it?

Auditor's ability to detect fraud depends on factors such as –

→ skillfulness of perpetrator
→ seniority of those individuals involved.
→ degree of collusion involved
→ relative size of Individual amounts manipulated
→ frequency & extent of manipulation

Investigation on behalf of an Individual or Firm Proposing to Buy a Business

A. Proprietary concerns or partnerships
   - ✓ Reasons for sale of business & effect on turnover & profits
   - ✓ Length of lease & prospects of renewal or extension
   - ✓ Unexpired period of patents
   - ✓ Age & prospects of employees continuing
   - ✓ Valuation of Goodwill

B. Ltd Co.
   - ✓ Authorised & issued share capital
   - ✓ Uncalled liability on shares
   - ✓ Capital divided in classes → rights of each class
   - ✓ Mortgage or charge on assets → registrar of charges
   - ✓ Price at which shares offered
     - Public co -> more than quoted price of stock exchange
     - Pvt co -> valuation

Investigation in connection with review of Profit/Financial Forecasts

Investigations which involve examination of future profits like,

1. Profit reports can be required as part of general investigation into purchase of a business or,
2. By banks and financial institutions with regard to project cash flow and profitability statements for appraisal of loan applications submitted by intending borrowers.
   - ➢ All forecasts depend on nature of business with its numerous and substantial uncertainties.
   - ➢ Therefore, such forecasts are not capable of verification in same way as F.S. which present results of a completed accounting period.
   - ➢ Normally, such situations involve special review as these depart from auditor's traditional role of expressing an opinion in relation to past events.

"The future belongs to those who believe in the beauty of their dreams."

SA 800, Special Considerations - Audits of FS prepared as per Special Purpose Frameworks (SPF)

Spl. purpose framework (SPF) is a FRF designed to meet financial info. needs of specific users. FRF may be a fair presentation framework or a compliance framework.

Examples of Special purpose frameworks are: -

- Cash basis of accounting & cash flow info. that entity may be required to prepare for creditors.
- FR provisions established by regulator to meet requirements of that regulator.
- FR provisions of contract, eg. bond indenture, loan agreement, or project grant.

✓ FRF designed to meet common financial info. needs of wide range of users → "General purpose framework"

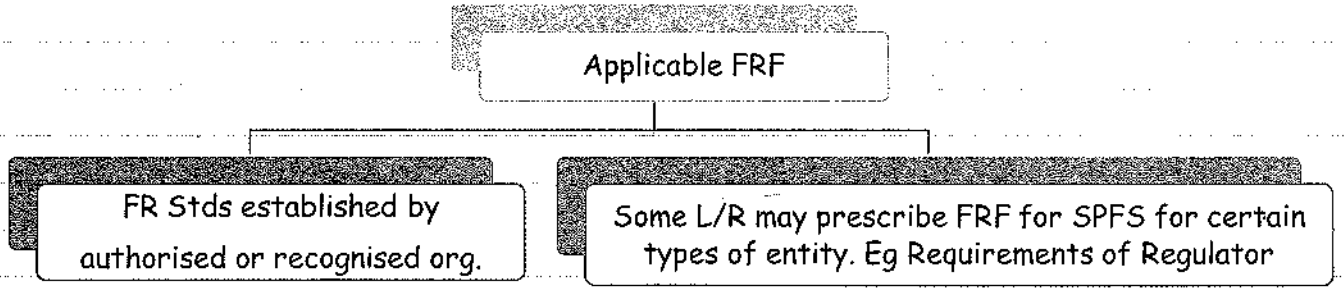
✓ FRF designed to meet financial info. needs of specific users → "Special purpose framework"

Note: Reference to "FS" in this SA means "a complete set of SPFS" including related notes. Related notes include summary of significant a/c policies & other explanatory info.

Considerations when Accepting such assignment

Main focus → Determining Acceptability of FRF

- In case of SPFS, financial info. needs of intended users are key factor in determining acceptability of FRF applied in preparation of F.S.



Note: Where financial reporting stds are supplemented by legislative or regulatory requirements. SA 210 requires auditor to determine whether any conflicts b/w financial reporting stds & additional requirements exist & prescribes actions by auditor if such conflicts exist.

- Applicable FRF may include Financial Reporting provisions of contract or sources other than described above.
- Acceptability of FRF determined by considering attributes of acceptable FRFs as per SA 210. For eg, for valuing net assets on date of sale, vendor & purchaser may agree on very prudent estimates of allowances for uncollectible a/c receivable, even though such financial info. isn't neutral compared with financial info. prepared as per a general purpose framework.

Considerations When Planning and Performing Such Audit

SA 200 requires auditor to comply with

a. relevant ethical requirements, including independence &
b. all SAs relevant to audit.

- Comply with each requirement of SA unless entire SA or requirement isn't relevant.
- In exceptional circumstances, auditor may judge necessary to depart from relevant requirement in SA by performing alternative audit procedures.

Application of some SAs in audit of SPFS may require special consideration by auditor (Examples)

Materiality [SA 320]

- Judgments about matters material based on consideration of common financial info. needs of users.
- In audit of SPFS, those judgments based on consideration of financial info. needs of intended users.

SA 315 requires auditor to obtain understanding of entity's selection & application of a/c policies.

- In case of FS prepared as per provisions of a contract, obtain understanding of any significant interpretations of contract that mgt made in preparation of FS.
- An interpretation is significant when adoption of another reasonable interpretation would have produced a material difference in info. presented in FS.
- In case of SPFS, prepared as per contract, mgt may agree with intended users on a threshold below which misstatements identified will not be corrected or adjusted.
- Existence of such threshold doesn't relieve auditor from determining materiality as per SA 320 for planning & performing audit of SPFS.

Communication with TCWG [SA 260]

- SA 260 requires auditor to determine appropriate person(s) within entity's governance structure to communicate. In some cases, all of TCWG are involved in managing entity & application of communication requirements is modified to recognize this position.
- When complete set of GPFS is also prepared by entity, those person(s) responsible for oversight of preparation of SPFS may not be same as TCWG responsible for GPFS.

SA 700 Forming opinion and reporting considerations in such audit

When forming opinion & reporting on SPFS, apply requirements in SA 700.

Description of Applicable FRF

- SA 700 requires auditor to evaluate whether FS adequately describe applicable FRF
- If F.S. prepared as per contract, evaluate whether FS adequately describe any significant interpretations of contract on which FS are based.

SA 700 deals with form & content of A/R, including specific ordering of certain elements.

In case of an auditor's report on SPFS: -

a. Auditor's report also describe purpose for which FS prepared & if necessary, intended users, or refer to note in SPFS that contain that info. &
b. If mgt has choice of FRFs, explanation of mgt's responsibility for F.S. also refer to responsibility for determining applicable FRF acceptable in circumstances.
c. When KAMs communicated in auditor's report on SPFS, SA 701 applies in its entirety.
d. SA 720: Reports containing/accompanying SPFS, where purpose is to provide owners (or similar stakeholders) with info. on SPFS –considered to be annual reports as per SA 720.
   "Similar stakeholders" includes specific users whose financial info. needs are met by SPF used to prepare SPFS. When auditor determines entity plans to issue such report, requirements of SA 720 applies.
e. As per SA 706, auditor may refer, in OM para in audit report on SPFS, to auditor's report on complete set of GPFS or to matter(s) reported.
   For eg, auditor may refer to MURG section included in auditor's report on complete set of GPFS.

Alerting Readers that FS Are Prepared as per a Special Purpose Framework (SPF)

- SPFS may be used for other purposes. For eg, regulator may require certain entities to place SPFS on public record.
- To avoid misunderstandings, auditor alerts users of auditor's report using EOM para explaining that
  - ✓ FS are prepared as per SPF &
  - ✓ therefore, may not be suitable for another purpose.
- SA 706 requires this para to be included within a separate section of audit report with appropriate heading that includes the term "Emphasis of Matter".

Example of Emphasis of Matter - Basis of Accounting & Restriction on Distribution & Use

We draw attention to Note X to FS, which describes basis of accounting.

FS are prepared to assist Co. in complying with financial reporting provisions of contract referred above. As a result, FS may not be suitable for another purpose. Our report is intended solely for Co. & DEF Co. Ltd & should not be distributed or used by parties other than Co. or DEF Co. Ltd.

Our opinion is not modified in respect of this matter.

Restriction on Distribution or Use

- In addition to alert, auditor may indicate that A/R is intended solely for specific users.
- Depending on L/R applicable, this may be achieved by restricting distribution or use of A/R.
- In these circumstances, para. alerting readers may be expanded to include these other matters & heading modified accordingly.

1. CA Lalita is auditor of a Co. She is also offered professional work of audit of FS prepared specifically for meeting requirements of a loan agreement for same period. She chooses to accept work & has made up her mind to disclose this fact in "Emphasis of matter Paragraph" in audit report to be issued by her for this specific engagement. Is her approach proper?

In given situation, approach of CA Lalita is proper. No bar upon accepting such an engg. even though she is auditor of Co. Besides, she has intended to disclose this fact in "EOM Para" of A/R to be issued by her for such specific engg.

2. CA Lakshmi has prepared a draft audit report for FS of X Ltd. prepared as per financial reporting provisions of a contract with Y Ltd. She has drafted an unmodified opinion to be given in audit report. Besides, she has also drawn attention in draft audit report to Note "A "to FS which describes the basis of accounting (under heading "Basis of accounting"). How she should ensure that report would not be misused? Draft a suitable para to be included in the report for this purpose.

She may consider it appropriate to indicate that A/R is intended solely for specific users.
Depending on law or regulation applicable, this may be achieved by restricting distribution or use of auditor's report. In these circumstances, para alerting readers may be expanded to include these other matters & heading modified accordingly.

<u>Draft para should read as under: -</u>
Basis of Accounting and Restriction on Distribution and Use
Without modifying our opinion, we draw attention to Note A to F.S, which describes basis of accounting. F.S. are prepared to assist Co. to comply with financial reporting provisions of contract referred above. As a result, FS may not be suitable for another purpose. Our report is intended solely for X Ltd. and Y Ltd. & shouldn't be distributed to or used by parties other than X and Y Ltd.

SA 805-Spl. Considerations—Audits of Single FS & Specific Elements, Accounts or Items of a FS.

Single FS is to be distinguished from complete set of FS. For eg, cash flow statement is single FS.
"Element of a FS" or "element" means an "element, a/c or item of a F.S."
For eg, trade receivables or cash & bank balances.
A single F.S. or specific element of a F.S. includes related notes comprising summary of significant a/c policies & other explanatory info. relevant to F.S. or element.

Note: Maybe prepared as per General/Special Purpose Framerwork. If SPF then SA 800 also applies.

✓ SA 805 doesn't apply to report of component auditor, issued as a result of work performed on financial info. of component at request of principal auditor for audit of Consol. FS.

Application of SAs

- SA 200 requires auditor to comply with all relevant SAs.
- In case of audit of single F.S. or specific element of F.S. this requirement applies irrespective of whether auditor also engaged to audit entity's complete set of F.S.
- If auditor not auditing complete set F.S → determine whether such audit as per SAs is practicable.

SA 200 requires auditor to comply with
(a) relevant ethical requirements, including independence & (b) all SAs relevant to audit.

- Requires auditor to comply with each requirement of SA unless entire SA isn't relevant or requirement is not relevant.
- In exceptional circumstances, auditor may judge necessary to depart from relevant requirement in SA by performing alternative audit procedures.

Compliance with requirements of SAs relevant to audit of a single FS or specific element of FS may not be practicable when auditor is not also engaged to audit entity's complete set of FS

- Auditor doesn't have same understanding of entity & its environment, including internal control, as auditor who also audits entity's complete set of FS.
- Also doesn't have audit evidence about general quality of a/c records or other a/c info. that would be acquired in audit of complete set of FS.
- So, auditor may need further evidence to corroborate audit evidence acquired from a/c records.
- For audit of specific element of FS, certain SAs require audit work that may be disproportionate to element being audited. For eg, SA 570 requirements likely to be relevant in audit of schedule of a/c receivable, complying with those requirements may not be practicable because of audit effort required.
- If auditor concludes that audit as per SAs may not be practicable, discuss with mgt whether another type of engg. might be more practicable.

Acceptability of FRF

- SA 210 requires determining acceptability of FRF applied in preparation of FS.
- For audit of single FS or specific element of FS, consider whether application of FRF will result in adequate disclosures enabling intended users to understand info in FS or element & effect of material transactions & events on info conveyed in FS or element.

Note:

- Single FS or specific element of FS may be prepared as per FRF established by authorised or recognised std. setting org. for preparation of complete set of FS.
- In such case, determine acceptability of applicable framework considering whether framework includes all relevant requirements of framework for presentation of single F.S. or specific element of F.S. that provides adequate disclosures.

Considerations When planning & performing Audit

Auditor shall adapt all SAs relevant to audit as necessary in circumstances of engg.

Even for audit of SEFS, SAs such as SA 240, SA 550 & SA 570 are relevant. This is because element could be misstated as a result of fraud, effect of related party transactions, or incorrect application of going concern basis of accounting under AFRF.

SA 260 requires auditor to determine appropriate person(s) within entity's governance structure to communicate.

- ✓ In some cases, all TCWG are involved in managing entity & communication requirements is modified to recognise this position.
- ✓ When complete set of FS is also prepared by entity, those person(s) responsible for oversight of preparation of SFS or SEFS may not be same as TCWG responsible for oversight of preparation of complete set of FS.

Audit Evidence

- When auditing (both) single F.S. or specific element of F.S. along with entity's complete set of F.S., auditor may be able to use audit evidence obtained as part of audit of entity's complete set of F.S. in audit of single F.S. or element.
- SAs require auditor to obtain SAAE to base opinion on single F.S. or element.

Inter-relation

- Individual FS that comprise a complete set of FS & many of elements of those FS, including their related notes, are interrelated.
- Hence when auditing single FS or specific element of FS, auditor may not be able to consider FS or element in isolation.
- Auditor may need to perform procedures in relation to interrelated items to meet objective of audit.

Materiality

- Materiality determined for a single F.S. or specific element of a FS may be lower than materiality for entity's complete set of FS
- Affecting NTE of audit procedures & evaluation of uncorrected misstatements.

Form of Opinion

SA 210 requires agreed terms of audit engg include expected form of reports to be issued by auditor.

For audit of single F.S. or specific element of F.S. → consider whether expected form of opinion is appropriate in circumstances.

Applicable FRF?

- For single FS or specific element of F.S, applicable FRF may not explicitly address presentation of FS or element.
- This may be case when applicable FRF is FRF established by authorised or recognised standards setting org. for preparation of complete set of FS
- Auditor considers whether expected form of opinion appropriate in light of applicable FRF.

Factors that may affect auditor's consideration as to whether to use phrases "presents fairly, in all material respects", or "gives a true and fair view" in auditor's opinion include:

- Whether applicable FRF is explicitly or implicitly restricted to preparation of complete set of FS.
- Whether single FS or specific element of FS will:
  - Comply fully with requirements of framework relevant to particular FS or element, & presentation of FS or specific element of FS include related notes & disclosures
  - If necessary to achieve fair presentation,
    - ✓ provide disclosures beyond those specifically required by framework or,
    - ✓ in exceptional circumstances, depart from a requirement of the framework.

Auditor's decision as to expected form of opinion is a matter of professional judgment.

Forming an Opinion and Reporting Considerations

When forming opinion & reporting on single F.S. or specific element of F.S → apply SA 700

SA 700 requires, in forming opinion, to evaluate whether FS provide adequate disclosures to enable intended users to understand effect of material transactions & events on info. conveyed in FS.

- Going Concern: Depending on AFRF used in preparation of SFS or SEFS, description of mgt & auditor responsibilities in auditor's report relating to going concern may need to be adapted, as necessary.

- Key Audit Matters: SA 700 requires auditor to communicate KAM as per SA 701 for audits of complete sets of general purpose FS of listed entities.
- Other Info: As per SA 720 reports containing or accompanying SFS or SEFS, where purpose is to provide owners (or similar stakeholders) with info. on SFS or SEFS, considered to be annual reports. When entity plans to issue such report, SA 720 apply to audit of SFS or SEFS.
- Signature of the Auditor: Signed by auditor (i.e. engg. partner) in his personal name & firm name (if firm appointed). Also mention membership no. & firm registration no.

Special Points:

1. Separate Opinion: If auditor reports on SFS or SEFS along with engg. to audit entity's complete set of FS, auditor shall express separate opinion for each engg.

2. Published Together: Audited SFS or SEFS may be published together with entity's audited complete set of FS.
   Differentiation:
   - ✓ If auditor concludes presentation of single F.S. or specific element of F.S. doesn't differentiate it from complete set of F.S ➔ ask mgt to rectify the situation.
   - ✓ Auditor shall also differentiate opinion on single FS or specific element of FS from opinion on complete set of FS.
   - ✓ Auditor shall not issue A/R containing opinion on single F.S. or specific element of F.S. until satisfied with differentiation.

3. Modified opinion/EOM/OM Para/MURG Section/Uncorrected MM of Other Info.
   - ➢ If A/R on complete set of FS includes modified opinion or EOM/OM para or MURG section or Uncorrected MM of Other Info., consider implications of this on A/R on SFS or SEFS.

Implications of matters included in audit report on complete set of FS for audit of SFS or SEFS
Consider implications, if any, of certain matters included in audit report on complete set of FS relevant for audit of SFS or SEFS & its audit report. This involves professional judgment.

Factors that may be relevant in considering those implications include:

- Nature of the matter(s) being described in A/R on complete set of FS & extent to which it relates to SFS or a SEFS.
- Pervasiveness of the matter(s) described in A/R on complete set of FS.
- Nature & extent of differences between the Applicable FRFs.
- Extent of difference between the Period(s) covered by complete set of FS compared to period(s) or dates of SFS or SEFS.
- Time elapsed since date of A/R on complete set of FS.



For eg, if there's a qualification of auditor's opinion in relation to debtors in A/R on complete set of FS & SFS includes a/c receivable, or SEFS relates to debtors, it is likely that there would be implications for audit.

On other hand, if qualification of auditor's opinion on complete set of FS relates to classification of long-term debt, then less likely that there would be implications for audit of SFS i.e. Statement of P&L or if SEFS relates to debtors.

OM → Inclusion of reference to A/R on complete set of FS (No implications)

Even when matters included in A/R on complete set of FS do not have implications for audit of SFS or SEFS, auditor may refer to matter(s) in OM para in A/R on SFS/SEFS as per SA 706.

For eg, auditor may consider appropriate to refer in auditor's report on SFS/SEFS to MURG section included in A/R on complete set of FS.

Adverse or Disclaimer of Opinion in A/R on Complete FS → Then we also have to modify?

If auditor express adverse or disclaim an opinion on entity's complete set of FS, SA 705 doesn't permit to include in same A/R unmodified opinion on a SFS or SEFS. Because such unmodified opinion would contradict adverse or disclaimer of opinion on entity's complete set of F.S. as a whole.

Exception: If auditor concludes necessary to express adverse or disclaim opinion on entity's complete set of FS but for separate audit of specific element included in those FS, auditor considers appropriate to express unmodified opinion, auditor shall only do so if:

a. Not prohibited by law or regulation
b. Opinion is expressed in auditor's report Not published together with auditor's report containing adverse opinion or disclaimer of opinion &
c. Specific element doesn't constitute major portion of entity's complete set of FS.

Q. What about Single Set of FS?

Not express unmodified opinion on a single FS [if A/D of opinion on Complete FS] even if A/R on single FS not published together with A/R containing A/D of opinion.

Because single FS is deemed to constitute a major portion of those F.S.

What? It's Different!!

In A/R on entity's complete set of FS, disclaimer of opinion on results of operations & cash flows & unmodified opinion on state of affairs is permitted since disclaimer of opinion is being issued in respect of results of operations & cash flows only & not in respect of FS as whole.

Examples of Specific Elements, Accounts or Items of a F.S. are:

- ✓ Accounts receivable, allowance for doubtful a/c receivable, inventory, liability for accrued benefits of pvt pension plan, recorded value of identified intangible assets, or liability for "incurred but not reported" claims in insurance portfolio, including related notes.
- ✓ Schedule of externally managed assets & income of a pvt pension plan, including related notes.
- ✓ Schedule of net tangible assets, including related notes.
- ✓ Schedule of disbursements in relation to a lease property, including explanatory notes.
- ✓ Schedule of profit participation or employee bonuses, including explanatory notes.

1. CA M. Surya is auditor for FS of entity prepared as per financial reporting provisions of a contract. He is also offered audit of trade receivables appearing in above FS. Can he accept such engagement? Discuss brief outline of his audit approach in such a situation.

- ➢ Single FS or specific element, a/c or item of FS may be prepared as per a general or special purpose framework. If prepared as per special purpose framework, SA 800 also applies to audit.
- ➢ In given case, FS of entity are prepared as per financial reporting provisions of a contract. It is a special purpose framework. Auditor of FS prepared as per special purpose framework is also offered audit of trade receivables appearing in above FS which relates to audit of element of F.S. prepared as per special purpose framework.
- ➢ Hence, his audit approach should include considering requirements of both SA 800 & SA 805.

2. CA G is offered appointment for audit of trade payables of FS of a Co. However, FS prepared under Companies Act, 2013 are audited by CA Jignesh. Discuss why it would be practically difficult for CA G to perform such an audit.

Compliance with requirements of SAs relevant to audit of a single FS or specific element of a FS. may not be practicable when auditor is not also engaged to audit entity's complete set of F.S. In such cases, auditor often doesn't have same understanding of entity & its environment, including its internal control, as auditor who also audits the entity's complete set of FS.
Accordingly, auditor may need further evidence to corroborate audit evidence acquired from A/C records. In case of audit of a specific element of a F.S, certain SAs require audit work that may be disproportionate to element being audited. If auditor concludes audit of a single FS or specific element of a FS as per SAs may not be practicable, discuss with mgt whether another type of engg. might be more practicable.

SA 810 - Engg. to Report on Summary FS

What do Summary FS Reflect?

Summary FS reflect historical financial info. derived from FS, but contains less detail than FS while providing structured representation consistent with FS of entity's economic resources or obligations at a point in time or changes therein for a period of time.

Engagement Acceptance

Auditor shall, ordinarily, accept engg. to report on summary FS only when auditor has been engaged to conduct an audit as per SAs of FS from which summary FS are derived.

Before accepting engg. to report on summary F.S, auditor shall:

- Auditor shall accept engg. to report on summary FS only when engaged to conduct audit as per SAs of FS from which summary FS are derived.
- If auditor has not audited FS from which summary FS are derived, auditor shall not have necessary knowledge to discharge responsibilities in relation to summary FS as per this SA.

a. Determine whether applied criteria are acceptable.

- Applied criteria means criteria applied by mgt in preparation of summary FS.
- Mgt is responsible for determining info. to be reflected in summary FS so that they are consistent, in all material respects, or represent fair summary of audited FS.
- Because summary FS contain aggregated info. & limited disclosure, there is increased risk that they may be misleading in circumstances.
- This risk increases when established criteria for preparation of summary FS do not exist.

Factors affecting auditor's determination of acceptability of applied criteria:

→ Nature of entity
→ Purpose of the summary F.S.
→ Info. needs of intended users of summary F.S. &
→ Whether applied criteria will result in summary FS that are not misleading in circumstances.

Presumption: Criteria for preparation of summary FS may be established by authorised or recognised standards setting organisation or L/R. Auditor may presume that such criteria are acceptable. Where established criteria don't exist, criteria may be developed by mgt, for eg, based on practice in a particular industry.

If applied criteria is unacceptable:

If auditor concludes applied criteria is unacceptable or unable to obtain agreement of mgt as discussed above, auditor shall not accept engg. to report on summary F.S, unless required by L/R.

✓ Engg. conducted as per such law or regulation doesn't comply with this SA.



✓ Accordingly, A/R on summary F.S. shall not indicate engg. was conducted as per this SA.
✓ Auditor shall include appropriate reference to this fact in terms of engg.
✓ Auditor shall also determine its effect on engg. to audit F.S. from which summary F.S. are derived.
✓ Adequate disclosure of summarised nature of summary FS & identity of audited FS, for eg, be provided by title such as *"Summary F.S. prepared from audited F.S. for year ended March 31, 20XX"*

b. Obtain agreement of mgt that it acknowledges & understands its responsibility:
i. For preparation of summary FS as per applied criteria.
ii. To make audited FS available to intended users of summary FS without undue difficulty (or, if L/R provides audited FS need not be made available to intended users of summary FS & establishes criteria for preparation of summary FS, to describe that L/R in summary FS)

Auditor's evaluation whether audited FS are available to intended users of summary FS without undue difficulty is affected by factors such as whether:
- Summary FS describe clearly from whom or where audited F.S. are available
- Audited FS are on public record or
- Mgt has established process by which intended users of summary FS can access audited FS.

iii. To include A/R on summary FS in any document that contains summary FS & indicates auditor has reported on them.

c. Agree with mgt on form of opinion to be expressed on summary F.S.

Nature of Procedures to be Performed by Auditor

Auditor shall perform following procedures, and any other procedures that auditor may consider necessary, as the basis for auditor's opinion on summary FS:

a. Evaluate whether summary FS adequately disclose summarised nature & identify audited F.S.
b. Evaluate, in view of purpose of summary FS, whether they contain info. necessary, and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.
c. Evaluate whether summary FS adequately disclose the applied criteria.
d. Evaluate whether summary FS are prepared as per the applied criteria.
e. Evaluate whether audited FS are available to intended users of summary FS without undue difficulty, unless L/R provides that they need not be made available & establishes criteria for preparation of summary FS.
f. When summary FS are not accompanied by audited FS, evaluate whether they describe clearly:
   i. From whom or where audited FS are available or
   ii. Law or regulation that specifies that audited F.S. need not be made available to intended users of summary F.S. & establishes criteria for preparation of summary FS.



g. Compare summary FS with related info. in audited FS to determine whether summary FS agree with or can be re-calculated from related info. in audited FS.

Form of Opinion

When auditor concludes unmodified opinion is appropriate, auditor's opinion shall, unless required by L/R, use one of following phrases:

a. Summary F.S. are consistent, in all material respects, with audited FS, as per applied criteria or
b. Summary F.S. are a fair summary of audited FS, as per applied criteria

If L/R prescribes wording of opinion on summary FS different from above, auditor shall:

a. Apply procedures discussed earlier & any further procedures necessary to enable auditor to express prescribed opinion &
b. Evaluate whether users might misunderstand auditor's opinion on summary FS & whether add. explanation can mitigate possible misunderstanding.
   - If auditor concludes add. explanation can't mitigate possible misunderstanding, not accept engg, unless required by L/R.
   - An engg, conducted as per such L/R doesn't comply with this SA.
   - Accordingly, A/R on summary F.S. shall not indicate that engg. was conducted as per this SA.

Auditor's Report on Summary FS

Elements of Auditor's Report :

a. Title clearly indicating it as report of an independent auditor
b. Addressee: If addressee of summary F.S. not same as A/R on audited FS, auditor shall evaluate appropriateness of using a different addressee.

☞ Factors that may affect auditor's evaluation of appropriateness of addressee of summary F.S. include terms of engg., nature of entity & purpose of summary FS.

c. Identification of summary FS, including title of each statement included in summary FS.
   When auditor is aware that summary FS will be included in a document that contains other info., auditor may consider, if form of presentation allows, identifying page nos. on which summary F.S. are presented. This helps readers to identify summary FS to which A/R relates.
d. Identification of audited FS.
e. Clear expression of an opinion.
f. Statement indicating summary FS don't contain all disclosures required by FRF applied in preparation of audited FS & reading summary FS & audit report is not a substitute for reading audited FS.
g. If required, statement that summary FS & audited FS don't reflect effects of events that occurred subsequent to date of A/R on audited FS.
h. Reference to A/R on audited FS, date of report & fact that unmodified opinion is expressed on audited FS.

i. Description of mgt's responsibility for preparing summary FS as per applied criteria.
j. Statement auditor is responsible for expressing opinion on summary FS.
k. Auditor's sign with firm registration No & membership no. assigned by ICAI & UDIN.
l. Date of Report: Auditor shall date A/R on summary F.S. no earlier than:
   i) Date on which auditor obtained SAAE, including evidence that summary FS have been prepared & recognised authority have asserted that they have taken responsibility for them &
   ii) Date of A/R on audited FS.
m. Place of signature.

Modifications to Opinion, EOM/OM Para in A/R on Audited FS

When A/R on audited FS contains Qualified opinion, EOM/OM para/ MURG/KAM/Uncorrected MM of Other Info, but auditor is satisfied that summary FS are consistent, in all material respects, with or are fair summary of audited FS, as per applied criteria, A/R on summary FS shall, also contain: -

a. State that A/R on audited FS contains a qualified opinion, EOM, OM, MURG, KAM para, Uncorrected MM of Other Info &
b. Describe:
   i. Basis for qualified opinion on audited FS
   ii. Matter referred in EOM/OM/MURG/KAM para in A/R on audited FS

   + Effect if any, on summary FS.

   iii. Uncorrected MM of other info & effect(s), if any, on info. included in document containing summary FS & its A/R.

When A/R on audited FS contains adverse or disclaimer of opinion, A/R on summary FS shall: -

a. State that A/R on audited F.S. contains adverse or disclaimer of opinion
b. Describe the basis for that adverse opinion or disclaimer of opinion &
c. State that, as result of adverse or disclaimer of opinion, it's inappropriate to express opinion on summary FS.

Modified Opinion on Summary F.S.

If, summary FS not consistent, in all material respects or not a fair summary of audited FS, as per applied criteria & mgt doesn't agree to make necessary changes → Adverse Opinion

Restriction on Distribution or Use or Alerting Readers to the Basis of Accounting

- When distribution or use of A/R on audited FS is restricted, or A/R on audited FS. alerts readers that audited F.S. are prepared as per special purpose framework,
- Auditor shall include a similar restriction or alert in A/R on summary F.S.



Comparatives

- If audited FS contain comparatives, but summary FS don't, auditor shall determine whether such omission is reasonable in circumstances of engg.
- Auditor shall determine effect of unreasonable omission on A/R on summary FS.
- If summary FS contain comparatives that were reported on by another auditor, A/R on summary FS shall also contain matters that SA 710 requires auditor to include in A/R on audited FS.

Unaudited Supplementary Info. Presented With Summary F.S.

- Auditor shall evaluate whether any unaudited supplementary info. presented with summary FS clearly differentiated from summary FS.
- If auditor concludes such unaudited info. isn't clearly differentiated from summary FS, ask mgt to change presentation of unaudited supplementary info.
- If mgt refuses, auditor shall explain in A/R that such info. isn't covered by that report.

Other Info. in Documents Containing Summary F.S

- Auditor shall read info. included in a document containing summary FS & A/R & consider whether there is material inconsistency b/w other info. & summary FS.
- If auditor identifies material inconsistency, discuss with mgt & determine whether summary FS or info. included in document containing summary FS & A/R thereon needs to be revised.
- If auditor determines that info. needs to be revised & mgt refuses to revise info., auditor shall take appropriate action, including considering implications for A/R on summary FS.

Auditor Association

If auditor becomes aware that entity plans to state that auditor has reported on summary FS. in a document containing summary FS, but doesn't plan to include related A/R, request mgt to include A/R in the document.

If mgt doesn't do so, auditor shall determine & carry out other appropriate actions to prevent mgt from inappropriately associating auditor with summary FS in that document.

Auditor may be engaged to report on FS of entity, while not engaged to report on summary FS.

If auditor becomes aware that entity plans to make a statement in a document that refers to auditor & fact that summary FS are derived from FS audited by auditor, be satisfied that:

(a) Reference to auditor is made in context of A/R on audited FS &

(b) Statement doesn't give impression that auditor has reported on summary F.S.

- If (a) or (b) not met, request mgt to change statement or not refer to auditor in document. Alternatively, entity may engage auditor to report on summary FS & include related A/R in document.
- If mgt doesn't agree, advise mgt that auditor disagrees with reference to auditor & take other appropriate actions to prevent mgt from inappropriately referring to auditor.

Timing of Work & Events Subsequent to Date of A/R on Audited FS

- When A/R on summary FS after completion of audit of FS, auditor isn't required to obtain add. audit evidence on audited FS or report on effects of events occurred subsequent to date of A/R on audited FS since summary FS are derived from audited FS.
- Auditor may become aware of facts that existed at date of A/R on audited FS but of which auditor was unaware. In such cases, auditor shall not issue A/R on summary FS until auditor's considers such facts in relation to audited FS as per SA 560.
- Additional reporting: A/R on summary FS may be dated later than date of A/R on audited FS. In such cases, A/R on summary FS shall state that summary FS & audited FS do not reflect effects of events that occurred subsequent to date of A/R on audited FS.

1. CA Madhur is auditor of a Co. and issued A/R dated 15th June of a particular year. A/R on summary FS derived from such audited FS is dated 15th July. Discuss whether there exists any additional reporting responsibility for auditor in such a situation in respect of A/R on summary F.S.

Audit report on summary FS derived from audited F.S. is dated 15th July. However, audit report on audited FS is dated 15th June.
In above situation, auditor's report on summary FS should state that summary FS & audited FS don't reflect effects of events that occurred subsequent to date of auditor's report on audited F.S.

2. Consider that audit report on F.S. issued by CA Madhur for above said Co. contains qualified opinion. Can he issue unmodified opinion on summary F.S. derived from audited F.S.? Discuss.

If auditor is satisfied that summary f.s. are consistent, in all material respects, with or are a fair summary of audited F.S, in accordance with applied criteria, he can issue an unmodified opinion.
However, when auditor's report on audited FS contains qualified opinion, auditor's report on summary FS shall, also contain following:
a. State that auditor's report on audited financial statements contains a qualified opinion
b. Describe:
i) Basis for qualified opinion on audited F.S. & qualified opinion in auditor's report and
ii) Effect on summary F.S., if any.
Hence, above points should be included by CA Madhur.

"It does not matter how slowly you go as long as you do not stop."

CHAPTER 14

Audit Related Services



Standards on Related Services (non-assurance engagements)

- SRS 4400 Engagements to Perform Agreed-upon Procedures Regarding Financial Information
- SRS 4410 Compilation Engagements

Not all engagements performed by practitioners are assurance engagements.

Other frequently performed engg. that don't meet definition of assurance engg. include:-

- Preparation of tax returns where no conclusion conveying assurance is expressed.
- Consulting (or advisory) engg. such as mgt & tax consulting.
- Engg. covered by Standards for Related Services, such as agreed-upon procedures engg. & compilations of financial or other info.

What are Agreed-upon Procedures?

Auditor is engaged to issue a report of factual findings, based on

- specified procedures performed
- on specified subject matter
- of specified elements, accounts or items of a F.S.

For eg, engg. to perform agreed-upon procedures may require auditor to perform certain procedures on individual items of financial data, say, a/c payable, a/c receivable, purchases from related parties & sales and profits of a segment of entity, or a F.S, say, a B.S. or even a complete set of FS.

However, person performing related services need not necessarily be auditor of entity's FS.

SRS 4400 Engg. to Perform Agreed Upon Procedure regarding Financial Information

Objective

- Auditor to carry out procedures of audit nature to which auditor & entity & any appropriate 3rd parties have agreed & report on factual findings.
- As auditor simply provides a report of factual findings of agreed upon procedures, no assurance is provided by him.
- Instead, users of report assess themselves procedures & findings reported by auditor & draw their own conclusions from work done by auditor.
- Report is usually restricted to those parties that have agreed to procedures to be performed since others, unaware of reasons for procedures, may misinterpret the results.

Summary: No assurance is provided in such a report. These are non-assurance engg.

Audit Vs. Agreed-upon Procedures

- Key b/w between audit & agreed-upon procedures relates to assurance.
- Audit expresses an opinion & provides assurance to users. However, in agreed-procedures engg, only report of factual findings is provided. No assurance is given to users.
- Instead, users draw their own conclusions based on factual findings stated in report.

For eg, agreed upon procedures engg. to evaluate validity of a/c payable may state the following:

- ✓ Comparing of names of major suppliers & amounts outstanding as on date to related names & amounts in trial balance.
- ✓ Obtaining suppliers statements or confirmations from suppliers to confirm balances o/s on a date Comparison of such statements or confirmations to amounts in trial balance
- ✓ Further, actual findings like variation in balances reflected in trial balance & statements or confirmations are given.
- ✓ Actual findings are reported as such without providing an assurance.

Q. Is Auditor required to be independent for such agreed upon Procedures? No but should comply with other ethical requirements.

Terms of Engagement

Matters to be agreed include the following: -

a. Nature of engg. including the fact that procedures performed will not constitute an audit or review & accordingly no assurance will be expressed.
b. Stated Purpose for engg.
c. Identification of financial info. to which agreed-upon procedures will be applied.
d. Nature, timing and extent of the specific procedures to be applied.
e. Limitations on distribution of report of factual findings. When such limitation is in conflict with legal requirements, if any, auditor would not accept engg.

Procedures

Procedures applied in an engagement to perform agreed-upon procedures may include:

- Inquiry and analysis
- Re computation, comparison and other clerical accuracy checks
- Observation
- Inspection
- Obtaining confirmations



Reporting

Report of factual findings should contain: -

a. Title
b. Addressee (ordinarily, the appointing authority)
c. Identification of specific financial or non-financial info. to which agreed upon procedures applied
d. Statement that procedures performed were those agreed-upon with recipient
e. A statement that engg. was performed as per SRS applicable to agreed-upon procedures engg.
f. Identification of purpose for which agreed-upon procedures were performed
g. A listing of specific procedures performed
h. Description of auditor's factual findings including sufficient details of errors & exceptions found
i. Statement that procedures performed don't constitute either audit or review and, as such, no assurance is expressed
j. Statement that had auditor performed additional procedures, audit or review, other matters might have come to light that would have been reported
k. Statement that report is restricted to those parties that have agreed to procedures performed
l. Statement (when applicable) that report relates only to elements, accounts, items or financial and non-financial info. specified & doesn't extend to entity's F.S as whole
m. Date of the report
n. Place of signature and
o. Auditor's signature

A Co. asks you to carry out process of confirmation of it's a/c receivables having balances in excess of ₹10 lacs as per its books of a/c at close of year. Work to be performed only involves preparing and sending confirmation requests to such parties, analysis of variations on receipt of confirmations & submission of a report in accordance with professional standards. What points have to be kept in mind for inclusion in report specifically for such engg?

Described engg. is an agreed-upon procedures engg.

Following points have to be kept in mind for being included in the report: -

- Statement that procedures performed were those agreed-upon with recipient
- Statement that engg. was performed as per SRS applicable to agreed-upon procedures engg.
- Identification of purpose for which the agreed-upon procedures were performed
- Listing of specific procedures performed
- Description of auditor's factual findings including sufficient details of errors & exceptions found
- Statement that procedures performed don't constitute either an audit or a review and, as such, no assurance is expressed
- Statement that had auditor performed additional procedures, audit or a review, other matters might have come to light that would have been reported

- Statement that report is restricted to parties that have agreed to procedures to be performed
- Statement that report relates only to elements, accounts, items or financial and non-financial info. specified & doesn't extend to entity's F.S. as whole

SRS 4410 Compilation Engg.

Deals with practitioner's responsibilities when engaged to assist mgt with preparation & presentation of historical financial info. without obtaining any assurance on that info, & report on engg. as per this SRS.

- It applies to compilation engg. for historical financial info.
- Compilation engg. for financial info. other than historical financial info, and non-financial info. can be performed under this Std after necessary adaptation.
- SQC 1 applies to compilation engg. too.
- Practitioner need not be independent but needs to comply with ethical requirements.

Remember, compilation engg. isn't assurance engg. → hence no expression of opinion.

Why Compilation Engg required?

Financial info. that's subject of a compilation engg. may be required for various purposes including: -

- To comply with mandatory periodic FR requirements established in L/R, if any or
- For purposes unrelated to mandatory FR under L/R, for eg: -
  - ✓ For mgt or TCWG, prepared on a basis appropriate for their particular purposes (such as preparation of financial info. for internal use).
  - ✓ For periodic FR undertaken for external parties under a contract or agreement (such as financial info. provided to a funding body to support provision or continuation of a grant).
  - ✓ For transactional purposes, for eg to support a transaction involving changes to entity's ownership or financing structure (such as for a merger or acquisition).

Engg. Acceptance and Continuance

Practitioner shall not accept engg. unless agreed terms of engg. with mgt & engaging party if different, including: -

a. Intended use & distribution of financial info, & any restrictions on either its use or its distribution where applicable
b. Identification of applicable FRF
c. Objective and scope of compilation engg.
d. Responsibilities of practitioner, including requirement to comply with relevant ethical requirements
e. Responsibilities of mgt for: -
   i) Financial info., and preparation & presentation as per an acceptable FRF
   ii) DIM of IC to enable preparation of F.S. free from M.M., whether due to fraud/error

iii) Accuracy & completeness of records, documents, explns and other info. provided by mgt for compilation engg. &

iv) Judgments needed in preparation & presentation of financial info., including those for which practitioner may provide assistance in course of compilation engg.

f. Expected form and content of report.

Practitioner shall record agreed terms of engg. in an engg. letter or other suitable form of written agreement, prior to performing the engg.

Performing the Engg.

- Practitioner shall obtain understanding of following matters to perform compilation engg: -
  a. Entity's Business & Operations, including a/c system & records &
  b. Applicable FRF, including its application in entity's industry
- Compile financial info. using records, documents, explanations & other info, including significant judgments, provided by mgt.
- Discuss with mgt, or TCWG, those significant judgments, for which practitioner has provided assistance in course of compiling financial info.
- Prior to completion of compilation engg, read compiled financial info. in light of understanding of entity's business & operations, & applicable FRF.
- If practitioner becomes aware that records, documents, explanations or other info, including significant judgments, provided by mgt are incomplete, inaccurate or unsatisfactory, bring to attention of mgt & request additional or corrected info.
- If unable to complete engg. because mgt has failed to provide records, documents, explanations or other info, including significant judgments, as requested, withdraw from engg, & inform mgt & TCWG of reasons for withdrawing.

Understanding [B&O + FRF] → Compile info. → Discuss → Read → Issues → Withdraw

If practitioner becomes aware during engg. that: -

a. Compiled financial info. doesn't adequately refer or describe applicable FRF,
b. Amendments required for to compiled financial info. not to be materially misstated or
c. Compiled financial info. is otherwise misleading,

practitioner shall *propose appropriate amendments* to mgt.

- If mgt declines or doesn't permit practitioner to make proposed amendments to compiled financial info., withdraw from engg. & inform mgt and TCWG reasons for withdrawing.
- If withdrawal not possible, determine applicable professional & legal responsibilities.

- Obtain acknowledgement from mgt or TCWG that they have taken responsibility for final version of compiled financial info.

Practitioner's Report

Clearly communicate nature of compilation engg. & practitioner's role & responsibilities. Report is not to express opinion or conclusion on financial info. in any form.

Report shall be in writing and include following elements: -

a. Report title
b. Addressee(s), as required by terms of engg.
c. Statement that practitioner has compiled financial info. based on info. provided by mgt
d. Description of responsibilities of mgt, or TCWG as appropriate, in relation to compilation engg, and in relation to financial info.
e. Identification of applicable FRF & if spl. purpose FRF is used, description or reference to spl purpose FRF in financial info.
f. Identification of financial info., including title of each element of financial info. if it comprises more than one element, & date of financial info. or period to which it relates
g. Description of practitioner's responsibilities in compiling financial info, including that engg. was performed as per this SRS, & practitioner has complied with ethical requirements
h. Description of what a compilation engg. entails as per this SRS
i. Explanations that: -
   i. Since a compilation engg. is not assurance engagement, practitioner not required to verify accuracy or completeness of info. provided by mgt for compilation &
   ii. Accordingly, practitioner doesn't express an audit opinion or review conclusion on whether financial info. is prepared as per applicable FRF.
j. If financial info. is prepared using special purpose FRF, an explanatory para. that: -
   i. Describes purpose for which financial info. is prepared and, if necessary, intended users, or contains reference to a note in financial info. that discloses this information and
   ii. Draws attention of readers to fact that financial info. is prepared as per a SPF & as a result, info. may not be suitable for other purposes
k. Date of practitioner's report
l. Practitioner's sign
m. Place of sign

Engagement Level Quality Control

EP shall take responsibility for:

a. Overall quality of each compilation engg. to which partner is assigned &
b. Engg. being performed as per firm's quality control policies and procedures



Documentation

Practitioner shall include in engg. documentation: -

a. Significant matters arising during compilation engg. & how those matters were addressed
b. A record of how compiled financial info. reconciles with underlying records, documents, explanations and other info, provided by mgt &
c. Copy of final version of compiled financial info. for which mgt or TCWG has acknowledged their responsibility, and practitioner's report.
d. May also include in engg. documentation copy of entity's trial balance, summary of significant a/c records or other info. used to perform compilation.

During course of performing compilation engg. as per SRS 4410, it becomes known to you that client had suffered theft loss of ₹100 lacs of its inventories over period of time at a storage location visited infrequently. Claim was lodged by client with insurance Co. which was repudiated due to certain technical reasons relating to coverage of policy. Client hasn't preferred a complaint or appeal against said repudiation. Amount is reflected under head "current assets" in trial balance of client. Discuss, how you should proceed to deal with the matter?

In given case, amount of ₹100 lacs is reflected under head "current assets" in trial balance. Since client's claim has been repudiated and no appeal has been preferred, it is a loss for client and should be dealt accordingly.

Therefore, amendments are required for financial info. not to be materially misstated.

- If practitioner becomes aware during course of engg. that amendments to compiled financial info. are required for it not to be materially misstated or compiled financial information is otherwise misleading, practitioner shall propose appropriate amendments to mgt.
- If mgt declines, or doesn't permit practitioner to make proposed amendments to compiled financial info, practitioner shall withdraw from engg. & inform mgt and TCWG of reasons for withdrawing.
- If withdrawal not possible, determine applicable professional & legal responsibilities.

Don't watch the clock, do what it does. Keep Going.

CHAPTER 15

Review of Financial Information



What is Review?

- "Review" is a limited assurance engg.
- Limited assurance is obtained where engg. risk is reduced to a level that's acceptable in the circumstances of engg., but where risk is greater than reasonable assurance engg, as basis for expressing a conclusion.
- Limited assurance engg. provides lower level of assurance than audit.
- It involves fewer procedures &, gathers SAAE on basis of which limited conclusions can be drawn up. However, "review" is related to FS prepared on basis of historical financial info. just like audit.

[SAAE → Sufficient & Appropriate Evidence]

SRE 2400 Engg. to Review Historical F.S.

SRE 2400 deals with: -

- ✓ Review of historical FS, when practitioner is not auditor of entity's FS and
- ✓ Form and content of practitioner's report on FS

Notes:

- ✓ FS may be prepared using general purpose or special purpose framework.
- ✓ Practitioner's conclusion is based on obtaining limited assurance.
- ✓ Primarily perform inquiry & analytical procedures to obtain SAAE as basis for a conclusion on FS.
- ✓ If practitioner becomes aware of matter causing practitioner to believe FS may be materially misstated, designs & perform additional procedures, necessary to conclude on FS.

Objectives

- Obtain limited assurance via inquiry & analytical procedures about whether FS are free from MM enabling to express conclusion that FS are prepared in all material respects as per applicable FRF
- Report on F.S. & communicate as per SRE

Note:

If limited assurance can't be obtained & modified conclusion is insufficient, disclaim conclusion or withdraw if possible under L/R

Q. Roma Ltd entered into contract with Dorma Ltd. There is a condition in contract that Roma Ltd is required to get its F.S. reviewed for a year on a quarterly basis as per financial reporting provisions of contract. Can Roma Ltd get its F.S. reviewed from a professional accountant in practice?

Above F.S. prepared as per special purpose framework in accordance with requirements of a contract. F.S. prepared as per special purpose framework can also be reviewed by a professional accountant in practice & review report may be issued as per SRE 2400.

Compliance with Ethical Requirements & Engagement Level Quality Control

Factors affecting Acceptance and Continuance of Client Relationships and Review Engg:

Unless required by L/R, not accept a review engagement if:

a. Practitioner is Not Satisfied:

(i) That there's a rational purpose for engg.

It may be unlikely that there is a rational purpose for engg. if, for eg,

1. there is significant limitation on scope of work or
2. practitioner suspects association of practitioner's name with FS in inappropriate manner
3. Similarly, when engg. is intended to comply with relevant L/R & such L/R requires FS to be audited, there is no rational purpose for such a review engg.

(ii) Review engg. would be appropriate in circumstances. When practitioner's preliminary understanding indicates accepting a review engg. would not be appropriate, may consider recommending another type of engg.

Depending on circumstances, practitioner may believe that performance of audit engg. would be more appropriate than review. In other cases, if engg. circumstances preclude performance of assurance engg, practitioner may recommend a compilation engg, or other accounting services engg, as appropriate.

b. Practitioner has reason to believe that relevant Ethical Requirements, including independence, will not be satisfied.

c. Practitioner's preliminary understanding of engg. indicates that INfo. needed to perform review engg. is likely to be unavailable or unreliable.

d. Practitioner has cause to doubt mgt's INtegrity such that it's likely to affect proper performance of review or

e. Mgt or TCWG impose a Limitation On Scope such that practitioner believes that limitation will result in disclaiming a conclusion on FS.

Preconditions for Accepting a Review Engg

Prior to accepting a review engg, practitioner shall: -

a. Determine whether FRF applied in preparation of FS is acceptable including, in case of special purpose FS, obtaining understanding of purpose for which FS are prepared & intended users, &

b. Obtain agreement of mgt that it acknowledges & understands its responsibilities:

i) For preparation of F.S. as per applicable FRF, including, where relevant, their fair presentation.

ii) For such internal control as mgt determines necessary to enable preparation of FS free from MM, whether due to fraud or error &

iii) To provide practitioner with: -

- ✓ Access to all info. of which mgt is aware relevant to preparation of FS, such as records, documentation & other matters
- ✓ Additional info. that practitioner may request from mgt for purpose of review &



✓ Unrestricted access to persons within entity necessary to obtain evidence.

Note:

- If not satisfied with any of above matter before acceptance → discuss with mgt/ TCWG.
- If changes can't be made to his satisfaction, not accept engg. unless reqd by L/R

What if after acceptance, not satisfied?

Discuss matter with mgt or TCWG and determine:

(a) Whether matter can be resolved

(b) Whether it is appropriate to continue with engg. &

(c) Whether and, if so, how to communicate matter in practitioner's report.

Agreeing to Terms of Engg.

- Agree to terms of engg. with mgt/TWCG prior to performing engg.
- Agreed terms shall be recorded in an engg. letter or other suitable form of written agreement.
- On recurring review engg, evaluate whether circumstances require terms of engg. to be revised & need to remind mgt/TCWG of existing terms.
- Practitioner not agree to change in terms where there is no reasonable justification for doing so.
- If, prior to completing review engg, requested to change engg. to an engg. for which no assurance is obtained, determine whether there is reasonable justification for doing so.
- If terms changed during course of engg., practitioner and mgt/TCWG shall agree & record new terms of engg. in engg. letter or any other suitable form of written agreement.

Overview of performing review engg. after acceptance as per SRE 2400

i) Materiality in a Review of FS.

ii) Obtain understanding of entity & applicable FRF to identify areas of possible M.M.

iii) Design and perform "Inquiry" and "Analytical procedures"

iv) Perform procedures to address specific circumstances

v) Perform other procedures, if necessary, in circumstances

i) Materiality in a Review of F.S.

- Determine materiality for FS as whole & apply this materiality in designing procedures & evaluating results obtained from those procedures.
- Practitioner's judgment about what's material in relation to FS as whole is same regardless of level of assurance obtained by a practitioner as basis for expressing conclusion on F.S.
- Practitioner shall revise materiality in event of becoming aware of any info. during review that would have caused to determine a different amount initially.

ii) Obtaining Understanding of Entity : Obtain understanding of entity & its environment and applicable FRF to identify areas in FS where MM likely to arise & thereby provide basis for designing procedures to address those areas.

iii) Designing and Performing Procedures to obtain SAAE: -

(a) To address all material items in F.S., including disclosures and

(b) To focus on areas in F.S. where M.M. are likely to arise.

- Designing and performing inquiry & analytical procedures, & procedures addressing specific circumstances, are designed to enable to achieve objectives of this SRE.
- Circumstances vary widely and, accordingly, practitioner may consider it effective or efficient to design & perform other procedures.
- For eg, for obtaining understanding of entity, practitioner becomes aware of a significant contract practitioner may choose to read the contract. Fact that practitioner may perform other procedures doesn't alter objective of obtaining limited assurance.
- Practitioner may consider, reviewing a/c records to identify significant or unusual transactions requiring specific attention.

INQUIRY

It includes seeking info. from mgt & other persons within entity, appropriate in circumstances.

- Inquiries may include matters relating to
  - ✓ existence of any actual, suspected or alleged fraud,
  - ✓ identification of related parties,
  - ✓ making of a/c estimates,
  - ✓ about significant, complex or unusual transactions,
  - ✓ events occurring b/w date of FS & report,
  - ✓ basis for mgt's G.C. assessment, events or conditions that cast doubt on entity's ability to continue as GC,
  - ✓ material commitments, contractual obligations or contingencies

  that affected or may affect entity's FS including disclosures & material non-monetary transactions or transactions for no consideration.
- Practitioner may also extend Inquiries to obtain non-financial data if appropriate.
- Evaluating responses provided by mgt is integral to inquiry process.
- Depending on circumstances, may also include inquiries about:
  - ☞ Actions taken at meetings of owners, TCWG & committees and proceedings at other meetings, affecting info. & disclosures in F.S.
  - ☞ Communications entity has received, or expects to receive or obtain, from regulatory agencies.
  - ☞ Matters arising in course of applying other procedures.



- What if inconsistency found?
  - ✓ When performing further inquiries on identified inconsistencies,
  - ✓ consider reasonableness & consistency of mgt's responses
  - ✓ in light of
    - o results obtained from other procedures, &
    - o practitioner's knowledge & understanding of entity & industry in which it operates.

ANALYTICAL PROCEDURES

Consider whether data from entity's a/c system & accounting records adequate for performing analytical procedures.

Q. Why "Inquiry" and "Analytical procedures" are important in Review?

- Evidence through inquiry is often principal source of evidence about mgt Intent. However, info. available to support mgt's intent may be limited.

In that case,

- ✓ understanding mgt's Past history of carrying out stated intentions,
- ✓ mgt's stated Reasons for choosing particular course of action, &
- ✓ mgt's Ability to pursue a specific course of action

may provide relevant info. to corroborate evidence obtained through inquiry.

- Application of professional scepticism in evaluating responses provided by mgt to evaluate whether there are any matters to believe FS may be materially misstated.
- Performing inquiry procedures also assists in obtaining or updating practitioner's understanding of entity & its environment, to identify areas where MM likely to arise in F.S.

Performing analytical procedures assists the practitioner in:

- Obtaining or updating understanding of entity & its environment, including areas where M.M. likely to arise in F.S.
- Identifying inconsistencies or variances from expected trends, values or norms in FS.
- Serving as additional procedures when practitioner becomes aware of matters causing to believe that FS may be materially misstated.
- Providing corroborative evidence to inquiries or analytical procedures already performed.

Eg. of such additional procedure is a comparative analysis of monthly revenue & cost figures across profit centers, branches or other components of entity, to provide evidence about financial info. contained in line items or disclosures made in F.S.

Various methods used to perform analytical procedures ranging from performing simple comparisons to performing complex analysis using statistical techniques.

Procedures to Address Specific Circumstances

1. Related parties: Remain alert for existence of related party relationships or transactions that mgt hasn't previously identified or disclosed to practitioner.
   If practitioner identifies significant transactions o/s entity's normal course of business during course of review, inquire with mgt about nature of transactions, possible involvement of related parties & business rationale (or lack thereof) of those transactions.

2. Fraud and non-compliance with laws or regulations: When there is indication that fraud or NOCLAR, or suspected fraud or NOCLAR, practitioner shall communicate to appropriate level of senior mgt or TCWG & request mgt's assessment of effects, if any, on FS.
   Practitioner has to consider effect, if any, of mgt's assessment of fraud or NOCLAR communicated to him on his conclusion on FS & his report & determine responsibility to report occurrence or suspicion of fraud or illegal acts to a party o/s entity.

3. Going concern: Consider entity's ability to continue as a GC. If, during review, practitioner becomes aware of events or conditions that may cast significant doubt about entity's ability to continue as a GC, practitioner shall:
   a. Inquire about mgt plans for future actions & their feasibility, & also whether mgt believes outcome of those plans will improve the situation regarding entity's ability to continue as a GC.
   b. Evaluate results of inquiries, to consider whether mgt's responses provide a sufficient basis to:-
      i) Continue to present FS on GC basis if applicable FRF includes assumption of entity's continuance as a GC or
      ii) Conclude whether FS are materially misstated, or are otherwise misleading regarding entity's ability to continue as a GC and
   c. Consider mgt's responses in light of all relevant info. of which practitioner is aware as a result of review.

4. Use of work performed by others: It may be necessary to use work of others possessing expertise in a field other than accounting or assurance. If practitioner uses work of another expert in course of review, take appropriate steps to be satisfied that work performed is adequate for practitioner's purposes. When practitioner is engaged to review FS of a group of entities, planned NTE of procedures for review are directed at achieving practitioner's objectives for review engagement as per this Standard but in context of group FS.

Let's Recall Procedures discussed till now!

Additional procedures when practitioner becomes aware that F.S. may be materially misstated

Design and perform additional procedures to enable practitioner to:

a. Conclude that the matter(s) is not likely to cause FS as whole to be materially misstated or
b. Determine that matter(s) causes FS as whole to be materially misstated.

These addn. procedures depend on circumstances & matter of P.J.

Procedures may be:

- Additional inquiry or analytical procedures, for eg, performing in greater detail or focused on affected items (i.e. amounts or disclosures related to a/cs or transactions reflected in F.S) or
- Other types of procedures, for eg, substantive test of details or external confirmations.

Evaluation of results of additional procedures may enable practitioner to get to (a) or (b) above.

If not, practitioner is required to: -

i) Continue performing additional procedures until practitioner reaches either (a) or (b) above or
ii) If practitioner unable to either conclude that matter is not likely to cause F.S. to be materially misstated or determine that matter causes F.S. to be materially misstated, then a scope limitation exists & practitioner is unable to form unmodified conclusion on F.S.

Effect of Subsequent Events

Between Date of F.S. & Report

If practitioner becomes aware of events occurring b/w date of F.S. and date of practitioner's report that require adjustment or disclosure in FS, request mgt to correct those misstatements.

After Report Date

No obligation to perform any procedures regarding F.S. after date of report.

However, if, after date of report but before date F.S. are issued, a fact becomes known to practitioner had it been known earlier at date of report, may have caused practitioner to amend report, practitioner shall: -

a. Discuss matter with mgt or TCWG, as appropriate
b. Determine whether F.S. need amendment and
c. If so, inquire how mgt intends to address the matter in F.S.

If,

→ mgt doesn't amend F.S. where practitioner believes they need to be amended, &
→ practitioner's report has already been provided to entity,

notify mgt and TCWG not to issue F.S. to 3rd parties before necessary amendments have been made.

If F.S. are still issued without necessary amendments, take appropriate action to prevent reliance on report.

Written Representations

Practitioner shall request mgt to provide WR that mgt has fulfilled its responsibilities described in agreed terms of engg. WR shall include that: -

a. Mgt has fulfilled responsibility for preparation of F.S. as per applicable FRF, including where relevant fair presentation, and provided all info. & access as agreed in terms of engg and

b. All transactions recorded & reflected in F.S.

Also request mgt's WR that mgt has disclosed to practitioner: -

a. Identity of entity's related parties and all related party relationships and transactions of which management is aware

b. Significant facts of frauds or suspected frauds known to mgt that may have affected entity

c. Known actual or possible NOCLAR for which effects of non-compliance affect entity's F.S;

d. All information relevant to use of G.C. assumption in F.S

e. All events occurring subsequent to date of F.S. and for which FRF requires adjustment or disclosure, have been adjusted or disclosed

f. Material commitments, contractual obligations or contingencies that have affected or may affect entity's F.S., including disclosures

g. Material non-monetary transactions or transactions for no consideration undertaken by entity in financial reporting period under consideration

If mgt doesn't provide one or more of requested WRs, practitioner shall:-

a. Discuss matter with mgt and TCWG, as appropriate

b. Re-evaluate integrity of mgt, & evaluate effect on reliability of representations (oral or written) & evidence in general &

c. Take appropriate actions, including determining possible effect on conclusion in practitioner's report as per this SRE.

Practitioner shall disclaim a conclusion on FS or withdraw from engg. if withdrawal is possible under applicable L/R, as appropriate, if:-

- Practitioner has sufficient doubt about integrity of mgt such that WR aren't reliable or
- Mgt doesn't provide required representations in respect of its responsibilities for preparation of FS & recording of all transactions in FS.

Evaluating evidence obtained from procedures performed

- Practitioner may not have obtained evidence that practitioner had expected to obtain through inquiry & analytical procedures & procedures addressing specific circumstances.
- If practitioner considers that evidence obtained from procedures performed is not SAAE to form a conclusion on FS.

Practitioner may:

→ Extend work performed or

→ Perform other procedures necessary in circumstances.

- Where neither of these is practicable, practitioner will not be able to obtain SAAE to form a conclusion and is required by this SRE to determine effect on report, or ability to complete the engg, for eg, if a member of mgt is unavailable at time of review to respond to inquiries on significant matters.
- If practitioner unable to obtain SAAE to form a conclusion, discuss with mgt and TCWG, as appropriate, effects such limitations have on scope of review.
(But...but...but...,but...)
- Inability to perform a specific procedure doesn't constitute limitation on scope if practitioner able to obtain SAAE by performing other procedures.
- Limitations on scope imposed by mgt may have other implications, such as consideration of areas where F.S. likely to be materially misstated, and engg. continuance.

Forming Conclusion on FS

Practitioner shall also consider impact of: -

a. Uncorrected misstatements identified during review, and in previous year's review of entity's FS, on FS as whole
b. Qualitative aspects of entity's a/c practices, including indicators of possible bias in mgt's judgments.

If FS prepared using fair presentation framework, also consider: -

a. Overall Presentation, Structure & Content of FS as per applicable framework &
b. Whether FS, including related notes, appear to represent underlying transactions & events in a manner that achieves fair presentation or give true & fair view, in context of FS.

Unmodified Conclusion: Express unmodified conclusion when obtained limited assurance to conclude that nothing has come to attention that causes to believe that FS not prepared, in all material respects, as per applicable FRF.

When practitioner expresses unmodified conclusion, practitioner shall, unless required by L/R, use one of following phrases, as appropriate: -

a. *"Based on our review, nothing has come to our attention that causes us to believe that F.S. don't give a true and fair view (or do not present fairly, in all material respects), in accordance with applicable FRF," (for F.S. prepared using fair presentation framework); or*
b. *"Based on our review, nothing has come to our attention that causes us to believe that F.S. are not prepared, in all material respects, in accordance with applicable FRF," (for F.S. prepared using a compliance framework).*

Modified Conclusion: Practitioner shall express modified conclusion in report on F.S. as whole when:

a) Determines, based on procedures performed & evidence obtained, F.S. are materially misstated or
b) Unable to obtain SAAE in relation to 1 or more items in F.S. that are material in F.S. as whole.

Summary:

1. No M.M. i.e. F.S. prepared in all material respects as per FRF → _____
2. Evidence obtained/not + material misstatement → _____

When practitioner modifies conclusion expressed on FS, practitioner shall:

a) Use heading "Qualified Conclusion," "Adverse Conclusion" or "Disclaimer of Conclusion," as appropriate, for conclusion para in report and
b) Provide a description of matter giving rise to modification, under an appropriate heading (for eg, "Basis for Qualified Conclusion," "Basis for Adverse Conclusion" or "Basis for Disclaimer of Conclusion," as appropriate) in a separate para in practitioner's report immediately before conclusion paragraph (referred to as basis for conclusion paragraph).

F.S. are materially misstated.

If practitioner determines that F.S. are materially misstated, practitioner shall express:

a) Qualified conclusion, when practitioner concludes effects of matter(s) giving rise to modification are material, but not pervasive to FS; or
b) Adverse conclusion, when effects of matter(s) giving rise to modification are both material and pervasive to FS.

QUALIFIED conclusion

Because of a MM, practitioner shall, unless otherwise required by L/R, use one of following phrases:-

- "Based on our review, except for effects of matter(s) described in Basis for Qualified Conclusion para, nothing has come to our attention that causes us to believe that FS don't give a true and fair view (or do not present fairly, in all material respects), in accordance with applicable FRF," (for FS prepared using a fair presentation framework) OR
- "Based on our review, except for the effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that FS are not prepared, in all material respects, in accordance with the applicable FRF," (for FS prepared using a compliance framework).

Due to inability to obtain SAAE, practitioner shall, unless required by L/R, use one of following phrases:-

a. "Based on our review, except for possible effects of matter(s) described in Basis for Qualified Conclusion para, nothing has come to our attention that causes us to believe that FS don't give a true

and fair view (or do not present fairly, in all material respects) in accordance with applicable FRF," (for FS prepared using a fair presentation framework); or

b. "Based on our review, except for the possible effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable FRF," (for FS prepared using a compliance framework).

When practitioner expresses ADVERSE conclusion on FS, practitioner shall, unless otherwise required by L/R, use one of following phrases, as appropriate:

a. "Based on our review, due to significance of matter(s) described in Basis for Adverse Conclusion para, FS don't give a true and fair view (or do not present fairly, in all material respects), in accordance with applicable FRF," (for FS prepared using a fair presentation framework); or

b. "Based on our review, due to significance of matter(s) described in Basis for Adverse Conclusion para, FS are not prepared, in all material respects, in accordance with applicable FRF," (for FS prepared using a compliance framework).

In BASIS for conclusion para, in relation to MM that give rise to either qualified or adverse conclusion, practitioner shall: -

a. Describe and quantify financial effects of misstatement if MM relates to specific amounts in FS (including quantitative disclosures), unless impracticable, in which case practitioner shall so state;

b. Explain how disclosures are misstated if MM relates to narrative disclosures; or

c. Describe nature of omitted info if MM relates to nondisclosure of info. required to be disclosed. Unless prohibited by L/R, practitioner shall include omitted disclosures where practicable to do so.

When disclaiming conclusion on FS practitioner shall state in conclusion para that:

a. Due to significance of matter(s) described in Basis for Disclaimer of Conclusion para, practitioner is unable to obtain SAAE to form a conclusion on FS; and

b. Accordingly, practitioner doesn't express a conclusion on FS.

Note:

In basis for conclusion para, in relation to either qualified conclusion due to inability of obtaining SAAE or when practitioner disclaims a conclusion, include reason(s) for inability to obtain SAAE.

Inability to obtain SAAE

If practitioner unable to form a conclusion on FS due to inability to obtain SAAE, practitioner shall:

a) Express qualified conclusion if practitioner concludes possible effects on FS of undetected misstatements, if any, could be material but not pervasive or

b) Disclaim if practitioner concludes possible effects of undetected misstatements, if any, could be both material and pervasive.

Practitioner shall withdraw from engg. if following conditions are present: -

a) Due to limitation on scope of review imposed by mgt after practitioner has accepted the engg, practitioner is unable to obtain SAAE to form a conclusion on FS;

b) Practitioner has determined that possible effects of undetected misstatements are material and pervasive and

c) Withdrawal is possible under applicable L/R.

Practitioner's Report

It shall be in writing and contain following elements: -

a) A title, clearly indicating it is report of independent practitioner for a review engg

b) The addressee(s), as reqd by circumstances of engg

c) An introductory para that:
   1) Identifies FS reviewed, including identification of title of each of statements contained in set of FS and date and period covered by each FS
   2) Refers to summary of significant a/c policies and other explanatory info and
   3) States that FS have been reviewed

d) A description of the responsibility of mgt for preparation of FS, including explanation that mgt is responsible for:
   1) Their preparation as per applicable FRF including, where relevant, their fair presentation;
   2) Such internal control as necessary to enable preparation of FS free from MM, whether due to fraud or error;

e) If FS are special purpose FS:
   1) A description of purpose for which FS are prepared and, if necessary, intended users, or reference to a note in special purpose FS that contains that info; and
   2) If mgt has choice of FRFs, a reference within explanation of mgt's responsibility for FS to mgt's responsibility for determining that applicable FRF is acceptable in circumstances

f) A description of practitioner's responsibility to express a conclusion on FS including reference to this SRE and, where relevant, applicable L/R.

g) Description of a review of FS and its limitations, and following statements:
   1) Review engg. under this SRE is a limited assurance engg.
   2) Practitioner performs procedures, primarily consisting of making inquiries of mgt & others within entity & applying analytical procedures & evaluates evidence obtained and
   3) Procedures performed are substantially less than audit conducted as per Standards on Auditing (SAs), and, accordingly, practitioner does not express audit opinion on FS.

h) Para under heading "Conclusion" that contains:
   1) Practitioner's conclusion on FS as a whole as appropriate and
   2) A reference to applicable FRF used to prepare FS.

i) When practitioner's conclusion on FS is modified:
   1) A para under appropriate heading that contains modified conclusion as appropriate &
   2) A para, under appropriate heading, providing description of matter(s) giving rise to modification

j) Reference to practitioner's obligation to comply with relevant ethical requirements

k) Date of report: Practitioner shall date report no earlier than date on which practitioner has obtained SAAE as the basis for practitioner's conclusion on FS, including being satisfied that: -
   1) All statements that comprise FS under applicable FRF, including related notes where applicable, have been prepared &
   2) Those with authority have asserted that they have taken responsibility for those FS.

l) Practitioner's signature

m) Place of signature.

EOM & OM Para in Practitioner's Report

EOM Para

Practitioner may consider it necessary to

- draw users' attention to a
- matter presented or disclosed in FS that, in practitioner's judgment,
- is of such importance that it is fundamental to users' understanding of FS.

- In such cases, include EOM para in report, provided practitioner has obtained SAAE to conclude that matter is not likely to be materially misstated as presented in FS.
- Such para shall refer only to info. presented or disclosed in FS.
- Practitioner shall include an EOM para immediately after para that contains practitioner's conclusion on FS under the heading "Emphasis of Matter," or other appropriate heading.

OM Para

If practitioner considers necessary to communicate a matter other than those presented or disclosed in FS that, in practitioner's judgment, relevant to users' understanding of

- review,
- practitioner's responsibilities or
- practitioner's report and this is not prohibited by law or regulation,

practitioner shall do so in a para in report with heading "Other Matter" or other appropriate heading.

Documentation

Practitioner shall document following aspects of engg. in a timely manner, to enable an experienced practitioner, having no previous connection with engg, to understand:

a) NTE of procedures performed to comply with this SRE and applicable L/R requirements
b) Results obtained & practitioner's conclusions formed on basis of those results &
c) Significant matters arising during engg, practitioner's conclusions reached thereon, & significant professional judgments made in reaching those conclusions.

While documenting NTE of procedures performed as required in this SRE, practitioner shall record:
a) Who performed work & date such work was completed
b) Who reviewed work performed & period and extent of review.

Also document discussions with mgt, TCWG, and others relevant to performance of review of significant matters arising during engg, including nature of those matters.

Audit Vs. Review

Audit	Review
Reasonable assurance engg providing reasonable assurance.	Limited assurance engg. providing lower level of assurance than reasonable assurance engg.
It performs elaborate and extensive procedures including TOCs & substantive procedures.	It performs fewer procedures primarily focusing on inquiry and analytical procedures.
It draws reasonable conclusions on basis of SAAE.	It draws limited conclusions on the basis of SAAE.
It provides an assurance opinion. Language of assurance opinion is positively worded.	It provides an assurance conclusion. Language of assurance conclusion is negatively worded.

Q. You are conducting review of FS. It is gathered upon inquiry that there is possibility of MM in FS. Discuss, how you would proceed further in the matter under SRE 2400.

If practitioner becomes aware of matters causing to believe FS may be materially misstated, practitioner shall design & perform additional procedures sufficient to enable practitioner to: -
(a) Conclude that matter(s) is not likely to cause FS as whole to be materially misstated or
(b) Determine that matter(s) causes FS as whole to be materially misstated.

Additional procedures focus on obtaining SAAE to form a conclusion on matters that practitioner believes may cause FS to be materially misstated.

Procedures may be:

- Additional inquiry or analytical procedures, for eg, being performed in greater detail or being focused on affected items (i.e. amounts or disclosures concerning affected a/cs or transactions as reflected in FS); or
- Other types of procedures, for eg, substantive TODs or external confirmations.

SRE 2410 Review of Interim Financial Info. performed by the Independent Auditor of Entity

SRE 2410 applies when review of interim financial info. is performed by independent auditor of FS of entity.

Interim financial info. is financial info. prepared & presented as per applicable FRF & comprises either a complete or condensed set of FS for a period shorter than entity's FY. For eg, interim financial info. may relate to FS of a quarter of FY.

Understanding Entity and its Environment including its Internal Control

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

- Reading documentation of preceding year's audit & reviews of prior interim period(s) of current year & corresponding interim period(s) of PY, to identify matters that may affect current-period interim financial info.
- Reading most recent annual & comparable prior period interim financial info.
- Considering any significant risks, including risk of mgt override of controls, identified in audit of prior year's FS.
- Considering nature of any corrected MMs & any identified uncorrected MMs in PY's FS.
- Considering significant financial accounting & reporting matters that may be of continuing significance such as material weaknesses in internal control.
- Considering materiality w.r.t applicable FRF to assist in determining nature & extent of procedures to be performed and evaluating effect of misstatements.
- Considering results of any audit procedures performed with respect to current year's FS.
- Considering results of any internal audit performed & subsequent actions taken by mgt.
- Inquiring of mgt about results of mgt's assessment of risk that interim financial info. may be materially misstated as a result of fraud.
- Inquiring of mgt about effect of changes in entity's business activities.
- Inquiring of mgt about significant changes in internal control & potential effect of any such changes on preparation of interim financial info.
- Inquiring of mgt of process by which interim financial info. has been prepared & reliability of underlying a/c records to which interim financial info. is agreed or reconciled.

Inquiries, Analytical and other Review procedures

Auditor ordinarily performs following procedures:-

1. Reading minutes of meetings of shareholders, TCWG, & other appropriate committees to identify matters that may affect interim financial info, & inquiring about matters dealt at meetings for which minutes not available that may affect interim financial info.

2. Considering effect, if any, of matters giving rise to a modification of audit or review report, a/c adjustments or unadjusted misstatements, at time of previous audit or reviews.
3. Communicating, where appropriate, with other auditors reviewing interim financial info. of reporting entity's significant components.
4. Inquiring of members of mgt responsible for financial and a/c matters, and others about following:
   - → Whether interim financial info. prepared and presented as per applicable FRF.
   - → Whether Related party transactions have been appropriately accounted and disclosed in interim financial info.
   - → Significant Assumptions relevant to fair value measurement or Disclosures & mgt's intention and ability to carry out specific courses of action on behalf of entity.
   - → Whether there have been any changes in A/c principles or methods of applying them.
   - → Whether any new transactions have necessitated application of a new A/c principle.
   - → Whether interim financial info. contains any known Uncorrected misstatements.
   - → Unusual or complex situations that may have affected interim financial info, such as a business combination or disposal of a segment of business.
   - → Compliance with Debt covenants.
   - → Significant changes in commitments and contractual obligations.
   - → Significant changes in contingent liabilities including litigation or claims.
   - → Matters about which questions have arisen in course of applying review procedures.
   - → Significant transactions occurring in last several days of interim period or first several days of next interim period.
   - → Knowledge of any fraud or suspected fraud affecting entity involving mgt, employees who have significant roles in internal control
   - → Knowledge of any allegations of fraud, or suspected fraud, affecting entity's interim financial info. communicated by employees, former employees, analysts, regulators, or others.
   - → Knowledge of any actual or possible NOCLAR that could have a material effect on interim financial info.
5. Applying analytical procedures to interim financial info. designed to identify relationships and individual items that appear to be unusual and may reflect a MM in interim financial info.
6. Reading interim financial info, & considering whether anything has come to auditor's attention that causes auditor to believe that interim financial info. is not prepared, in all material respects, as per applicable FRF.

Q. Direct communication with entity lawyer required?

A review of interim financial info. ordinarily doesn't require corroborating inquiries about litigation or claims. It is, therefore, not necessary to send an inquiry letter to the entity's lawyer. Direct communication may be appropriate if a matter comes to auditor's attention that causes auditor to

question whether interim financial info. is not prepared, in all material respects, as per applicable FRF, & auditor believes entity's lawyer may have pertinent info.

Subsequent Events

Auditor should inquire whether mgt has identified all events up to date of review report that may require adjustment or disclosure in interim financial info. It is not necessary to perform other procedures to identify events occurring after date of review report.

Going Concern

Auditor should inquire whether mgt has changed its assessment of entity's ability to continue as GC.

When, as a result of this inquiry or other review procedures, auditor becomes aware of events or conditions that may cast significant doubt on entity's ability to continue as a GC, auditor should:

a. Inquire of mgt as to its plans for future actions, feasibility of these plans, and whether mgt believes that outcome of these plans will improve the situation &

b. Consider adequacy of disclosure about such matters in interim financial info.

How to know abt events?

Events or conditions which may cast significant doubt on entity's ability to continue as a GC may have existed at date of annual FS or may be identified as result of inquiries of mgt or in course of performing other review procedures.

What to do?

- When such events or conditions come to auditor's attention, auditor inquires of mgt as to its plans for future action, such as its plans to *liquidate assets, borrow money* or *restructure debt, reduce or delay expenditures*, or *increase capital.*
- Also inquires as to feasibility of mgt's plans & whether mgt believes outcome of these plans will improve the situation. However, it isn't necessary to corroborate feasibility of mgt's plans & whether outcome of these plans will improve the situation.

Doubt about accounting treatment

- When a matter comes to auditor's attention that leads to question whether a material adjustment should be made for interim financial info. to be prepared, in all material respects, as per applicable FRF, make additional inquiries or perform other procedures to express a conclusion in review report.

For eg, if auditor's review procedures lead auditor to question whether a significant sales transaction is recorded as per applicable FRF, auditor performs additional procedures to resolve auditor's questions, such as discussing terms of transaction with senior marketing and accounting personnel, or reading sales contract.

Evaluation of Misstatements

- Auditor should evaluate, individually and in aggregate, whether uncorrected misstatements that have come to auditor's attention are material to interim financial info.
- Misstatements which come to auditor's attention, including inadequate disclosures, are evaluated individually and in aggregate to determine whether a material adjustment is required to be made to interim financial info. for it to be prepared, in all material respects, as per applicable FRF.
- Auditor exercises professional judgment in evaluating materiality of any misstatements that entity has not corrected.

Management representations

Auditor should obtain written representation from mgt that: -

a. It acknowledges its responsibility for design & implementation of internal control to prevent & detect fraud & error
b. Interim financial info. is prepared and presented as per applicable FRF
c. It believes effect of those uncorrected misstatements aggregated by auditor during review are immaterial, both individually and aggregate, to interim financial info. taken as a whole. Summary of such items is included or attached to written representations
d. It has disclosed to auditor all significant facts relating to any frauds or suspected frauds known to mgt that may have affected entity
e. It has disclosed to auditor the results of its assessment of risks that interim financial info. may be materially misstated as a result of fraud
f. It has disclosed to auditor all known actual or possible NOCLAR whose effects are to be considered when preparing interim financial info and
g. It has disclosed to auditor all significant events that have occurred subsequent to BS date till date of review report that may require adjustment or disclosure in interim financial info.

Auditor's Responsibility for Accompanying Info.

- Auditor should read other info. that accompanies interim financial info. to consider whether any such info. is materially inconsistent with interim financial info.
- If auditor identifies a material inconsistency, consider whether interim financial info. or other info. needs to be amended.
- If amendment is necessary in interim financial info. & mgt refuses to make such amendment, considers implications for review report.
- If amendment is necessary in other info. & mgt refuses to make such amendment, considers including in review report an additional para describing material inconsistency, or taking other actions, such as withholding issuance of review report or withdrawing from engg.

Example of Material Inconsistency?

For eg, mgt may present alternative measures of earnings that more positively portray results of operations than interim financial info, & such alternative measures are given excessive prominence, are not clearly defined, or not clearly reconciled to interim financial info. such that they are confusing and potentially misleading.

Q. What if auditor identified material misstatement of FACT in other info?

- Discuss matter with entity's mgt.
- When discussing with entity's mgt, consider validity of other info. & mgt's responses to auditor's inquiries, whether valid differences of judgment or opinion exist and whether to request mgt to consult with a qualified 3rd party to resolve apparent misstatement of fact.
- If amendment is necessary to correct MM of fact and mgt refuses to make amendment, consider taking further action as appropriate, such as notifying TCWG & obtaining a legal advice.

Communication

- When auditor believes necessary to make a material adjustment to interim financial info. for it to be prepared, in all material respects, as per applicable FRF, communicate this matter ASAP to mgt.
- When, in auditor's judgment, mgt doesn't respond appropriately within reasonable period of time, inform TCWG.
- Communication is made ASAP, either orally or in writing. Decision to communicate orally or in writing is affected by factors such as nature, sensitivity and& significance of matter to be communicated & timing of such communications. If info. communicated orally, auditor documents the communication.
- When auditor believes in existence of fraud or NOCLAR, communicate ASAP to Mgt. Determination of which level of mgt is appropriate is affected by likelihood of collusion or involvement of a member of mgt.
- Auditor also considers need to report such matters to TCWG and considers implication for review. Auditor should communicate relevant matters of governance interest arising from review of interim financial info. with TCWG.
- Matters that in auditor's opinion both important & relevant to TCWG in overseeing financial reporting and disclosure process. Auditor communicates such matters to TCWG.

Reporting Nature, Extent and Results of Review of Interim Financial Info.

Content of Written Report:

a. Title.
b. Addressee
c. Identification of interim financial info. reviewed, including identification of title of each of statements contained in complete or condensed set of FS & date & period covered by interim financial info.

d. If interim financial info. comprises a complete set of general-purpose FS prepared as per a Fair Presentation FRF, statement that mgt is responsible for preparation & fair presentation of interim financial info. as per applicable FRF.

e. In other circumstances, statement that mgt is responsible for preparation & presentation of interim financial info. as per applicable FRF.

f. Statement that auditor is responsible for expressing conclusion on interim financial info. based on review.

g. Statement that review of interim financial info. was conducted as per SRE 2410 & a statement that that such review consists of making inquiries, primarily of persons responsible for financial and accounting matters, & applying analytical and other review procedures.

h. Statement that a review is substantially less in scope than an audit conducted as per SA and doesn't enable auditor to obtain assurance that auditor would become aware of all significant matters that might be identified in audit & that accordingly no audit opinion is expressed.

i. If interim financial info. comprises a complete set of general purpose FS prepared as per a fair presentation FRF, conclusion as to whether anything has come to auditor's attention that causes auditor to believe that interim financial info. doesn't give a true and fair view, or does not present fairly, in all material respects, as per applicable financial reporting framework.

j. In other circumstances, a conclusion as to whether anything has come to auditor's attention that causes auditor to believe that interim financial info. not prepared, in all material respects, as per applicable FRF

k. Date of report.

l. Place of Signature.

m. Auditor's signature and membership no. assigned by ICAI.

n. Firm's reg. no.

Q. UDIN also required?

Besides, *UDIN has also to be generated and stated* for review engg. as it is also in nature of assurance engg. UDIN has to be stated for engagements performed in accordance with SRE 2400 or SRE 2410.

Ab Clause BATAO? _____

Departure from the Applicable FRF

- Material adjustment reqd in interim financial info. for it to be prepared, in all material respects, as per applicable FRF ➔ Express qualified or adverse conclusion
- Describe nature of departure & if practicable, states effects on interim financial info.

Inadequate Disclosure

If info. that auditor believes is necessary for adequate disclosure is not included in interim financial info, auditor modifies review report and, if practicable, includes necessary info. in review report.

→ Modification to review report is ordinarily accomplished by adding an explanatory paragraph to review report & qualifying the conclusion.

→ When effect of departure is so material & pervasive to interim financial info. that auditor concludes a qualified conclusion isn't adequate to disclose misleading or incomplete nature of interim financial info, express adverse conclusion.

Limitation on Scope

When auditor unable to complete review, communicate, in writing, to appropriate level of mgt and TCWG reason why review can't be completed & consider whether its appropriate to issue a report.

Limitation on Scope Imposed by Mgt

- Auditor doesn't accept an engg. if auditor would be unable to complete review because there will be a limitation on scope imposed by mgt.
- If, after accepting engg, mgt imposes a limitation on the scope of review, auditor requests removal of that limitation.
- If mgt refuses to do so, auditor is unable to complete review and express a conclusion.
- In such cases, auditor communicates, in writing, to appropriate level of mgt and TCWG reason why review cannot be completed.
- Auditor also considers L/R responsibilities, including whether there is requirement to issue report.
- If yes, auditor disclaims a conclusion & provides reason why review can't be completed.

Other Limitations on Scope

- There may be some rare circumstances where limitation is confined to specific matters that, while material, are not pervasive to interim financial info.
- In such circumstances, auditor modifies review report by indicating that, except for matter which is described in an explanatory para. to review report, review was conducted as per this SRE, & by qualifying the conclusion.
- Auditor may have expressed qualified opinion on audit of latest annual FS because of limitation on scope. Consider whether that limitation still exists and, if so, implications for review report.

Going Concern and Significant Uncertainties

- Material uncertainty relating to an event or condition comes to auditor's attention that may cast significant doubt on entity's ability to continue as a GC & adequate disclosure is made in interim financial info. auditor modifies review report by adding an EOM para.
- Auditor may have modified a prior audit or review report by adding an EOM para to highlight a MU relating to E/C that may cast significant doubt on entity's ability to continue as GC.
- If MU still exists & adequate disclosure is made in interim financial info, auditor modifies the review report on current interim financial info. by adding a para to highlight continued MU.

- If a MU that casts significant doubt about entity's ability to continue as a GC isn't adequately disclosed in interim financial info, express a qualified or adverse conclusion, as appropriate.
- Report should include specific reference to fact that there is such a material uncertainty.

Other Considerations

Report with Interim Financial Info.

- Agree with mgt that where any document containing interim financial info. indicates that such info. has been reviewed by entity's auditor, review report will also be included in document.
- If mgt has not included review report in document, auditor considers seeking legal advice to determine appropriate course of action in circumstances.
- If auditor has issued modified review report & mgt issues interim financial info. without including modified review report in document containing interim financial info, seek legal advice to determine appropriate course of action & possibility of resigning from audit of annual FS.

Condensed set of FS

- Interim financial info. consisting of condensed set of FS doesn't necessarily include all info. that would be included in a complete set of FS, but may rather present explanation of events & changes to understand changes in state of affairs & performance of entity since annual reporting date.
- This is because its presumed that users of interim financial info. will have access to latest audited FS, such as is the case with listed entities.
- In other cases, auditor discusses with mgt need for such interim financial info. to include a statement that it is to be read with latest audited FS.
- In absence of such statement, auditor considers whether, without a reference to latest audited FS, interim financial info. is misleading and implications for review report.

Documentation

Prepare review documentation that's sufficient & appropriate to provide basis for auditor's conclusion and evidence that review was performed as per this SRE and applicable L/R requirements.

Q. During review of quarterly results of a Co. of which you are auditor, it is gathered on inquiries made that there has been a major fire in fabric processing plant of Co. during the quarter. It has resulted in massive disruption in operations of Co. Worse still, machinery and inventories of plant were uninsured due to carelessness of concerned staff leading to substantial losses. Matter has been disclosed in interim financial info. appropriately. Discuss, how you would deal with the same in review report?

Uninsured assets in a disaster are examples of events or conditions that, individually or collectively, may cast significant doubt about going concern assumption. As a result of fire, there is massive

disruption in operations of Co. Besides, Co. would have to bear losses as its damaged assets are uninsured.

As per SRE 2410, if, as result of inquiries or other review procedures, a material uncertainty relating to an event or condition comes to auditor's attention that may cast significant doubt on entity's ability to continue as a going concern, & adequate disclosure is made in interim financial information, auditor modifies review report by adding an EOM para.

Therefore, EOM para should be added in review report.

Q. CA. Seerat is conducting review of quarterly financial info. of a Co. of which she is also auditor. She believes that it is necessary to make a material adjustment to quarterly financial info. for it to be prepared, in all material respects, in accordance with applicable FRF. She has communicated the matter to CFO and audit committee. However, no response was received even after waiting for a reasonable time. What are the options available to her?

In such a case, options available to her in accordance with SRE 2410 are: -
(a) Whether to modify the report or
(b) The possibility of withdrawing from the engagement and
(c) The possibility of resigning from the appointment to audit the annual FS.

"The expert was also once a beginner"

CHAPTER 16

Prospective Financial Information



Standards on Assurance Engagement

- Assurance engg. may relate to examination of subject matters other than examination of FS prepared on basis of "historical financial info".
- In such cases, examination may relate to prospective financial information or non-financial matters like design & operation of internal control in an entity.
- Level of assurance provided by these Standards on Assurance Engg. is moderate.

SAE 3400 - The Examination of Prospective Financial Information
SAE 3402 - Assurance Reports on Controls at a Service Organisation
SAE 3420 - Assurance Engg. to Report on Compilation of Pro Forma Financial Info. included in Prospectus

SAE 3400 - The Examination of Prospective Financial Information

Guidance on engg. to examine & report on prospective financial info. including examination procedures for best-estimate & hypothetical assumptions.
Note: Need not necessarily be performed by stat. auditor of entity's FS.

What is Prospective financial information (PFI)?
"Prospective financial info" is Financial info based on:

- Assumptions about events that may occur in the future &
- Possible actions by entity.

Its highly subjective in nature & requires exercise of considerable judgment.

Prospective financial info can be in form of :

- a forecast,
- a projection,
- or a combination of both (for example a 1-year forecast plus a 5-year projection.)

What is Forecast?
Forecast means Prospective Financial Info prepared on the basis of:

- Assumptions as to
  - ✓ future events which mgt expects to take place &
  - ✓ Actions mgt expects to take as of date the info is prepared.

(Best estimate assumptions- An assumption that reflects anticipated experience with no provision for risk of adverse deviation.).

Eg. In present market conditions, supply availability, historical buying patterns and seasonal trends, CFO of a X ltd a expects sales to increase by 5% over the next quarter. Therefore, a 5% sales increase is his financial forecast for the period.

What is Projection?

Prospective Financial Info. prepared on basis of:

- Hypothetical assumptions about future events & mgt actions not necessarily expected to take place, eg for entities in start-up phase or considering major change in nature of operations or
- Mixture of best-estimate and hypothetical assumptions (imagined or suggested)

Examples:

1. X Ltd may project a course of action to take when one or more hypothetical situations arise, such as creating a new product to meet demand of expected market growth. As a result of assuming possibility of different events occurring, financial projections typically serve as an outline for evaluating desired outcomes X ltd. expects to see, including its financial, cash flow and operational outcomes.
2. Co. plans to raise funds from a prospective equity investor & has asked a firm of CAs to examine profit forecast for placing it before prospective equity investor.
3. Co. is in process of setting up new plant. Needs financial assistance from bank in shape of term loan and working capital credit facilities. Prepared a projection of its profits, cash flows for next 7 years along with assumptions.

Responsibility of Preparation & Presentation of PFI

Mgt is responsible for preparation and presentation of PFI including:

- Identification & disclosure of PFI
- Explaining basis of forecast
- Underlying assumptions

Can Professional Accountants be associated with PFI?

- *Clause 3 of Second Schedule to CA Act, 1949* states CAiP shall be deemed to be guilty of Prof. Misconduct, if he permits his or firm's name to be used in connection with an EOE contingent upon future transactions in a manner which may lead to belief that he vouches for accuracy of forecast.
- CA can prepare profit/financial forecasts & review them, clearly indicating in report: Sources of info, Basis of forecasts & major Assumptions made & doesn't vouch for accuracy of forecasts.
- Also applies to projections made on basis of hypothetical assumptions about future events & mgt actions not necessarily expected to take place so long as vouching for accuracy isn't made.

Duties of Member Examining PFI

Auditor should obtain SAAE as to whether:

a. Mgt's best-estimate assumptions are not unreasonable & hypothetical assumptions are consistent with purpose of info
b. PFI is properly prepared on basis of assumptions



c. PFI is properly presented & all material assumptions adequately disclosed, including clear indication whether they are best-estimate or hypothetical assumptions and

d. PFI is prepared on consistent basis with historical FS, using appropriate a/c principles.

Nature of Assurance regarding PFI

Opinion as to whether results shown in PFI will be achieved cannot be expressed.

Precautions to be taken by Auditor Before Accepting such an Engg

Before accepting an engg to examine PFI, auditor would consider, amongst other things:

- Intended use of the info.
- Whether the info. will be for general or limited distribution
- Nature of assumptions, i.e, whether they are best estimates or hypothetical Assumptions
- Elements to be included in the info. and
- Period covered by the info.

Notes:

1. Conditions → Decline/Withdraw from engg?

When assumptions are clearly unrealistic or auditor believes that PFI will be inappropriate for its intended use. Auditor should consider extent to which reliance on entity's historical financial info. is justified.

2. Steps to formalise terms of engg?

To formalize terms of engg, essential to agree on terms with client by sending an engg. letter, like in other engagements.

Examination Procedures

When determining NTE of examination procedures, following matters should be considered: -

a. Knowledge obtained during any previous engg

b. Mgt's competence regarding preparation of PFI

c. Likelihood of Material Misstatement

d. Extent to which PFI is affected by Mgt's judgment

e. Sources of info. considered by mgt for the purpose, their adequacy, reliability of underlying data, including data derived from 3rd parties, such as industry statistics, to support the assumptions

f. Stability of entity's business &

g. Engg team's experience with business & industry in which entity operates & reporting on PFI

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Presentation and Disclosure

When assessing presentation & disclosure of PFI & underlying assumptions, in addition to specific requirements of relevant statutes need to consider whether: -

a. Presentation of PFI is informative and not misleading
b. A/c policies clearly disclosed in notes to PFI;
c. Assumptions adequately disclosed in notes to PFI. State whether assumptions represent mgt's Best-estimates or hypothetical & when assumptions are made in material areas & subject to high degree of uncertainty, uncertainty and resulting sensitivity of results to be adequately disclosed
d. Date as of which PFI was prepared is disclosed. Mgt needs to confirm that assumptions are appropriate on this date, even though underlying info. may be accumulated over a period of time
e. if there is any Change in a/c policy of entity from that disclosed in most recent historical FS, whether reason for change and effect on PFI adequately disclosed.

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Report on Examination of PFI

Report for an examination of PFI should contain the following:

a. Title
b. Addressee
c. Identification of PFI
d. Reference to the SA applicable to examination of PFI
e. Statement that mgt is responsible for PFI including underlying assumptions
f. When applicable, a reference to purpose and/or restricted distribution of PFI
g. Statement that examination procedures included examination, on a test basis, of evidence supporting assumptions, amounts and other disclosures in forecast/projection
h. Statement of negative assurance as to whether assumptions provide a reasonable basis for PFI
i. Opinion as to whether PFI properly prepared on basis of assumptions & presented as per FRF
j. Appropriate caveats concerning achievability of results indicated by PFI
k. Date of report (which should be the date procedures have been completed)
l. Place of signature and
m. Signature

Such a report would: -

- state whether, based on examination of evidence supporting assumptions, anything come to attention, that assumptions don't provide a reasonable basis for PFI.
- express opinion whether PFI properly prepared on basis of assumptions & presented as per FRF.



- State that: -

→ Actual results likely to be different from PFI since anticipated events frequently don't occur as expected & variation could be material. Likewise, when PFI is expressed as a range, state that there can be no assurance that actual results will fall within the range &

→ In case of projection, PFI prepared for (intended use), using set of assumptions that include hypothetical assumptions about future events and mgt's actions aren't necessarily expected to occur. Consequently, readers are cautioned that PFI shouldn't be used for purposes other than mentioned intended use.

When presentation & disclosure of PFI isn't adequate, qualified or adverse opinion should be expressed or withdrawal be made as appropriate.

Eg. where financial info. fails to adequately disclose consequences of highly sensitive assumptions.

When its believed that one or more significant assumptions don't provide a reasonable basis for PFI

☞ prepared on best-estimate assumptions or

☞ given the hypothetical assumptions,

an adverse opinion should be expressed with reasons, or withdrawal from engg.

When examination is affected by conditions that preclude application of one or more necessary procedures, either withdrawal from engg. or disclaimer of opinion & describe scope limitation in report.

Documentation

Matters important in providing evidence to support report on examination of PFI, and evidence that such examination was carried out as per this SAE should be documented.

A Co. has approached CA. Hemant for an assurance report in respect of PFI of a project. On going through project details, its noticed that depreciation reflected on proposed fixed assets to be acquired has been calculated as per provisions of Income Tax Act. No disclosure is made in this respect too. How the matter should be proceeded with?

In such types of engg, its duty of a professional accountant to see that PFI is based on a consistent basis with historical FS using appropriate a/c principles. In the case of a Co, historical FS are prepared considering requirements of Companies Act, and depreciation is calculated accordingly.

However, in given situation, depreciation has been calculated as per Income Tax Act which is not consistent with historical FS. Therefore, it is not proper. Fact that the projection has not been prepared on a consistent basis with historical FS, using appropriate a/c principles needs to be stated.

Further, when presentation & disclosure are not adequate, a Qualified or Adverse opinion should be given or Withdrawal from engg should be made as appropriate.

SAE 3402 Assurance Reports on Controls at a Service Organisation (SO)

Scope of SAE 3402

Applies only when SO responsible for or able to make an assertion about, suitable design of controls.

It does not deal with assurance engg:

a. To report only on whether controls at SO operated as described or
b. To report only on controls at a SO other than those related to a service relevant to user entities' internal control as it relates to financial reporting (for eg, controls that affect user entities' production or quality control).

Objectives of Service Auditor

a. To obtain reasonable assurance whether, in all material respects, based on suitable criteria: -
   i) SO's description of system fairly presents system as designed & implemented throughout specified period (or in case of type 1 report, as at specified date)
   ii) Controls related to control objectives stated in SO's description of system suitably designed throughout specified period (or in case of type 1 report, as at specified date)
   iii) Where included in scope, controls operated effectively to provide RA that control objectives were achieved throughout specified period.
b. To Report on matters in (a) above as per service auditor's findings.

Description of system → Design of controls → Operating effectiveness

Type 1 Report	Type 2 Report
(i) SO's description of its system	(i) SO's description of its system
(ii) Written assertion by SO that, in all material respects, and based on suitable criteria: a. Description fairly presents SO's system as designed & implemented at *specified date* b. Controls related to control objectives stated in SO's description	(ii) Written assertion by SO that in all material respects & based on suitable criteria: a. Description fairly presents SO's system as designed & implemented *throughout period* b. Controls related to control objectives stated in SO's description of system were suitably designed *throughout specified period* &

of its system were suitably designed as at a *specified date* &	c. Controls related to control objectives stated in SO's description of system operated effectively throughout specified period &
(iii) Service auditor's assurance report that conveys RA about matters referred to in (ii)	(iii) Service auditor's assurance report that: - a. Conveys RA about matters in (ii) and b. Includes description of TOCs & results.

Summary: Type 1 is a report on description & design of controls of SO at specified date whereas type 2 report is a report on description, design and operating effectiveness of controls of SO throughout period.

How such an Engg is Proceeded with?

1) Compliance with ethical requirements: Comply with relevant ethical requirements, including independence, relating to assurance engg.

2) Determination of Mgt & TCWG & communication with them: Inquire, request representations, communicate with, or otherwise interact with the SO wherever required.

3) Acceptance and changes in terms of engg:
   - Before, accepting ensure that necessary capabilities & competence are possessed by him.
   - Also ensure criteria to be applied by SO to prepare description of system will be suitable & available to user entities & their auditors.
   - Scope of engg & SO's description of its system will not be so limited that they are unlikely to be useful to user entities & their auditors.
   - If SO requests change in scope of engg before completion of engg, be satisfied that there's reasonable justification for change.

4) Assessing of suitability of Criteria: Assess whether SO used suitable criteria
   - in preparing description of its system,
   - in evaluating whether controls are suitably designed &
   - in case of type 2 reports in evaluating whether controls are operating effectively.

5) Determination of Materiality: Consider materiality wrt
   - fair presentation of description,
   - suitability of design of controls and,
   - in the case of a type 2 report, operating effectiveness of controls.

6) Obtaining understanding of SO's system: Obtain understanding of SO's system, including controls.

7) Obtaining evidence regarding description: Obtain & read SO's description of system & evaluate whether description is fairly presented.

8) Obtaining evidence regarding design of controls: Determine controls to achieve control objectives stated in description of system & assess whether they were suitably designed.

9) Obtaining evidence regarding operating effectiveness of controls: When providing a type 2 report, test those controls necessary to achieve control objectives stated in description of system and assess their operating effectiveness throughout the period.

10) Understanding internal audit function: Obtain understanding of nature of responsibilities of internal audit function & activities performed to determine whether internal audit function is likely to be relevant for service auditor to use specific work of internal auditors.

11) Asking for Written Representations: Service auditor shall request SO to provide WRs:-

(a) That reaffirm assertion accompanying description of the system

(b) That it has provided service auditor with all relevant info. & access agreed and

(c) That it has disclosed to service auditor any of the following of which it is aware:-

i) NOCLAR, fraud, or uncorrected deviations in SO that may affect 1 or more user entities

ii) Design deficiencies in controls

iii) Instances where controls have not operated as described &

iv) Any events subsequent to period covered by SO's description of system up to date of service auditor's assurance report that could have a significant effect on assurance report.

12) Subsequent Events: Inquire whether SO aware of events subsequent to period covered by SO's description of system up to date of service auditor's assurance report that could have a significant effect on service auditor's assurance report.

Reporting

Include the following basic elements: -

a. Title that clearly indicates report is an independent service auditor's assurance report.

b. An addressee.

c. Identification of:

i) SO's description of system, and SO's assertion, which includes matters for a type 2 report, or for type 1 report.

ii) Parts of description of system not covered by service auditor's opinion.

iii) If description refers to need for complementary user entity controls, statement that service auditor has not evaluated design or operating effectiveness of such controls & control objectives stated in SO's description of system can be achieved only if such controls suitably designed or operating effectively, along with controls at SO.

iv) If services are performed by a SSO, nature of activities performed by SSO.

d. Identification of criteria & party specifying control objectives.

e. Statement that report is intended only for user entities & their auditors, who have a sufficient understanding

f. Statement that SO is responsible for: -

(i) Preparing description of system and accompanying assertion, including completeness, accuracy and method of presentation of that description & assertion

(ii) Providing services covered by SO's description of its system

(iii) Stating control objectives (where not identified by L/R, or another party, for eg, a user group or a professional body) &

(iv) Designing & implementing controls to achieve control objectives.

g. Statement that service auditor's responsibility is to express opinion on SO's description, design of controls related to control objectives and in case of type 2 report, operating effectiveness of controls, based audit procedures.

h. Statement that engg. was performed as per SAE 3402 which requires service auditor to comply with ethical requirements & plan and perform procedures to obtain RA whether, in all material respects, SO's description of system fairly presented & controls suitably designed and in case of type 2 report, operating effectively.

i. Summary of service auditor's procedures to obtain RA & statement of service auditor's belief that evidence obtained is sufficient & appropriate to provide basis for opinion & in case of type 1 report, statement that service auditor hasn't performed any procedures regarding operating effectiveness of controls & therefore no opinion is expressed.

j. Statement of limitations of controls & in the case of a type 2 report, risk of projecting to future periods any evaluation of operating effectiveness of controls.

k. Service auditor's opinion, expressed in positive form whether in all material respects, based on suitable criteria:

i) In case of a type 2 report: -

a. Description fairly presents SO's system designed & implemented throughout specified period

b. Controls related to control objectives stated in SO's description of system suitably designed throughout specified period and

c. Controls tested, those which were necessary to provide RA that control objectives stated in description were achieved, operated effectively throughout specified period.

ii) In the case of a type 1 report:-

a. Description fairly presents SO's system been designed & implemented as at specified date &

b. Controls related to control objectives stated in SO's description of system were suitably designed as at specified date.

l. Date of report

m. Signature

n. Place of signature

Additional matters requiring reporting in type 2 report:

- Include separate section after opinion or attachment, that describes TOCs performed & results of those tests.
- In describing TOCs, clearly state controls tested, identify whether all items tested or selected items in population, & indicate nature of tests in sufficient detail to enable user auditors to determine effect of such tests on their risk assessments.
- If deviations identified, include extent of testing performed that led to identification of deviations (including sample size where sampling used) & no. & nature of deviations noted.
- Report deviations even if, on basis of tests performed, service auditor concluded that related control objective was achieved.

If service auditor concludes that:

a. SO's description doesn't present fairly, in all material respects, system as designed & implemented

b. Controls related to control objectives weren't suitably designed, in all material respects

c. In case of type 2 report, controls tested, which were necessary to provide RA that control objectives were achieved, didn't operate effectively, in all material respects or

d. Service auditor is unable to obtain SAAE,

Opinion shall be modified & report shall contain clear description of reasons for modification.

Documentation

Documentation to enable experienced service auditor, with no connection with engg, to understand:

a. NTE of procedures performed to comply with this SAE and applicable L/R requirements

b. Results of procedures performed & evidence obtained and

c. Significant matters arising during engg, & conclusions reached thereon & significant professional judgments in reaching those conclusions

Bansi Group is a leading institution running prestigious post graduate courses in field of mgt. Its FS are audited by independent auditor. Before start of this academic session, Board of institution had outsourced its entire process of inviting student applications, submission of applications, & collection of application fees including late fees and such matters to Easy Solutions Ltd. Auditors of Bansi Group want to be sure about design & operating effectiveness of controls at Easy Solutions Ltd. What should be nature of report to be provided by auditors of Easy Solutions Ltd specifically for use by Bansi Group and its auditors in this regard in terms of SA 3402?

In such case, auditors of Bansi Group want to be sure about design and operating effectiveness of controls at organization providing services to their client. Type 2 report is a report on description, design and operating effectiveness of controls operating at SO.

Auditors of Easy Solutions Ltd should provide such report giving assurance on these matters. It should also include details of TOCs performed and details of deviations, if any.

SAE 3420 Assurance Engagements to Report on Compilation of Pro Forma Financial Information Included in a Prospectus

Applies where such reporting is required by securities L/R in jurisdiction where prospectus is issued or this reporting is generally accepted practice in such jurisdiction.

What is Pro forma financial information (PFFI)?

- PFFI refers to financial info. shown with adjustments to illustrate impact of event or transaction on unadjusted financial info. as if event had occurred or transaction undertaken at earlier date selected for purposes of illustration.
- PFFI is used in offer documents to demonstrate effect of a transaction on FS as if those transactions occurred at an earlier date.
- PFFI may take form of P&L & Balance Sheet to illustrate how transactions might have affected assets, liabilities & earnings of Issuer. Also include notes in relation to significant aspects of transactions, assumptions & adjustments made.

Objectives

a. To obtain RA about whether PPFI has been compiled, in all material respects, by responsible party on basis of applicable criteria &

b. To report in accordance with practitioner's findings.

Compilation of Pro forma financial information

Steps involved in this process include:-

- Identifying source of unadjusted financial info. to be used in compiling PPFI, & extracting unadjusted financial info. from that source
- Making pro forma adjustments to unadjusted financial info. for purpose for which PPFI is presented &
- Presenting resulting PFFI with accompanying disclosures.

Nature of Practitioner's Responsibility

- No responsibility to compile PFFI for entity. Such responsibility rests with responsible party.
- Sole responsibility is to report whether PFFI compiled, in all material respects, as per applicable criteria.

- It's a RA engg to report on compilation of PFFI involving performing procedures to assess whether applicable criteria used by responsible party in compilation of PFFI provide a reasonable basis for presenting significant effects directly attributable to event or transaction.

Steps involved in such an Engagement

1. Engagement Acceptance

a. Determine that practitioner has capabilities & competence to perform the engg

b. On basis of a preliminary knowledge & discussion with responsible party, determine that applicable criteria are suitable & unlikely that PFFI will be misleading for intended purpose.

c. Evaluate wording of opinion prescribed by relevant L/R, if any, to determine that practitioner will likely be able to express opinion based on performing procedures specified in this SAE

d. Where sources from which unadjusted financial info been extracted been audited/reviewed & modified audit opinion/review conclusion been expressed or report contains EOM para, consider whether relevant L/R permits use or reference in practitioner's report to, modified audit opinion or review conclusion or report containing EOM para wrt such sources

e. If entity's historical financial info. never been audited/reviewed, consider whether sufficient understanding obtained of entity & accounting & financial reporting practices to perform engg

f. If event or transaction includes acquisition & acquiree's historical financial info. never been audited/reviewed, consider whether sufficient understanding be obtained of acquiree & its accounting & financial reporting practices to perform engg and

g. Obtain agreement of responsible party that it acknowledges & understands its responsibility for:

i) Adequately disclosing & describing applicable criteria to intended users if not publicly available

ii) Compiling PFFI on basis of applicable criteria &

iii) Providing practitioner with:-

a. Access to all info. (including, info. of acquiree(s) in a business combination), such as records, documentation and other material, relevant to evaluating whether PFFI has been compiled, in all material respects, on basis of applicable criteria

b. Additional info. that practitioner may request from responsible party for purpose of engg

c. Access to those within entity & entity's advisors from whom practitioner determines necessary to obtain evidence relating to evaluating whether PFFI been compiled, in all material respects, on basis of applicable criteria &

d. When needed for purposes of engg, access to appropriate individuals within acquiree(s) in a business combination.

2. Planning and Performing the Enngg

- Assess whether applicable criteria are suitable, as required by Framework for Assurance Engg.
- When planning & performing engg, consider materiality wrt evaluating whether PFFI compiled, in all material respects, on basis of applicable criteria.

- Understanding of how responsible party compiled PFFI and other engg. circumstances
- Obtain evidence about appropriateness of source from which unadjusted financial info extracted
- If no audit or review report on source from which unadj. financial info extracted, perform procedures to be satisfied that source is appropriate.
- Determine whether responsible party appropriately extracted unadjusted financial info from source.
- Obtain evidence about appropriateness of pro forma adjustments.

In relation to unadjusted financial info, Pro forma adjustments include:

a. Adjustments to unadjusted financial info. that illustrate impact of significant event/transaction as if event occurred/transaction undertaken at earlier date &

b. Adjustments to unadjusted financial info. necessary for PFFI to be compiled on a basis consistent with applicable FRF of reporting entity & it's a/c policies under that framework.

- Evaluate presentation of PFFI.
- Read other info included in Prospectus to identify material inconsistencies with PFFI

Written Representations

Request written representations from responsible party that:-

a. In compiling PFFI, responsible party has identified all appropriate pro forma adjustments necessary to illustrate impact of event or transaction at date or for the period of illustration and

b. PFFI has been compiled, in all material respects, on the basis of applicable criteria.

Opinion

Unmodified Opinion: Express unmodified opinion when practitioner concludes that pro forma financial info. been compiled, in all material respects, on the basis of applicable criteria.

Modified Opinion

a. Prospectus Not Permitted: Where relevant L/R precludes publication of prospectus that contains a modified opinion wrt whether PFFI been compiled, in all material respects, on basis of applicable criteria & practitioner concludes modified opinion is appropriate, discuss the matter with responsible party.

If responsible party doesn't agree to make necessary changes, practitioner shall:
Withdraw from engg or Consider seeking legal advice.

b. Prospectus Permitted: Where relevant L/R may not preclude publication of a prospectus that contains modified opinion wrt whether PFFI been compiled, in all material respects, on basis of applicable criteria & practitioner determines that modified opinion is appropriate, apply the requirements in Framework for Assurance Engg regarding modified opinions.

Emphasis of Matter Para

- May consider it necessary to draw user's attention to a matter presented or disclosed in PFFI or accompanying explanatory notes.
- In practitioner's opinion, matter is of such importance that its fundamental to user's understanding of whether PFFI been compiled, in all material respects, on basis of applicable criteria.
- Include EOM para provided practitioner obtained SAAE that matter doesn't affect whether the PFFI been compiled, in all material respects, on basis of applicable criteria.
- Such para refer only to info. presented or disclosed in PFFI or accompanying explanatory notes.

Preparing Assurance Report

Basic elements of Assurance Report:

a. Title that clearly indicates that report is independent assurance report

b. An addressee(s), as agreed in terms of engg.

c. Introductory paras. that identify: -
   i) PFFI
   ii) Source of unadjusted financial info. and whether audit/review report on such source published
   iii) Period covered by/ date of PFFI and
   iv) Reference to applicable criteria & source of criteria

d. Statement that responsible party is responsible for compiling PFFI on basis of applicable criteria

e. Description of practitioner's responsibilities, including statements that: -
   i) Practitioner's responsibility to express opinion about whether PFFI been compiled, in all material respects, by responsible party on basis of applicable criteria
   ii) For purposes of this engg, practitioner isn't responsible for updating/reissuing any reports or opinions on any historical financial info. used in compiling PFFI, nor in course of this engg, performed an audit/review of financial info. used in compiling the PFFI and
   iii) Purpose of PFFI solely is to illustrate impact of significant event/transaction on unadjusted financial info. as if event had occurred/transaction undertaken at earlier date. Practitioner doesn't provide any assurance that actual outcome of event/transaction at that date would have been as presented

f. Statement that engg. was performed as per SAE 3420 which requires compliance with ethical requirements & obtain RA whether PFFI compiled in all material respects as per applicable criteria

g. Statements that: -
   i) A RA engg to report on whether PFFI been compiled, in all material respects, on basis of applicable criteria involves performing procedures to assess whether applicable criteria used provide reasonable basis for presenting significant effects directly attributable to event/transaction & obtain SAAE about whether: -
      - Related pro forma adjustments give appropriate effect to those criteria &
      - PFFI reflects proper application of those adjustments to unadjusted financial info.

ii) Procedures depend on practitioner's judgment, having regard to understanding of entity, event/transaction for which PFFI been compiled & other relevant engg. circumstances and

iii) Engg also involves evaluating overall presentation of PFFI

h. Unless required by L/R, opinion using 1 of following phrases, regarded as being equivalent:-

i) PFFI been compiled, in all material respects, on basis of applicable criteria or

ii) PFFI been properly compiled on the basis stated.

i. Signature

j. Date of report and

k. Place of signature.

Mgt of S Ltd. requests you to accept an engg. to report on compilation of PFFI to be included in a prospectus. In light of SAE 3420, what factors you will consider regarding the Co. acknowledging and understanding its responsibility in this matter before accepting engg?

Co's responsibility has to be acknowledged for following matters:-

i) Adequately disclosing & describing applicable criteria to intended users if not publicly available

ii) Compiling PFFI on basis of applicable criteria &

iii) Providing practitioner with:-

a. Access to all info. (including, info. of acquiree(s) in a business combination), such as records, documentation and other material, relevant to evaluating whether PFFI has been compiled, in all material respects, on basis of applicable criteria

b. Additional info. that practitioner may request from responsible party for purpose of engg

c. Access to those within entity and entity's advisors from whom practitioner determines necessary to obtain evidence relating to evaluating whether PFFI been compiled, in all material respects, on basis of applicable criteria and

d. When needed for purposes of engg, access to appropriate individuals within acquiree(s) in a business combination.

Only person you should try to be better than is the person you were yesterday.


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CHAPTER 17

Digital Auditing



What is a Digital Audit?

Digital Audit is placing assurance on effectiveness of IT systems implemented in an organization.

Key Features of Digital Audit

- Encourages auditee to embrace latest technological advancements & provides confidence stay updated in a constantly evolving environment.
- Allows to standardize processes & controls to be implemented to mitigate risk.
- Savings in time, cost & human effort which can be utilized towards more productive tasks.
- Improves quality of opinion. Consequently leads to a more reliable audit report
- It can help auditee to make informed decisions.

Advantages of Digital Audit

i. Enhanced Effectiveness & Efficiency: With use of tools & automation, standardized processes & routine tasks can be automated increasing efficiency & saves time & costs.

ii. Better Analytics: Improved analytics capabilities can aid mgt & auditors in seeing trends & patterns that may be challenging to spot manually.

iii. Improved Risk Assessment: Mgt & auditors put their testing efforts on sites with higher RoMM & make informed decisions.

iv. Better Audit Quality: Technology can quickly & correctly evaluate massive volumes of data. This can assist in determining areas that require more testing.

v. Lower Costs: By automating manual processes, technology can assist with lowering cost of auditing.

Consideration & Challenges of Digital Audit

Some considerations that org. should keep in mind while using digital techniques & automation:

- Know what business benefits organization wants to achieve with automation
- Think people first and do not underestimate change is difficult
- Target the right processes - this is a key for successful automation.
- Ensure process works & is standardised before automating.
- Automation is not a standalone solution & should be part of a broader digitalization strategy.
- Automation introduces new challenges for organization. Don't forget about governance & data security in the risk framework.

Auditor's Areas of focus could include understanding of following:

- New activities or changes to existing Processes due to new technology (eg, new revenue streams, changes in roles & responsibilities of entity personnel, etc)
- Changes in the way entity's Systems are developed & maintained & whether these changes introduce new risks & require new controls to respond to those risks
- Impact new technology as to how organization obtains/generates & uses info. to support functioning of internal control.

Key Features or Advantages of Auditing Digitally

Following are key features or advantages of Auditing Digitally:

i) Improved Quality of Audits: Through automation, data analytics techniques we can easily move from sample auditing to full population of transactions being reviewed or re-performed.

ii) Decreasing human dependency: Using technology minimizes manual intervention ultimately results in reducing risk of manual errors.

iii) Increases Transparency: New ERPs & tools have audit trail feature to trace transaction end to end.

iv) Automation & Ease: Automating tasks like recording work, extracting data & sampling have improved audit quality & reduced manual error.

v) Improved Efficiency: What used to take weeks to learn & programme using deep experts, is now easily available to auditors after some simple training and digital upskilling.

vi) Better risk assessment: Focus on real challenges & assess potential risk precisely. Dashboards, visual presentations & other tools helps in understanding where the risk lies & what areas need attention.

Considerations in Auditing Digitally

While all industry sectors are affected by emergence of new technologies its important to remember that the auditor's needs are unique. There are few questions it is important to ask and answer:

Q1 What problems are you trying to solve?

- Continuously evaluate emerging technologies & latest tools to see what can benefit audit.
- Think about what would make audit easier/better & how you will measure your ROI.

Q2 Which tech can help you?

- There are no. of tools available & many vendors & start-ups using data acquisition, manipulation & visualization tools.
- Consider how comfortably these solutions will integrate in your current processes & flag any potential implementation issues early on.

Q3 How will you upskill your people to make best use of tech available?

- Tech is only as good as people using it.
- Training & development are critical to ensure teams understand how & why they are using the tech.
- Reluctance to change is obvious, however continuous training help them to get better.

Q4 Range of automated solutions:

- There are range of automation solutions, from low to high sophistication, which helps to standardize repeatable tasks & optimize the efforts resulting in doing better.
- Some of the techniques are using robotics & automation for data gathering activities, use of data analytics for planning & budgeting & reporting by dashboards.

Understand the IT Environment

As per SA 315, Auditor's understanding of automated environment should include the following:

- Applications that are being used by the Co.
- Details of IT infrastructure components for each of the application.
- Organization structure and governance.
- Policies, procedures and processes followed.
- Extent of IT integration, use of service organizations.
- IT risks and controls.

Understand >> Identify >> Assess

Key Areas for an Auditor to Understand IT Environment

1. Understand the flow of transaction: Identifying & understanding IT applications & other aspects of IT environment relevant to flows of transactions & processing of info. in info system.
2. Identification of Significant Systems: Identify IT applications & supporting IT infrastructure while understanding how info. relating to Significant ABCD flows into & out of entity's info. system.
3. Identification of Manual & Automated Controls: Entity's system of internal control contains manual & automated elements. These are relevant to auditor's identification & assessment of RoMM.
4. Identification of technologies used: Understand emerging techs implemented & role they play in info. processing & consider their risks. May decide to engage specialists &/or auditor's experts.
   Some eg. of emerging technologies are:
   - ✓ Blockchain, including crypto businesses,
   - ✓ Robotics, Artificial Intelligence,
   - ✓ Internet of Things,
   - ✓ Biometrics
   - ✓ Drone
5. Assessing complexity of IT environment: Not all applications of IT environment have same level of complexity. Level of complexity for individual characteristics differs across applications.

5 IT Dependencies

Type	Description
Automated Controls	These are designed into IT environment to enforce business rules. For eg, PO approval via ✓ workflow or format checks (e.g., only a particular date format accepted), ✓ existence checks (eg, Duplicate customer no. can't exist), ✓ &/or reasonableness checks (eg, max. payment amt) when transaction entered.

Reports	System generated reports are info. generated by IT systems. ✓ These reports are often used in entity's execution of a manual control, including business performance reviews, or ✓ Maybe source of entity info. used for selecting items for testing, performing substantive TOD or substantive analytical procedure. E.g. (Vendor master report, customer ageing report)
Calculations	Accounting procedures performed by IT system instead of a person. For eg, system calculating 'straight-line' depreciation of asset (i.e., cost of asset, less residual value at end of useful life divided by useful life) or customer invoice amt by multiplying item price times with quantity shipped.
Security	Security including SOD enabled by IT environment to restrict access to info. & determine separation of roles & responsibilities.
Interface	Programmed logic that transfer data from one IT system to another. For eg, transfer data from a payroll subledger to general ledger.

Overview of Control Objectives and controls for each area of General IT Controls

Access Security

Objective: To ensure access to programs & data is authenticated & authorized to meet financial reporting objectives

Activities:

- Security policies & procedures are maintained
- Access requests to application are properly reviewed & authorized by mgt
- Access of terminated user is removed on a timely basis
- Access rights to applications are periodically monitored for appropriateness
- Transactions of administrative & sensitive generic IDs are monitored

Program Change

Objective: To ensure modified systems continue to meet FR objectives

Activities:

- Change Management policy & procedures are maintained.
- Development, testing & production environments segregated for changes to application config.
- SODs maintained between developer & implementor.
- Changes to application config. adequately tested & approved before being migrated into production
- Changes are adequately tracked & recorded.
- Emergency changes are approved.



Data Centre and network operations

Objective: To ensure production systems appropriately backed up to meet FR objectives

Activities:

- Policies & procedures for data back & recovery is maintained.
- Data is appropriately backed up & recoverable
- Restoration testing is perfomed
- Monitoring and compliance of service level agreements.

Cyber Attacks

Cyber-attack is an attempt to gain unauthorized access to computing system or network with intent to cause damage, steal, expose, alter, disable, or destroy data.

Most common types of cyberattacks are:

Malware: Malware or malicious software is any program or code created with intent to harm a computer, network or server.

Types:

1. Ransomware

   Adversary encrypts a victim's data & offers to provide a decryption key in exchange for a payment.

2. Fileless Malware

   A malicious activity that uses native, legitimate tools built into a system to execute a cyber-attack. Unlike traditional malware, fileless malware doesn't require an attacker to install any code on a target's system, making it hard to detect.

3. Trojan

   It's a malware that appears to be legitimate software disguised as native operating system programs or harmless files like free downloads.

4. Mobile Malware

   Type of malware designed to target mobile devices. Its delivered through malicious downloads, operating system vulnerabilities, phishing, smishing, & use of unsecured Wi-Fi.

Denial-of-Service (DoS) attack is a malicious, targeted attack that floods a network with false requests to disrupt business operations.

- In a DoS attack, users are unable to perform routine & necessary tasks, such as accessing email, websites, online a/cs or other resources that are operated by a compromised computer or network.
- While most DoS attacks don't result in lost data & typically resolved without paying a ransom, they cost organization time, money & other resources to restore critical business operations.

PHISHING is a type of cyberattack that uses email, SMS, phone, social media, & social engineering techniques to entice a victim to share sensitive info. — such as passwords or a/c nos. — or download a malicious file that will install viruses on their computer or phone.

Types:

1. Spear Phishing is a type of phishing attack that targets specific individuals or organizations through malicious emails. Goal is to steal sensitive info such as login credentials or infect targets' device with malware.
2. Whaling is a type of social engineering attack specifically targeting senior or C-level executive employees with purpose of stealing money or info. or gaining access to person's computer to execute further cyberattacks.
3. Smishing is a type of fraudulent practice of sending text messages purporting to be from reputable Cos to induce individuals to reveal personal info, eg. passwords or credit card nos.
4. Vishing, a voice phishing attack, fraudulent use of phone calls & voice messages pretending to be from a reputable org. to convince individuals to reveal pvt info such as bank details and passwords.

SPOOFING is a technique through which cybercriminal disguises themselves as known or trusted source. Adversary is able to engage with the target & access their systems or devices with ultimate goal of stealing info, extorting money or installing malware or other harmful software on the device.

Types:

1. Domain Spoofing is a form of phishing where attacker impersonates a known business or person with fake website or email domain to fool people into trusting them. Typically, domain appears to be legitimate at 1st glance, but closer look reveal subtle differences.

2. Email Spoofing is a type of cyberattack that targets businesses by using emails with forged sender addresses. Because recipient trusts alleged sender, they are more likely to open the email and interact with its contents, such as a malicious link or attachment.

Identity-Based Attacks: When a valid user's credentials been compromised & adversary pretend to be that user. For eg, people use same user ID & password across multiple accounts. Therefore, possessing credentials for one account may be able to grant access to other, unrelated account.

Insider Threats: When current or former employees that pose danger to an org. because they have direct access to Co. network, sensitive data, and intellectual property (IP), as well as knowledge of business processes, company policies or other info. that would help carry out such an attack.

DNS Tunneling is a type of cyberattack that leverages domain name system (DNS) queries & responses to bypass traditional security measures & transmit data & code within network.
This tunnel gives hacker a route to unleash malware & extract data, IP or other sensitive info. by encoding it bit by bit in a series of DNS responses.

IoT-Based Attack is any cyberattack that targets an Internet of Things (IoT) device or network. Once compromised, hacker can take control of device, steal data, or join a group of infected devices

Stages of Cyber Risks

Stage 1 - Assessing the cyber risk: No org. is completely immune to cyber risk. Every org. should consider at least common threats

- Ransomware disabling their organization (including their plants and manufacturing facilities)
- Common criminals using email phishing & hacks for fraud & theft.
- Insiders committing malicious or accidental activities resulting in unintended info. theft & frauds.

Stage 2 - Impact of cyber risk:

Cyber-attack can impact 1, 2 or more types of risks. Impact of attack would vary from org. to org and most importantly from an attack to attack.

Some of the indicative areas can be –

- Regulatory costs
- Business interruptions causing an operational challenge for an organization.
- Data loss, reputational loss & litigation.
- Ransomware - more common these days where entire systems are encrypted
- Intellectual property theft which may not only take competitive advantage, but may also result in impairment charge because of loss of IP.
- Incident response cost which could be for investigations & remediations
- Breach of Privacy, if personal data of consumer is hacked having significant impact on org.
- Fines and penalties

Stage 3 - Managing cyber risk:

Strategic approach to cyber risk mgt can help an organization to:

- Gain understanding of cyber risks, threats facing their organization & other financial institutions
- Assess existing IT & cybersecurity prog. & capabilities against relevant regulatory requirements
- Align cybersecurity and IT transformation initiatives with strategic objectives
- Understand accepted risks & documented compensating controls

Cyber Security Framework

It includes how mgt is identifying risk, protecting & safeguarding its assets from the risk.

I. Identify the risk: Auditor has to determine whether entity's RAP considers cybersecurity risks.
- Entity should conduct periodic risk assessment & develop mgt strategy which identifies cybersecurity risks around IT system.

- Entity maintains & periodically reviews inventory of their info. assets i.e. Asset Mgt (e.g., intellectual property, patents, etc).
- From governance perspective mgt should review how cybersecurity risks affect ICFR.
- To determine overall responsibility for cybersecurity in business environment entity should establish roles & responsibilities over cybersecurity (CISO, CIO).

II. Protect the risk:
- Obtained understanding of processes for safeguarding of assets subject to cybersecurity.
- Entity monitors whether there has been unauthorized access to electronic assets & any related impact on financial reporting.
- Formal training should be conducted to make teams aware of risk associated with cyberattacks.
- Entity should implement effective controls for data security.

III. Detect: Have controls and procedures that enable it to
- identify cybersecurity risks & incidents and
- to assess and analyse their impact on the entity's business,
- evaluate the significance associated with such risks and incidents, &
- consider timely disclosures.

IV. Respond to the risk
- Capture details of nature of incident & how incident or data breach was identified.
- Mgt should assess Litigation, Regulatory investigation & Remediation costs as a part of mitigation process & improvement
- Mgt should assess future action plans to safeguard organisation from such attacks.

V. Recover from risk
- Once the impact evaluated & communicated with regulators recovery plan needs to be implemented to overcome the impact.
- Necessary improvements - like patch upgrades, better controls, improved technology in terms of firewall, anti-virus, tools etc needs to be implemented to safeguard the entity.

Identify >> Protect >> Detect >> Respond >> Recover

Sukanya, a CA final student, is of view that cyber risks are issues of IT and result only in info. loss to an entity. She also feels that many cyber-attacks are not directly targeted at financial systems and do not pose risk of material misstatements to FS of an entity. Is her view proper?

Cyber risks are not an issue of IT alone. Rather, a business risk and has effect on whole business org. Affects entity's reputation & can lead to many other consequences which listed below: -

- Regulatory costs
- Business interruptions causing an operational challenge for an organization.
- Data loss, reputational loss and litigation.
- Ransomware - more common these days where entire systems are encrypted
- Intellectual property theft which may not only take competitive advantage, but may also result in impairment charge because of loss of IP.
- Incident response cost which could be for investigations & remediations
- Breach of Privacy, if personal data of consumer is hacked having significant impact on org.
- Fines and penalties

It may happen that many cyber-attacks are not directly targeted at financial systems.

However, access gained by attackers may provide them ability to:

- Manipulate or modify financial records
- Modify key automated business rules
- Modify automated controls relied upon by the management.

Further, auditor should consider whether cyber risk (like other business risks) represents a risk of MM to FS as part of audit risk assessment activities. Focus should be on understanding cyber risks affecting entity and actions being taken to address these risks.

Control considerations for Cyber Risks

1) Controls around vendor setup and modifications:

- Who is responsible for making changes to vendor master data? Is process centralized or decentralized?
- Are other communication channels, such as email, used to request changes to vendor master data? (If yes, consider if multi-factor authentication enabled for email).
- What systems & technologies used to initiate, authorize & process requests related to changes to vendor master data?
- Are authentication protocols defined to verify modifications to vendor master data (e.g., call back procedures, multi-factor authentication)?

2) Controls around electronic transfer of funds:

- Are personnel responsible for wire transfers educated on relevant threats & common phishing scams associated with fraudulent requests for wire transfers?

- Are authentication protocols defined to verify wire transfer requests (e.g., call back procedures, dual-authentication procedures)?
- What systems and technologies used to facilitate request/initiation, authorization & release of wire transfers?

3) Controls around patch management:
- Does entity have a patch mgt program?
- Does entity run periodic vulnerability scans to identify missing/unapplied patches?
- How is entity notified of patches by external vendors (e.g., Microsoft for Windows patches)?

Remote Audit

- Remote audit or virtual audit is when auditor uses online or electronic means to conduct audit.
- It could be partially or completely virtual, using technology to obtain audit evidence or perform documentation review with participation of auditee.

Considerations for remote audit

1. Feasibility & Planning
- Planning should involve agreeing audit timelines, meeting platform (Zoom calls/ Microsoft Teams / Google Meet) to be used for audit sessions, data exchange, any access authorization requests.
- Ensure feasibility in determining what technology may be used, if auditors & auditees have competencies & resources are available.
- Execution phases of remote audit involve video/tele conferencing with auditees.
- Documentation for audit evidence should be trfd through a document sharing platform.

2. Confidentiality, Security and Data Protection
- To ensure data security & confidentiality, access to document sharing platform should be restricted & secured by encrypting data sent across the network.
- Info, once reviewed & documented by auditor, is removed from platform & stored as per archiving standards & data protection requirements.
- Consider legislation & regulations, which may require additional agreements from both sides (e.g. no recording of sound & images or authorizations to use people's images).
- Shouldn't take screenshots as audit evidence. Any screenshots of documents or records should be previously authorized by client.
- For accessing auditee's IT system use VPN (Virtual private network). VPN creates safe & encrypted online connection.

3. Risk assessment: Assessment if remote audit would be sufficient to achieve audit objectives should be done & documented.



Advantages and Disadvantages of remote audit

Advantages	Disadvantages
Cost & time effective: No travel time & costs.	Limited or no ability to visualize culture of org, & body language of client. Time zone issues could also affect efficiency of remote audit session
Comfort & flexibility to audit team as they would be working from home environment	Due to network issues, interviews & meetings can be interrupted.
Time to gather evidence can spread over several weeks, instead of concentrated into a small period that takes personnel from their daily activities.	Opportunity to present doctored documents & omit relevant info is increased. This may call for additional planning, audit procedures, Security & confidentiality violation.
Auditor can get first-hand evidence directly from IT system as direct access may be provided.	Remote access to sensitive IT systems may not be allowed. Security aspects related to remote access and privacy needs to be assessed
Widens selection of auditors from global network of experts.	Cultural challenges for auditor. Lack of knowledge for local L/R could impact audit. Audit procedures like physical verification of assets & stock taking can't be performed.

Emerging Technologies in Audit

Data Analytic Techniques

- Generating & preparing meaningful info from raw system data using processes, tools, and techniques is known as Data Analytics.
- Involves analyzing large sets of data to find actionable insights, trends, draw conclusions & for informed decision making.
- Allows more effective audit of large amounts of data held & processed in IT systems in larger clients.

Audit analytics helps:

- ✓ To discover and analyze patterns
- ✓ Identifying anomalies
- ✓ Extract other useful information in data

Data analytics methods used in audit are known as Computer Assisted Auditing Techniques or CAATs.

Some of popular tools used across industry as part of CAATs are listed below:

1. ACL - Audit Command Language (ACL) Analytics is a data extraction & analysis software used for fraud detection & prevention, and risk mgt.
   It samples large data sets to find irregularities or patterns in transactions that could indicate control weaknesses or fraud.
   Example: ACL is used to analyse and check complete data sets to perform Trial Balance reconciliations during Audits. In such scenarios, entity provides GL dump & system Trial Balance.

2. Alteryx is used to consolidate financial or operational data to assess controls.
   - Fully transparent audit trail of every action is performed in Alteryx in form of a workflow making easier for user to learn as no prior knowledge of coding or scripting is required.
   - Can be used to automate analytics & perform Machine Learning to
     - ✓ search for patterns of fraud or irregularities &
     - ✓ speed up processes like accounting, tax filings, etc.
   - Also used to automate set procedures performed periodically like reconciliations, consolidations etc.

   Example:
   - ✓ Alteryx used for logistics org. to recompute revenue recorded by system to match with financials that showcased expected revenue turnover.
   - ✓ Due to Alteryx's processing speed & ease to implement functions, auditors could perform re-computation for all transactions entry & noted that revenue was being understated as expected revenue was more than actual calculated.
   - ✓ This was due to addendum b/w logistic Co. & client wasn't revised in system & old rates used to compute revenue. Alteryx helped in analysing & recomputing revenue & focus on actual risk.

3. Power Bi is a business intelligence (BI) platform that provides non-technical business users with tools for aggregating, analyzing, visualizing & sharing data.
   - From audit perspective, can be used to find outliers in population
   - Also be used for reporting purpose to higher mgt.

   Example:
   Power BI dashboard used for checking outliers of apparel Co. Auditors were required to analyse trends of sales during the year. By use of Power BI, sales data provided by client was further converted into dashboard to analyse trends & patterns as per market standards.

4. CaseWare is a data analysis software & provide tools that help in conducting audit engg. quickly, accurately and consistently.
   - Shares analytical insights helping in taking better informed decisions.



- Helps in streamlining processes & eliminating routine tasks.
- Used by a/c firms, governments and corporations worldwide, this trusted platform integrates everything you need to conduct assurance and reporting engg.

Example:

- ✓ CaseWare provides solutions to build a/c software which turns any document, including FS into cost effective client ready report.
- ✓ It automatically links to client data & securely communicate with client in real time.

Q. CA Y is planning to use CAATs extensively in audit of a Co. Be it for compliance tests or substantive tests. Can you list out eg. Of few situations of tests performed by him using CAATs?

i) Identify exceptions: Identify exceptional transactions based on set criteria. For eg, cash transactions above ` 10,000.
ii) Identify errors: Identify data, which is inconsistent or erroneous. For e.g.: a/c number which is not numeric.
iii) Verify calculations: Re-perform various computations in audit software to confirm results from application software confirm with audit software. For e.g.: TDS rate applied as per criteria.
iv) Data completeness: Identify whether all fields have valid data. For example: null values in any key field such as date, invoice number or value or name.
v) Data consistency: Identify data, which are not consistent with the regular format. For eg: invoices which are not in the required sequence.

Automated Tools in Audit

1. Internet of Things

- IoT is concept of connecting any device (cell phones, coffee makers, etc) to internet.
- Key components of IoT are data collection, analytics, connectivity & people and process.
- IoT not only changes business model, but also affects strategic objectives of org.
- Risk profile of entity changes with exposure to new L/R

Audit Implications

Risk Assessment

Consumer facing tools that connect to business environments in new ways can impact flow of transactions & introduce new risks for mgt & auditors to consider.

Eg. payment processing tools allowing users to pay via credit card through mobile device at retail location. Creating a new path for incoming payments that may rely on new service provider.

- Auditors need to consider volume of those transactions, processes & controls related to it.

Control Testing

- Shift to connected devices & systems may result in auditors unable to rely only on manual controls.
- Instead, auditors may need to scope new systems into their audit.
- Need to train & upskill auditors to evaluate design & operating effectiveness of automated controls.

Common risks

Device hijacking, data siphoning, denial of service attacks, data breaches and device theft.

2. Artificial Intelligence (AI)

- Refers to system or machine that can think and learn.
- AI systems utilize data analysis & algorithms to make decisions based on predictive methods.
- Complex algos are developed to propose decisions based on a pattern or behaviour learned over time.

Examples:

- ✓ Self-driving cars, manufacturing robots, smart assistants, virtual travel booking agent etc.
- ✓ AI predicting when to book lowest prices for flights, hotels, car & vacation home rentals. Using historical flight and hotel data, AI will also recommend to user whether booking has reached its lowest price point or if user should hold out a bit longer for price to drop.

Auditor Implications

- Focus: Given invisible nature of algos, audits must focus on logical flow of processes.
- Algo Check: Ascertain whether unintended bias added to algos. Assess effectiveness of algos & whether their output is appropriately reviewed & approved.
- Bugs & Vulnerability: Because AI is built on software modules, consider cybersecurity & search for possible bugs and vulnerabilities that can impact AI functionality.
- AI Affect: Confirm their understanding of how use of AI affects entity's flows of transactions, including generation of reports or analytics used by mgt.
- Decision Making: Whether AI is making decisions or utilized by mgt as part of decision making process.

Common risks for AI

- Security is one of key risks. More data system uses, from more sources, more entry points & connections are formed and greater potential risks.
- Inappropriate configuration: AI may be used to diagnose medical conditions. If it is badly configured or malfunctions, it could harm people before problem is spotted.
- Data privacy: Data used & shared should have necessary explicit consent from data providers.

3. Blockchain
   - Based on a decentralized & distributed ledger secured through encryption.
   - Each transaction is validated by blockchain participants, creating a block of info. that's replicated & distributed to all participants.
   - All blocks are sequenced so that any modification or deletion of block disqualifies the info.

Example

Bitcoin, cryptocurrency transfer application - Blockchain in money transfer, blockchain smart contracts.

Audit Implications

- Governance & Security: Consider appropriate governance & security measures around transactions.
  - ✓ Blockchain's core security premise rests on cryptography, there are risks associated with it.
  - ✓ As blockchain interacts with legacy systems & business partners, concerns related to insecure application programming interfaces (APIs), data confidentiality & privacy can't be ignored.
- Weak blockchain application development protocols are something auditors cannot overlook.
- Data Privacy Laws: Data privacy L/R may be area of concern as data communicated across geographic boundaries. Determine whether data put on blockchain will expose entity to liability for NOCLAR.

Common risks for blockchain technology (Strengths of blockchain can also be its weaknesses)

- ✓ Inability to reverse transactions & access data without required keys make system secure
- ✓ But also mean org. need specific protocols & processes to ensure they aren't locked out & have contingency plans.
- ✓ Operating through network nodes also expose org. to cyber-attacks and data hacks, so security issues are important.

4. NFT (Non-Fungible Token)
   - NFT means something is unique & can't be replaced.
   - Fungible? Physical money & cryptos are fungible (ie. they can be traded or exchanged for one another) NFTs are non-fungible tokens. They contains digital signature making them unique.
   - What it is? NFTs are tokens used to represent ownership of unique items. NFTs allow their creators to tokenize things like art, collectibles, or even real estate.
   - Ownership: They are secured by blockchain & can only have one official owner at a time. No one can change record of ownership or copy/paste a new NFT into existence.

Key Features of NFT -

- Digital Asset - It's a digital asset that represents Internet collectibles like art, music, & games with authentic certificate created by blockchain technology that underlies Cryptocurrency.

- Unique - It can't be forged or manipulated.
- Exchange - NFT exchanges take place with cryptos such as Bitcoin on specialist sites.

Challenges of NFT:

- Challenges like ownership & copyright concerns, security risks, market isn't that wide, online frauds etc.
- NFT audit considerations includes comprehensive code review for verifying safety of token, valid contract, data privacy and potential cyber threat.

5. Robotic Process Automation

- RPA is automation of repetitive processes performed by users.
- Its a software tech that emulate humans' actions interacting with digital systems & software.
- Process efficiency, customer experience & control effectiveness contributed to RPA.
- RPA software bots can interact with any application or system same way people do, except that RPA bots can operate around the clock, nonstop, faster & with 100% reliability & precision.

Audit Implications

- ✓ It is of utmost importance to understand RPA processes, which include data extraction, aggregation, sanitization & cleansing. Unless auditors understand, they will not be in a position to initiate audit.
- ✓ A comprehensive assurance process might demand review of the source code.
- ✓ To perform substantive testing, auditors must have an understanding of tools used to develop & maintain RPA.
- ✓ This will be helpful when auditors review logs, configuration controls, privileged access controls & the like.

Common Risks of RPA

Operational and execution risks:

- ✓ Robots deployed without proper operating model.
- ✓ Buying wrong tool, making wrong assumptions, taking shortcuts, & jeopardizing security and compliance.
- ✓ Assigning proper responsibilities, training and clearly stating about changing roles also can help you reduce operational risk to a great extent.

Change management risks: Not following change mgt implementation lifecycle, improper & incomplete testing (not covering all scenarios) leads to inaccurate results.

RPA Strategy Risk: Setting wrong expectations, improper KPIs, & unrealistic business goals creates environment of uncertainty.

Mgt should discuss & analyse complete working, potential & limitations of RPA before drafting a RPA.

Control Considerations or Objectives of Auditing Digitally

Emerging technologies can bring great benefits, but also come with varied set of substantial risks.

As they address challenge of assessing technology risk, auditors can & should focus on following control considerations:

1. Auditors should gain holistic understanding of changes in industry & IT environment to effectively evaluate mgt's process for initiating, processing, & recording transactions & then design appropriate auditing procedures.
2. Auditors should consider risks resulting from implementation of new technologies & how those risks may differ from those that arise from more traditional, legacy systems.
3. Consider whether digital upskilling or specialists are necessary to determine impact of new technologies & assist in risk assessment & understanding of design, implementation, and operating effectiveness of controls. Eg, cybersecurity control experts, IT specialists in team etc.

Examples of technology risks where auditors should test appropriate controls for relying on digital systems

Covered in SA 315

Key Steps for Auditors in a Changing Technology Environment

As auditors obtain understanding of impact of technology on a Co's business, its systems of internal control, and financial reporting, some important reminders include the following:

- Maintain sufficient professional skepticism when reviewing mgt's risk assessment for new systems.
- Understand direct and indirect effects of new technology & determine how its use impacts auditor's overall risk assessment.
- Understand how technologies impact flow of transactions, assess completeness of in-scope ICFR systems, and design a sufficient and appropriate audit response.
- Assess appropriateness of mgt's processes to select, develop, operate, and maintain controls related to organization's technology based on the extent of technology used.

A Co. is planning to use Robotics process automation (RPA) to streamline its hiring process. Earlier, Co. used to hire from campuses of various mgt institutes leading to high recruitment costs, inefficient hire yield and resultant lack of diversity. How RPA can be used to automate hiring process? List out tentative few such steps. What could be likely benefits of using RPA in hiring process?

RPA can be used to streamline hiring process in a Co.

Tentative steps could include: -

- Place advertisements on social media/career advice sites.
- Link redirects candidate to a career site.
- Career site pulls information of candidate.
- An algorithm scans applicants for desired and suitable roles.
- Selected candidates may be asked to play online games to assess their skills.
- Certain percentage of applicants called for a video interview using interview software.

Automated hiring process will reduce full time effort involvement, provide with a wider assessment range, reduce impact of recruiter biases, increase the efficiency of mapping of interested candidates, reduce recruiting costs, increase hire yield, reduce time to hire, increase diversity.

NEXT GENERATION AUDIT

From → To

Sampling → Full Population analysis

Multiple Datasets → One dataset

Disconnected tools → Integrated ecosystem services

Manual risk assessment → Dynamic, data driven risk assessment

Separated communication → Embedded communication

Repetitive tasks → High value work & capacity for growth

Manual Work → automation

Ad hoc insights → Insights from broader audit

Drone Technology

- Using drone technology in remote locations for stock counts.
- Drones have great payload capacity for carrying sensors & cameras, they can photograph and physically examine count of large quantities of fixed assets & inventory.
- Drone captured info. can be combined with various alternative sources of info. such as QR code readers, handheld bar scanners, manual counts etc. to optimise quality of deliverables, consolidate audit info. & enhance execution speed while ensuring correctness & completeness of data.

Augmented reality: Allows users to view real-world environment with augmented (added) elements, generated by digital devices. One famous eg was Pokémon Go, mobile game in which players chase imaginary digital creatures (visible on their mobiles) around physical locations.

Virtual reality: VR goes a step forward & replaces real world entirely with a simulated environment, created through digitally generated images, sounds, and even touch and smell. Using special

equipment, such as a custom headset, user can explore simulated world or simulate experiences such as flying or skydiving.

Metaverse is emerging 3-D digital space that uses VR, AR and other advanced internet technology to allow people to have lifelike personal & business experiences online. It represents convergence of digital technology to combine & extend reach and use of Cryptos, AI, AR and VR.

Case scenarios to illustrate potential application of metaverse in financial domain

- Virtual Banking and Transactions: Forward-thinking financial institution, establishes a presence in metaverse to offer virtual banking services. Users can create virtual bank a/c, access personalized financial dashboards & perform transactions using virtual currencies.
- Digital Asset Management: A digital asset mgt Co, recognizes growing popularity of virtual assets in metaverse. They launch a virtual asset trading platform within metaverse, allowing users to buy, sell, and trade NFTs and other digital assets.
- Virtual Financial Education and Training: Financial Learning Academy(FLA) aims to enhance financial literacy using metaverse. Create virtual classroom environment where participants can attend interactive education sessions.
- Virtual Meetings and Conferences: For a leading industry even an organisation hosts virtual conference within the metaverse. Participants from around the world can access conference through their virtual avatars.
- Data Visualization and Analytics: A Co. utilizes metaverse to offer advanced data visualization and analytics tools to financial professionals. Their virtual analytics platform allows users to visualize complex financial data in interactive and immersive 3D environments.

Common Risks associated: Public safety, cybersecurity, data privacy, data protection, lack of standards and technical challenges. 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.

"Success is not key to happiness. Happiness is key to success"

Emerging Areas



What's "Sustainability reporting"? List some of its expected benefits?

- Sustainability reporting is practice of reporting publicly economic, environmental, and/or social impacts & contributions (positive or negative) towards sustainable development.
- Info that companies provide about performance to outside world on regular basis in structured way.

Expected Benefits:

- Understand performance: Help stakeholders to understand organizations performance vis a vis sustainability & impacts. Reporting process links financial & non-financial performance.
- Long term value: Such reporting can help entities to focus on long-term value creation, by addressing environmental, social and governance (ESG) issues.
- Investing: Investors are increasingly recognising environmental & social issues provide both risks & opportunities in respect of investments & seeking disclosures on environmental & social performance of businesses, they can use ESG performance to make investment decisions.

Three pillars constitute ESG

A. Environment (E): Environmental stands for corporate climate policies, energy use, waste, pollutions, natural resource conservation, & treatment of animals. Includes natural resources that every entity absorbs for functioning like coal, water etc.
B. Social (S): It addresses relationships & reputation with people & institutions you do business. Also includes labour relations, diversity & inclusions. Every Co. operates within broader & diverse society.
C. Governance (G): It is internal system of controls & procedures entity adopts to govern itself, make effective investment decisions, comply with law and meet needs of stakeholders.

ESG Reporting:

ESG reporting is about disclosure of info, data, metrics that explain added value in these 3 areas.

- ESG reporting can be both quantitative & qualitative in nature.
- Qualitative reports describe a Co's strategy or policy around relevant topics & Quantitative approach includes metrics & KPIs of each area to measure progress against goals & report achievements.
- Mixed approach that uses both qualitative & quantitative info adds to quality of disclosures.

Sustainable Development Goals [Quick Read]

17 SDGs: No Poverty | Zero Hunger | Good health & well being | Quality Education | Gender Equality | Clean Water & Sanitization | Affordable & Clean Energy | Decent Work & Economic Growth | Industry Innovation & Infrastructure | Reduced Inequalities | Sustainable Cities & Communities | Responsible Consumption & Production | Climate Action | Life Below Water | Life on Land | Peace | Justice & Strong Institutions | Partnership for the Goals

Note: Corporates can contribute to SDGs due to their capacity to provide solutions for meeting SDGs. Cos. can lead in innovation & contribute to achievement of SDGs.

Integrated Reporting

6 Cs of Integrated Reporting - also known as 6 capitals:

(i) Financial Capital: Pool of funds available to org for use in production of goods or services. Obtained via financing, eg debt, equity or grants or generated through operations or investments.

(ii) Manufactured Capital: Seen as human-created, production equipment & tools. Available for use in production of goods or provision of services.

(iii) Natural Capital: Is input to production of goods or services. An org's activities also impact natural capital. Includes water, land, minerals and forests, biodiversity, and ecosystem health.

(iv) Human Capital: People's skills & experience, capacity and motivations to innovate, including their:
- Alignment with & support of organization's governance framework & ethical values.
- Ability to understand & implement organization's strategy.
- Loyalties & motivations for improving processes, goods & services

(v) Social Capital: Institutions & relationships established within & between each community, group of stakeholders and other networks to enhance individual and collective well-being.
Includes:
- ✓ Common values and behaviour.
- ✓ key relationships, trust & loyalty developed with customers, suppliers & business partners.
- ✓ social license to operate.

(vi) Intellectual Capital: Key element in org's future earning potential, investment in R&D, innovation, HR and external relationships, which can determine organization's competitive advantage.

Q. Trustworthy Industries Ltd (a listed Co.) has already been preparing & disclosing its sustainability report based upon internationally accepted reporting framework of "Integrated Reporting" on a voluntary basis even some years before BRSR reporting became mandatory.
Even after BRSR reporting became mandatory, its cross-referencing disclosures made under such reporting to disclosures sought under BRSR. Key thrust of "Integrated Reporting" is how Co. creates value over short, medium & long term.
Following further information is provided in respect of the above Co: -
[i] It has increased no. of customers using digital customer mobile app of Co. from 2 lac users to 4 lac users. There is 100% increase in digital collection. It has benefitted customers of Co. and resulted in use of digital methods for business operations of Co.
[ii] It has increased no. of beneficiaries under its flagship CSR programmes from previous 10000 to 75000. It has provided value for communities and provided sustainable livelihood to them.
Discussing above information, identify which of the capitals of "Integrated Reporting" are being referred to at [i] and [ii] respectively?

Information at [i] states that Co. increased no. of customers using digital mobile app. Besides, it has led to 100% increase in digital collection. Therefore, it involves use of technology for deriving



business benefits. It has invested in innovation deriving business benefits from digitization. Capital referred to at [i] is "Intellectual Capital".

Increase in no. of beneficiaries under flagship CSR programmes providing value for communities and sustainable livelihood is an eg of relationships established within & between each community, group of stakeholders and other networks to enhance individual and collective well-being. Capital referred to at [ii] is "Social and Relationship Capital."

Business Responsibility & Sustainability Report (BRSR)

Top 1000 listed companies by market capitalization required to file BRSR.

Reporting questionnaire is divided into 3 sections:

i) Section A – General Disclosures

Contains details of listed cos., its products, services, operations, employee related details, its holding, subsidiary, associate cos. etc.

ii) Section B – Management Process and disclosures

Contains questions related to policy & management processes, governance, leadership, and oversight.

iii) Section C – Principle-wise performance disclosures

Cos. are required to report upon Key performance indicators (KPIs) in alignment with 9 principles of NGRBC [National Guidelines on Responsible Business Conduct]

The section classifies KPIs into 2 categories that companies are required to report upon:

- Essential indicators (Mandatory disclosures)

Include data on training programs, environmental data on energy, emissions, water, waste mgt etc.

- Leadership indicators (Optional disclosures)

Include life cycle assessments, details of conflict mgt policy, additional data on biodiversity, energy consumptions, supply chain mgt etc.

Nine Principles of BRSR

9 principles in BRSR are categorized into ESG components of Environment, Social and Governance with 2 in Environment, 3 in social and 4 in Governance.

For eg, environmental protection is closely linked to stakeholder engagement & inclusive growth.

Principle 1 – Ethics, Transparency and Accountability

Emphasizes that business decisions should be open to disclosure & accessible to relevant parties.

Core elements:

a) Policies: Entities' governing structure should develop policies, procedures & practices for their offices, factories and work areas, ensuring that ethics is not compromised.

b) Share with stakeholders: Info. relating to policies, procedures & practices with performance should be made available to stakeholders.

c) Adverse effects: In case of adverse effects, care has to be taken for transparent disclosures.

d) Encourage others: Entities in value chain should be encouraged to adopt these principles by governance structure.

e) Proactively respond: Entities should proactively respond to outside entities that violate 9 principles. This includes suppliers, distributors, sub-contractors, or regulatory officers that engage with business concern.

Principle 2 – Safe and Sustainable Goals and Service:

Make sure that goods, services & operations result in better life for consumers & end-users.

Core elements:

a) Minimise Resources: When product is designed by entity, production methods & technologies have to be devised in a way to minimize resource usage to make it sustainable.

b) Spread Awareness: Entities are responsible to educate & make their consumers & clients aware about their rights.

c) RRR: Entities should take measures that reduce over exploitation of nature's resources by consuming sustainably & encourage methods for reduce, reuse and recycling of resources.

Principle 3 – Promote well-being of all employees including those in value chain

Initiatives entity takes for benefit of its employees dignity, health, well-being.

Core elements:

a) Compliance: Ensure compliance with all regulatory requirements as far as employees are concerned.

b) Dignity & Freedom: Respect dignity of employee as human being & shouldn't restrict their freedom of associations, unions & other mechanisms for collective bargaining of rights & redressal of issues they face at workplace.

c) Child Labour: Prevent child labour, bonded labour & any other forms of involuntary labour.

d) Work life Balance: Entities should have system in which work-life balance is not compromised.

e) Timely Payment: Businesses have to ensure timely payment of worker's wages and compensation.

f) Living wages: Payment of wages has to be as per living wages, considering basic needs & provide economic security to employees.

g) Harassment free: Creation of workplace free of harassment & violence is 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 & voluntary systems that relate to mgt system of any organisation, be it related to quality, environment or occupational health & safety of workers.

Core elements:

a) Disclose Impact: Be transparent & communicate with stakeholders about impacts of operations & decisions on people & nature. Policies, decisions & impact of operations have to be disclosed transparently with no ambiguity on extent of issues.

b) Determine Context: Entities have to systematically determine context of their operation & identify their interested parties.

c) Share Benefits: Entities should fairly share benefits to stakeholders or give opportunity to them to benefit from operations in equitable manner.

Principle 5 - Respect & promote human rights

Covers a variety of violence & belligerent abusive issues faced by people. Refers to human rights issues that happen directly or indirectly due to operation of business.

Core elements:

a) Understanding: Entities should have clear understanding of human rights & various ways by which human rights can be violated from perspective of Constitution of India, national laws & policies & content of International Bill of Human Rights.

b) Mgt Systems: Entities when developing mgt systems, should integrate human rights element into their policies, procedures and practices.

c) Respect all: Businesses should recognize & respect human rights of all stakeholders & groups within & beyond workplace, including communities, consumers & vulnerable and marginalized groups.

Principle 6 - Protection and restoration of Environment

Looks at environmental responsibility as a basic requirement for economic prosperity & sustainability.

Core elements:

a) Policies: Have policies, procedures & practices to assess and rectify impacts to environment. This should cover whole life cycle of product.

b) Optimum use: Make use of natural & manmade resources in optimum manner to ensure sustainability by taking feedback from stakeholders.

c) Measure performance: Measure their performance relating to prevention of pollution, destruction of forests, waste generation, energy use, land use, etc.

d) Climate change initiatives: Contribute towards climate change resilience supporting India's commitment to international mechanisms like Paris Agreement & National Action Plans.

e) Best practices: Explore comparison of its activities with industry best practices to reduce, reuse and recycle/ recover materials, resources.

Principle 7 - Influence on Public and Regulatory Policy

Positively recognizes that businesses operate within the framework of statutory & legislative policies of governing authority.

Principle further highlights that -

a) Core elements of BRSR met holistically when org. go ahead with their contributions to policy formulation & policy advocacy.

b) Collective associations such as, trade groups and industry chambers have to be utilized when moving ahead with policy advocacy and formulation.

c) Role in policy advocacy by organisation should be in such a way that it encourages fair competition & prevents human rights abuses.

Principle 8 - Promote Inclusive Growth and equitable development

This can work only with close participation & collaboration amongst entities, authorities, civil associations contributing to one another for a better livelihood, & assistance to marginalized communities.

Core elements of the eighth principle are:

a) Systems: Have systems to identify & address impacts of activities on social, cultural, and economic aspects of people. This includes business created issues like, land acquisition, use & construction activities for new facilities.

b) Adverse impacts: Review, measure & track adverse impacts of their activities on society and environment and make action plans to mitigate them adequately.

c) Creativity: Make efforts to bring up creative products, technologies & business concerns that help marginalized communities to have well-being & better quality of life.

d) CSR: When designing CSR activities review local & regional development priorities to help marginalized groups & communities.

e) Displacement of Communities: Ensure that displacement or relocation of communities doesn't happen & in unavoidable cases, mutually agree, participative & informed negotiations provide fair compensation to affected people.

Principle 9 – Provide value to consumers in a responsible manner

Primary purpose of any business is to create or provide useful products & services to customer in exchange of reasonable profits.

Core elements associated with the principle are:

a) Reduce Negative Impact: Entities should put in efforts to reduce negative impacts of products & services on consumers, natural environment & society at large.

b) Freedom of choice: When conceptualizing, designing & marketing their products, org shouldn't prevent freedom of choice & fair competition.

c) Transparency: Entities should transparently & accurately disclose all kinds of adverse impacts to user, planet, society, on biodiversity from their products.

d) Privacy of data: When handling customer data, right to privacy of customer needs to be maintained.

e) Inform customers: Inform customers on safe & responsible ways of usage, reuse, recycling, and disposal of their products and ways to eliminate over-consumption.

f) Misleading Ads: When advertising about products, ensure that misleading and confusing info not provided to customers about products or usage.

g) Grievance Redressal: Make available transparent & accessible grievance redressal & feedback mgt system for customers to raise voices or seek clarifications.

h) Universal Access: Entities providing essential goods and services (e.g., Utilities), enable universal access, in a non-discriminatory & responsible manner

Assurance in BRSR

ICAI has recently issued Standard on Sustainability Assurance Engagements (SSAE) 3000 Assurance Engagements on Sustainability Information. Applicable to all assurance engg. on Sustainability info.

Intended users of this Standard include:

- Assurance providers providing assurance on sustainability info.
- Entities seeking to engage a professional auditor.
- Regulators, investors, and other users of Sustainability Reporting data.

This Std. applies for assurance engg. providing reasonable or limited assurance on sustainability info.

Effective date of application of SSAE 3000:

- Voluntary basis for assurance reports covering periods ending on 31.03.23.
- Mandatory basis for assurance reports covering periods ending on or after 31.3.24.

ICAI has also issued SSAE 3410, Assurance Engg. on Greenhouse Gas Statements which deal with assurance engg. on entity's sustainability info. including assurance of BRSR.

Methodology to provide assurance on BRSR

- Preliminary Review of ESG report, parameters
- On-site Assessment / Verification of ESG Report
- Issuance of Assessment Report & Assessment Statement
- Review of responses & clarifications on findings
- Submission of findings of onsite assessment & document review
- Preparation of Assessment/Verification report including final results of Assess./ Recommendation

Role of Auditor - Consideration of Climate Related Risks in Audit of FS

Role of auditor is to obtain RA whether FS as whole are free from MM, whether due to fraud/error, to enable auditor to report whether FS are prepared in all material respects as per applicable FRF.

In understanding entity, auditor should consider climate related risks & how these risks relevant to audits. Climate-related risks could be more relevant in certain sectors or industries, e.g., banks & insurance, energy, transportation, materials & buildings, agriculture, food & forestry products.

Many investors & stakeholders are seeking info from auditor's reports about how climate related risks were addressed in audit. Auditor need to be aware of & may face increasing pressure for transparency about climate matters in auditor's reports. However, audit reports must follow applicable auditing standards.

Audit report is communication to users about audit performed. In addition to audit opinion, it provides info about auditor's responsibilities and, when required, understanding of matters of most significance in audit & how they were addressed.

In some circumstances, inclusion of EOM Para to draw attention to disclosures that are fundamental to users' understanding of FS. Auditor should also determine whether entity has appropriately disclosed relevant climate-related info in FS as per applicable FRF e.g., Ind AS or AS.

Also read other info for consistency with FS & info outside FS publicly communicated to stakeholders, such as mgt report in annual report, press releases or investor updates. This is required under ISA 720 and SA 720, Auditor's Responsibilities Relating to Other Information.



Global Trends in Sustainable Reporting

Mandatory reporting mostly associated with public sector or govt run companies, large corporations, MNCs, and listed cos. in stock ex.

Most widely used framework in world is Global Reporting Initiative (GRI) Sustainability Reporting Standards having 93% of world's largest 250 corporates doing sustainability reporting through GRI. It is used in over 100 countries to report sustainability. This independent international org. is based in Amsterdam, Netherlands, and has operational hubs in Brazil, China, Colombia, India, South Africa, and US.

GRI Sustainability Reporting Standards are developed with true multi-stakeholder contributions and rooted in the public interest.

1. Global Reporting Initiative (GRI) – helps org. to report on economic, environmental, and social impacts. General disclosures required under this std are Economic, Environment and Social. Report is addressed to all stakeholders of entity.

2. Carbon Disclosure Project (CDP) – captures environmental performance data related to GHG emissions, water, forests, and supply chain. Major details reported are climate change, Forest, and Water security. Addressed to all investors, buyers, and other stakeholders of entity.

3. International Integrated Reporting Framework (IIRC) – has established guiding principles & content elements in order to allow companies to produce integrated reports. This report consists of Organisational overview, Governance structure, Business model, risks and opportunities, strategy, performance, outlook etc.

Applicability

To every Co. including foreign Co. except:

- Banking Co.
- Insurance Co.
- Sec 8 Co. (NGO)
- One Person Co. (OPC) & Small Co.
- Pvt ltd Co. (not holding/subsy of Public Co.)



BaSSI Pvt Ltd

Paid up Share Cap + Reserves & Surplus <= 1 Cr (B.S. Date) &
Borrowings (Bank or FI) <= 1 Cr (Any time during year) &
Revenue (including revenue from discontinued operations) <= 10 Cr as per F/S
*CARO not applicable to Consolidated financial statements except clause (xxi)

Eg 1: 'Educating Child' is a Ltd Co. regd u/s 8 of Companies Act, 2013.
In given case, 'Educating Child' is licensed to operate under Sec 8 of Companies Act, 2013.
Therefore, CARO, 2020 shall not be applicable to 'Educating Child' accordingly.

Eg 2: Ashu Pvt. Ltd. has fully paid capital and reserves of ₹50 lakh. During the year, Co. had borrowed ₹70 lakh each from a bank and a financial institution independently. It has turnover of ₹900 lakh.
In given case of Ashu Pvt. Ltd, has paid capital and reserves of ₹50 lakh i.e. less than 1 Cr, turnover of ₹9 crore i.e. less than ₹10 crore. However, it has maximum outstanding borrowings of ₹1.40 crore ₹70 lakh + ₹70 lakh) collectively from bank and financial institution. Therefore, it fails to fulfill condition relating to borrowings. Thus, CARO, 2020 shall be applicable to Ashu Pvt. Ltd. accordingly.

Para 3: Clauses (i) to (xxi)

(i) (Proper records of PPE/Intangibles + Physical verification + Title deeds + Revaluation + Benami)

a. (A) whether Co. is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment
(B) whether company is maintaining proper records showing full particulars of intangible assets

b. whether these PPE have been physically verified by mgt at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether same have been properly dealt in books of a/c

c. whether title deeds of all immovable properties (other than properties where Co. is lessee & lease agreements duly executed in favour of lessee) disclosed in F.S. are held in name of Co, if not, provide details in format below:-

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held-indicate range, where appropriate	Reason for not being held in name of Co.* Indicate any dispute

d. whether Co. revalued its PPE (including Right of Use assets) or intangible assets or both during year and, if so, whether revaluation is based on valuation by Registered Valuer; specify amt of change, if change is 10% or more in aggregate of net carrying value of each class of PPE or intangible assets

e. whether any proceedings initiated or pending against Co. for holding any benami property under Benami Transactions (Prohibition) Act, 1988 and rules made thereunder, if so, whether Co. has appropriately disclosed details in its F.S.

(ii) [Inventory → Physical verification + Working capital loans]

a. whether physical verification of inventory conducted at reasonable intervals by mgt and whether, in opinion of auditor, coverage & procedure of verification by mgt appropriate; whether any discrepancies of 10% or more in aggregate for each class of inventory noticed and if so, whether they have been properly dealt with in books of a/c

b. whether during any point of time of year, Co. been sanctioned working capital limits in excess of 5 Cr, in aggregate, from banks or financial institutions on basis of security of current assets; whether quarterly returns or statements filed by Co. with such banks or financial institutions in agreement with books of a/c of Co. if not, give details

Co. has dispensed with practice of taking inventory of their inventories at year-end as in their opinion exercise is redundant, time consuming and intrusion to normal functioning of operations.
Explain reporting requirement under CARO, 2020.
Reporting for Physical Verification of Inventory:
Clause (ii) of Para 3 of CARO, 2020, requires auditor to report
[Reporting requirement discussed above]
In given case, above requirement of physical verification of inventory by mgt hasn't taken place and therefore auditor should point out the same under CARO, 2020.
He may consider impact on F.S. and report accordingly

(iii) Loans, Investments, Guarantee & Securities (LIGS)

whether during year Co. made investments, provided any guarantee/security or granted any loans/advances in nature of loans, secured/unsecured, to Cos, firms, LLPs or other parties, if so,-

a. whether during year Co. has provided loans or provided advances in nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate-
(A) aggregate amt during year, and balance o/s at BS date w.r.t. such loans or advances and guarantees or security to subsidiaries, joint ventures and associates
(B) Agg. amt during year, and balance outstanding at BS date w.r.t such LAGS to parties other than subsidiaries, joint ventures and associates

b. whether investments made, guarantees provided, security given and T&Cs of grant of all loans and advances in nature of loans and guarantees provided are not prejudicial to the company's interest

c. in respect of loans and advances in nature of loans, whether schedule of repayment of principal and payment of interest has been stipulated and whether repayments or receipts are regular

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 of principal and interest

e. whether any loan or advance in nature of loan granted which has fallen due during year, has been renewed or extended or fresh loans granted to settle overdues of existing loans given to the same parties, if so, specify aggregate amt of such dues renewed or extended or settled by fresh loans & %age of agg. to total loans or advances in nature of loans granted during year [not applicable to companies whose principal business is to give loans]

f. whether Co. granted any loans/advances in nature of loans repayable on demand or without specifying any terms or period of repayment, if so, specify agg. amt, %age to total loans granted, agg. amt of loans granted to Promoters, related parties defined u/s 2(76) of Cos Act, 2013

(iv) Sec 185 & 186

in respect of loans, investments, guarantees, and security (LIGS), whether provisions of sections 185 and 186 of the Companies Act have been complied with, if not, provide the details thereof

(v) Deposits

in respect of deposits accepted by Co. or amounts deemed to be deposits, whether

- directives issued by RBI and
- provisions of Sec 73 to 76 or any other relevant provisions of Cos. Act and rules made thereunder, where applicable, have been complied with,

if not,

- nature of such contraventions be stated
- if an order 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 records

whether maintenance of cost records been specified by CG under section 148(1) of Companies Act and whether such accounts and records have been so made and maintained

(vii) Statutory dues

a. whether Co. is

- ✓ regular in depositing undisputed statutory dues including GST, PF, ESI, income-tax, sales-tax, service tax, customs duty, excise duty, VAT, cess & any other stat dues to appropriate authorities and

- ✓ if not, extent of arrears of o/s statutory dues as on last day of FY concerned for a period of more than 6 months from date they became payable, shall be indicated

b. where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then
- ✓ amounts involved and
- ✓ forum where dispute is pending shall be mentioned

(a mere representation to the concerned Department shall not be treated as a dispute)

(viii) Income Disclosure

whether any transactions not recorded in books of a/c have been surrendered or disclosed as income during year in the tax assessments under Income Tax Act, 1961, if so, whether previously unrecorded income has been properly recorded in the books of a/c during the year

(ix) Repayment of loans

a) whether Co. 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:-

Nature of borrowing, including debt securities	Name of lender	Amt not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any

*lender wise details in case of default to Bank, financial institutions & Govt

b) whether Co. is a declared wilful defaulter by any bank or financial institution or other lender

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

d) whether funds raised on short term basis have been utilised for long term purposes, if yes, nature and amount to be indicated

e) whether Co. has taken any funds from any entity or person on account of or to meet obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and amt in each case

f) whether Co. 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 Co. has defaulted in repayment of such loans raised

(x) (a) IPO/ FPO Reporting

whether moneys raised by way of initial public offer or further public offer (including debt instruments) during year were applied for purposes raised, if not, details together with delays or default & subsequent rectification, if any, as may be applicable, be reported;

(x) (b) Preferential Allotment/Private placement

whether Co. made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during year and if so, whether the requirements of Sec 42 and Sec 62 of the Companies Act, 2013 have been complied with and funds raised have been used for purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance

(xi) Fraud

a. whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, nature and amount involved is to be indicated
b. whether any report under Sec 143(12) of Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the CG
c. whether auditor has considered whistle-blower complaints, if any, received during the year by Co.

(xii) Nidhi Company

a. whether Nidhi Co. complied with Net Owned Funds to Deposits in ratio of 1:20 to meet out liability
b. whether Nidhi Co. is maintaining 10% unencumbered term deposits to meet out the liability
c. whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof

(xiii) Related Parties

whether all transactions with related parties are in compliance with Sec 177 and 188 of Companies Act where applicable and details have been disclosed in F.S. as reqd. by applicable a/c standards

(xiv) Internal Audit

a. whether the Co. has internal audit system commensurate with size and nature of its business
b. whether reports of Internal Auditors for period under audit were considered by statutory auditor

(xv) Non cash transactions

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

(xvi) RBI

a. whether Co. is required to be regd. under Sec 45-IA of RBI Act, 1934 (2 of 1934) and if so, whether registration has been obtained
b. whether Co. has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from RBI as per RBI Act, 1934

c. whether company is a Core Investment Company (CIC) as defined in regulations made by RBI, if so, whether it continues to fulfil criteria of a CIC, and in case Co. is exempted or unregistered CIC, whether it continues to fulfil such criteria

d. whether Group has more than 1 CIC as part of Group, if yes, indicate no. of CICs part of Group

(xvii) Cash Losses

whether Co. has incurred cash losses in financial year and in immediately preceding financial year, if so, state the amount of cash losses [Cash loss even in any 1 year has to be disclosed)

(xviii) Resignation by Statutory Auditors

whether there has been any resignation of statutory auditors during year, if so, whether auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors

(xix) Going Concern

on basis of:

- financial ratios,
- ageing and expected dates of realisation of financial assets and
- payment of financial liabilities,
- other information accompanying the F.S,
- auditor's knowledge of Board of Directors and management plans,

whether auditor is of the opinion that no material uncertainty exists as on date of audit report that Co. is capable of meeting its liabilities existing at date of B.S. as and when they fall due within a period of 1 year from B.S. Date;

(xx) CSR Reporting

a. whether, in respect of other than ongoing projects, Co. has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of 6 months of the expiry of FY in compliance with second proviso to Sec 135(5) of the said Act

b. whether any amount remaining unspent under Sec 135(5) of the Companies Act, pursuant to any ongoing project, has been transferred to special a/c in compliance with Sec 135(6) of the said Act

(xxi) Qualifications in CFS

whether there have been any qualifications or adverse remarks by respective auditors in the CARO reports of companies included in the consolidated financial statements, if yes, indicate details of companies and paragraph numbers of CARO report containing qualifications or adverse remarks.



Small Company

A Co. that isn't a public Co. &

- ✓ Has Paid up share capital <= ₹4 Cr &
- ✓ Turnover as per preceding FY <= ₹40 Cr

Not treated as small Co:

- Holding or subsidiary co.
- Sec 8 Co.
- Body corporate or company governed by special Act

Note: In case a Co. is covered under definition of small Co., it will remain exempted from CARO even if it falls under any of criteria specified for private Co.

Short Quiz:

Hera Pheri Pvt Ltd	Bhagam Bhaag Pvt Ltd	De Dana Dan Pvt Ltd
31.3.23 PUSC = 2.5 Cr T/o = 35 Cr 31.3.24 PUSC including R&S = 4 Cr T/o = 32 Cr Borrowings = 40 L	31.3.23 PUSC = 3.5 Cr T/o = 42 Cr 31.3.24 PUSC including R&S = 90 L T/o = 9 Cr Borrowings = 55 L	31.3.23 PUSC = 4.5 Cr T/o = 55 Cr 31.3.24 PUSC including R&S = 80 L T/o = 8 Cr Borrowings = 65 Lakhs [During the year 1.5 Cr was borrowed and repayed]
CARO Applicable No (It is Small Co.)	No, Pvt ltd conditions not satisfied.	Yes, borrowings exceed 1 Cr during the year

Company Audit [Selected Topics]

Sec 143(1) Duty to enquire on Certain Matters

a) Loans & advances made on security have been properly secured & whether terms prejudicial to interest of Co. or its members
b) Transactions merely represented by book entries prejudicial to intt of Co.
c) Where Co. not being Investment/ Banking Co. whether its assets consisting of shares, debentures & other securities sold at price < purchase price
d) Whether Loans & Advances shown as Deposits
e) Whether personal expenses charged to Revenue a/c
f) Where shares of Co. have been allotted For cash, whether cash received & if no cash recd, position as per books & balance sheet, correct, regular & non misleading

Notes:

- Auditor not reqd to report on above matters unless spl. comments to make
- Auditor should report only when ans. to any of matters is in adverse

Sec 143(3) Duty to Report

Auditor's report shall state:

a. whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;
b. whether, in his opinion, proper books of account as reqd by law have been kept by the Co. so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
c. whether report on accounts of branch office of the Co. audited u/s 143(8) by a person other than company's auditors has been sent to him and the manner he has dealt with it in preparing report;
d. whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
e. whether, in his opinion, the financial statements comply with the accounting standards;
f. the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
g. whether any director is disqualified from being appointed as a director u/s 164(2)
h. any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
i. whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls;
j. such other matters as may be prescribed.

Rule 11 of Cos. (Audit and Auditors) Rules, 2014 other matters to be included in auditor's report namely:-

i) whether Co. has disclosed impact of pending litigations on its financial position in its financial statement

ii) whether Co. has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts

iii) whether there has been delay in transferring amt. to Investor Education and Protection Fund by Co.

iv) i) Whether mgt has represented to best of knowledge & belief, other than disclosed in notes, no funds advanced, loaned or invested by Co. in any person or entity including foreign entity with understanding that Intermediary will lend or invest in another entity or provide guarantee or security on behalf of Co. (Ultimate Beneficiary)

ii) Whether mgt has represented to best of knowledge & belief, other than disclosed in notes, no funds received by Co. from any person or entity including foreign entity(Funding Parties) with understanding that Co. will lend or invest in another entity (Ultimate Beneficiary) or provide guarantee or security on behalf of Funding Party

iii) Auditor has found no material misstatement in above representations

v) Whether Dividend declared & paid as per Sec 123

vi) Co. used a/c software to maintain books of a/c having audit trail & same operated throughout year & audit trail hasn't been tampered & preserved by Co. for retention.

Note: Auditors of public cos. Required to report remuneration to directors within limits u/s 197 under the Section Report on Other Legal and Regulatory Requirements.

Sec 145 Duty to sign Audit Report

- Firm including LLP → Only Partners who are CAs → act & sign on behalf of firm
- Qualifications, observations or comments on financial transactions which have adverse effect on functioning of Co.
- Read before in GM & open for inspection by members of Co.

Report on Frauds [Sec 143(12) read with Rule 13 of CAAR,2014]

- If auditor has reason to believe offence of fraud involving amount of 1 Cr or above committed in Co. by its officers or employees
- Auditor shall report to CG within such time & manner as prescribed

Manner of reporting

- Report to Board or AC within 2 days seeking their reply within 45 days (AC→ Audit Committee)
- On receipt of reply forward
  - His Report
  - Reply or observation of board or AC

➢ With his comments

- to CG within 15 days of receipt of reply
- If no reply recd. then shall forward only his report
- Send to Secretary, MCA in sealed cover by Regd post with acknowledgment due (RPAD) or by Speed post followed by e-mail
- Report format → ADT 4
- On letter head of auditor with post address, e-mail, mobile no., & signed by auditor with Seal + Membership no.

If fraud < 1 Cr → report to AC or Board within 2 days specifying following:

a) Nature of fraud
b) Amount involved
c) Parties involved

Disclosure in Board Report: Nature of fraud, amount, parties involved (if remedial action not taken) or remedial action taken (fraud < 1 Cr)

Sec 143(13) safeguards auditor from fraud reported out of Good Faith.

Provisions of reporting on Fraud also apply to Cost & Secretarial Auditor.

Penalty for non-compliance:

Listed Co: 5L

Any other Co: 1L

CARO 2020: Auditor is also required to report under clause (xi) of para 3 of CARO, 2020 on whether any fraud by company or any fraud on Company has been noticed or reported during year. If yes, nature and amount involved is to be indicated.

Eg: Senior Mgr on instruction of CEO entered fake invoices of credit purchases in books of a/c aggregating to 95 L and cleared all payments to such bogus creditor. Here, auditor is required to report fraudulent activity to Board or Audit Committee (as the case may be) within 2 days of knowledge of fraud. Further, Co. also required to disclose in Board's Report. Auditor need not report to CG as amount of fraud is less than 1 cr, however, reporting under CARO, 2020 is required.

Sec 144 Prohibited services (Auditor → Co./Holding/Subsy)

(i) accounting & book- keeping services	(ii) internal audit
(iii) design and implementation of any financial information system	(iv) actuarial services
(v) investment advisory services	(vi) investment banking services
(vii) rendering of outsourced financial services	(viii) management services and
(ix) any other kind of services as may be prescribed.	

"Pain you feel today will be the strength you feel tomorrow"

CHAPTER

20 Miscellaneous



Peer Review

Peer review means examination and review

- of systems & procedures
- to determine whether same have been put in place by Practice Unit
- for ensuring quality of assurance services
- as reqd by technical, professional and ethical (TPE) Standards or other regulatory requirements.

Peer review Board is constituted by Council of ICAI.

Main objective is to ensure that, in carrying out assurance assignments: -

- TPE standards including regulatory requirements complied by members of ICAI.
- Proper systems in place including documentation which depict quality of assurance services provided by members.

On completion of this exercise, a "peer review certificate" is issued in case of unqualified report issued by Peer Reviewer. In case of qualified report, its informed to PU that same can't be issued along with reasons as well as inform about due date for conducting follow-on review decided by Board.

Quality Review Board

Quality review Board set up by CG. It consists of members nominated by CG and ICAI .

Functions of QRB are: -

a) To make recommendations to Council regarding quality of services provided by members of ICAI

b) To review quality of services provided by members of ICAI including audit services &

c) To guide members of ICAI to improve quality of services & adherence to various statutory & other regulatory requirements

Statutory auditors in respect of companies identified for audit quality review based upon risk-based approach. Review is carried out by technical reviewers who are empanelled by QRB.

National Financial Reporting Authority (NFRA)

Duties of NFRA also include following:

- Monitor & enforce compliance with a/c and auditing standards
- Oversee quality of service of professions associated with ensuring compliance with such standards & suggest measures for improvement in quality of service

➢ It has power to monitor & enforce compliance with a/c & auditing standards & oversee quality of service or undertake investigation of auditors of listed, insurance, banking & other companies in rule 3 of NFRA Rules.

➢ QRB can review quality of audit services provided by members of ICAI only in respect of entities other than specified under Rule 3 of NFRA Rules, 2018 & referred to QRB by NFRA.

Notes

Notes