

Kingfisher Tycoon Vijay Mallya flees India Amid Multi Million Dollar Fraud Charges

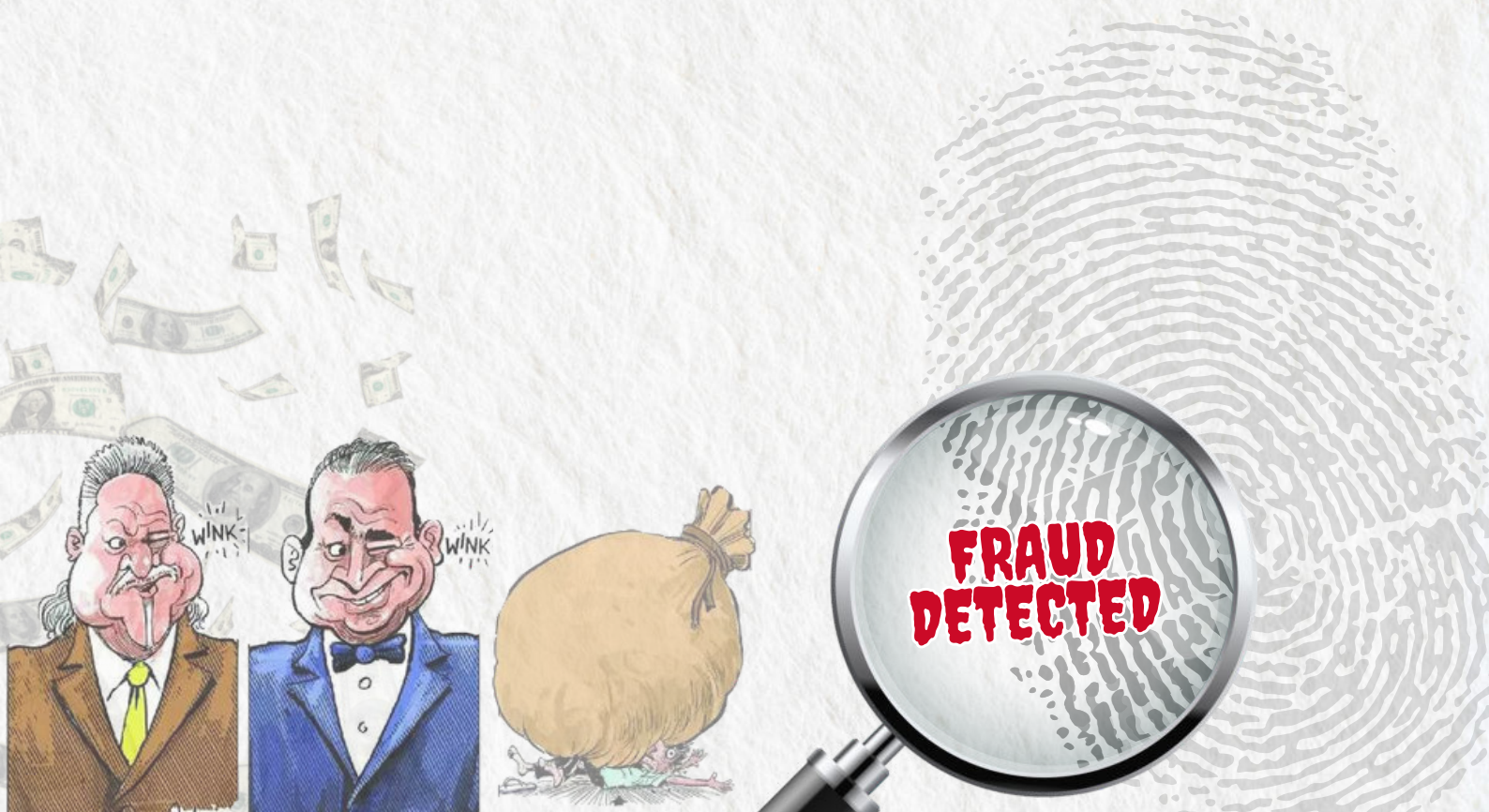
Nirav Modi escapes India following \$2 Billion Bank Fraud Scandal

Satyam Scandal Unveiled: India's Biggest Corporate Fraud exposes \$1.5 Billion Accounting Scam

PART B

COMPLIANCE MANAGEMENT, AUDIT & DUE DILIGENCE

CS Muskan Gupta





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PART-B

8	<i>Concepts of various audit</i>	8.1-8.61
9	<i>Audit Engagement</i>	9.1-9.31
10	<i>Audit Principles & Techniques</i>	10.1-10.38
11	<i>Audit Process & Documentation</i>	11.1-11.25
12	<i>Forming an Opinion & Reporting</i>	12.1-12.29
13	<i>Secretarial Audit</i>	13.1-13.51
14	<i>Internal Audit & Performance Audit</i>	14.1-14.37
15	<i>Peer Review & Quality Review</i>	15.1-15.39
16	<i>Due Diligence</i>	16.1-16.45

SUMMARISED VERSION (MIND MAP)

CHAPTER 8- CONCEPTS OF VARIOUS AUDITS

I. INTRODUCTION

- i. Audit is an independent and systematic examination of statutory records, books of accounts, documents and vouchers of an organization to ascertain how far the financial statements as well as non-financial disclosures present a true and fair view of the concern as to.
- ii. Audit provides and significant assurance to the management and other stakeholders on the affairs of the company.

The term audit is derived from the Latin word "audire" which means to hear.

- iii. Sections 139 to 147 under chapter X of the Companies Act, 2013 along with the Companies (Audit and Auditors) Rules, 2014 contain provisions regarding audit and auditors covering the appointment, removal, resignation of auditors, eligibility, qualifications and disqualifications of auditors, remuneration of auditors, powers and duties of auditors etc. for the statutory auditors of the company.
- iv. The Companies Act, 2013 contains the provisions relating to the following Audits:

Secretarial Audit (Section 204)

Statutory Audit (Section 139 to 147)

Cost Audit (Section 148)

Internal Audit (Section 138)

- v. Audit can be of two types i.e. the Financial Audit and the Compliance Audit.
- vi. The Financial Audit cover the Statutory Audit, Cost Audit and Internal Audit whereas the Compliance Audit cover the Secretarial Audit, CSR Audit, and Corporate Governance Audit, Takeover Audit, Insider trading Audit, Labour law Audit, Cyber Audit, Systems Audit, Social Audit and Forensic Audit etc.

2. CORPORATE GOVERNANCE AUDIT

- i. Corporate Governance deals with conducting the affairs of a company in such a way that there is fairness to all stakeholders and that its actions benefit the greatest number of stakeholders. It is about transparency, integrity and accountability.
- ii. Recent scandals in Indian Corporates have raised questions not only about the practices adopted by companies to solicit business but also about the standards of accountability in public administration including within the government machinery and institutions.
- iii. Corporate Governance provisions under the former listing agreement popularly known as the Clause 49 requirements have been overhauled by the Companies Act 2013, recent adoptions of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR Regulations"). Schedule II of the said regulations have elaborated on the Corporate Governance measures and are applicable to the entities which are listed with recognized stock exchange(s). These have aligned India's corporate governance regime with the developed countries.
- iv. Audit of corporate governance processes provides assurance to the various stakeholders that all the required governance activities have been accomplished.
- v. Corporate Governance Audit mechanism works primarily through Audit Committee and the Auditor.

Need for Corporate Governance Audit (CGA)

- To ensure commitment of the Board in managing the company in a transparent manner.
- Improving corporate governance will also increase capital flows to companies; from domestic and global capital, equity and debt, and from public securities markets and private capital sources even the increased customer base.

Scope of Audit of Corporate Governance Activities

- 1 · Financial and non-financial information's and disclosures
- 2 · Rights of stakeholders
- 3 · Boards of directors (composition, mix, independence)
- 4 · Control Environment (accounting, controls, internal and external audit)
- 5 · Risk Management
- 6 · Transparency and disclosures of financial information and executive compensation
- 7 · Strategic plans, programs and guidance on social responsibilities

Role of Audit Committee

Audit Committee plays a vital role in the corporate governance of an entity.

According to Section 177 of Companies Act, 2013, the Board of Directors of the following class of companies shall constitute an Audit Committee:

- i. every listed public company; or
- ii. the Public Companies having paid up share capital of ten crore rupees or more; or
- iii. the Public Companies having turnover of one hundred crore rupees or more; or
- iv. the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees.

The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority.

Provided that majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, the financial statement.

Regulation 18 of SEBI (LODR) Regulations, 2015 provides that every listed entity shall constitute a qualified and independent audit committee in accordance with the terms of reference, subject to the following:

- i. **Minimum No. of Directors:** The audit committee shall have minimum **three directors as members**.
- ii. **Requirement of IDs:** **Two-thirds of the members** of audit committee shall be independent directors and in case of a listed entity having outstanding SR equity shares, the audit committee shall only comprise of independent directors.
- iii. **Financial Literacy:** **All members** of audit committee shall be **financially literate** and **at least one member shall have accounting or related financial management expertise**.
- iv. **Presence of Chairperson in AGM:** The chairperson **shall be an independent director** and he/she shall be **present at the annual general meeting** to answer shareholder queries.
- v. **CS as Secretary of Audit Committee:** **company secretary shall act as the secretary** of the committee
- vi. **Invitation to Executives:** The audit committee **at its discretion shall invite the finance director or head of the finance function, head of internal audit and a representative of the statutory auditor** and any other such executives to be present at the meetings of the committee

Under LODR regulation role of Audit Committee is as following:

1. Oversight of the listed entity's financial reporting process and the **disclosure of its financial information** to ensure that the financial statement is correct, sufficient and credible;
2. **Recommendation for appointment, remuneration and terms of appointment** of auditors of the listed entity;
3. **Approval of payment to statutory auditors** for any other services rendered by the statutory auditors;
4. **Reviewing, with the management, the annual financial statements and auditor's report thereon** before submission to the board for approval, with particular reference to:
 - a. matters required to be included in the director's responsibility statement to be included in the board's report in terms of clause (c) of sub-section (3) of Section 134 of the Companies Act, 2013;
 - b. changes, if any, in accounting policies and practices and reasons for the same;
 - c. major accounting entries involving estimates based on the exercise of judgment by management;
 - d. significant adjustments made in the financial statements arising out of audit findings;

- e. compliance with listing and other legal requirements relating to financial statements;
- f. disclosure of any related party transactions;
- g. modified opinion(s) in the draft audit report.
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval;
6. Reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the board to take up steps in this matter;
7. Reviewing and monitoring the auditor's independence and performance, and effectiveness of audit process;
8. Approval or any subsequent modification of transactions of the listed entity with related parties;
9. Scrutiny of inter-corporate loans and investments;
10. Valuation of undertakings or assets of the listed entity, wherever it is necessary;
11. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems;
12. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit;
13. Discussion with internal auditors of any significant findings and follow up there on;
14. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board;
15. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern;
16. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors;
17. To review the functioning of the whistle blower mechanism;
18. Approval of appointment of chief financial officer after assessing the qualifications, experience and background, etc. of the candidate;

19. Carrying out any other function as is mentioned in the terms of reference of the audit committee;
20. Reviewing the utilization of loans and/ or advances from/investment by the holding company in the subsidiary exceeding rupees 100 crore or 10% of the asset size of the subsidiary, whichever is lower including existing loans / advances / investments existing;
21. Consider and comment on rationale, cost-benefits and impact of schemes involving merger, demerger, amalgamation etc., on the listed entity and its shareholders.

Illustrative Checklist for Auditing Corporate Governance System in a Company

Accountability

- i. Check there is separation of ownership and control.
- ii. Check whether executive management is accountable to Board.
- iii. Check whether board is accountable to shareholders.
- iv. Check whether there is a board / audit committee charter/ policies.
- v. Check whether the independent directors have powers to play their role effectively.
- vi. Check whether sufficient number of meetings held, and are the meetings of sufficient length and depth to cover the agenda and provide healthy discussion of issues.
- vii. Check whether the auditors of the company have full access to information and authority to present their view points at board meetings.
- viii. Check whether the company has policies on ethical marketing practices, bribery and dishonesty, employee and customer privacy, fair employment practices, gifts, entertainment, related party transactions and conflict of interests.

Fairness

- i. Check whether all shareholders, including minorities are treated equitably.
- ii. Check whether there are defined procedure for effective resolutions of violations.
- iii. Check whether the company has pricing policy and fair market practice code.

Transparency

- i. Investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected.

- ii. Check whether there is a timely, accurate disclosure on all material matters, including financial and non-financial information, performance, ownership, frauds, going concern crisis and governance.
- iii. Check whether the company has a policy for making political contributions.
- iv. Check whether the company has comprehensive insider trading disclosure and compliance practices.
- v. Check whether shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.
- vi. Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

Responsibility

- i. Check whether the company has policy on stakeholder's rights, social responsibility and business sustainability requirements.
- ii. Check whether the board's responsibility includes review and guiding of corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.

Shareholder Interests

- i. Check whether shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:
 - a. amendments to the statutes, or articles of incorporation or similar governing documents of the company;
 - b. the authorisation of additional shares; and
 - c. extra-ordinary transactions, including the transfer of all or substantially all assets that in effect result in the sale of the company.
- ii. Check whether **capital structures and arrangements** that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership **should be disclosed**.
- iii. There exists rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of

corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.

- iv. The exercise of **ownership rights by all shareholders**, including institutional investors, should be facilitated.
- v. **Minority shareholders should be protected from abusive actions** by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.
- vi. **Members of the board and key executives should be required to disclose to the board** whether they, directly, indirectly or on behalf of third parties, **have a material interest in any transaction or matter directly affecting the corporation.**

In the Corporate Governance Audit, the auditor issue the compliance certificate and summarizes his opinion and descriptive narration of areas of improvement.

The Compliance certificate shall be given either the practicing company secretaries or auditors regarding compliance of conditions of corporate governance which shall be annexed with the directors' report.

CORPORATE GOVERNANCE DUE DILIGENCE – COVERAGE

BOARD INDEPENDENCE & GOVERNANCE

- i. Board Composition
 - a. Is the chairperson an executive chairperson?
 - b. If chairperson is executive, does 50% or more of the board consist of independent directors?
 - c. If the non-executive chairperson is a promoter of the company or is related to any promoter or person occupying management positions at the board level or at one level below the board, does 50% or more of the board consist of independent directors?
 - d. If the non-executive chairperson is not a promoter of the company or is not related to any promoter or person occupying management positions at the board level or at one level below the board, does 1/3rd or more of the board consist of independent directors?
- (ii) The proportion of independent directors to total number of directors.
- (iii) The company has at least one woman director.

- (iv) In case of top 1000 listed entities, the Board of directors has at least one independent woman director.
- (v) In case of top 2000 listed entities, the board of directors has not less than six directors.
- (vi) Senior/lead independent director if any, if the offices of chairperson and chief executive officer are not held by different persons.
- (vii) Written policy/ procedure if any for induction of independent directors.
- (viii) Disclosure if any, in the annual report the basis on which independent directors are nominated on the board
- (ix) Letter of appointment of non-executive directors.
- (x) Maximum tenure of independent directors if any specified.
- (xi) Details of separate meetings of independent directors.
- (xii) Details of orientation programme /training of directors.
- (xiii) Details of D&O insurance if any provided.
- (xiv) Gap between resignation and appointment of independent directors.
- (xv) Details of affirmative statement from each of the independent directors that they meet the criteria of independence (annual and at the time of appointment).

BOARD SYSTEMS AND PROCEDURES

- i. Details of circulation of agenda.
- ii. Details of board meetings.
- iii. Attendance in board meeting.
- iv. Details of meeting through video conferencing.
- v. List of applicable laws if any maintained by the company.
- vi. Information /certificate to the board on statutory compliances.
- vii. Communication of board decisions to various departments.
- viii. Details of written code of conduct for directors, senior management and other employees.
- ix. Policy on succession planning at senior management level (just one level below the board),
- x. Policy on action taken report
- xi. Policy on reviewing the effectiveness of board and its members.
- xii. Share dealings by directors and his relatives.

BOARD COMMITTEES

- i. Names of board committees, its terms of reference, composition and meetings.
- ii. Details of chairperson of board committees.
- iii. Proportion of independent directors in audit committee.
- iv. Risk assessment process by audit committee.
- v. Process of reviewing the related party transactions by the audit committee.
- vi. Details of financial experts in the audit committee.
- vii. Communication mechanism between internal auditor, audit committee and CFO.
- viii. Details of rotation of auditors/audit partners.
- ix. Details of pending investor grievances.

TRANSPARENCY AND DISCLOSURE COMPLIANCES

- i. Details of disclosures in the Annual Report.
- ii. Disclosure on the details of remuneration paid to Board members.
- iii. Disclosure on related party transaction.
- iv. Disclosure on material cases pending against the company.
- v. Details of directors appointed or proposed to be appointed.
- vi. Means of communication.
- vii. Details of filings with Corp filing portal.
- viii. Disclosures on insider trading.
- ix. Disclosure of CEO/CFO on compliance under LODR Regulations.
- x. Compliance of Secretarial Standards issued by ICSI.
- xi. Compliance of Accounting Standard/Cost Accounting Standard (if applicable).
- xii. Details of Secretarial Audit if any.
- xiii. Adverse remarks in Audit Report, Cost Audit Report, Secretarial Audit Report.
- xiv. Disclosure of director's relationship inter-se.
- xv. Details of corporate disclosure policy.

CONSISTENT SHAREHOLDER VALUE ENHANCEMENT

- i. Growth in net-worth.
- ii. Details of dividend paid.

- iii. Dividend policy, if any.
- iv. EPS
- v. Details of public shareholdings.
- vi. Details of investor satisfaction survey, if any.

OTHER STAKEHOLDERS VALUE ENHANCEMENT

- i. Details of Vendor/Supplier/Customer Satisfaction surveys.
- ii. Personnel policy.
- iii. Policy on employee participation in management.
- iv. Policy on ESOPs
- v. Policy on prevention of sexual harassment.
- vi. Vendor Development policy.

CORPORATE SOCIAL RESPONSIBILITY

- i. Policy on CSR, if any.
- ii. CSR/Sustainability Report, if any.
- iii. Energy conservation initiatives.
- iv. Water/ waste management initiatives.
- v. Budget for CSR activities etc.

4. SECRETARIAL AUDIT

- i. Every Company, while pursuing its business activities, has to comply with the rules and regulations relating to the Companies Act, Securities laws, FEMA, Industry Specific laws and General laws like Labour laws, Competition law and Environmental and Pollution related laws and should also pursue the good governance practices.
- ii. Secretarial Audit covers non-financial aspects of the business vis-à-vis their impact on the performance of the company and verifies compliances of applicable laws, regulations and guidelines.
- iii. Secretarial Audit is an independent and objective assurance intended to add value and improve operations of a company. It helps to accomplish the organisation's objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes.

Applicability of Secretarial Audit

Section 204(1) of the Companies Act, 2013 read with Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides that-

1. Every listed company and a company belonging to other class of companies as may be prescribed shall annex with its Board's report made in terms of section 134(3), a secretarial audit report, given by a company secretary in practice, in such form No.MR-3.
2. It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.
3. The Board of Directors, in their report made in terms of section 134(3), shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report under sub-section (1).
4. If a company or any officer of the company or the company secretary in practice, contravenes the provisions of this section, the company, every officer of the company or the company secretary in practice, who is in default, shall be liable to a penalty of Rs. 2,00,000.

In terms of **Rule 9(1) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014**, for the purposes of sub-section (1) of section 204, the other class of companies shall be as under-

- a. Every Public Company having a paid-up share capital of 50 crore rupees or more; or
- b. Every Public Company having a turnover of 250 crore rupees or more; or
- c. Every Company having outstanding loans or borrowings from banks or public financial institutions of 100 crore rupees or more.

Secretarial Audit and Secretarial Compliance Report under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

In view of the criticality of secretarial functions for ensuring efficient functioning of the Board, the Kotak Committee on Corporate Governance, in its report dated October 05, 2017, recommended that-

- a. Secretarial Audit to be made compulsory for all listed entities under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Regulations") in line with the provisions of the Companies Act, 2013.

- b. Secretarial Audit to be extended to all material unlisted Indian subsidiaries in line with the recommendations of the Committee on strengthening group oversight and improving compliance at a group level for listed entities.

Accordingly, SEBI vide circular no. CIR/CFD/CMD1/27/2019 dated February 08, 2019 notified the following provisions to be included in the SEBI (LODR) Regulations, 2015:

Regulation 24A: Secretarial Audit: Every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex with its annual report, a secretarial audit report, given by a company secretary in practice, in such form as may be prescribed with effect from the year ended March 31, 2019.

The above provision has been substituted by the SEBI vide amendment dated 05.05.2021 which reads as under:

Regulation 24A: Every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex a secretarial audit report given by a company secretary in practice, in such form as specified, with the annual report of the listed entity.

- i. Every listed entity shall submit a secretarial compliance report in such form as specified, to stock exchanges, within 60 days from end of each financial year.
- ii. In order to avoid duplication, the listed entity and its unlisted material subsidiaries shall continue to use the same Form No. MR-3 as required under Companies Act, 2013 and the rules made thereunder for the purpose of compliance with Regulation 24A of SEBI (LODR) Regulations, 2015 as well.
- iii. While the Annual Secretarial Audit shall cover a broad check on compliance with all laws applicable to the entity, listed entities shall additionally, on an annual basis, require a check by the Company Secretary in Practice on compliance of all applicable SEBI Regulations and circulars / guidelines issued thereunder, consequent to which, the Company Secretary in Practice shall submit a report to the listed entity.

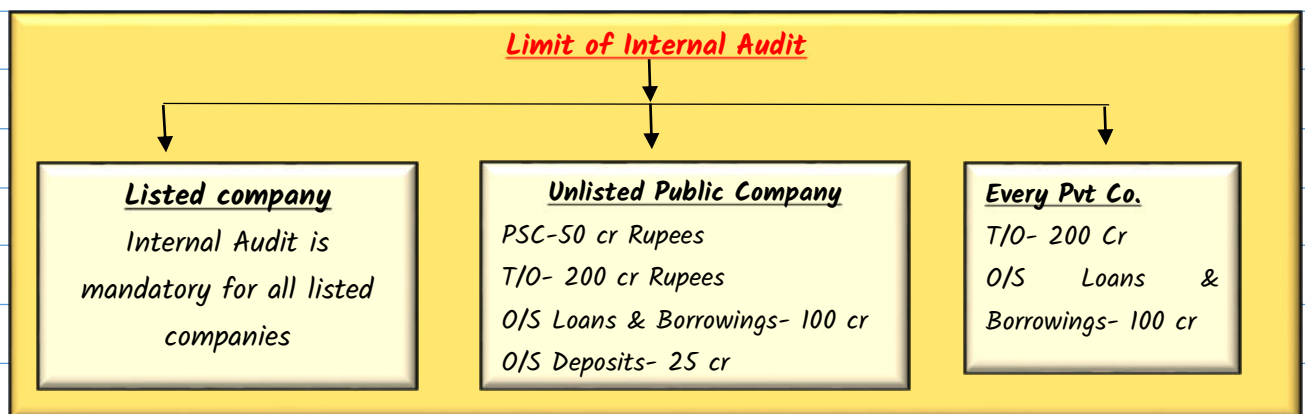
Purpose of Secretarial Audit

- i. Secretarial Audit provides an effective mechanism to ensure that compliance of various legislations and regulations including the Companies Act, SEBI Law, Secretarial Standards and other corporate and economic laws applicable to the company has been diligently done.
- ii. Secretarial Audit facilitates monitoring compliances with the requirements of law through a formal compliance management programme which can produce following positive results to the stakeholders of a company:
 - Companies that go the extra mile with their compliance programs lay the foundation for good governance.
 - Companies with an effective compliance management programme have lesser chance of being penalised, both monetarily and by way of imprisonment.
 - Companies that imbibe business and personal ethics and an effective compliance management programme within their work culture often enjoy employee and customer loyalty and public respect for their brand, which can translate into better market capitalization and shareholder returns.
 - Recognition for the company as a good corporate citizen.

5. INTERNAL AUDIT

- i. Internal audit is a process of evaluating and assessing an organization's internal controls, risk management procedures, and governance practices.
- ii. The goal of internal audit is to help organizations achieve their objectives by providing independent, objective assurance and consulting services.
- iii. Performed by professionals with an in-depth understanding of the business culture, systems, and processes, the internal audit activity provides assurance that internal controls in place are adequate to mitigate the risks, governance processes are effective and efficient, and organizational goals and objectives are met.
- iv. Performed by professionals with an in-depth understanding of the business culture, systems, and processes, the internal audit activity provides assurance that internal controls in place are adequate to mitigate the risks, governance processes are effective and efficient, and organizational goals and objectives are met.
- v. The internal audit may contribute in the following areas:

- a. **Independent review and appraisal of control systems** across the organization (both financial control systems and operational areas where the organization may reap benefits).
 - b. Ascertainment of the extent of **compliance of policies, procedures, regulations and legislations**.
Checking compliance management systems of an organization.
 - c. **Facilitate good practices in management of risk**. This requires systems for ascertaining, measuring, managing and where possible mitigation or dispersion of the risk.
 - d. Achieve savings by identifying waste, inefficiency and duplication of effort across the organization.
 - e. **Structuring programs and activities** such that company assets are safeguarded and there are internal check systems which minimize the possibility for reducing fraud / early warning signals for identifying fraud.
- vi. Section 138 of the Companies Act, 2013 provides that such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.



6. CORPORATE SOCIAL RESPONSIBILITY (CSR) AUDIT

- i. Corporate Social responsibility includes the way a company treats and proactively contributes to its community, promotes fair working conditions and a non-discriminatory environment, conveys transparent and honest accounting reports, and generally earns a reputation of trust and integrity in the society where it serves.

- ii. CSR has become a mandatory part of many Companies vide introduction in Companies Act, 2013 and has changed the dynamics of CSR. An increased emphasis on governance, stricter monitoring and reporting obligations requires companies to be more accountable, disciplined and strategic in their CSR approach

Applicability of CSR Spending/Committee		
Net worth of rupees five hundred crore; or	Turnover of rupees one thousand crore or more; or	Net profit of rupees five crore or more
During the immediately preceding financial year		

Section 135 of the Companies Act, 2013 provides that every company on whom CSR is applicable shall:

- constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director;
- In case, where a company is not required to appoint an independent director under sub-section (4) of section 149 of Companies Act, 2013, the company shall have in its Corporate Social Responsibility Committee two or more directors.
- adopt a CSR Policy in order to develop a sustainable CSR road map to help determine both compliance and social relevance with the Act.
- spend, in every financial year, at least 2% of its average net profits made during the three immediately preceding financial years, in pursuance of its CSR policy.

Objective of CSR Audit

Corporate Social Responsibility (CSR) audit help in measuring the actual social performance against the social objectives set by the Company. The audit helps meeting the expectations of stakeholder groups relating to social and environmental responsibilities of the company.

Purpose of CSR Audit

- To ensure compliance with the provisions of Companies Act, 2013 with respect to constitution of the Committee, adoption of policy and appropriate spending towards CSR activities.

- To facilitate transparent monitoring mechanism and a mentor for the company's CSR activities and implementation of CSR policy.
- To evaluate internal control and governance framework.
- To assess the project life cycle.
- To conduct financial review of projects to confirm the utilization of budgets for achieving desired outcomes.

Methodology for CSR Audit

1. Review of CSR policy, CSR committee, governance structure, strategy, projects, partner identification and selection process, monitoring, evaluation and reporting.
2. Interact with beneficiaries, project team, management and other stake holders.
3. Review of beneficiary identification and selection process, budget allocation, outcomes monitoring and reporting.
4. Review of CSR expenditure, project's direct expenditure, overheads and administrative expenses, traceability and genuineness of expenditure, per beneficiary cost, reasons for inability to spend 2% of profits.

Conducting CSR Audit

The CSR audit may be conducted internally by the company or engage external agencies having expertise in CSR projects. However the companies publish periodical report on their social initiatives and through the Website. According to provisions of Companies Act, 2013, Companies are required to annex report on the corporate social responsibilities with the board report of the company.

Coverage of CSR Audit

Schedule VII of the Companies Act, 2013 provides the list of activities which could be taken by the company as their CSR Activities. These activities cover the following:

1. Eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swachh Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water.

2. promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects.
3. promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups.
4. ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga.
5. protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional art and handicrafts.
6. measures for the benefit of armed forces veterans, war widows and their dependents, Central Armed Police Forces (CAPF) and Central Para Military Forces (CPMF) veterans, and their dependents including widows.
7. training to promote rural sports, nationally recognised sports, paralympic sports and olympic sports.
8. contribution to the prime minister's national relief fund or Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES Fund) or any other fund set up by the central govt. for socio economic development and relief and welfare of the schedule caste, tribes, other backward classes, minorities and women;
9. Contribution to incubators or research and development projects in the field of science, technology, engineering and medicine, funded by the Central Government or State Government or Public Sector Undertaking or any agency of the Central Government or State Government; and
10. Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and autonomous bodies established under Department of Atomic Energy (DAE); Department of Biotechnology (DBT); Department of Science and Technology (DST); Department of Pharmaceuticals; Ministry of Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homoeopathy (AYUSH); Ministry of Electronics and Information Technology and other bodies, namely Defense Research and Development Organisation (DRDO); Indian Council of Agricultural Research (ICAR); Indian Council of Medical Research (ICMR) and Council of Scientific and Industrial Research

(CSIR), engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs).

11. rural development projects.
12. slum area development different. Explanation- For the purposes of this item, the term 'slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force.
13. disaster management, including relief, rehabilitation and reconstruction activities. Explanation- For the purpose of this item, the term 'Slum area' shall mean any area declared as such by the Central Government or any State Government any other competent out authority under any Law for the time being in force.

Illustrative Checklist for Corporate Social Responsibility provisions under the Companies Act, 2013

1. Check if the constitution of CSR Committee is applicable to company.
2. If yes, whether the company has constituted CSR committee of the board consisting of three or more directors, out of which at least one director is an independent director. In case where a company is not required to appoint an independent director under sub-section (4) of 149, it shall have in its CSR Committee two or more directors.
3. Whether the company has CSR policy approved by the CSR Committee.
4. Whether the CSR committee has recommended list of CSR projects or programme within the purview of schedule VII.
5. Whether the monitoring process of such projects or programme has been established by the company.
6. The composition of CSR committee is disclosed in the board's report.
7. Check whether the CSR activities were under taken as per CSR policy and projects, programs or activities excludes activities undertaken in pursuance of its normal course of business
8. Corporate social responsibility committee has recommended the amount of expenditure to be incurred on the activities referred in the Corporate Social Responsibility policy.
9. The company has instituted a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.
10. The company has disclosed the contents of the policy in board's report and at its website, if any.

11. The board's report includes an annual report on CSR containing prescribed particulars.
12. In case the company does not spend the specified amount (i.e. at least two percent of the average net profits made during the three immediately preceding financial years), Board's report specifies the reason for not spending the amount.
13. Check if the net profits of the company are in accordance with the provisions section 198 of the Companies Act, 2013 or not.
14. In case the company has built CSR capacities of their own personnel, check whether the expenditure including expenditure on administrative overheads shall not exceed five percent of total CSR expenditure of the company in one financial year.
15. The company has complied with all other requirement of the CSR Rules.

The different measures of the CSR Audit Includes:

1. How the Company has identified the major socio-economic changes in the key communities caused by its presence/ operations/ major expansion programs.
2. How the company has conducted social surveys before undertaking a particular CSR activity.
3. How the company has identified the possible impact of its CSR activities on the life style of communities.
4. How the company undertakes the Impact assessment of the CSR activities.

7. TAKEOVER AUDIT

The Takeover audit includes the compliances relating disclosure requirements (event based /continuous disclosures), Pricing, Open offer and verification of the compliance of various stage of takeover process etc., under the provision of the Companies Act, 2013 and the SEBI (Substantial Acquisition of Shares and Take- overs) Regulations, 2011. However, the takeover audit primarily includes:

The takeover audit primarily includes:

Identification and categorisation

- *Identify and categorises of acquirer i.e. promoter, promoter group, person in control, persons acting in concert, associates, immediate relatives etc.*

Timely Disclosures

- *Ensuring that the timely disclosures have been made by promoters, members of promoter group and PAC's relating to acquisition, transfer and encumbrance.*

Monitoring of promoters holding

- *Effective monitoring of the holdings of promoters, members of promoter group and PACs and take necessary action as required.*

Timely Intimation

- *Ensuring that timely intimation is sent to stock exchanges in respects of transfers exempt under SEBI (SAST) Regulations, 2011.*

Timely reports under SAST

- *Ensuring that timely reports are filed in respect of transfers exempt under SEBI (SAST) Regulations with stock exchanges and SEBI, if applicable.*

Checking timely Compliances

- *Thoroughly examine the takeover regulations through checklist and timeline for compliances.*

Takeover audit for a business deal may be done as:

- pre-acquisition;
- post-acquisition.

CONSEQUENCES OF VIOLATION OF OBLIGATIONS SEBI (SAST) REGULATIONS, 2011

SEBI (SAST) Regulations, 2011 have laid down the general obligations of acquirer, target company and the manager to the open offer.

Penalties for non-compliance with SEBI (SAST) Regulation, 2011 includes:

- i. directing the divestment of shares acquired;
- ii. directing the transfer of the shares / proceeds of a directed sale of shares to the investor protection and education fund;
- iii. directing the target company / any depository not to give effect to any transfer of shares;
- iv. directing the acquirer not to exercise any voting or other rights attached to shares acquired;
- v. debarring person(s) from accessing the capital market or dealing in securities
- vi. directing the acquirer to make an open offer at an offer price determined by SEBI in accordance with the Regulations;
- vii. directing the acquirer not to cause, and the target company not to effect, any disposal of assets of the target company or any of its subsidiaries unless mentioned in the letter of offer;
- viii. directing the acquirer to make an offer and pay interest on the offer price for having failed to make an offer or has delayed an open offer;
- ix. directing the acquirer not to make an open offer or enter into a transaction that would trigger an open offer, if the acquirer has failed to make payment of the open offer consideration;
- x. directing the acquirer to pay interest of for delayed payment of the open offer consideration;
- xi. directing any person to cease and desist from exercising control acquired over any target company;
- xii. directing divestiture of such number of shares as would result in the shareholding of an acquirer and persons acting in concert with him being limited to the maximum permissible non-public shareholding limit or below.

8. INSIDER TRADING AUDIT

The insider trading audit includes the compliances requirements (event based /continuous disclosures) under the SEBI (Prohibition of Insider Trading) Regulations, 2015 which includes:

- i. **Initial disclosures of trades** which is to be made by only the promoters, key managerial personnel, directors internally;
- ii. **Continual disclosures** which is to be made by every promoter, employee or director in case value of trade exceed monetary threshold of ten lakh rupees over a calendar quarter;
- iii. company to accordingly **notify stock exchanges within 2 trading days**;
- iv. **Submission of trading plans**; Appointment of compliance officer;
- v. **Pre-clearance for trading**; Codes of fair disclosure and conduct;
- vi. Role of the designate person; Manner of **dealing with UPSI** (unpublished price sensitive information).

Illustrative checkpoints for verification of Compliance under the SEBI (Prohibition of Insider Trading) Regulations, 2015 includes whether:

- i. The company has **appointed a compliance officer**.
- ii. The company has maintained **structured digital database containing the nature of unpublished price sensitive information and the names of such persons who have shared the information and also the names of such persons with whom information is shared** under this regulation along with the Permanent Account Number or any other identifier authorized by law where Permanent Account Number is not available.
- iii. The **structured digital database is preserved for a period of not less than eight years after completion of the relevant transactions** and in the event of receipt of any information from the Board regarding any investigation or enforcement proceedings, the relevant information in the structured digital database shall be preserved till the completion of such proceedings.
- iv. The company has **designated an officer to administer the code of conduct** and other requirements under Insider trading regulations. (Regulation 9)
- v. The Board of Directors of has formulated **a code of practices and procedures for fair disclosure of unpublished price sensitive information** as per Schedule A of Insider trading regulations.
- vi. **The Code has been hosted on the website of the company** and a copy of the same must be sent to the stock exchange.
- vii. The **code of conduct has stipulated the sanctions and disciplinary actions, including wage freeze, suspension, recovery, clawback** etc. and any amount collected has been remitted to the SEBI for

credit to the Investor Protection and Education Fund administered by the SEBI under the SEBI Act, 1992.

- viii. The Company has designated a Chief Investor Relation Officer, who is also a senior officer of the company to deal with dissemination of information and disclosure of unpublished price sensitive information, as per the principles set out in Schedule A of Insider trading regulations.
- ix. The Company has formulated code of conduct to regulate, monitor and report trading by insiders as per Schedule B of these regulations.
- x. The Company has formulated an internal code of conduct for governing dealing in securities as per the minimum standards set out in Schedule B of Insider trading regulations.
- xi. Every such code of practices and procedure relating to unpublished price sensitive information and every document thereto has been promptly intimated to the stock exchange where the securities are listed.
- xii. The trading plan has been formulated in compliance with Regulation 5. If yes, whether necessary compliances have been made.
- xiii. The disclosures were taken from the KMPs of the Company and from those relating to trading by such person's immediate relatives, and by any other person for whom such person takes trading decisions.
- xiv. The connected person or class of connected persons have made disclosures of holdings and trading in securities of the company in such form and at such frequency as may be determined by the company in order to monitor compliance with these regulations.
- xv. Every code of practices and procedures for fair disclosure of unpublished price sensitive information and every amendment thereto has been promptly intimated to the stock exchanges where the securities are listed. (Regulation 8)
- xvi. Any action has been sanctioned by the Board for the violation/ contravention of the provisions these regulations. (Regulation 10)
- xvii. The Compliance officer has reviewed and monitored the trading plans if any, submitted by any insider and approved the trading plan that it has not violated these regulations.
- xviii. The Compliance officer has received undertaking or declaration from insider with respect to the trading plan, as the case may be.
- xix. The Compliance officer has notified the trading plan to the stock exchange(s), if any.

- xx. The Company maintains the record of the said disclosures as required for a minimum period of five years.
- xxi. The Company has received the initial disclosure from every promoter, Key Managerial Personnel (KMP) and Directors with respect to the securities held by them in Company.
- xxii. The Company receives disclosure by every person on appointment as KMP or Director or upon becoming a promoter within seven working days of such appointment or becoming promoter.
- xxiii. The Company is regular in receiving continual disclosure from the promoter, member of the promoter group, designated person and directors with respect to the number of securities acquired or disposed of within two trading days of such transaction, if such transactions exceed Rs.10,00,000 or such other value as may be specified in a calendar quarter.
- xxiv. The Company has notified the particulars of such trading to the stock exchange(s) within two trading days of receipt of the disclosure or from becoming aware of such information.
- xxv. The Company is regular in receiving disclosures of holding & trading of securities of the company by any other connected person or class of connected persons, held or traded by them. The Company has in its discretion require this information & set out the frequency for seeking such information.
- xxvi. The Compliance officer has provided reports of trading to the Chairman of Audit Committee, if any or to the Chairman of the Board of Directors as per the frequency stipulated by the Board of Directors.
- xxvii. The Company follows Chinese wall procedures & processes as per the norms contained in the code of conduct, wherever applicable.
- xxviii. The Compliance officer determines the timing of closure of the trading window and re-opening of the trading window.
- xxix. The Compliance officer has put in place appropriate procedure for pre-clearance of trades for designated persons.
- xxx. The Designated Person have not entered into any contra trade as per the specified period as mentioned in the code of conduct which shall be not less than six months from the date of trade in securities of the Company.
- xxxi. The profit arises from the Contra trade, if executed inadvertently or otherwise, has been liable to be disgorged for remittance to SEBI for credit to the Investor Protection and Education Fund administered by the SEBI under the Act.

- xxxii. Any action has been initiated by SEBI against the company or any of its promoter, director, Key Managerial Personnel, officer or employee under the PIT regulations in the past or present.
- xxxiii. The company or any of its promoters, director, Key Managerial Personnel, officer or employee has been convicted by SEBI with respect to Insider Trading in the past or present.
- xxxiv. Any action taken against persons responsible for non-adherence with respect to formulation of code of conduct.
- xxxv. Any other prevention mode with respect to insider trading as adopted by the Company.

9. INDUSTRIAL AND LABOUR LAW AUDIT

- i. Industrial and Labour law Audit is an effective tool for compliance management of labour, employment and Industrial laws.
- ii. Audit helps to detect non-compliances of labour and employment laws applicable to a business and take corrective measures to avoid any unwarranted legal actions by the regulators against the business and its management.
- iii. Labour Law audit is useful in promoting cordial relations between employees and employers and also lead to better governance and value creation for the business

Scope of Industrial and Labour Audit

Labour laws audit differs from other compliance/audits in the country because where most audits focus on the financial impact on a company, labor laws audits consider human values and the rights of workers.

The scope of secretarial audit also includes examining and reporting on whether the adequate systems and processes are in place to monitor and ensure compliance required under the various industrial and labour laws.

Though the Industrial and Labour audit include the various State and Local Laws along with the central laws, However the illustrative list of the compliance requirement under the various central law has been provided below:

Factories Act, 1948

- 1. The Factories Act, 1948 is applicable to the company.

2. The occupier has at least fifteen days before occupying or using any premises as a factory, sent to the Chief Inspector a written notice as contained in section 7.
3. The provisions regarding registration / licence as prescribed in section 6 have been complied with.
4. The employer has appointed the manager/ occupier of the factory under the Factories Act, 1948 and sent notice to the competent authority.
5. The company has complied with provisions of:
 - "Health" measures as provided in chapter III;
 - "Safety" measures as provided in chapter IV; Applicable provisions of chapter IV-A - Hazardous Processes;
 - "Welfare" measures as provided in chapter V;
 - "Working Hours" of adults as provided in chapter VI;
 - "Employment of Young Persons" as provided in chapter VII; and
 - "Annual Leave with Wages" as provided in chapter VIII.
6. Under the Factories Act, 1948 Registers, Return & Abstracts:
 - Register of Compensatory Holidays
 - Register of Adult Workers
 - Register of Leave with Wage
 - Register Muster Roll Register of Accident & Dangerous Occurrences
 - Inspection Book
 - Half yearly returns (Before 15th of July & 15th of January) of every year in duplicate)
 - Accident & Dangerous Occurrences (Every Month)
 - Combined Annual Returns (Before January every year)
 - Notice of Adult workers
 - Abstract of Factories Act, 1948.

Industrial Disputes Act, 1947

1. The Industrial Disputes Act, 1947 is applicable to the company.
2. There is an industrial dispute, as defined under Section 2A of the Act.
3. The company has maintained a muster roll as required under section 25-D of the Act.
4. The Company is an industrial establishment, having one hundred or more workmen. If yes, the company has constituted Works Committee as required under Section 3 of the Act.

5. Any change in the conditions of service applicable to any workman in respect of any matter specified in the fourth schedule of the Act, has been made after giving 21 days' notice to the workmen, of such intention in Form E, as required under Section 9A of the Act, read with Rule 34.
6. The company has twenty or more workmen. If yes, the company has constituted Grievance Redressal Committee as required under Section 9-C of the Act.
7. The Company is a Public Utility Service. If yes, the lockout if any has been carried out after giving sufficient notice in Form N, as required under Section 22(3) of the Act read with rule 73.
8. The Company has complied with the conditions precedent to the retrenchment of workmen, as required under Section 25F and Section 25N, as applicable.
9. The Company maintains a muster roll for its workmen as required under Section 25-D.
10. The Company has compensated for being laid off, the workmen, whose name is in the muster rolls and has completed not less than one year of continuous service. (Section 25C)
11. The company has compensated the workmen in case of closing down of undertakings, as prescribed in section 25FFF.

The Payment of Wages Act, 1936

1. The Payment of Wages Act, 1936 is applicable to the company.
2. The payment of wages is made before:
 - (a) before the expiry of the 7th day of the following month, when less than 1000 persons are employed.
 - (b) before the expiry of the 10th day of the following month, when more than 1000 workers are employed.
3. The deductions made from the wages of the employee are in accordance with section 7 of the Act.
4. If any deduction has been made on account of damage or loss, show cause notice has been given to the employee.
5. In case any deduction has been made for unauthorized absence, opportunity of being heard is given.

6. The registers and records giving particulars of persons employed, the work performed by them, the wages paid to them, the deductions made from their wages and the receipts given by them are maintained and preserved for a period of 3 years or more.
7. The employer has displayed the abstract of the Act and Rules made thereunder in the manner prescribed under section 25.

The Minimum Wages Act, 1948

1. The Minimum Wages Act, 1948 is applicable to the Company.
2. The company has been paying the minimum wages as notified from time to time by the appropriate Government under the Act.
3. The company has paid wages in cash. If not, the wages in kind has been paid after following the procedure prescribed under section 11 of the Act.
4. The company follows the conditions prescribed with regard to working hours, working day under section 13 of the Act.
5. The company has paid overtime rate as prescribed under section 14 of the Act read with rule 25.
6. The company has maintained all registers and records that are required to be maintained under section 18 of the Act and rule 26.
7. The company has followed the procedure prescribed with respect to payment of undisbursed amounts due to employees, for reasons such as death, whereabouts not known etc.
8. The company has followed the procedure prescribed in rule 21 of the Minimum Wages (Central) Rules, 1950 with respect to deductions made from the wages.
9. The company has followed time and conditions of payments of wages prescribed in rule 21 of the Minimum Wages (Central) Rules, 1950.
10. Notices in prescribed Form, containing the minimum rate of wages has been displayed at the main entrance to the establishment, as specified in rule 22.

Employees' State Insurance Act, 1948

1. The Employees' State Insurance Act, 1948 is applicable to the company.
2. The factory or establishment to which the Act applies has been registered.
3. The rate of contribution of the employer and employee is in accordance with the Act. [Rule 51 of ESI (Central) Rules, 1950.]

4. The manner and time Limit for making payment of contribution is in accordance with the Act.
5. The employer has maintained the register of employees in ç.
6. Submission of returns/reports:
 - a. Annual return;
 - b. Return of contributions;
 - c. Report of accident;
 - d. Report of death of insured persons.
7. The benefits provided in Chapter V of the Act were made available to the applicable employee.

The Employees' Provident Fund and Miscellaneous Provisions Act, 1952

1. The Employees' Provident Fund and Miscellaneous Provisions Act, 1952 is applicable to the company.
2. The contributions made by the employer and the employee and payment thereof are in accordance with para 29 and 30 of the Employees' Provident Funds Scheme, 1952.
3. The employer has obtained declarations from the persons taking up the employment. (Para 34 of the scheme)
4. The employer has prepared the contribution card in Form No. 3 or 3-A as appropriate in respect of every employee in his employment.
5. The employer has sent to the Commissioner:
 - a. Consolidated return in the form specified by the commissioner.
 - b. Monthly return in prescribed Form together with declaration.
 - c. In such form as the commissioner may specify of employees leaving service of the employer during the preceding month.
 - d. Inspection note book in such form as the commissioner may specify, is maintained.
 - e. Accounts relating to amount contributed to the fund by the employer and by the employee have been maintained. (Para 36 of scheme)
6. The employer has furnished particulars of ownership to the Regional Commissioner. (Para 36 A of scheme)
7. The employer has forwarded the monthly abstract to the commissioner. [Para 38 (2) of scheme]
8. Consolidated annual contribution statement was sent to the commissioner. [Para 38(3) of scheme]

9. Submission of contribution card to the commissioner with a statement.
10. Any proceedings under the Act have been initiated against the Directors for recovery of dues.
11. If the Employer has created its own trust, whether the terms of trust are more beneficial than those provided under the trust.
12. The conditions imposed by PF Commissioner for the creation of Trust are satisfied.
13. The provisions relating to Employees' Pension Scheme, 1995 have been complied with.
14. The provisions relating to Employees' Deposit Linked Insurance Scheme, 1976 have been complied with.

The Payment of Bonus Act, 1965

1. The Payment of Bonus Act, 1965 is applicable to the company.
2. Computation of available surplus, allocable surplus and bonus are correctly arrived at.
3. Any amount has been deducted from bonus and if so, whether they are in accordance with the provisions of section 18.
4. Bonus is paid to the eligible employees.
5. The minimum or maximum amount of bonus paid is in accordance with section 10 or section 11, as the case may be.
6. The company has paid bonus to the employee:
 - a. Where there is a dispute regarding payment of bonus pending before any authority under section 22-within a month from the date on which the award becomes enforceable or the settlement comes into operation, in respect of such dispute;
 - b. In any other case-within a period of eight months from the close of the accounting year.
7. The company has maintained the registers as provided in rule 4.
8. The company has submitted the annual return of payment of bonus to the Inspector in Form No. D within thirty days after the expiry of the time limit prescribed in section 19.

The Payment of Gratuity Act, 1972

1. The Payment of Gratuity Act, 1972 is applicable to the company.
2. There are employees who have worked for a continuous period of 5 years or more.
3. Any gratuity has been paid to any employee. If yes, whether it has been paid within 30 days.

4. The employer has displayed a notice as provided in rule 4, specifying the name of the officer with designation who is authorised to receive notice under the Act or the rules made thereunder.
5. The employer has complied with the provisions related to nominations as specified in rule 6.
6. Gratuity of any employee has been forfeited. If yes, whether an opportunity of being heard is given?
7. The gratuity has been forfeited for the reasons as specified in the Act.
8. The employer has displayed the abstract of the Act and rules made thereunder at or near the main entrance of the establishment, as specified in rule 20.
9. The employer has obtained insurance for liability of payment of gratuity as specified in section 4A of the Act.

The Contract Labour (Regulation and Abolition) Act, 1970

1. The Contract Labour (Regulation and Abolition) Act, 1970 is applicable to the company.
2. The principal employer has obtained the certificate of registration for the establishment.
3. The appropriate Government has by a notification prohibited the employment of contract labour under section 10.
4. The contractors have obtained license from the Licensing Authority for contract labour undertaken or executed by them.
5. The contractors have got their license renewed in time.
6. The contractors are employing workmen as per license and registration certificate.
7. The number of workmen actually employed by the contractor's tallies with the number of workmen shown in the license.
8. The contractors are sending half-yearly returns in time.
9. Where the wage period is one week or more, the contractors are issuing wages slips one day prior to the disbursement of wages.
10. The principal employer maintains register of contractors.
11. The principal employer has sent annual return in to the Registering Officer.
12. The principal employer has within fifteen days of commencement or completion of each contract, submitted return to the Inspector.
13. Minimum rate of wages are being paid to the contractor labour in the presence of authorized representative of the principal employer.

14. The authorized representative of the principal employer gives a certificate to this effect at the end of the entries in the register of wage- cum- Muster Roll, as the case may be.
15. The contractors are properly depositing ESI, EPF contributions in respect of their workmen and submitting copies of the challan to the HR Department of the company.
16. The contract labour is provided the facility of rest room, canteen, wash room, first aid and other facilities.
17. The contract labour is granted leave with wages.
18. The contract labour is being paid over time at double rate.
19. The workmen engaged by the contractor are ensured benefits from ESI Scheme including issue of cards, temporary slips and are provided medical facilities.
20. The contract labour is being given contribution slips of EPF issued by the Regional Provident Commissioner.
21. The payment of wages to contract labour is being made in accordance with rule 65.
22. The leave applications and gate passes of the contract labour are being signed by the contractor and his agent.
23. The gate passes to the contract Labour are issued and signed by the company's employees.
24. The contractors are maintaining records as provided in rule 78.
25. Under the Contract Labour (Regulation & Abolition) Act, 1970.
 - Registration Certificate (Before appointing contractor)
 - Register of Contractor
 - Register of Employees employed by Contractor
 - Muster Roll, Wage Register, Over Time Register, Fine Register
 - Deduction Register, Advance Register (contractor)
 - Notice regarding rates of wages
 - Display of the Act & Rules
 - Half yearly return by contractor
 - Annual Return by Principle Employer (before 15th Feb)

The Maternity Benefit Act, 1961

1. The Maternity Benefit Act, 1961 is applicable to the company.

2. The employer has knowingly employed a woman in any establishment during the six weeks immediately following the day of her delivery, miscarriage or medical termination of her pregnancy.
3. Any pregnant woman has made any request not to give her any work which is of an arduous nature or which involves long hours of standing, etc. during the period of one month immediately preceding the period of six weeks, before the date of her expected delivery.
4. Any woman employee is entitled for maternity benefit, medical bonus and nursing break and if yes, whether payment has been made and nursing break was allowed in accordance with the Act.
5. The employer exhibited the abstract of the provisions of the Act and the rules made thereunder in accordance with section 19 of the Act.
6. Whether the employer has maintained muster rolls, registers and records as prescribed, if any, by the appropriate Government.
7. Whether the employer has submitted annual return in the form prescribed, if any, by the appropriate Government.

The Child and Adolescent Labour (Prohibition and Regulation) Act, 1986

1. The Child and Adolescent Labour (Prohibition and Regulation) Act, 1986 is applicable to the company.
2. The occupier has sent notice to Inspector as per section 9 when a child is employed or permitted to work.
3. The employer has employed any child labour in occupations set forth in Part-A or Process set forth in Part-B of the Schedule to the Act.
4. The employer has maintained the register in Form No. A in respect of children employed or permitted to work as specified in section 11.
5. The occupier has displayed notice containing abstract of sections 3 and 14 as specified in section

The Industrial Employment (Standing Orders) Act, 1946

1. The Industrial Employment (Standing Orders) Act, 1946 is applicable to the company.
2. One hundred or more workmen are employed, or were employed on any day of the preceding twelve months.
3. The industrial establishment has submitted to the Certifying Officer, five copies of the draft Standing Orders proposed by it for adoption in the establishment.

4. The text of the Standing Orders as finally certified has been prominently posted by the company in English and in the language understood by the majority of workmen on special boards to be maintained for the purpose.
5. The industrial establishment has modified the Standing Orders on agreement between the employer and the workmen or a trade union or other representative body of the workmen.
6. Any workman was suspended by the industrial establishment pending investigation or inquiry into complaints or charges of misconduct.
7. The industrial establishment has paid any subsistence allowance to any suspended employee.

The Employees' Compensation Act, 1923

1. The Employees' Compensation Act, 1923 is applicable to the company.
2. Any personal injury is caused to an employee by an accident arising out of or in the course of employment. If yes, the company has paid compensation as prescribed under Section 4 of the Act.
3. The company has maintained notice book in its premises, for reporting notice of accidents as prescribed in Section 10(3) of the Act.
4. The company has reported of fatal accident or serious bodily injuries in prescribed Form to the Commissioner, as prescribed in section 10-B read with Rule 11 of the rules.
5. The company has deposited compensation with the Commissioner in respect of the workman whose injury has resulted in death and has furnished statement in Form No. A, OR In other cases company shall furnish statement in Form 'AA', as prescribed in section 8(1) read with rule 6(1).
(As Applicable)
6. The company has furnished a statement in Form 'D', while depositing compensation, as required under section 8(2) read with rule 9.
7. The company has sent a return as to compensation paid during the previous year. (As specified by the State Government in respective state law)
8. On settlement of compensation amount in between company and workman, company executed a memorandum of agreement with the workman in Form No. K, L or M, as the case, may be and submitted such agreement along with an application to register it to the Commissioner, as prescribed in rule 48.

9. The provisions for reservation of apprentice training places for SC/ST/OBC have been made in designated trades.
10. The contract of apprenticeship was sent by the employer to the apprenticeship advisor/entered on the port-site within 7 days for verification & registration.

Equal Remuneration Act, 1976

1. Equal Remuneration Act, 1976 is applicable to the Company.
2. Payment of equal remuneration has been made to all for same work or work of similar nature and there is no discrimination between men and women while recruiting or subsequent to recruitment, promotion etc. (As per Section 4 read with section 5)
3. The company has maintained register in relation to workers in Form No. D as required under rule 6.

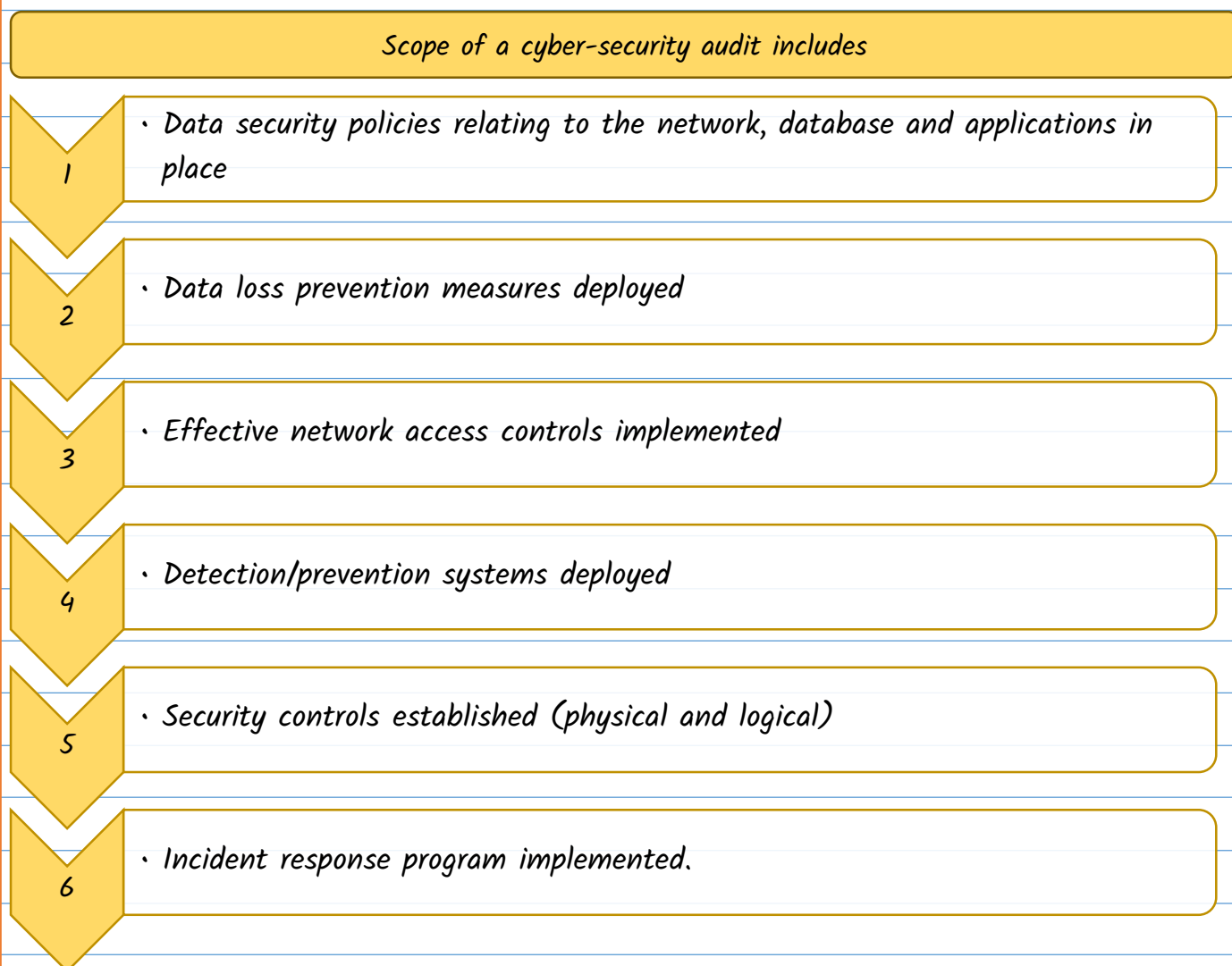
The Employment Exchange (Compulsory Notification of Vacancies) Act, 1959

1. The Employment Exchange (Compulsory Notification of Vacancies) Act, 1959 is applicable to the company.
2. The company has notified the vacancies to employment exchanges, as prescribed in section 4 of the Act read with rule 5.
3. The company has furnished quarterly returns, biennial return to local employment exchange as prescribed in rule 6.

10. CYBER AUDIT

- i. Cyber security is an attempt to minimising any risk of financial loss, disruption or damage to the reputation of an organisation that may arises from the failure of its information technology systems.
- ii. The objective of the cyber audit is to provide an assessment of the operating effectiveness of cyber security policies and procedures, identify, protect, detect, respond and recover processes and activities to the board.
- iii. The security and control issues which deals under cyber security audits includes:
 - a. Protection of sensitive data and intellectual property
 - b. Protection of networks to which multiple information resource are connected

c. *Responsibility and accountability for the device and information contained in it.*



Dimension of the Cyber Security Audit Process

Management

Management of the Company ultimately owns the risk decisions made for the organization. Therefore, it *has a vested interest in ensuring that cyber security controls exist and are operating effectively.*

Risk Management

Risk assessments are typically made based on guidance by the Cyber security officer at an organization and enterprise management make decisions, employing risk management processes.

The **objective** in any risk assessment is twofold.

- a. First, is clear communication. It is **critical to clearly communicate the state of risk** for easy understanding.
- b. Second, **Identify ways to address the risk.**

This provides both problem and solution, and mitigates the negative impact of that risk to an enterprise.

The risk landscape is always changing. To deal with this, it's crucial to have clear processes, a skilled cybersecurity team, and a governance framework. This ensures that leaders can take appropriate actions effectively, addressing both current and emerging threats.

Internal Audit

- a. Internal auditors and risk management professionals have **key roles to play as they report to the audit committee to ensure an independent view is being communicated at the board level** of the enterprise.
- b. Audits **help companies deal with cyber threats. They assess controls, suggest improvements, and assist senior management and the board in understanding and responding to cyber risks.**

Illustrative checkpoint on the Cyber Security Audit

- **Personnel Security**
 1. Whether the staff wears ID badges?
 2. Whether it is a current picture part of the ID badge?
 3. Are authorized access levels and type (employee, contractor, visitor) identified on the Badge?
 4. Whether the credentials of external contractors are checked?
 5. Whether the company has policies addressing background checks for employees and contractors?
 6. Whether the Company has a process for effectively cutting off access to facilities and information systems when an employee/contractor terminates employment?

- **Physical Security**

1. Whether the Company has policies and procedures that address allowing authorized and limiting unauthorized physical access to electronic information systems and the facilities in which they are housed?
2. Whether the Company's policies and procedures specify the methods used to control physical access to your secure areas, such as door locks, access control systems, security officers, or video monitoring?
3. Whether the access to the computing area is controlled (single point, reception or security desk, sign-in/ sign-out log, temporary/visitor badges)?

- **Account and Password Management**

1. Whether the Company has policies and standards covering electronic authentication, authorization, and access control of personnel and resources to your information systems, applications and data?
2. Whether the Company ensures that only authorized personnel have access to the computers?
3. Whether the Company requires and enforces appropriate passwords? 4. Are your passwords secure (not easy to guess, regularly changed, no use of temporary or default passwords)?

- **Confidentiality of Data**

1. Whether the Company is exercising responsibilities to protect sensitive data under their control?
2. Whether the most valuable or sensitive data encrypted?
3. Whether the Company has a policy for identifying the retention of information (both hard and soft copies)?

- **Compliance and Audit**

1. Whether the Company reviews and revises the security documents, such as: policies, standards, procedures, and guidelines, on a regular basis?
2. Whether the Company audits the processes and procedures for compliance with established policies and standards?
3. Whether the Company test the disaster plans on a regular basis?
4. Does management regularly review lists of individuals with physical access to sensitive facilities or electronic access to information systems.

II. ENVIRONMENTAL AUDIT

- i. According to Section 2(a) of the Environmental Protection Act, 1986, 'Environment' includes **Water, air and land.**
- ii. Environmental audit in general term reflect various types of evaluations **intended to verify the environmental compliance** and management system implementation gaps, along with related corrective actions.
- iii. **Objectives** of environmental audit are to **evaluate the efficacy of the utilization of resources** of man, machine, materials, and to **identify the areas of environmental risks and liabilities and weaknesses of management system** and problems in compliance of the directives of the regulatory agencies and control the generation of pollutants and / or waste.
- iv. During an audit of financial statements related to environmental matters, the following issues will merit special attention:
 - a. Initiatives to prevent, abate, or remedy damage to environment;
 - b. Conservation of renewable and non-renewable resources;
 - c. (Mentioned in Director's Report) Consequences of violating environment laws, rules and regulations;
 - d. Consequences of vicarious liability imposed by the government, courts etc.
- v. There are generally **two different types of environmental audits:**

Compliance Audit

**Management System
Audit**

Compliance audits and Management systems audits..

a. **Environmental Compliance audits**

Environment Compliance Audit provides assurance that government and private companies activities are conducted according to laws/rules/regulations/notifications/standards.

Following laws are covered under the environmental compliance audit:

Air Pollution

- i. *The Indian Boilers Act, 1923.*
- ii. *The Motor Vehicles Act, 1988.*
- iii. *The Mines and Minerals (Development and Regulation) Act, 1957.*
- iv. *The Factories Act, 1948.*
- v. *The Industries (Development and Regulation) Act, 1951.*
- vi. *The Air (Prevention and Control of Pollution) Act, 1981.*

Water Pollution

- i. *The River Boards Act, 1956.*
- ii. *The Merchant Shipping (Amendment) Act, 1970.*
- iii. *The Water (Prevention and Control of Pollution) Act, 1974.*

Radiation

The Atomic Energy Act, 1962.

Pesticides

- i. *The Poison Act, 1919.*
- ii. *The Factories Act, 1948.*
- iii. *The Insecticides Act, 1968.*

Miscellaneous

- i. *The Indian Forest Act, 1927.*
- ii. *The Ancient Monuments and Archaeological Sites and Remains Act, 1958.*
- iii. *The Wildlife (Protection) Act, 1972.*
- iv. *The Urban Land (Ceiling and Regulation) Repeal Act, 1999.*
- v. *The Forest (Conservation) Act, 1980.*
- vi. *The Environment (Protection) Act, 1986.*
- vii. *The Public Liability Insurance Act, 1991.*

2. Environmental Management Systems Audit

ISO 14001

ISO 14001 is an *environment management system standard* published by International Organisation for standardization in the year 1996 and later updated in the year 2005. It *provides highly effective, globally accepted framework for establishing and continually improving the effectiveness of environmental management.*

Implementation of ISO 14001 may bring with it both reductions in environmental risk and environmental costs.

The International Organization of Standardization (ISO) defines an environmental management system as “*part of the management system used to manage environmental aspects, fulfil compliance obligations, and address risks and opportunities.*”

An Enterprise Management System meeting the requirements of ISO 14001:2015 is a management tool enabling an organization to:

- i. *Identify and control the environmental impact of its activities, products or services;*
- ii. *Improve its environmental performance continually, and*
- iii. *Implement a systematic approach to setting environmental objectives and targets, to achieving these and to demonstrating that they have been achieved.*

Process of Environment Audit

1. Understanding the industrial activity and Pre-audit or planning stage

Collection of background information about the entity, definition of objectives and scope of audit, formation of audit team and development of audit plan and protocols.

2. On-site or Field Audit

Schedule necessary meetings and interviews, identify areas of concern, site / facility inspection, evidence / records / document review, staff interviews, initial review of findings.

3. Assessing the impact and post-audit

Final evaluation of findings, submit preliminary report with type and magnitude of impact on the environment, get approval of management, introduce the findings to the auditees, submit final environment audit report along with short/ long term acceptability.

4. Follow up or review

Verify the action taken on audit findings and recommendations.

Checklist on Environment Audit

A. Environment Policy

1. Whether the company have defined and documented its environmental policy.
2. Whether such policy is based on significant environmental aspects and corporate policy.
3. Whether such policy is appropriate to the organization's activities and their potential environmental impacts and regulatory requirements.
4. Does the policy include commitments to:
 - Continual improvement;
 - Prevention of pollution;
 - Comply with environmental legislation and other requirements.
5. Does the policy provide a framework for setting environmental objectives and targets.
6. Is the policy documented, implemented, maintained and communicated to all persons working for or on behalf of the organization.
7. Is the policy available is freely available to public.

B. Environment Aspects

1. Whether a procedure been established, implemented and maintained to identify the environmental aspects of its current and relevant past activities.
2. Whether aspects related to potential significant environmental aspects been considered in establishing and implementing the EMS.
3. Whether aspects having legal and/or regulatory reporting, monitoring or operational requirements been identified as "significant" aspects.
4. Are the following environmental aspects considered in sufficient detail:
 - Air emission
 - Wastewater effluent
 - Waste management
 - Soil pollution
 - Raw material and natural resource usage
 - Hazardous and toxic material
 - Impact on well-being (e.g. noise, smell, heat, landscape, protection)
 - Utility, energy and resource.

5. Other environmental specific issues on site such as housekeeping, storage, areas, piping.
6. Are the following operational aspects considered: Normal operating conditions Abnormal operating conditions (e.g. start up and shut down conditions, maintenance, incidents) Development of new or modified processes, products or services.
7. Actual and potential emergency conditions and accidents.
8. Have significant aspects been identified.

C. Legal and Other Requirements

1. Has a procedure been developed and implemented to identify applicable regulatory, legal and other requirements.
2. Are current copies of all applicable regulatory and other requirements accessible to personnel as necessary.
3. Have all further agreements the organization needs to fulfil been integrated in the procedure:
 - Business related agreements
 - Agreements with public authorities.
4. Guideline other than legal requirements (e.g. company policy, industry codes and practices, etc.)
5. Are the following licenses, permits and approvals available to demonstrate full legal compliance:
 - Licenses of waste collectors
 - Air emission permits
 - Wastewater discharge permits
 - Permits and licenses related to dangerous goods
 - Environmental fees, e.g. wastewater discharge fee
 - Registration at authorities (e.g. wastewater discharge, air emission inspection).

12. INFORMATION SYSTEMS AUDIT

Information systems auditing or systems audit is an ongoing process of evaluating controls, collecting and evaluating evidence to determine whether a computer system safeguards assets, maintains data integrity, allows organizational goals to be achieved effectively, and uses resources efficiently.

An information systems audit performed in an organisation is a comprehensive examination of a given targeted system.

The audit consists of an evaluation of the components which comprise that system, with examination and testing in the following areas:

- High-level systems architecture review
- Business process mapping (e.g. determining information systems dependency with respect to user business processes)
- End user identity management (e.g. authentication mechanisms, password standards, roles limiting or granting systems functionality)
- Operating systems configurations (e.g. services hardening)
- Application security controls
- Database access controls (e.g. database configuration, account access to the database, roles defined in the database)
- Anti-virus/Anti-malware controls
- Network controls (e.g. running configurations on switches and routers, use of Access control lists, and firewall rules)
- Logging and auditing systems and processes
- IT privileged access control (e.g. System Administrator or root access)
- IT processes in support of the system (e.g. user account reviews, change management)
- Backup/Restore procedures.

During the System audit, the auditors are required to understand and evaluate the overall control environment. The control environment reflects the overall attitude of, awareness of, and actions by the board of directors, management, and others concerning the importance of internal controls in the enterprise.

CHECKLIST ON SYSTEMS AUDIT

A. Management Controls

1. Security Policy and Standards

- a. Whether the organization has a Security Policy?
- b. If a security policy exists, it needs to be examined for adequacy in proportion to the risk.

2. Constitution of Steering Committee

The formulation and implementation of a sound security policy should be a team effort, brought into effect by a committee in which there is at least one member of the Board of Directors apart from the Chief Information Officer (CIO) and user HoDs.

3. Business Continuity Planning

The Auditor should examine all such possibilities by which the availability of Computer Systems is threatened with temporary or permanent breakdown. In sensitive areas, even proofing against mob violence/terrorist strikes should be kept in view.

4. Systems Development Methodology

The documentation should be properly cross-indexed. The effect of a change made in the system should be well understood and thorough testing should be done and documented. The System Auditor should get necessary evidence and comment on the lack of proper adherence to procedure.

B. Operational Controls

1. Monitoring physical assets

- a. Whether monitoring of physical assets are done in regular intervals?
- b. Any discrepancy in the data collected and the current data of physical assets are addressed immediately or not?

2. Ensure adequate environmental controls:

- a. Whether proper facilities of Air-conditioning (dust, temperature & humidity controls), Power Conditioning (Online UPS functioning all the time with backups, proper earthing) are timely reviewed?
- b. Whether the cable connections/electronic points are functioning properly or not is reviewed on regular intervals?

C. Organizational Controls

- a. Whether the roles, responsibilities and duties of User Departments and IT Department are defined?
- b. The CIO should have three reportees- one for taking care of the development team, one for ensuring Information System / IT Centre security and another for managing the facilities (i.e., operations and maintenance of hardware), OS, database administration, vendor management, service providers etc.

D. Application Controls

Whether each of the Computer Systems and subsystems must have its own set of controls for Inputs, processing & outputs. Processing controls should also ensure checks for legal compliance.

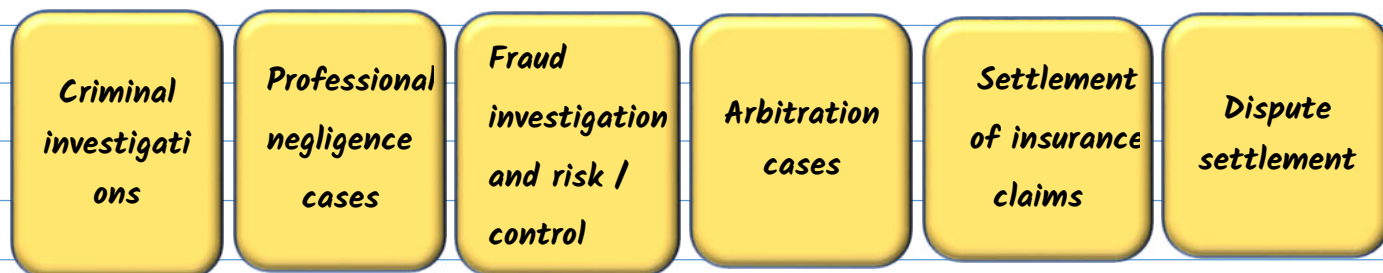
BOX PAGE 326 Mandatory Audits

13. FORENSIC AUDIT

- i. Forensic is the **application of science to crime concerns**. Forensic science is science applied to legal matters especially criminal matters.
- ii. Forensic Audit is a **tool in combating corruption, financial crimes and frauds through investigations** and resolving allegations of fraud and embezzlement.
- iii. Forensic audits are **highly specialized**, and the work **requires detailed knowledge of fraud investigation techniques and the legal framework**. Forensic accountants are trained to look beyond the numbers and has necessary skills and experience to accept the work.
- iv. A forensic audit, also known as forensic accounting, **refers to the application of accounting methods for detection and gathering evidence of frauds**, embezzlement, or any other such white-collar crime.
- v. Forensic audit is done in two-phases:
 1. **Investigation Services** - At first the auditor begins with an investigation, looking into the accounts and statement, and identifying defects in it. Post this, it moves on to find ways to deal with such defects.
 2. **Litigation Services** - It is entirely possible the frauds detected be resolved within the company itself. However, there are times when they need to be resolved through legal channels. During

such situations, forensic auditors give litigation support to the advocates. Their **advice and consultation about the legalities of commercial disputes** are very essential. They are also **called up by the Court as an expert witness** for further investigation.

Areas of Forensic Audit



PURPOSE OF FORENSIC AUDIT

I. Corruption

In Forensic audit, while investigating fraud, auditor would look out for:

- a. **Conflicts of interest** – When fraudster **used his/her influence for personal gains** detrimental to company. For example, if a manager allows and approves inaccurate expenses of employee with whom he has personal relations. Even though the manager is not benefitted from this approval but he is likely to receive personal benefits after making such inappropriate approvals.
- b. **Bribery** – **Offering money to get things done** or influence a situation one's favour would be bribery.
- c. **Extortion** – if someone demands money so as to award Tender to other party then it would amount to extortion.

II. Asset Misappropriation

Misappropriation of cash, raising fake invoices, payments made to non-existing suppliers or employees, misuse of assets or theft of Inventory are few examples of such asset misappropriation.

III. Financial statement fraud

Companies commit fraud to make their performance look better than it really is. They may do this to boost liquidity, ensure top management gets bonuses, or meet market performance expectations.

Some examples of such frauds are - Intentional forgery of accounting records; omitting transactions - either revenue or expense transactions, non-disclosures of relevant details from the financial statements; or not applying the requisite financial reporting standards.

Procedure of Forensic Auditing Investigation

• Step 1 - Accepting the Investigation

- i. A forensic audit is always **assigned to an independent firm/group of investigators** in order to conduct an unbiased and truthful audit and investigation.
- ii. When a firm receives an invitation to conduct an audit, their first step is to understand the business, identify possible frauds and determine whether or not they have the necessary tools, skills and expertise to go forward with such an investigation.
- iii. If, they are satisfied with such considerations, can they go ahead and accept the investigation.

• Step 2 - Planning the Investigation

The auditors **need to clearly understand the goal of the audit and carefully plan the procedures to achieve it.** They should identify potential fraud signs before planning the investigation.

Planning also **includes the identification of the best way/mode to gather evidence.** Thus, it is necessary that ample research should be done regarding certain investigative, analytical, and technology-based techniques, and also related legal process, with regard to the outcome of such investigation

Symptoms of Fraud

- Delayed submission of returns information etc.;
- Delayed remittances into Bank;
- Delay or non-preparation of Bank reconciliation statements;
- Lifestyle of promoters/directors and key employees ;
- Continued internal control lapses and not following norms of corporate governance.

Internal Indicators

- Delay in finalisation of accounts;
- Frequent changes in Accounting Policies;

- Continuing Losses;
- Over drawl of loans or advances;
- Higher cost per unit of production;
- High amount of losses or wastage shown in books v/s Norms;
- High investment in group companies;
- Profit not supported by increased cash availability.

They should also be clear on the final categories of the report, which are as follows,

- Identifying the type of fraud that has been operating, how long it has been operating for, and how the fraud has been concealed;
- Identifying the fraudster(s) involved;
- Quantifying the financial loss suffered by the client;
- Gathering evidence to be used in court proceedings;
- Providing advice to prevent the recurrence of the fraud.

Illustrative Checklist on Forensic Audit

- Whether the fraud detected is at the management level or employee level?
- What was the reason or motive behind the fraud?
- How is the internal check on cash transactions, raising of invoices etc.?
- Who is responsible for the checking if all the things are in order in regular intervals?
- What is the nature of fraud – corruption, assets misappropriation or financial misstatement?
- Whether the entries passed are properly reflected in the balance sheet without any omission?
- Whether IT returns are filed every year properly?
- Whether bank entries are reconciled on regular basis?
- Whether bank statements do not have any discrepancy.

Thoda Extra gyaaannnn..... Swaad Anusaaar (Short Note)

Fraud Triangle and Fraud Risk

A fraud triangle is a tool used in forensic auditing that explains three interrelated elements that assist the commission of fraud- Pressure (motive), opportunity (ability to carry out the fraud) and rationalization (justification of dishonest intentions). Fraud risk is the vulnerability company/organisation has to those who are capable of overcoming the three elements in the fraud triangle. Fraud risk assessment is the identification of fraud risks that exist in the company/organisation. The planning involves the formulation of techniques and procedures that align with the fraud risk and fraud risk management.

- **Step 3 – Gathering Evidence**
 - i. In forensic auditing **specific procedures are carried out in order to produce evidence.**
 - ii. In order to continue, it is pertinent that the planning stage has been thoroughly understood by the investigating team, who are skilled in collecting the necessary evidence. It is also important to keep clear sequence of custody until the evidence is presented in court. A logical flow of evidence helps in understanding the fraud and evidence presented in a better manner. If the same is not done then the evidence can be challenged in court, or the court would not admit it.
 - iii. The investigators can use the following techniques to gather evidence or data about symptoms, testing controls to gather evidence which identifies the weaknesses, which allowed the fraud to be perpetrated.
 - a. **Analytical Procedure:** Using analytical procedures to compare trends over time or to provide comparatives between different segments of the business applying computer-assisted audit techniques, for example, to identify the timing and location of relevant details being altered in the computer system.
 - b. **Discussions and Interviews:** Discussions and interviews with employees.
 - c. **Substantive Techniques:** Substantive techniques such as reconciliations, cash counts and reviews of documentation.
 - d. **Forensic Data Analysis (FDA):** FDA is the technology used to conduct fraud investigations; the process by which evidence is gathered, summarized and compared with existing different sets of

data. The aim here is to detect any anomalies in the data and identify the pattern of such anomalies to indicate fraudulent activity.

- **Step 4 – Reporting**

The reporting stage is the most obvious element in a forensic audit. After investigating and gathering evidence, the investigating team is expected to give a report of the findings of the investigation, and also the summary of the evidence and conclusion about the loss suffered due to the fraud. It should also include the plan of the fraud itself, and how it unfolded, basically the whole trail of events, and suggestions to prevent such fraud in the future.

- **Step 5 – Court Proceedings**

The last stage expands over those audits that lead to legal proceedings. Here the auditors will give litigation support to the Company/Regulators. The auditors are called to Court, and also included in the advocacy process. The understanding here is that they are called in because of their skill and expertise in commercial issues and their legal process. It is important that they lay down the facts and findings in an understandable and objective manner for everyone to comprehend so that the desired action can be taken up. They need to simplify the complex accounting processes and issues for others to understand the evidence and its implications.

FORENSIC AUDIT REPORT

Illustrative table of contents of a Forensic Audit Report include the following points:

1. Executive Summary
2. Origin of the audit
3. Audit Objective
4. Proposed Audit Outputs
5. Audit Implementation approach
6. Risk Analysis
7. Internal Environment Risk: Customers, product and Competitors; Financial Management; Human Resource Management; Information Technology; Business processes
8. External Environment Risk: Economy and market situation; political and legal scenario; Technology in the sector

9. Audit Process
10. Preliminary understanding of scope and incident coverage
11. Collect evidence
12. Conduct Interviews
13. Analyse findings
14. Validate inferences and conclusions
15. Evidence of risk events
16. Conflicts of interest; Bribery; Extortion; Theft; Fraudulent transactions; inventory frauds; misuse of assets; financial statement frauds
17. Audit recommendations
18. Logical framework approach
19. Preconditions and risks
20. Governance on recommendation implementation
21. Stakeholders
22. Budget considerations

14. SOCIAL AUDIT

- i. A social audit is a way of measuring, understanding, reporting and ultimately improving an organization's social and ethical performance. A social audit helps to narrow gaps between vision/goal and reality, between efficiency and effectiveness and creates an impact upon governance.
- ii. Social auditing is taken up for the purpose of enhancing local governance, particularly for strengthening accountability and transparency in local bodies. Social audit is a process of reviewing official records and determining whether state reported expenditures reflect the actual money spent on the ground.
- iii. A social audit is a formal review of a company's endeavors in social responsibility.
- iv. The key difference between development and social audit is that a social audit focuses on the neglected issue of social impacts, while a development audit has a broader focus including environment and economic issues, such as the efficiency of a project or programme.

Implications of Social Audit

Social auditing creates an impact upon governance. It values the voice of stakeholders, including marginalized/poor groups whose voices are rarely heard.

Social auditing is taken up for the purpose of enhancing local governance, particularly for strengthening accountability and transparency in local bodies.

Social Audit makes it sure that in democracy, the powers of decision makers should be used as far as possible with the consent and understanding of all concerned.

Objectives of Social audit

1

• Assessing the physical and financial gaps between needs and resources available for local development.

2

• Creating awareness among beneficiaries and providers of local social and productive services.

3

• Increasing efficacy and effectiveness of local development programmes.

4

• Scrutiny of various policy decisions, keeping in view stakeholder interests and priorities, particularly of rural poor.

5

• Estimation of the opportunity cost for stakeholders of not getting timely access to public services.

6

• Provision of information needed to improve the effectiveness of programs designed to enhance community development.

Rights of Social Auditor to be effective

- 1 • seek clarifications from the implementing agency about any decision-making, activity,
- 2 • consider and scrutinize existing schemes and local activities of the agency; and
- 3 • access registers and documents relating to all development activities undertaken by the implementing agency or by any other government department.

SOCIAL AUDIT- COVERAGE

A social audit *examines issues regarding internal practices or policies and how they affect the identified society*. The activities included tend to pertain to the concepts of social responsibility. This can include activities affecting the financial stability of a region, any environmental impact resulting from standard operations and issues of transparency in reporting.

Use of Social Audit

- i. *Findings* as a social audit is *completely voluntary*, the *results* of the audit are *not required to be released to the general public or any regulatory agency*.
- ii. *Positive results* may be *voluntarily disclosed*, *negative results* may be *kept internal* and used to identify potential improvements that can make the results of the next social audit more favorable.

Implementation of Social Audit

1. Empowerment of people:

Social audit is most effective when the actual beneficiaries of an activity are involved in it. However, people can only get involved in the process when they are given appropriate authority and rights. To this end, the 73rd amendment of the constitution has empowered the Gram Sabha to conduct social audit. This is relevant only in the villages. In the cities, the Right to Information Act empowers the people to inspect public records.

2. Proper Documentation:

Everything right from the requirement gathering to planning to implementation must be properly documented. Some of the documents that should be made mandatory are: Applications, tenders, and proposals. Financial statements, income - expense statements. Registers of workers. Inspection reports.

3. Accessibility of Documents:

Merely generating documents is useless if they are not easily accessible. In this information age, all the documents must be put on line.

4. Punitive Action:

The final and most important provision, about which nothing is being done yet is to have punitive actions for non-conformance of the process of social audit. Unless there is legal punishment, there will be no incentive for the people in authority to implement the processes in a fair manner.

Steps for Social Audit

- Clarity of purpose and goal of the local elected body.
- Identify stakeholders with a focus on their specific roles and duties.
- Definition of performance indicators which must be understood and accepted by all
- Regular meetings to review and discuss data/information on performance indicators.
- Follow-up of social audit meeting with the panchayat body reviewing stakeholders' actions, activities and viewpoints, making commitments on changes and agreeing on future action as recommended by the stakeholders.
- Establishment of a group of trusted local people including elderly people, teachers and others who are committed and independent, to be involved in the verification and to judge if the decisions based upon social audit have been implemented.
- The findings of the social audit should be shared with all local stakeholders. This encourages transparency and accountability.

Checklist on Social Audit

- Whether the company has well defined policies for development of the society especially the poor and rural people?

- Whether on regular basis the scrutiny of fulfilment of the policy is done?
- Whether the physical and financial gaps between needs and resources available for local development are assessed on regular intervals?
- Whether the voice of the minority shareholders are considered?
- Are necessary actions taken over them?

15. ICSI SOCIAL AUDIT STANDARDS

The Institute of Company Secretaries of India has approved the ICSI Social Audit Standards covering all the sixteen areas of activities listed by the Regulatory Authorities, where a Social Enterprise can operate to be eligible to register on the Social Stock Exchanges.

Objectives

- i. The main object of Social Audit is to ascertain the impact made by the Social Enterprise through its activities, intervention, programs or projects implemented during the reporting period. It will also analyse whether the implemented activities, intervention, programs or projects has addressed the challenges set at the implementation stage or those mentioned in the fund-raising documents.
- ii. The impact report aims to highlight the positive impact made to the target area, unintended negative impact and gap between desired object and actual impact made by the Social Enterprise during the reporting period.
- iii. The main objects of Social Audit are as follows:
 - Assessing the impact made by the Social Enterprise through implementation of activities, intervention, programs or projects;
 - Verifying the authenticity and validity of implementation of projects;
 - To identify and report the gap between desired object and actual impact made by the Social Enterprise;
 - Assessing the nature, intensity and duration of impact of the project;
 - Evaluating the cost and efficiency of the projects/ interventions being carried out by the Social Enterprise;
 - Evaluating the unintended effects and how to use the experience from the running projects to improve the design of future projects;
 - Verifying whether all the statutory requirements are fulfilled or not.

Scope

Different projects may have a very different list of social issues. The Social Auditor is to exercise his own technical judgement to determine which issues should be subject to inquiry. The minimum issues which must be addressed by the Social Auditor are enumerated as under:

- Will the project significantly impact the economic, environment and social condition of the local community?
- Will there be a significant change in the general access that the communities have to natural resources, such as drinking water and energy?
- Does the local community have effective governance mechanisms to deal with the long-term effects of the project?
- Are there groups (indigenous groups, women, ethnic minorities, LGBTQIA+ and so on) who will be differentially impacted by the project?
- Will the project increase or decrease the demand for services, such as education or health?
- Will the project produce any population or demographic movement, such as the change in size of the communities affected by the project?

Above questions can help the auditor and the Enterprise to determine the extent of the impact, as well as any unmanageable social obstacles ahead of the project. This allows for the anticipation of any adverse significant social effects of the infrastructure and for avoiding, minimizing, or offsetting them.

Mandatory nature of framework and Standards

These Social Audit Standards are applicable to all Social Auditors empanelled with the ICSI Institute of Social Auditors who undertake the Social Audit assignment as per the relevant provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 and other relevant provisions notified from time to time. The Standards are formulated for the effective assessment of impact made by the Social Enterprises through the projects identified and the eligibility criteria as notified by SEBI vide Regulation 292E (2) (a) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

Eligibility Criteria

As per Regulation 292E (2) (a) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, in order to establish the primacy of its social intent, such Social Enterprise shall meet the following eligibility criteria: -

- i. Eradicating hunger, poverty, malnutrition and inequality;
- ii. Promoting health care including mental healthcare, sanitation and making available safe drinking water;
- iii. Promoting education, employability and livelihoods;
- iv. Promoting gender equality, empowerment of women and LGBTQIA+ communities;
- v. Ensuring environmental sustainability, addressing climate change including mitigation and adaptation, forest and wildlife conservation;
- vi. Protection of national heritage, art and culture;
- vii. Training to promote rural sports, nationally recognised sports, Paralympic sports and Olympic sports;
- viii. Supporting incubators of Social Enterprises;
- ix. Supporting other platforms that strengthen the non-profit ecosystem in fundraising and capacity building;
- x. Promoting livelihoods for rural and urban poor including enhancing income of small and marginal farmers and workers in the non-farm sector;
- xi. Slum area development, affordable housing and other interventions to build sustainable and resilient cities;
- xii. Disaster management, including relief, rehabilitation and reconstruction activities;
- xiii. Promotion of financial inclusion;
- xiv. Facilitating access to land and property assets for disadvantaged communities;
- xv. Bridging the digital divide in internet and mobile phone access, addressing issues of misinformation and data protection;
- xvi. Promoting welfare of migrants and displaced persons.

Social Audit Standards for other items, if any, identified by the SEBI or Government of India from time to time, will be notified as and when the items are notified by the SEBI or Government of India. The Social Auditors empanelled under IISA shall maintain and preserve the records and

evidences collected in the course of Social Audit for a minimum period of eight (8) years from the date of the respective Social Impact Assessment Report.

Benefits and Advantages of Social Audit

- **Financial data on social activities/ programs/ interventions:** Social Audit assesses the source of funding, its utilisation and appropriate reporting to the Governing Body of the Social Enterprise.
- **Encourage for social performance:** Social Audit assesses the impact of the activities undertaken and brings the social point of view to the attention of the management, and thus encourages the Social Enterprise to perform better.
- **Improve relationships with Stakeholders:** By Implementing the auditors' recommended improvements, it helps the Social Enterprise to meet stakeholder expectations, enabling it to build a good relationship with them in the long term.
- **Comparison of different activities:** The Social Audit provides data for comparing effectiveness of different types of social welfare programmes undertaken and this further enables to assess which activity has better social impact.
- **Enhances Social Reputation:** Social Audit helps the organization to build up the image and reputation of the organization in the minds of the public.
- **Sense of Social Responsibility among Shareholders and Community as a whole:** Social Audit helps shareholders as well as other stakeholders realize the importance of socially beneficial programmes and extend their cooperation to the Social Enterprise's programmes of social welfare and development.

EXTRA

There are 16 social auditing standards issued by ICSI but all 16 are the eligibility criteria given above. (ICSI SAS 01- ICSI SAS 16)

16. ICSI AUDITING STANDARDS – AN OVERVIEW

- i. The Companies Act, 2013 has introduced the concept of Secretarial Audit (Audit) for Bigger Companies in order to have third party professional assurance in the areas of governance, compliances and disclosures by the companies.

- ii. A Practicing Company Secretary (PCS) who is holding Certificate of Practice (CoP) have been casted an exclusive responsibility to undertake such audit of companies.
- iii. The ICSI has setup an Auditing Standards Board for laying down the foundations of Company Secretaries Auditing Standards (CSAS) in India and for inculcation of best auditing practices among its members, and issued CSAS-1 to CSAS-4 effective from it 1st April, 2021.
- iv. Observance of ICSI auditing for standards by PCS, will lead to good governance, compliance and transparency among the companies. It will also help the PCS to comply with its important function of detection and reporting of frauds.
- v. The Council of the Institute of Company Secretaries of India (ICSI) has approved the issuance of four ICSI Auditing Standards. The Standards are required to be observed by the Company Secretaries undertaking Audits. The Standards seek to promote best auditing practices, uniformity and consistency while conducting audits.

The four Standards namely

CSAS-1: Auditing Standard on Audit Engagement which lays down the Auditor's role and responsibilities with respect to an Audit Engagement and the process of entering into an understanding/agreement with the Appointing Authority for the purpose of audit.

CSAS-2: Auditing Standard on Audit Process and Documentation which lays down the responsibilities and duties of the Auditor with respect to Audit Process in conducting audit and maintaining proper audit records.

CSAS-3: Auditing Standard on Forming of Opinion covers the basis and manner for forming Auditor's opinion on subject matter of the audit.

CSAS-4: Auditing Standard on Secretarial Audit covers the basis and manner for carrying out the Secretarial Audit. However, the developments arising due to the spread of Covid-19 pandemic, the mandatory applicability of ICSI Auditing Standards CSAS-1 to CSAS-4 is extended for Audit Engagements accepted by the Auditor on or after 1st April, 2021

SUMMARISED VERSION (MIND MAP)

1. MEANING OF AUDIT ENGAGEMENT

The audit engagement is a contractual arrangement by way of the Audit Engagement letter between the auditee and the auditor.

ICSI issued CSAS-1 – Auditing Standard on Audit Engagement effective from 1st April, 2021, which defines: “Audit Engagement” means detailed terms of reference of appointment including scope of audit, remuneration and limiting conditions.

Offer and acceptance of the Audit Engagement

The offer for the audit engagement may be initiated either by the Auditee or by the auditor. However it is necessary that the engagement are accepted by the auditors and the auditor fulfils the various criteria for acting as an auditor prescribed in the various applicable laws.

For example in case of the statutory audit the auditor shall fulfil the eligibility criteria as prescribed under section 141 of the Companies Act, 2013. An auditor may be appointed either as a result of one to one communication between the auditor and the Management or through a tendering process followed by the Management.

In case the auditor is to be appointed by the management on one to one basis, following steps should be taken care by the auditor:

1. Selection or screening of prospective auditee based on following risk / assessment
 - a. Client acceptance and engagement risk
 - b. Performance Risk – capacity, resources et
 - c. Engagement Contract Risk
 - d. Reputation Risk
 - e. Commercials
2. Communicating his willingness to take up the audit assignment
3. Conducting a pre- engagement meeting with the management
4. Signing the engagement letter with the Management and issuance of certificate by auditor before accepting an audit.

In case the auditor is to be appointed by tendering process, following steps should be taken care by the auditor

1. Pre-bid meeting with the management to discuss upon various aspects of the tender, scope of work terms of engagement, prior year audit results, appropriateness of reporting framework, understanding business and environment
2. Submission of technical bid as per the requirements of the tender document of the management
3. Signing the engagement letter with the management
4. Certificate by auditor before accepting an audit

The Auditor shall furnish a certificate to the Appointing Authority that:

- i. The number of audits are within the ceiling prescribed by the ICSI as specified in para 2 of CSAS I.
- ii. No substantial conflict of interest as defined in para 3 of CSAS-I exists with the Auditee.
- iii. There is no restriction to render the professional services under ICSI Guidelines.
- iv. He is not debarred to undertake such audit under any law or under the disciplinary mechanism of the ICSI

Preconditions of accepting/continuing any professional engagement

Prior to acceptance of any Audit engagement, the auditor, in order to establish whether the preconditions for accepting professional assignment are present, the auditor should check that:

- a. Whether the reporting framework as required in the preparation, performance of audit, review of the secretarial/ non-financial statements is acceptable; and
- b. Whether the management is in agreement to acknowledge and understands its responsibility relating to:
 - i. Preparation of the secretarial/ non-financial statements in accordance with the applicable reporting framework, including their fair presentation;
 - ii. Development of internal control/systems/procedure to enable the preparation of secretarial/ non-financial statements which are free from material misstatement, whether due to fraud or error; and

iii. Providing:

- a. Access to all information of which management is aware that is relevant to the preparation/ audit/ review etc. of the secretarial/ non-financial statements such as records, documentation and other matters;
- b. Additional information that the auditor may request from management for the relevant purpose; and
- c. Unrestricted access to persons within the company from whom the auditor determines it necessary to obtain audit evidence.

Limitation on scope prior to Engagement Acceptance

If management or appointing authority impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that **the auditor believes the limitation will result in the auditor disclaiming an opinion on the Secretarial records/non-financial statements, the auditor shall not accept such a limited engagement** as an audit engagement, unless required by law or regulation to do so.

Other factors affecting Engagement Acceptance

If the preconditions for an audit/professional assignment are not present, the auditor should discuss the matter with management. Unless required by law or regulation to do so, the auditor should not accept the proposed audit engagement:

- a. If the auditor assesses that the reporting framework to be applied in the preparation of the secretarial records/ non-financial statements is unacceptable, or
- b. If the agreement has not been concluded.
- c. Reference to the expected form and content of any reports and a statement that there may be circumstances in which a report may differ from its expected form and content.

Criteria for declining and withdrawing from an Engagement

Based on the evaluation of client information and the following factors, the auditor should determine and document the conditions beyond which it would be prudent to decline, or withdraw from an engagement:

- a. Client's status/information that is likely to impact adversely on the independence of the firm.

- b. Ability of the firm to provide appropriate service to the client, considering needs for technical skills, knowledge of the industry and personnel.
- c. Consider circumstances which would cause the firm to regard the engagement as one requiring special attention or presenting unusual risks.

2. APPOINTING AUTHORITY

The appointing authority means the person who is appointing the Auditors of the company. The Auditee under the Statute could be a company or any other form of entity. Appointing Authority will depend upon the type of the Auditee. In case the Auditee is a company, the Appointing Authority would be the Board of company or members of the company, and in other cases, it would be the persons who have been entrusted with the responsibility of governance and compliances of the Auditee. Further, the Appointing Authority may also include Court, Tribunal or Regulator or any officer thereof.

ICSI auditing standard CSAS-1 (Auditing Standard on Audit Engagement) defines "Appointing Authority" as any person having authority to appoint the Auditor. "Auditee" means a person subject to audit.

- i. Under the provision of the Section 139 of the Companies Act, 2013, it has been specifically provided that the first statutory auditor shall be appointed by the Board of Directors of the company within 30 days of the incorporation of the company, however, subsequent auditors shall be appointed upon the recommendation of the board or the audit committee of the company, if any, by the members at the general meeting of the company.
- ii. For example, to conduct audit of the function and activities of the company in case of Secretarial Audit under Section 204 of Companies Act, 2013 or Clause 24A of the SEBI (LODR) Regulations, 2015 and Internal Audit under Section 138 of Companies Act, 2013, the Appointing Authority would be the Board of the Company.
- iii. In case where the tribunal/ official liquidator by exercising his power, appointed the auditor, the tribunal/ official liquidator is considered as the appointing authority.
- iv. In case where the law specifically provides for the appointing authority and the appointing authority may authorize such person to sign the engagement letter, however instances where

the law has not provided, the person who signs the engagement letter in official capacity can be considered as the appointing authority.

- v. In case, the Auditee is under Corporate Insolvency Resolution Process, the Appointing Authority shall be the Resolution Professional.
- vi. In case of Audit of Depository Participants, the Appointing Authority may depend upon the type of Auditee, e.g. if the Depository Participant is a company then the Appointing Authority will be the Board or in case of an LLP it could be the designated partner or any other partner as may be authorised to appoint the Auditor.
- vii. In case of Internal Audit of Stock Brokers, Internal Audit of Investment Advisors, Internal Audit of Portfolio Managers, Internal Audit of Credit Rating Agencies and Internal Audit of Research Analysts, the Appointing Authority would depend upon the type of Auditee.

Types of appointing authorities	
First statutory auditor of the Company	Board of Directors or members in EGM
Statutory Auditor	Members in AGM
Secretarial Auditor	Board of Directors
Internal Auditors	Board of Directors
Auditee is under Corporate Insolvency Resolution Process	Resolution Professional
Tribunal/ official liquidator by exercising his power	Tribunal/Official Liquidator
Audit of Depository Participants	Director /Designated etc. partner depends on nature of Organisation
Internal Audit of Stock Brokers	Depends upon the type of auditee

CASE STUDY

- i. Sun Moon Limited is a listed company and operates in the manufacturing sector. In January 2023, the company received a notice from the Securities and Exchange Board of India (SEBI) stating that Sun Moon Limited had failed to comply with several provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.
- ii. The SEBI notice also required the company to appoint a practicing company secretary to conduct a secretarial audit of its records and submit a report to SEBI.

- iii. The board of directors of Sun Moon Limited have decided to appoint a M/S RR & Associates (Practicing Company Secretaries Firm) to conduct the secretarial audit and passed the Board resolution in their meeting.
- iv. However, Mr. Abhinav (shareholder) of the company challenged the appointment of the secretarial auditor in court, stating that the board did not have the authority to appoint the auditor and that the appointment should have been made by SEBI.
- v. The matter was referred to court. The court examined the provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, and found that the regulations did not specify who had the authority to appoint a secretarial auditor.
- vi. However, the court noted that the regulations required the secretarial auditor to be appointed by the company to conduct the audit. Based on these findings, the court ruled that the board of directors of Sun Moon Limited had the authority to appoint the secretarial auditor, and that the appointment was valid.

The secretarial audit was conducted, and the report was submitted to SEBI. Sun Moon Limited took corrective measures to rectify the non-compliances identified during the audit

Terms and Conditions of Audit engagement

This is essential that the auditor as well as the auditee should agree upon the terms of audit engagement and documented the same in the audit engagement letter or other suitable form of written agreement which can be referred on any conflict arising during the course of audit. While drafting the terms and conditions of audit these 4 corners requires the specific attention of the auditors and auditee:

- The objective and purpose of the audit;
- The responsibilities of the auditor;
- The responsibilities of management/ Auditee;
- The audit risk;
- The audit limitation;
- The audit plan

3. AUDIT FEE & EXPENSES

Audit fee which is to be charge by the auditor depends on several factors, which includes:

- Size of the organization;
 - Nature of business;
 - Internal Controls systems & Technology adopted;
 - Scope of audit;
 - Frequency of audit etc.
- i. Audit fees should be a fair reflection of the value of the work performed for the auditee, taking into account the above-mentioned factors. However, the **Audit services should not be offered or rendered under an arrangement whereby no fee will be charged** unless specified findings or results are obtained, or where the fee is otherwise contingent upon the findings or results of such services, and fees should not be regarded as being contingent if fixed by a court or other public authority.
- ii. The **charge or accept a fee for professional work on a percentage basis** is not advisable except where that course is authorized by statute or has been approved by a member body as generally accepted practice for certain work.
- iii. Auditors **should not accept a very low level of fee as a result of competing for business.** However, charging a lower fee than has previously been charged by another auditor for similar work is not restricted in any law.
- iv. In case of Statutory Auditors, **Section 142 of the Companies Act, 2013 provides that the remuneration to the Auditors shall be fixed in the general meeting of the company,** also the auditor can claim the expenses incurred by him in connection with the audit of the company.
- v. In case of the **Secretarial Audit and the Internal Audit, the Audit fee shall be decided by the Audit committee** or by the board of the company.

CASE STUDY

In Re R. Swarup Reddy Vs. M.N Pratap Reddy, NCLAT New Delhi,

In this matter CLB appointed Independent auditors for auditing books of account the company. Auditors completed their work and claimed fees of Rs. 36.16 lakh. The director company stated that fees claimed by auditors was on higher side and at best they were entitled for a fees of Rs. 8 lakh. The Court observed that said auditors had not only done audit but also did investigation, particularly with reference to related party transactions entered at instance of

appellant with its two sister companies for period from 1-4-2007 to 31-3-2014. Further, amount claimed by said auditors was supported by number of days spent and composition of people working on assignment. It was also observed that appellant had paid nearly Rs. 62 lakh for auditing of sister concerns for same period. Therefore, fees claimed by auditors were reasonable. Court was justified in directing the company to remit to said auditors entire claimed amount

ICSI Guidance Note on Audit Engagement

The Auditing Standard on Audit Engagement (CSAS-1) is applicable to the Practicing Company Secretaries (PCS).

CSAS-1 is not applicable for Audits entrusted on a voluntary basis by the Auditee to the Auditor. However, adherence to the Standard is recommended in respect of Audits entrusted on voluntary basis also.

Following is an illustrative list of Audits which may be undertaken by a Company Secretary under various Statutes:

Type of Audit	Act/Regulation	Section/ Regulation	Auditee
Secretarial Audit	Companies Act, 2013	204	Company
Secretarial Audit	SEBI (LODR) Regulations, 2015	24A	Listed Entities

Type of Audit	Act/Regulation	Section/ Regulation	Auditee
Internal Audit	Companies Act, 2013	138	Company
Audit of Depository Participants	SEBI (Depositories and Participants) Regulations 2018 read with SEBI circular no. SEBI/HO/MRD/DOP2-DSA2/CIR/P/2019/22 dated January 23, 2019	76	Sole Proprietorship, Partnership Firm, LLP, Company
Internal Audit of Stock Brokers	SEBI (Stock and sub-broker) Regulations, 1993	SEBI circular no. MIRSD/ DPSIII/ Cir-26/08	Sole Proprietorship, HUF, Partnership Firm, LLP, Company
Internal Audit of Investment Advisors	SEBI (Investment Advisors) Regulations, 2013	19(3)	Sole Proprietorship, Partnership Firm, LLP, Company
Internal Audit of Portfolio Managers	SEBI (Portfolio Managers) Regulations, 1993	SEBI circular no. IMD/ PMS/CIR/1/21727/03 dated November 18, 2003	Body Corporate
Internal Audit of Credit Rating Agencies	SEBI (Credit Rating Agencies) Regulations 1999	SEBI circular no. MRD/ CRA/CIR-01/2010 dated January 06, 2010	Public Financial Institution, Scheduled Commercial Bank, Foreign Bank operating in India with RBI approval, Foreign Credit Rating Agency recognised by or under any law, Company, Body Corporate
Internal Audit of Research Analysts	SEBI (Research Analysts) Regulation, 2014	25(3)	Sole, Proprietorship, Partnership Firm, LLP, Company

New Audit Engagement – Covers an **audit being conducted first time** and therefore the appointment of the Auditor is an initial appointment. It will also cover the situations where the audit for the previous period was conducted by another Auditor.

Recurring Audit Engagement – Covers the situation **where the Auditor had conducted the audit for the previous period** and is requested to conduct the audit for the subsequent period as well. In such a case, the Auditor should obtain fresh Audit Engagement Letter if the period of engagement has expired.

Changes in terms of Audit Engagement – Whenever there is a **change in the terms of Audit Engagement in the middle of an ongoing audit**, the Auditor shall adhere to the Standard and initiate a revised Engagement Letter in terms of this Standard.

Definitions:

- **“Auditor”** means a member of the ICSI who holds a valid Certificate of Practice under Section 2(2) of the Company Secretaries Act, 1980. It includes a firm or Limited Liability Partnership (LLP) registered with ICSI and whose partners are members of the ICSI.
- The term **“Management”** includes Board of Directors and persons who have been entrusted with the responsibility of governance and compliances of the Auditee like In case of Companies.
- The term **“persons who have been entrusted with the responsibility of governance and compliances of the Auditee”** include the Key Managerial Personnel as defined under Section 2(51) of the Companies Act, 2013 and senior As per Section 2(51) of Companies Act, 2013:
- **“Key Managerial Personnel”**, in relation to a company, means –
 - (i) the Chief Executive Officer or the Managing Director or the Manager;
 - (ii) the Company Secretary;
 - (iii) the whole-time Director;
 - (iv) the Chief Financial Officer;
 - (v) such other officer, not more than one level below the directors who is in whole-time employment, designated as Key Managerial Personnel by the Board; and
 - (vi) such other officer as may be prescribed.

- As per Regulation 16(1)(d) of SEBI (LODR) Regulations, 2015 : “Senior Management” shall mean officers/ personnel of the listed entity who are members of its core management team excluding board of directors and normally this shall comprise all members of Management one level below the Chief Executive Officer/Managing Director/ whole time Director/ Manager (including Chief Executive Officer/Manager, in case they are not part of the board) and shall specifically include Company Secretary and Chief Financial Officer:

4. AUDITING STANDARD ON AUDIT ENGAGEMENT (CSAS-1)

Pre-Engagement

- i. Pre engagement meeting is a , meeting Before accepting the Audit Engagement.
- ii. The meeting may include discussion about the terms of engagement, prior year audit findings and conclusions, appropriateness of reporting framework, understanding Auditee’s business operations and environment including internal control system, commercial terms of the audit and the timelines and milestones, if any, for conducting the Audit and submission of the Audit Report.
- iii. The Auditor shall be under Confidentiality obligation with respect to the information obtained during the pre-engagement meeting.

Appointment

Before accepting an audit, the Auditor shall furnish a certificate to the Appointing Authority that:

- a. The number of audits are within the ceiling prescribed by the ICSI as specified in para 2 of CSAS 1.
- b. No substantial conflict of interest as defined in para 3 of CSAS-1 exists with the Auditee.
- c. There is no restriction to render the professional services under ICSI Guidelines.
- d. He is not debarred to undertake such audit under any law or under the disciplinary mechanism of the ICSI.

Example

Section 179(3)(k) of Companies Act, 2013 read with Rule 8(4) of Companies (Meeting of Board and its Powers) Rules, 2014 requires that the Internal Auditor and Secretarial Auditor of the company shall be appointed by passing a resolution at a duly convened meeting of the

Board. Therefore, the appointment of Internal Auditor/Secretarial Auditor cannot be made by passing a resolution by circulation. Further, the said appointment cannot be made by Key Managerial Personnel or Senior Management, even if authorised by the Board in this regard

The Auditor shall obtain an Audit Engagement Letter along with a copy of the resolution and shall provide acceptance to the Appointing Authority. The Auditor may give his acceptance to undertake the audit either on the copy of the Audit Engagement letter or through a separate letter.

Audit engagement letter

- i. The engagement letter contain terms and conditions with respect to the scope of the Audit Engagement and roles & responsibilities between the Auditor and the Auditee.
- ii. It is in interest of both the management and the auditor that the auditor should get an audit engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the terms of engagement.
- iii. It should be reviewed every year to ensure that it is up to date but does not need to be reissued every year unless there are changes to the terms of the engagement.
- iv. The auditor shall obtain a new engagement letter if the scope or context of the assignment changes after initial appointment.
- v. It documents the terms of Audit Engagement agreed between the Auditor and the Appointing Authority with reference to scope of audit, responsibilities of Auditor and Auditee, remuneration and limiting conditions.

The Audit Engagement

Letter shall include:

- a. The objective and scope of the audit;
- b. The responsibilities of the Auditor and the Auditee;
- c. Written representations provided and/or to be provided by the Management to the Auditor, including particulars of the Predecessor or Previous Auditor;
- d. The period within which the audit report shall be submitted by the Auditor, along with milestones, if any;

- e. The commercial terms regarding audit fees and reimbursement of out of pocket expenses in connection with the audit; and
- f. Limitations of audit, if any.

The Responsibilities of Auditor inter alia include the following:

- To take up the audit as per the terms of the engagement.
- To depute personnel who have the knowledge of the laws under which the audit is being carried out, subject to his overall supervision.
- To observe and ensure observance of highest standards of ethics and maintain utmost professionalism at all times by the employees, staff and other team members involved in the Audit and persons engaged by him to provide advice or assistance for the conduct of audit.
- To maintain and ensure confidentiality by the employees, staff and other team members involved in the audit and persons engaged by him to provide advice or assistance for the conduct of audit.
- To not trade in securities relating to which unpublished price sensitive information has come to his/ her knowledge during the course of audit, which responsibility shall extend to the employees, staff and other team members involved in the audit and persons engaged by him to provide advice or assistance for the conduct of audit also.

Responsibilities of Auditee inter alia include:

- To provide access to premises of the Auditee and timely access to Records, documents, legal opinions, show cause notices, inspection reports and other information, explanations and reports as may be necessary in connection with the audit.
- To identify and depute a responsible official to timely provide relevant documents, information and explanations required by the Auditor.
- To provide written Management representations, if any, to the Auditor during the course of audit, which shall provide the Auditor a substantive evidence of important assertions and the Management's primary responsibility for the assertions and its accuracy.
- To provide details of the Predecessor or Previous Auditor, so as to enable proposed Auditor to communicate with the Predecessor or Previous Auditor.

Audit remuneration and expenses may depend on several factors including:

- Size of the organisation;
 - Location of business and its branches;
 - Type of company (Listed/Unlisted);
 - Sector to which company belongs;
 - Nature of business;
 - Internal control mechanism;
 - Scope of Audit Engagement;
 - Frequency of audit, whether monthly, quarterly, yearly;
 - Type of audit, whether sole, joint or concurrent audit;
 - The experience of the Auditor in conducting audits;
 - Estimated man-hours required to complete the assignment;
 - Guidance/Advisory issued by the ICSI, if any;
 - Any other term or a combination of any of the above.
- i. Auditor should include a statement in the Audit Engagement Letter that because of inherent limitations of an audit, inherent limitations of internal control, an unavoidable risk exists that some material non-compliance may not be detected, even though the audit is properly planned and performed in accordance with the applicable Auditing Standards.
- ii. Audit Engagement Letter should specify the involvement of third party and experts in some aspects of the Audit.
- iii. If the **Appointing Authority has imposed a limitation** on the scope of the Auditor's work in the terms of engagement and the Auditor believes that **such limitation will not give assurance** than what is required under law, **the Auditor shall not accept such an engagement**, unless required by law or regulation to do so.

Communication to Previous Auditor

As a measure of the professional etiquettes, while taking up the any audit engagement, **the auditors shall give intimation to the previous auditor**, intimating his engagement as auditors of the company.

The term **predecessor or previous auditor** can be defined as an auditor who has conducted the most recent audit assignment of the Auditee of the same nature and submitted report thereon

prior to the incumbent auditor or was engaged but did not complete the audit assignment due to his resignation, termination or otherwise.

Example:

Mr. P was appointed as the Secretarial Auditor of ABC Ltd. for the F.Y. 2019-20. However, during the course of audit, he intimated the Appointing Authority his inability to complete the audit of ABC Ltd. and therefore cannot give audit report thereon. ABC Ltd. accepted the request of Mr. P and approached Mr. Q to become the secretarial Auditor for F.Y. 2019-20. In such case, Mr. Q has to first communicate to the Predecessor Auditor i.e. Mr. P of his intention to accept the secretarial audit assignment of ABC Ltd. and wait for 7 days from the date of intimation to Mr. P, before accepting the secretarial audit of ABC Ltd. for F.Y. 2019-20.

There should be an effective communication with the Predecessor or Previous Auditor, if any. Auditor should communicate with the Predecessor or Previous Auditor in such manner as to retain positive evidence of the delivery of the communication. Communication with predecessor can be by a letter sent by Registered Acknowledgement Due or by courier or by hand against the written Acknowledgement or through an email to provide an evidence of the delivery of communication.

The Auditor shall wait for a period of 7 days from the date of communication before accepting the audit. In case any information is provided by the Predecessor Auditor, the Successor Auditor shall take cognizance of the same. The information obtained from the Predecessor may be useful in undertaking the audit. Such information shall remain confidential.

CASE STUDY

1. XYZ Limited is a listed company and recently hired a new secretarial auditor firm (M/s AA & Associates) to replace the previous auditor firm (M/s BB & Associates), who had been serving the company for two years. The M/s AA & Associates was made responsible for ensuring compliance with various regulations and guidelines and preparing audit report.
2. The primary challenge faced by XYZ Limited was to smoothly execute the transition of responsibilities between new and old auditors to communicate effectively with the M/s BB &

Associates. This was crucial, as the new auditor would need access to all previous records, reports, and other information related to the company's secretarial audit

3. To address this challenge, the company's management decided to set up a meeting between the M/s AA & Associates and the M/s BB & Associates. During the meeting, the new auditor would have the opportunity to ask any questions, clarify any doubts, and obtain access to all relevant records and reports.
4. The communication between the previous secretarial auditor and the new auditor was successful as a written communication in form of email has been made by M/s AA & Associates to previous auditor, and the M/s AA & Associates was able to obtain all necessary information to perform their duties effectively. The information provided by the previous auditor was extremely useful, as it helped the new auditor to identify any areas of concern and address them promptly.

The Council of the Institute of Company Secretaries of India has resolved that it shall be **mandatory for every Company Secretary in Practice**, before accepting any of the following assignments, to **communicate to the previous incumbent**, in terms of terms of clause (8) of part I of the First Schedule to the Company Secretaries Act, 1980:

- i. **Signing of Annual Return in Form MGT-7** under Section 92(1) of the Companies Act, 2013 and rule 11(1) of the Companies (Management and Administration) Rules, 2014.
- ii. **Certification of Annual Return in Form MGT-8** under Section 92(2) of the Companies Act, 2013 and rule 11(2) of the Companies (Management and Administration) Rules, 2014.
- iii. Issuance of **Secretarial Audit Report in terms of Section 204** of the Companies Act, 2013.
- iv. Issue of Secretarial Audit Report to material unlisted subsidiaries of Listed entities (whose equity shares are listed) under **Regulation 24A of SEBI (LODR) Regulations, 2015**.
- v. Issue of **Annual Secretarial Compliance Report** to Listed entities (whose equity shares are listed) under **Regulations 24A of SEBI (LODR) Regulations, 2015**.
- vi. **Certification under SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015** that none of the directors on the board of the company have been **debarred or disqualified from being appointed or continuing as directors of companies** by the Board/ Ministry of Corporate Affairs or any such statutory authority under Schedule V, Part C, Clause (10)(i).

- vii. Certification under *Regulation 40(9) of SEBI (LODR) Regulations, 2015* certifying that all certificates have been issued within thirty days of the date of lodgement for transfer, sub-division, consolidation, renewal, exchange or endorsement of calls/ allotment monies.
- viii. Conduct of *Internal Audit of Operations of the Depository Participants registered with NSDL & CDSL* under the provisions of the Depositories Act, 1996 read with SEBI (Depositories and Participants) Regulations, 1996.
- ix. *Certificate of Reconciliation of Share Capital Audit.*
- x. Issuance of Audit Report as provided under *Regulation 76 the SEBI (Depositories and Participants) Regulations, 2018*, by the unlisted public companies, to be submitted on a half-yearly basis to the ROC, under whose jurisdiction the registered office of the company is situated, under the provisions of the Rule 9A(8) of the Companies (Prospectus & Allotment of Securities) Rules, 2014.
- xi. *Diligence Reporting for Banks* in case of multiple banking/consortium lending arrangements in terms of the circular issued by RBI.
- xii. *Conduct of Internal Audit of Depository Participants.*
- xiii. Conduct of Internal Audit of stock brokers/sub brokers under SCRA, 1956 and Rules and Regulations made thereunder.

Further, Council of ICSI has prescribed the following format to be issued by Company Secretaries under Clause 8 of the First Schedule of the Company Secretaries Act, 1980:

CS.....

Address

Dear Sir / Madam,

Sub.: Intimation in terms of Clause 8 of the First Schedule to the Company Secretaries Act, 1980.

I, CS /We, M/s., Company Secretary in Practice / Firm of Company Secretaries have been

approached by the Management of M/s..... Limited to..(list of professional services) for the FY

..... vide their letter No. dated..... We understand that earlier the abovementioned professional

services were being rendered by your goodself/ firm to M/s. Limited during the Financial Year

I / We request you to kindly take this communication as an intimation to be given to the previous incumbent in terms of Clause 8 of the First Schedule to the Company Secretaries Act, 1980.

Regards, CS

Membership No.ACS / FCS

CoP No.....

For & Co./ & Associates, Company

Secretaries Firm Unique Code

Date:

Place:

Limits on Audit Engagements

Auditor should conduct as many audit as per the limit prescribed by ICSI. Violation of the limits by the auditor may attract disciplinary actions against the auditor. To uphold the quality of services rendered by members of the Institute, the Institute has issued the following guidelines:

Guidelines	Guidelines Issued at
<p>Limits for the issue of Secretarial Audit Reports:</p> <ul style="list-style-type: none"> ● 10 Secretarial Audits per partner/ PCS, and ● an additional limit of 5 Secretarial Audits per partner/PCS in case the unit is peer reviewed. <p>The limits will be applicable for the Secretarial Audit Reports issued for the FY2016-17 onwards)</p>	235th meeting of the Council held on 11th February, 2016
<p>Number of Annual Secretarial Compliance Reports to be issued by PCS are 5 (five) reports individually / per partner in each financial year w.e.f. 1st April, 2020 and an additional limit of 5 (five) ASCR individually/ per partner in case the unit has been Peer Reviewed.</p>	260th meeting of the Council held on 4-5 May, 2019
<p>In case of the following, Secretarial Audit/ Secretarial Compliance Report to be done by Peer Reviewed Units only:</p> <ul style="list-style-type: none"> ● Top 100 companies as per market capitalization w.e.f April 1, 2020 ● Top 500 companies as per market capitalization w.e.f April 1, 2021 ● All listed companies w.e.f April 1, 2022 ● All companies w.e.f April 1, 2023 	259th meeting of the Council held on 16th March, 2019

5. CONFLICT OF INTEREST

- i. CSAS-1 (Auditing Standard on Audit Engagement) effective from 1st April, 2021, defines: "Conflict of Interest" as: *The Auditor shall not have any substantial conflict of interest with the Auditee. Any conflict of interest, other than substantial conflict of interest, must be disclosed by the Auditor before accepting the Audit Engagement or as soon as the Auditor becomes aware of the same, as the case may be.*
- ii. The conflict of interest with the Auditee explained below shall not be construed as a substantial conflict of interest:
- Auditor holding *not more than 2% paid up share capital or shares of nominal value of Rs. 50,000, which ever is lower or more than 2% voting power.*
 - Auditor *indebted to the Auditee for an amount not exceeding Rs. 5,00,000.*

Illustration 1 Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. B holds 1% paid-up share capital in a company XYZ Ltd. Wife and daughter of Mr. A, who are financially dependent on him hold 1% paid-up share capital in XYZ Ltd. each. Mr. A has been offered the Secretarial Audit of XYZ Ltd. In this case, Mr. A is not directly holding any interest in XYZ Ltd. However according to para 3.1 of CSAS-1, Mr. A is having a substantial conflict of interest in XYZ Ltd. as the aggregate value of paid-up share capital held by his wife, daughter and partner in XYZ Ltd. is 3%. Hence, he is not eligible to become Secretarial Auditor of XYZ Ltd.

Illustration 2 Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. A holds 1% paid-up share capital in a company XYZ Ltd. and Mr. B holds shares of nominal value of Rs. 60,000 in XYZ Ltd. Mr. A has been offered the Secretarial Audit of XYZ Ltd.

In this case, though Mr. A holds only 1% of the paid up share capital in XYZ Ltd. But according to para 3.1 of CSAS-1, he is having a substantial conflict of interest in XYZ Ltd. as his partner Mr. B is having a share capital of nominal value of more than Rs.50,000 in XYZ Ltd. and therefore Mr. A is not eligible to become Secretarial Auditor of XYZ Ltd.

Illustration 3 Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. A & Mr. B each holds 0.5% paid-up share capital in a company XYZ Ltd. Nominal value of such shares held by each of them is Rs. 20,000. Mr. A has been offered the Secretarial Audit of XYZ Ltd.

In this case, though Mr. A is having a conflict of interest in XYZ Ltd. The same will not be considered as a substantial conflict of interest. Therefore, Mr. A can accept the Secretarial Audit of XYZ Ltd. In this case he shall disclose to the Appointing Authority the fact that he has a conflict of interest with the company, but the same is not substantial conflict of interest in accordance with CSAS-1.

Illustration 4 Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. A holds 1% of the paid-up share capital in company XYZ Ltd. Nominal value of such shares is Rs. 60,000. The market value of the shares held by Mr. A is Rs. 40,000. Mr. A has been offered the Secretarial Audit of XYZ Ltd. In this case, there will be a substantial conflict of interest between Mr. A and the company XYZ Ltd. as the nominal value of shares held by Mr. A is more than Rs. 50,000, therefore he cannot accept the Secretarial Audit of XYZ Ltd. The market value of the shares is irrelevant while deciding the conflict of interest based on ownership in accordance with CSAS-1.

Illustration 5 Mr. A, Mr. B and Mr. C are partners in ABC, LLP, a firm of Practicing Company Secretaries. Mr. A holds 1% of the paid-up share capital in company XYZ Ltd. Nominal value of such shares is Rs. 60,000. XYZ Ltd. wants to give its Internal Audit assignment to ABC, LLP.

In this case, there exists a substantial conflict of interest of ABC, LLP with the company XYZ Ltd. due to the fact that one of the partners of the LLP is holding shares of a nominal value of more than Rs. 50,000 in XYZ Ltd. Therefore, it will not be eligible to undertake the internal audit assignment of XYZ Ltd. as per CSAS-I.

Indebtedness of the Auditor for an amount exceeding rupees five lakh other than that arising out of ordinary course of business of the Auditee:

Provided that any indebtedness that may seriously impair his independence shall also be considered as substantial conflict of interest. Before accepting the audit the Auditor shall disclose that there is no conflict of financial interest as specified in this standard or prescribed law under which the audit is carried on.

The limit of rupees five lakh as specified shall be applicable to the combined indebtedness of the audit firm including indebtedness by the partners in their individual capacity.

Illustration 1 Mr. A is a Practicing Company Secretary. He has taken a personal loan of Rs. 5,00,000 from a XYZ LLP wherein Mr. B, who is the designated partner is friend of Mr. A. The payment of such loan is still outstanding in full. Mr. A has been offered to undertake the Internal Audit of XYZ, LLP.

In the given case, Mr. A has a conflict of interest in XYZ LLP, but it doesn't debar Mr. A from undertaking the Internal Audit of XYZ LLP. Mr. A shall disclose the fact to the Appointing Authority before accepting such Audit.

Illustration 2 Mr. A is a Practicing Company Secretary. He had taken a personal loan of Rs. 5,00,000 from XYZ Ltd. wherein his uncle is Managing Director. Mr. A has been offered to undertake the Secretarial Audit of XYZ Ltd.

In the given case, Mr. A has conflict of interest with the Auditee, as the amount of indebtedness is Rs. 5,00,000, but the same is not considered as substantial conflict of interest. In this case, he is required to make disclosure of the fact to Appointing Authority.

Illustration 3 Mr. P is a Practicing Company Secretary and is offered to conduct the Secretarial Audit of ABC Ltd. Mr. P is indebted to the Director of the company for an amount Rs. 6,00,000. Whether he can accept the Secretarial Audit Engagement of ABC Ltd.

In the given case, Mr. P has a substantial conflict of interest in ABC Ltd. And therefore he can't accept the secretarial audit assignment.

Illustration 4 Mr. A is a Practicing Company Secretary. He had taken a personal loan of Rs. 25,00,000 from XYZ Ltd.. He has used such loan towards purchase of his house which has been mortgaged with XYZ Ltd. Due to some financial crisis, Mr. A has not been able to repay any amount towards the loan since past 2 years. Mr. A has been offered to undertake the Secretarial Audit of XYZ Ltd.

The circumstances of the case suggest that indebtedness of Mr. A towards XYZ Ltd. is such that, if he accepts the Audit of XYZ Ltd., it may substantially impair the independence of Mr. A while forming an opinion on the basis of his audit findings and therefore considered as substantial conflict of interest. Therefore in this case, Mr. A shall be debarred from accepting the Secretarial Audit assignment of XYZ Ltd.

Where an Auditor was in employment of the Auditee, its holding or subsidiary company and 2 (two) years have not lapsed from the date of cessation of employment, the same shall be considered as substantial conflict of interest.

A PCS or member/partner of a PCS firm cannot undertake the audit of that undertaking where the member was in employment prior to holding the Certificate of Practice, unless two years have lapsed from the date of cessation of employment.

Illustration 1 Mr. A was the Company Secretary of PQR Ltd. from 1st October, 2015 till 31st May, 2018. He left the job w.e.f. 31st May, 2018 and joined in ABC and Associates (CS Firm) as a partner. On 1st January 2020, ABC and Associates has been offered to conduct Secretarial Audit of ST Ltd. for the F.Y. 2020-21. ST Ltd. is the wholly owned subsidiary of PQR Ltd.

According to para 3 of CSAS-I, Mr. A or ABC and Associates, in which he is a partner cannot undertake any audit assignment in PQR Ltd. and/or its holding or subsidiary companies till 31st May, 2020, i.e. two years from the date of cessation of his employment in PQR Ltd. Therefore, ABC and associates cannot undertake the Secretarial Audit assignment of ST Ltd. for the F.Y. 2020-21.

Illustration 2 Mr. A was the Company Secretary of PQR Ltd. from 1st October, 2015 till 31st May, 2018. He left the job w.e.f. 31st May, 2018 and joined ABC and Associates (CS Firm) as an employee. On 1st January 2020, ABC and Associates has been offered to conduct Secretarial Audit of ST Ltd. for the F.Y. 2020 -21. ST Ltd. is the wholly owned subsidiary of PQR Ltd.

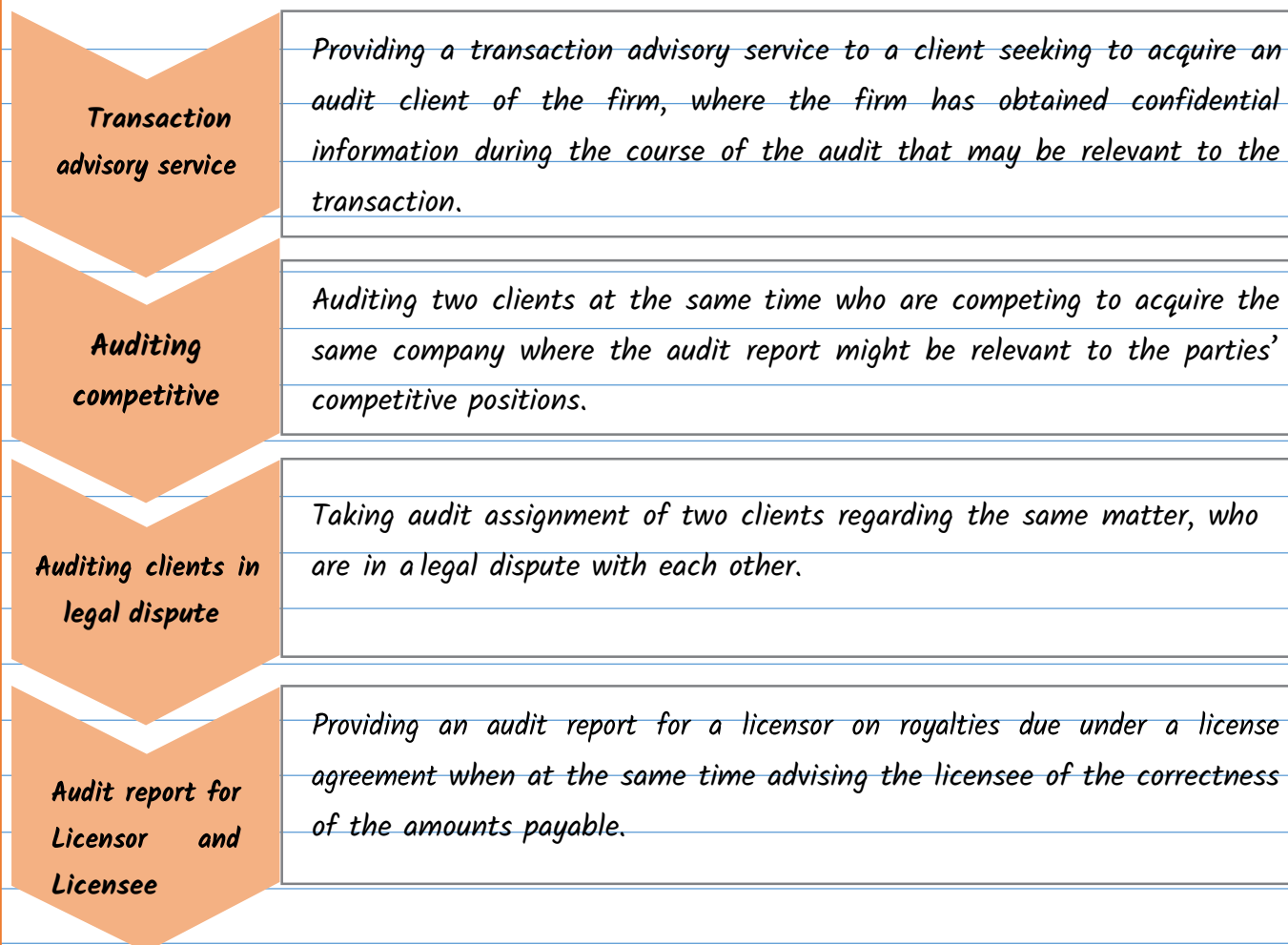
Since Mr. A has joined ABC and Associates in the capacity of an employee, ABC and associates can undertake the Secretarial Audit assignment of ST. Ltd. for the F.Y. 2020-21.

Effect of Substantial Interest

- i. The Company Secretaries Act, 1980 makes it an act of misconduct for a Company Secretary to express an opinion on any report or statement of a business or enterprise in which he or his firm or a partner of his firm has a substantial interest, unless he discloses the interest also in his report.
- ii. The Companies Act, 2013 does not define the phrase "substantial interest". This should be left to the judgment and discretion of the professional to determine the extent of interest which would affect his independence.
- iii. The professional must take care to see that he does not get into situations where there could be a conflict of interest and duty.

- iv. *A conflict of interest creates a threat to objectivity and may create threats to the other fundamental principles. Such threats may be created when:*
- *The professional provides a professional service related to a particular matter for two or more clients whose interests with respect to that matter are in conflict; or*
 - *The interests of the professional with respect to a particular matter and the interests of the client for whom the professional provides a professional service related to that matter are in conflict.*

An auditor shall not allow a conflict of interest to compromise professional judgment. Examples of situations in which conflicts of interest may arise include:



When addressing conflicts of interest, including making disclosures or sharing information within the firm or network and seeking guidance of third parties, the auditor shall remain alert to the fundamental principle of confidentiality.

If the threat created by a conflict of interest is not at an acceptable level, the auditor shall apply safeguards to eliminate the threat or reduce it to an acceptable level. If safeguards cannot reduce the threat to an acceptable level, the auditor shall decline to perform the audit; or shall terminate relevant relationships or dispose of relevant interests to eliminate the threat or reduce it to an acceptable level.

Before accepting a new client relationship, engagement, or business relationship, an auditor shall take reasonable steps to identify circumstances that might create a conflict of interest, including identification of:

- 5. The nature of the relevant interests and relationships between the parties involved; and*
- 6. The nature of the service and its implication for relevant parties.*

6. CONFIDENTIALITY

The Auditors of a company while performing the audit assignment access the various confidential information of the company and it is most required for the auditors to maintain the confidentiality of the auditee information.

Disclosing information

Disclosing information acquired as a result of professional relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and

Using information for personal advantage

Using information acquired as a result of professional relationships to their personal advantage or the advantage of third parties.

Inadvertent disclosures

An auditor should maintain confidentiality even in a social environment. The auditor should be alert to the possibility of inadvertent disclosure, particularly in circumstances involving long association with a business associate or a relative.

Information disclosed by a Prospective client

An auditor should also maintain confidentiality of information disclosed by a prospective client or employer.

Confidentiality within the firm

An auditor should also consider the need to maintain confidentiality of information within the firm or employing organization.

Control of Staff

An auditor should take all reasonable steps to ensure that staff under the auditor's control and persons from whom advice and assistance is obtained respect the auditor's duty of confidentiality.

- i. Clause (1) of Part I of the Second Schedule to the Company Secretaries Act, 1980 provides that a Company Secretary in practice shall be deemed to be guilty of professional misconduct, if the member – “discloses information acquired in the course of professional engagement to any person other than the Auditee so engaging him, without the consent of the Auditee, or otherwise than as required by any law for the time being in force.”
- ii. During the course of audit, Auditor receives, verifies and inspects various audit documents, evidence, representation etc. to form an opinion or to give a report. These may be confidential and privileged information that remain in possession of the Auditor and shall not be disclosed without the express authority of the Auditee.
- iii. It is the **inherent duty of the Auditor to maintain the confidentiality of any information about the Auditee or his business** that came to his knowledge as a result of performing the audit work.
- iv. If permitted by the Auditee, Auditor may disclose or share such information with any other person as may be specifically allowed by Auditee.
- v. An Auditor shall **maintain confidentiality even in a social environment**. The Auditor shall be alert to the possibility of inadvertent disclosure, particularly in circumstances involving long association with a business associate or a relative or friends etc.
- vi. If the Auditor gives any reference of the audit evidence or documents while forming the opinion in the audit report, it will be deemed to be the disclosure of information under the legal obligation or in the performance of the duty.
- vii. If during the course of audit and forming opinion, the Auditor uses the decisions of the judicial authority, it will not be treated as use or sharing of confidential information.
- viii. The Auditor shall educate his employees, staff and other team members about the importance of the confidentiality of the information available to them during the course of audit.
- ix. The Auditor shall ensure that reasonable procedures have been followed to maintain the confidentiality of the information. The Auditor shall also take a duly signed Non Disclosure Agreement (NDA) from such personnel who may have access to such confidential information.
- x. The Auditor shall also ensure that reasonable procedures and safeguards are being followed to prevent unauthorised access to such confidential information.

7. CHANGES IN TERMS OF ENGAGEMENT

- i. The Auditor shall not agree to a change in the terms of the Audit Engagement where there is no reasonable justification for doing so.
- ii. If the terms of the Audit Engagement are changed, the Auditor and the Appointing Authority shall agree on the new terms of the engagement by way of a supplementary/revised engagement letter or any other suitable form in writing.
- iii. A request from the Appointing Authority to change the terms of Audit Engagement may result from a change in circumstances affecting the need for the service or a restriction on the scope of Audit Engagement, whether imposed by Management or caused by other circumstances. The Auditor shall consider the justification given for the request, particularly the implication of a restriction on the scope of the Audit Engagement.
- iv. With mutual consent the terms of the Audit Engagement may be changed. When such changes are there, the Auditor shall obtain the supplementary/revised engagement letter with a justification for the change and it shall be duly signed by the Appointing Authority. The impact of such change on the level of assurance shall be ascertained before accepting the same.
- v. However, the Auditor should take the following precautions while accepting the change:
 - (1) The Auditor should not agree to a change in the terms of the Audit Engagement which restricts the scope of audit provided under any statutes.
 - (2) If the term of the Audit Engagement is changed when it is expected that Auditor may have to issue a modified report, such type of changes should be resisted.
 - (3) Any request to change to avoid or circumvent unfavorable Auditor's report is also unjustified and should not be accepted.
 - (4) If the terms of the Audit Engagement are changed before the completion of the audit, the Auditor should not disregard the evidences obtained prior to the change in scope of audit.

Specimen Certificate of Eligibility as Secretarial Auditor

Date:

To

The Board of Directors, Dear Sir,

Sub: Proposed Appointment as Secretarial Auditor

I/We thank you for your communication dated..... 2019 seeking my/our consent to act as the Secretarial Auditor of your company for the financial year..... I/We give my/ our consent for being appointed as Secretarial Auditor of the company.

I/we hereby confirm that:

- 1. I am/we are eligible for appointment and not disqualified for appointment as per the Companies Secretaries Act, 1980 and rules and regulations made thereunder and ICSI Auditing Standards;*
- 2. The proposed appointment is within the limits, if any laid down by ICSI;*
- 3. I/We do not have any substantial conflict of interest in terms of ICSI Auditing Standard on Audit Engagement (CSAS 1);*
- 4. I/We do not have any conflict of interest in terms of ICSI Auditing Standard on Audit Engagement (CSAS 1) Or*

I/We do have conflict of interest other than substantial conflict of interest which are as below:

Thanking you, Yours

sincerely,

Specimen Audit Engagement Letter

To,

ABC & Associates (name of Audit firm)

Company Secretaries (Address)

Dear Sir,

This engagement letter is provided in connection with (type of audit) of XYZ Ltd.

1. Scope of work

The scope of the Audit shall include (For example, in case of Secretarial Audit, the scope of audit shall be as specified in Section 204 of the Companies Act, 2013)

2. Responsibilities of Auditor

The Auditor shall carry out the audit with utmost integrity in terms of this Audit Engagement Letter adhering to the highest level of ethics and standards. The Audit shall be conducted in accordance of the requirements of the Act.

3. Duties of Auditee

Auditee acknowledges its responsibility for maintenance of Records and compliances under the applicable laws, acts, rules and regulations. Auditee acknowledges its responsibility to provide the Auditor access to Records and documents of the Auditee, reports of third party and information as may be sought by the Auditor. The Auditee shall be responsible for the correctness and appropriateness of the Records, documents and information of the Auditee.

4. Timeline

The Auditor shall submit the Audit Report for the F.Y. 20XX-XX within days of the end of the financial year. Auditor may also submit a quarterly/half-yearly review report in which the audit observations of the Auditor made during the quarter for timely redressal.

5. Commercial Terms

Audit fees for the F.Y. 20XX-XX is fixed at Rs. XXXXXXX plus applicable taxes. Fees will be billed as the work progresses. Out-of-pocket expenses by the Auditor shall be reimbursed on actual basis.

6. Confidentiality

The Auditor shall not disclose the information obtained during the course of Audit without proper and specific authority or unless there is a legal obligation or duty to disclose.

7. Indemnity

During and after the term of this Engagement, both Parties agree to protect, indemnify, defend and hold harmless other Party, and to extent required from time to time non defaulting party, its officers, agents, and employees, from and against any and all expenses, damages, claims , suits, losses, actions, judgments, liabilities, and costs whatsoever (including legal fees on a full indemnity basis) arising out of, connected with, or resulting from, defaulting Party's negligence, misrepresentation or the breach of any obligations to be performed by the other party and/or its representatives under this Engagement. In no event will either party's liability towards other party arising from the terms of this Engagement exceed the total sum of fees paid under this Engagement.

8. Any other term as may be agreed between the Auditor and the Auditee, if any

For XYZ Limited

Date

Place

Director

Director

SUMMARISED VERSION (MIND MAP)

I. FUNDAMENTAL PRINCIPLES GOVERNING AN AUDIT

A. Integrity, Independence, and Objectivity:

The inspector must be truthful and straightforward during the inspection process, should stay free from every kind of biasness and should not have any interest in the association he is inspecting, which permits him to be autonomous and fair-minded consistently.

Integrity – being trustworthy, straightforward, honest, complying with the spirit as well as the letter of applicable ethical principles, laws and regulations and respecting confidentiality except where disclosure is in the public interest or is required to adhere to legal and professional responsibilities.

Objectivity – acting and making decisions and judgements impartially, fairly and on merit without discrimination, bias, or compromise because of commercial or personal self-interest, and have given due consideration to the best available evidence.

Independence – freedom from conditions and relationships which, in the context of an engagement, would compromise the integrity or objectivity of the firm or covered persons.

B. Confidentiality:

The auditor comes across a great deal of sensitive monetary data of the association. He can't uncover any delicate data to any outsider except if it is a necessity by law.

C. Skill and Competence:

The examiner should be capable, prepared & qualified for conducting any audit. He should be aware and upgrade on the latest changes, declarations and rules. He should keep up to date with the new accounting and auditing methodology.

D. Work Performed by Others:

The extent of an audit on occasion can be extremely immense. So an auditor can utilise his representatives, delegates, and others who work under him. However the auditor, will be completely liable for the work done by these individuals working for him. Hence the auditor should cautiously oversee and audit such work.

E. Documentation:

The examiner keeps a review notepad, a review or audit plan, and an evaluating document or an audit file. It is significant the auditor tracks significant reports for his review work, as it is proof of the work the evaluator has completed.

F. Planning:

A review plan permits the inspector to arrange his work and empowers him to conduct the audit more efficiently.

G. Audit Evidence:

The auditor needs enough evidence for the final evaluation. This evidence is collected through substantive and consistency methods. There are two origins of this proof – inward or internal and outer or external.

H. Accounting Systems and Internal Controls:

The auditor must ensure that the organization's records are accurate and provide a true and fair picture of its financial status. Additionally, they need to make sure that all important information is recorded in the accounting records.

I. Audit Conclusions and Reporting:

Once the auditor gathers all evidence, they should form their opinion based on the following principles:

- All applicable bookkeeping guidelines were applied consistently.
- Budget reports are consistent with all guidelines and legal prerequisites.
- All material data has been revealed.

- **Materiality:** An auditor is conducting an audit of a company's financial statements. The auditor determines that a certain error in the financial statements is immaterial and does not need to be corrected. However, the error is later discovered to be material and the company faces legal action as a result. This case highlights the importance of properly assessing materiality and the potential consequences of misjudging it.
- **Risk Assessment:** An auditor is conducting an audit of a manufacturing company. During the risk assessment process, the auditor identifies a significant risk related to inventory management. The auditor then designs audit procedures to test the controls related to inventory management and discovers that there are significant weaknesses in the company's internal controls. This case highlights the importance of proper risk assessment and the need to design appropriate audit procedures based on the identified risks.
- **Lehman Brothers:** Lehman Brothers' bankruptcy in 2008 is another example of the failure of audit principles and techniques. The company's financial statements did not accurately reflect its true financial position, and its auditors failed to identify the risks associated with the company's mortgage-backed securities

2. AUDIT TECHNIQUES

Audit techniques are the methods and procedures used by auditors to obtain sufficient and appropriate audit evidence to support their audit opinion. Here are some common audit techniques used by auditors:

1. Examination of Record:

This technique is commonly used by the auditors, the inspection of books and documents is made to verify the validity of data.

2. Inquiry:

The auditor can also use the technique of inquiry. He can get the information from resource persons inside or outside the enterprise.

3. Sampling:

The auditor can choose a few items from the entire set of accounting information. This method allows them to gather and assess evidence about certain aspects of the entire group. It is useful in reaching conclusions.

4. **Confirmation:**

Confirmation is response to an inquiry to prove certain data recorded in the books.

5. **Compliance Test:**

These tests are designed to check the effectiveness and compliance of internal control. In obtaining the audit evidence, auditor is concerned with the existence of effective internal control.

6. **Use of Computer Techniques:**

There are large number of audit techniques like audit software, test packs and mapping which can be used by the auditor to test the accuracy of the data.

7. **Substantive Test:**

They are designed to obtain evidence that data produced by accounting system is accurate or not and is of two types:

- a. Test of detail transaction.
- b. Test of significant ratios and trends.

8. **Dependence on Experts and Auditors:**

The auditor has to rely on the internal and other auditors to complete his work, along with experts like lawyers, engineers and doctors for their expert opinion about the business.

9. **Analytical Review:**

It consists of studying significant ratios, trends and investigating different changes. This review procedure relies on comparing past and present data.

The selection of techniques depends on the auditor's judgment and the nature of the entity being audited.

Background: ABC Corporation, a manufacturing company producing widgets, has undergone a management change. The new CEO is concerned about the accuracy of the financial statements prepared by the previous management team. As a response, the company has engaged an independent auditor to perform a thorough audit of its financial statements.

Audit Techniques Used: The auditor initiates the audit by conducting an initial assessment of the company's internal controls. This involves reviewing accounting policies, interviewing key personnel, and walking through the accounting system to uncover any weaknesses in the internal control structure.

Based on this assessment, the auditor decides to employ a combination of audit techniques to gather sufficient and appropriate evidence for the audit opinion:

1. **Analytical Procedures:** The auditor begins by performing analytical procedures. They compare the current year's financial statements to the prior year's to identify significant changes or trends. Additionally, ratio analysis is conducted to evaluate liquidity, profitability, and financial stability.

2. **Sampling:** The auditor selects a sample of sales transactions from the company's sales ledger and tests them to verify proper recording in the accounting records. Similarly, a sample of inventory items is chosen, and a physical count is performed to validate inventory quantities and values in the financial statements.

3. **Computer-Assisted Audit Techniques (CAATs):** The auditor employs data analysis software (CAATs) to scan the accounting records for anomalies or trends that may indicate errors or fraud. The software is also used to test the accuracy and completeness of inventory and accounts payable balances.

Communication and Reporting: Throughout the audit process, the auditor maintains open communication with the company's management team. They keep the management informed about any findings or concerns that arise during the audit. At the conclusion of the audit, the auditor issues an audit opinion based on the evidence collected through the various audit techniques employed.

Outcomes: By utilizing a combination of audit techniques, the auditor successfully identifies potential risks and concerns within the financial statements. This approach allows the company to address these issues promptly, leading to improvements in the accuracy and reliability

3. PRELIMINARY PREPARATION

Preliminary preparation is an essential step in the audit process. It involves planning and preparing for the audit to ensure that the audit is conducted effectively and efficiently. Here are some of the activities that auditors typically undertake during the preliminary preparation phase:

1. **Understanding the entity:** The auditor needs to obtain a good understanding of the entity's business operations, industry, and environment. This includes *understanding the entity's organizational structure, key personnel, accounting policies and procedures, and risk management processes.*
2. **Assessing risk:** The auditor needs to assess the risks associated with the entity's business operations and financial reporting. This includes *identifying the risks of material misstatement, evaluating the effectiveness of internal controls, and determining the materiality threshold for the audit.*
3. **Developing an audit plan:** The auditor needs to develop an *audit plan that outlines the scope and objectives of the audit, the audit approach, the timeline, and the budget for the audit.*
4. **Assigning audit team members:** The auditor needs to assign audit team members *based on their experience, skills, and knowledge of the entity's business operations and industry.*
5. **Communicating with the entity:** The auditor *needs to communicate with the entity's management team to discuss the audit plan, obtain necessary information, and establish a timeline for the audit.*
6. **Developing audit programs:** The auditor needs to develop audit programs *that outline the specific audit procedures to be performed during the audit. The audit programs should be based on the audit plan and the risks identified.*

7. **Establishing an audit file:** The auditor *needs to establish an audit file to document the audit plan, the audit programs, and the evidence obtained during the audit.*

Preliminary Preparation Activities in Auditing: A Case Study on XYZ Limited

Company Overview: XYZ Limited is a small manufacturing company specializing in widget production and sales. The company has engaged an independent auditor to perform an audit of its financial statements.

Preliminary Preparation Activities: The auditor initiates the audit process by conducting various preliminary preparation activities to ensure an effective and efficient audit:

1. **Understanding Business Operations and Environment:** The auditor gains a comprehensive understanding of XYZ Limited's business operations, industry, and environment. This includes comprehending the organizational structure, key personnel, accounting policies, procedures, and risk management processes.
2. **Assessing Financial Performance and Complex Transactions:** The auditor evaluates XYZ Limited's financial performance and identifies any unusual or complex transactions that may have an impact on the financial statements.
3. **Risk Assessment:** The auditor assesses the risks associated with the company's business operations and financial reporting. This involves identifying potential risks of material misstatement, evaluating the effectiveness of internal controls, and determining the materiality threshold for the audit.
4. **Defining Audit Scope and Approach:** Based on the risk assessment, the auditor determines the scope of the audit and the approach to be taken. This helps in designing the audit plan that outlines the audit's objectives, approach, timeline, and budget. The plan aligns with the understanding of the company and the identified risks.
5. **Consulting with Management:** The auditor collaborates with XYZ Limited's management team to seek their input on the audit plan, confirm details, and establish a timeline for the audit. This ensures mutual understanding and cooperation.
6. **Assigning Audit Team Members:** The auditor assigns audit team members based on their relevant experience, skills, and knowledge of XYZ Limited's business operations and industry.
7. **Developing Audit Programs:** The auditor designs audit programs that outline specific audit procedures to be conducted during the audit. These programs are based on the audit plan and the identified risks. They ensure that the audit is comprehensive and covers all critical areas.
8. **Establishing an Audit File:** The auditor creates an organized audit file that includes the audit plan, audit programs, and evidence collected during the audit. This file structure facilitates efficient review by the auditor's supervisor or peer reviewers.

9. **Communication and Representation Letter:** The auditor communicates with XYZ Limited's management team to discuss the audit plan, collect necessary information, and establish an audit timeline. Additionally, the auditor obtains a representation letter from the management team, which confirms the accuracy of provided information.

Benefits of Preliminary Preparation: Conducting these preliminary preparation activities equips the auditor with a solid foundation to effectively plan and execute the audit. By understanding the company's operations, assessing risks, developing appropriate audit plans, and establishing communication with management, the auditor is better positioned to select suitable audit procedures that generate sufficient and appropriate audit evidence. This comprehensive approach ensures a high-quality audit process that serves to enhance the accuracy and reliability of XYZ Limited's financial statements.

4. QUESTIONNAIRE

- i. Questionnaire is a comprehensive series of questions concerning internal control. This is the most widely used from for collecting information about the existence, operation and efficiency of internal control in an organisation.
- ii. An important advantage of the questionnaire approach is that the oversight or omission of significant internal control review procedures is less likely to occur with this method.
- iii. In the questionnaire, generally questions are so framed that a 'Yes' answer denotes satisfactory position and a 'No' answer suggests weakness.
- iv. Provision is made for an explanation or further details of 'No' answers. In respect of questions not relevant to the business, 'Not applicable' reply is given.
- v. The questionnaire is annually issued to the client and the client is requested to get it filled by the concerned executives and employees. If on a perusal of the answers, inconsistencies or apparent incongruities are noticed, the matter is further discussed by auditors with the client for a clear picture and accordingly the auditor prepares a report of deficiencies and recommendation for improvements.
- vi. A questionnaire can be a useful tool for auditors to gather information from the auditee (the organization being audited) in order to gain a better understanding of the organization's operations, processes, and risks.

Here are certain points to be kept in mind as to how a questionnaire may be used in an audit:

1. **Planning the audit:** The auditor reviews the auditee's documentation and identifies areas of potential risk. The auditor designs a questionnaire that is tailored to the specific risks and issues identified.
2. **Administering the questionnaire:** The questionnaire is sent to the auditee to complete. The auditee is given a deadline to complete and return the questionnaire.
3. **Analyzing the responses:** The auditor analyzes the responses to the questionnaire to identify areas of concern and potential risk which helps the auditor to identify areas where additional information or documentation is needed.
4. **Conducting follow-up interviews:** Based on the responses to the questionnaire, the auditor may conduct follow-up interviews with key personnel to gather additional information and clarify any areas of concern.
5. **Reporting the findings:** The auditor prepares a report that summarizes the findings of the audit, including any areas of concern identified through the questionnaire and follow-up interviews.



CAN YOU SOLVE THIS?

XYZ Company Ltd is a manufacturing company that specializes in producing high-tech electronics. The company has recently experienced a decline in sales and profits, and the management team has requested an audit to identify the root cause of the problem. The auditor decides to use a questionnaire to gather information from the auditee (the company) to gain a better understanding of the company's operations, processes, and risks. Draft a questionnaire for the company

5. INTERACTION THROUGH INTERVIEWS

The main purposes for an interview in context of an audit are orientation, examination and confirmation. An interview can have one or two of these purposes, **but normally not all three at the same time.**

Orientation

- i. It is during the panning phase and a learning process for the team.
- ii. It aims at exploring and giving an overview of a specific area or function, e.g., interpretation of documents (reports, instructions or, budgets).
- iii. The objective could be to identify possible audit subjects or to find out about other available sources of information, such as key persons or documentation.
- iv. Orientation involves a less structured approach, giving the auditor flexibility to explore new themes and thoroughly examine the responses provided.
- v. The auditor generally does not have a prior hypotheses or deep knowledge of the project or activity.

Examination

- i. It aims at specific issues with a view of collecting new information which can be used as audit evidence.
- ii. Sometimes, this information hasn't been recorded before but is known by the interviewee through personal experiences or opinions. In other cases, the knowledge can be obtained through the (joint) interpretation of internal documents, reports, or records.
- iii. It should be noted that evidence obtained from interviews often needs to be corroborated by evidence from other data collection methods.
- iv. The objective is often a more focused examination of an area, in order to capture simple, factual data, to document or clarify certain points or to test hypotheses.
- v. Interviews will typically have a more structured form.
- vi. The auditor has a firm grasp of the issues he wants to cover and should know in advance what type of data he wants

Confirmation

- i. It often goes together with either orientation or examination.
- ii. Confirmation is based on information that has already been gathered.
- iii. In the planning phase, it is important to have basic conditions and facts explicitly confirmed by stakeholders. However, in the execution phase there might also be a need to confirm facts and findings. If data is incorrectly understood, the quality of the whole audit may suffer and a lot of work may be in vain.
- iv. Needs a fairly structured approach in order to have important facts and conditions verified

6. AUDIT PROGRAMME

- i. Most of the time audit is conducted by a team instead of just an individual. In smaller businesses or less complex tasks, one person can handle the entire audit. Yet, due to workload, time constraints, and other factors, multiple individuals are often necessary. In order to properly assign work to each individual and what is required to be done by whom there must be some kind of instructions set and work profile, otherwise, more than one member might be auditing the same area or in other case some areas may be left completely unaudited. Audit programs efficiently guide each person's work, ensuring an effective and thorough audit.
- iii. Audit programme **contains step by step instructions to be carried out by team members** i.e. it is simply a list of audit procedures to be executed by team members.
- iv. The **main purpose** of audit programme is that **every material area has been audited appropriately and sufficient appropriate audit evidence has been obtained** in respect of every important areas of audit.
- v. Audit programmes **are prepared on the basis of audit** plan usually by the auditor who is signing the Audit Report of the company. But sometimes, auditors have a basic audit programme and the same is used by the auditor after making some modifications according to the audit engagement in hand.
- vi. Mostly it is **in the form of a checklist** which can be used by the Audit executives to make sure every required procedure has been implemented.
- vii. The prepared audit program **may be revised if needed in accordance with the prevailing circumstances**. An audit program largely depends on the size of the organization and other relevant factors.
- viii. Audit programme **is documented in the Audit Working Papers**, which are the official record that contains the planning and execution of the audit agreement.

Difference between Audit Plan and Audit Programme

Audit Plan	Audit Programme
Audit Plan lays down the audit strategies to be followed for conducting an audit such as identifying the areas where special audit	Audit programme is an outline of how the audit is to be done, who is to do what work and within what time

consideration and skills may be necessary, obtain the knowledge of business etc.	
Plans should be made to cover the following among other things:	It lays down the following audit procedure to be followed:
(i) Acquiring knowledge of accounting systems, policies and internal control procedures	(i) Evaluation process
(ii) Establishing the expected degree of reliance to be placed on the internal control	(ii) Ascertaining accuracy
(iii) Determining the nature, timing and extent of the audit procedures to be performed	(iii) Verification of Document
(iv) Co-ordinating the work to be done	(iv) Scrutiny of supporting Documents
	(v) Checking of overall disclosure and presentation of all items in the audit completion.
	(vi) Preparation and submission of audit report.

7. IDENTIFICATION OF APPLICABLE LAWS

- i. In India, every mode of business needs to obey various laws, rules, regulations, orders etc. depending on the manner of doing business, business activities and areas of doing business. Sometimes, this may include laws from multiple countries and sometimes such laws have conflicting requirements on each other.
- ii. In such situations, the best approach is to work with legal team or with an expert to create an outline of all the regulations and contractual obligations. Identify which requirements may impact the organization and discuss the results with management to determine and development of suitable measures which are sufficient for compliance.
- iii. Further, the identification of the compliance requirements under applicable laws is just one part of the auditor, but for the management of the company it is necessary to make sure there is sufficient evidence that the company is compliant with each and every one of them.
- iv. For ensuring the compliance of the applicable laws the company:

Inventory of Applicable Laws

- should have a documented inventory of every applicable law, regulation, contractual obligation and any other form of compliance requirement which needs to comply

Publishing Compliance Policy

- should publish its compliance policy which should be supported by standards, procedures, and guidelines

Communication

- should exchange emails with legal\compliance team, functional heads, compliance officers and others with information on compliance obligations and skills (e.g. Privacy, Procurement, HR, Finance, IT) concerning compliance matters in the information security context;

Agendas Minutes etc.

- should share related agendas, minutes or notes of meetings with those people on related matters;

Internal Reports on Compliance

- should place Internal reports concerning applicable compliance obligations, ideally with evidence that management is actively engaged in assessing the extent to which compliance is needed and aware of the risks of non-compliance;

Compliance Assessment

- should conduct Compliance assessment\review\audit reports, noting the content, form, distribution, status.

For an auditor and the company, it is required to identify the applicable legal requirement of act, regulation but should also identify the sections applicable under such regulation.

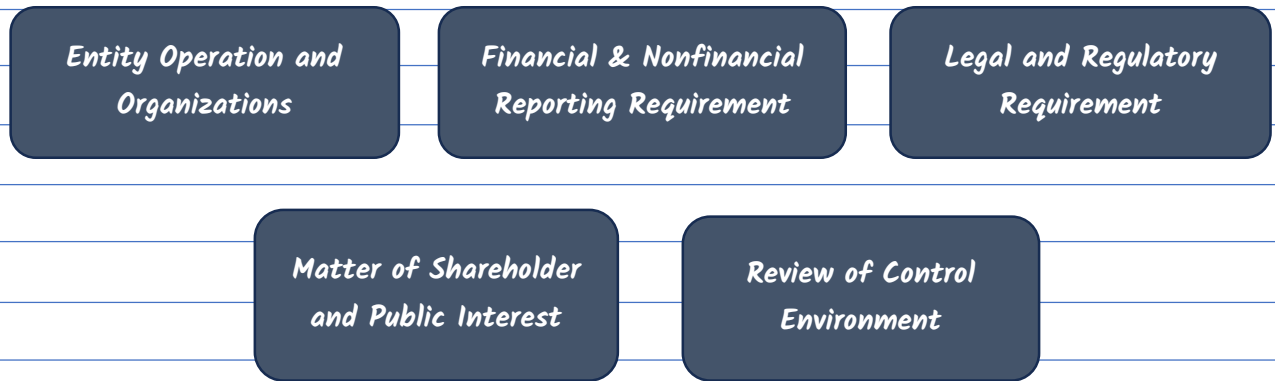
Further, the legal compliance for a holding company/subsidiary company/joint venture company with diverse operations, the compliance requirement will vary from operation to operation based on the nature of the operations and the locations of the different operation and also based on the applicable legal instruments, and the applicable sections of the relevant laws referred in those legal instruments. The diverse operation and different geographical location may create a complexity in compliance.

Dealing with the amendment in the laws is another concern in fulfilling compliance requirement, which requires that the company should keep up to date information on the compliance requirement with an information of the changes in the laws and regulations. Further, the legal team of the company should continuously communicate the effect of such changes on the Company, its holding, subsidiary, Joint Venture Company or any of the geographical area where the company operates.

Some of the regulators like MCA, RBI, SEBI, on time to time issue the Master Circulars, and Master Direction, Removal of Difficulties Order etc., which helps in identifying and figure out the actual requirement of the law which needs to be complied with.

8. CREATION OF MASTER CHECKLIST

- i. The Audit is not a process of the collecting data and checking the checkbox, it **is the postmortem of the affairs of the company.**
- ii. The data and **evidence collected** during the execution of the audit **shall be independently reviewed by the auditor** and submit its report to the shareholders. Unless the auditor independently reviews the facts & data, the auditor is not able to give his independent opinion.
- iii. Simply **having a control chart doesn't guarantee compliance** or lead to substantial, lasting process improvement to complete the audit.
- iv. Typically, an **audit checklist can be categorized into different headings** based on their importance in the audit scope.



1. Entity operation and organizations:

This checklist contains the matters relating to:

- Product manufactured/ service delivered/ operation performed by the company
- Statutory status basis for these operations
- Objects of the company as per the memorandum of association
- Capital structure of the company and funding status
- Details of the promoters and directors of the company
- Details of subsidiaries, joint ventures and associate companies
- Transactions with the related parties
- Material changes took place during the audit period
- Recipient of the products/services of the company
- Details of the key managerial personnel
- Details of the functional head responsible for audit
- Details of the audit committee and its term of references
- Details of the geographical location where the company operates
- Audit observations of the previous year's etc.

2. Financial & Non-financial Reporting Requirement

In case of financial disclosures, the audit team should familiarize itself with the format of financial statement which needs to be submitted to the regulators which covers the points relating to changes in laws, regulations, accounting standards, accounting rules or accounting

policies since the last audit, new heads of accounts introduced since the last audit, changes in the format of accounts or any such item which require exercising of judgement or estimation.

In case of the non-financial disclosures the audit team should have the detailed requirements under legal and regulatory framework along with the procedural requirements of the same. The auditor should check the limits, eligibility, criteria etc. on the various dates to understand the compliance requirement.

3. Legal and Regulatory requirement

The legal and regulatory requirement of every company differs according to the nature and status of the company, its business activity, area of operation, geographical location etc. depending on the relevant central, state and local laws, rules & regulations.

4. Matter of Shareholder and public interest

The audit team should identify the extent of the shareholder and public interest in the company's activities and the financial statement. The factors which might indicate such interest includes the public deposit, loan and advances dividend, corporate social responsibility, small shareholders interest, high level of comment in media etc.

5. Review of Control Environment

- i. The control environment comprises the conditions under which the various process of the entity are designed, implemented and functions and based on that the audit team should seek to arrive at a conclusion as to whether the control environment is reliable and justifiable in accordance with the size and operations of the company.*
- ii. If based on the understanding of the control environment, the audit team has fundamental doubts about the effectiveness of the prevailing systems and controls, the same should be reported to the entity and should be kept in mind while carrying the audit.*
- iii. The checklist shall contain the checkpoints relating to following:*
 - The operating environment and culture*
 - Management commitment to designing and maintaining reliable accounting systems*
 - The ability of management to control the operations*

- The organizational structure of the entity
- Methods of assigning authority and responsibility
- Supervision and monitoring
- Senior management control methods.

9. WORKING PAPERS AND MAINTENANCE OF WORK SHEET

• Working Papers

- i. The working paper file contains the documents relating to the work performed by the auditor.
- ii. The working papers serve as the connecting link in between the audit assignment, the auditor's fieldwork and the final report.
- iii. Working papers contain the records of planning and preliminary surveys, the audit program, audit procedures, fieldwork, fact findings and other documents relating to the audit.
- iv. In the working papers document the auditor's conclusions and the reasons as to why those conclusions were reached should be documented.
- v. Audit working papers are used to support the audit work done in order to provide assurance that the audit was performed in accordance with the applicable standards. (Auditing standards).
- vi. Working papers include all the evidence gathered by auditor indicating what work has been done by him and provide information that whether:
 - a. audit was properly planned;
 - b. audit was carried out;
 - c. audit was adequately supervised;
 - d. the appropriate review was undertaken;
 - e. the evidence is sufficient and appropriate to support the audit opinion.
- vii. The working papers may include:
 - a. Scanned Documents as working papers
When you are scanning a document, it should be noted where they came from and why, this helps understand the audit work better.

b. Tick marks

Tick marks do not need to be standardized throughout the set of working papers, but must be consistent throughout a particular work paper. Tick mark explanations must be a part of the working paper or included in a separate tick mark legend work paper.

c. Cross Referencing

- i. Cross-references *should be used to refer information useful in more than one place.*
- ii. Cross referencing *is an audit technique used to compare and match data from different sources to ensure accuracy and completeness.* This technique is especially useful when auditing financial statements and transactions, as it helps to identify any discrepancies or errors in the data.
- iii. A cross reference from the Audit Procedures to the primary working paper provides a reference to where the work was performed. It is not necessary to cross refer all work papers to the Audit Procedures - only the primary work paper should be cross referred.

There is a scenario where an auditor is conducting an audit of a company's financial statements. As part of the audit process, the auditor is comparing the company's bank statements with its accounting records to ensure the accuracy of financial transactions. One payment of Rs 10 Lacs to a vendor is identified as a discrepancy because it doesn't match any recorded vendor payment in the company's accounting system.

To investigate this discrepancy, the auditor uses a technique called cross referencing. Cross referencing involves comparing data from different sources to identify inconsistencies or errors. In this case, the auditor cross references the bank statement with the company's accounting records. The auditor first identifies the check number on the bank statement and searches for it in the company's check register. It's discovered that the check was issued to a different vendor for a different purpose than what was recorded on the bank statement. To further investigate, the auditor reviews the company's invoices and purchase orders to determine if there were any other payments made to the vendor listed on the bank statement.

It's found that the vendor did provide services to the company, but the payment was not correctly recorded in the accounting system.

The text then mentions that cross referencing is beneficial for ensuring the accuracy and completeness of financial statements. However, a question is posed regarding which of the provided benefits is not associated with cross referencing, and the correct answer is identified as (D) "All information in one document."

In summary, cross referencing is a technique that helps auditors identify discrepancies and errors by comparing data from various sources. It ensures the accuracy of financial records and can lead to necessary adjustments to the financial statements to correct any inconsistencies

d. Standard Working papers

A standard set of working papers will include at least the following documents:

(a) General File:

- i. The General File contains key information through the various phases of the audit including planning (audit objectives, planning comments including etc.), reporting process, audit programs and comments for the next audit.
- ii. The General File will include the draft and final reports.
- iii. Audit responses will also be included in the file.

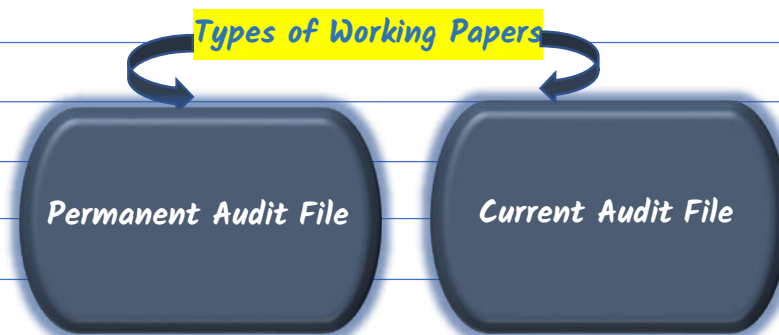
(b) **Work paper File:** This file should contain the detailed audit procedures and detailed audit working papers. Detailed audit procedures provide detailed audit steps of the audit work to be performed during fieldwork that will achieve the specific audit objectives outlined in the audit program.

(c) **Future Audit Considerations:** Auditors are encouraged to develop and document future audit ideas during the course of their work. These should be included in the "Comments for next audit" section of the general file.

Thoda Extra gyaaannnn..... Swaad Anusaaar (Short Note)

- i. Working papers are the connecting link between the client's records and the audited records.
- ii. These provide permanent historical record and serve as a great guide to the staff to whom the work of audit has been assigned after the previous year audit.
- iii. These would come to the help of the auditor in future in case the client files a suit against the auditor's negligence.
- iv. The working papers are the property of the auditor and the client cannot ask the auditor for their custody. However, it is the duty of the auditor to maintain confidentiality of the client information.





The auditor's working papers are divided into two parts:

(i) Permanent File

The permanent file usually contains documents and matters of continuing importance of clients' business which will be required for more than one audit. The data in these files are the information, which is of continuous interest and relevant to succeeding audits. Data in this file can include the following:

A. Statutory Documents

B. The rules and regulations of the company:

- i. Memorandum of Association.
- ii. Articles of Association.
- iii. Certificate of Incorporation/Commencement of Business.
- iv. Registration documents under various statutory bodies.

C. Copies of documents of continuing importance and relevance to the auditor:

- i. Letter of engagement and Board Resolution for appointment of the auditor.
- ii. Record of communication with the retiring auditor.
- iii. Royalty Agreement/Technical collaboration.
- iv. Copies of important legal documents/contracts.

D. Addresses of the registered office and business -The Company's registered office address and all other units/premises, with a short description of the work carried on at such places.

E. An organization chart - Details of all departments and sub-divisions thereof showing hierarchy of management.

- F. **List of books and records with location** - List of books and records maintained by the company and place of their location. Names, positions, specimens of signatures and initials of persons responsible for books and document should also be included.
- G. **An outline history of the organization.**
- H. **Analysis of significant ratios and trends.**
- I. **Internal Controls** - Notes on internal control with Details of study & evaluation of internal controls in the form of narrative record, questionnaires or flow charts etc.
- J. **The business structure within a group and associated companies** - List of all holding, subsidiary and associate companies.
- K. **Company's advisors** - list of the company's advisors such as bankers, merchant bankers, stockbrokers, solicitors, valuers, insurance brokers etc.

(ii) Current Audit File

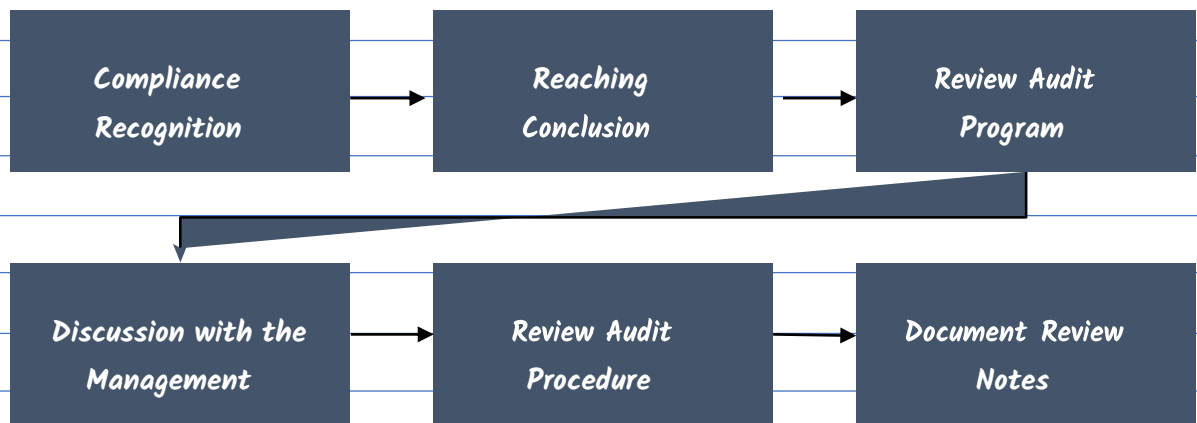
These file contains information relating to the audit of the current period.

- A. Appointment letter for the Current Year, along with the defined scope of Audit;
- B. Extracts of important board/management meetings;
- C. List of responsible persons with their designation and contact details;
- D. Secretarial Audit Report/Financial Audit Report for current year as well as previous year;
- E. Actions initiated by company towards Secretarial Auditor's observations and suggestions in previous years reports;
- F. Audit Plan/Audit Program;
- G. Current year's Secretarial Records;
- H. Communications with the company/management team;
- I. Letters of representations, confirmations received from company;
- J. Audit review points and highlights of analysis.

e. Working paper Review

The auditor should review all working papers to determine whether they are relevant and have a useful purpose, evidence the audit work performed and sufficiently support the audit findings.

The review will consist of:



- (a) Determining compliance with working paper guidelines.
- (b) Reviewing the audit program that outlines the major objectives of the audit, and ensure that the procedures accomplish the objective(s).
- (c) Reviewing the audit procedures and the referenced working papers to ensure the working papers support the procedures performed and all procedures have been completed.
- (d) Determine that the working papers adequately are documented and the conclusions reached in the report.
- (e) Ensuring that all findings prepared have been discussed with the appropriate member of management, and that the disposition of the audit concerned is documented.
- (f) Documenting review notes.

Filing and Protection of Working papers

All working papers that are considered confidential, are the property of the Auditor, and are to be kept under adequate control. Working papers often contain sensitive information or data that must be protected from unauthorized use or review.

Retention Policy

All working papers pertaining to an audit belong to the Auditor. All such data is to be kept by the Auditor and is subject to the retention requirements as required by law.

10. IDENTIFICATION OF THE EVENT AND CORPORATE ACTIONS

The following points considered as events/information on which the auditor should specifically verify the compliance required under applicable laws.

1. **Acquisition(s)** (including agreement to acquire), Scheme of Arrangement (amalgamation/ merger/ demerger/ restructuring), or sale or disposal of any unit(s), division(s) or subsidiary of the Company or any other restructuring.
2. **Issuance or forfeiture of securities, split or consolidation of shares, buyback of securities, any restriction on transferability of securities or alteration in terms or structure of existing securities including forfeiture, reissue of forfeited securities, alteration of calls, redemption of securities etc.**
3. **Revision in Rating(s).**
4. **Outcome of Meetings of the board of director relating to:**
 - dividends and/or cash bonuses recommended or declared or the decision to pass any dividend and the date on which dividend shall be paid/dispatched;
 - any cancellation of dividend with reasons thereof;
 - the decision on buyback of securities;
 - the decision with respect to fund raising proposed to be undertaken;
 - increase in capital by issue of bonus shares through capitalization including the date on which such bonus shares shall be credited/dispatched;
 - reissue of forfeited shares or securities, or the issue of shares or securities held in reserve for future issue or the creation in any form or manner of new shares or securities or any other rights, privileges or benefits to subscribe to;
 - short particulars of any other alterations of capital, including calls;
 - financial results;
 - decision on voluntary delisting by the listed entity from stock exchange(s).
5. **Agreements** (viz. shareholder agreement(s), joint venture agreement(s), family settlement agreement(s) impacting management and control of the Company, agreement(s)/treaty(ies)/contract(s) with media companies) which are binding and not in normal course of business, revision(s) or amendment(s) and termination(s) thereof.
6. **Fraud/defaults by promoter or key managerial personnel** or by Company or arrest of key managerial personnel or promoter.

7. Change in directors, key managerial personnel (Managing Director, Chief Executive Officer, Chief Financial Officer, Company Secretary etc.), Auditor and Compliance Officer.
8. Appointment or discontinuation of share transfer agent.
9. Corporate debt restructuring.
10. One time settlement with a bank.
11. Reference to IBC, 2016 and winding-up petition filed by any party/creditors.
12. Issuance of Notices, call letters, resolutions and circulars sent to shareholders, debenture holders or creditors or any class of them or advertised in the media by the Company.
13. Proceedings of Annual and extraordinary general meetings.
14. Amendments to memorandum and articles of association.
15. Commencement or any postponement in the date of commencement of commercial production or commercial operations of any unit/division.
16. Change in the general character or nature of business brought about by arrangements for strategic, technical, manufacturing, or marketing tie-up, adoption of new lines of business or closure of operations of any unit/ division (entirety or piecemeal).
17. Capacity addition or product launch.
18. Awarding, bagging/receiving, amendment or termination of awarded/bagged orders/contracts not in the normal course of business.
19. Agreements (viz. loan agreement(s) (as a borrower) or any other agreement(s) which are binding and not in normal course of business) and revision(s) or amendment(s) or termination(s) thereof.
20. Disruption of operations of any one or more units or division of the Company due to natural calamity (earthquake, flood, fire etc.), force majeure or events such as strikes, lockouts etc.
21. Effect(s) arising out of change in the regulatory framework applicable to the Company.
22. Litigation(s)/dispute(s)/regulatory action(s) with impact.
23. Fraud/defaults etc. by directors (other than key managerial personnel) or employees of Company.
24. Options to purchase securities including any ESOP/ESPS Scheme.
25. Giving of guarantees or indemnity or becoming a surety for any third party.
26. Granting, withdrawal, surrender, cancellation or suspension of key licenses or regulatory approvals.

27. Any other information/event viz. major development that is likely to affect business, e.g. emergence of new technologies, expiry of patents, any change of accounting policy that may have a significant impact on the accounts, etc. and brief details thereof and any other information which is exclusively known to the Company and which may be necessary to enable the holders of securities of the Company to appraise its position and to avoid the establishment of a false market in such securities.

II. TESTING METHODS USED DURING AUDIT PROCEDURES

- i. There are five core testing methods that auditors use to confirm the facts and answers that a business wants to attain during an audit.
- ii. Each testing method helps the auditor issue a well-informed opinion, based on evidence.
- iii. These are the five types of testing methods used during audits.

- a. Inquiry
- b. Observation
- c. Examination or Inspection of Evidence
- d. Re-performance
- e. Computer Assisted Audit Technique (CAAT)

• Inquiry

Inquiry is a fairly straightforward testing method, where **auditors ask questions of the organization's managers**, accountants and any other key staff to help determine some relevant information. Because the quality of the information gained from inquiry depends on the accuracy and truthfulness of the interviewee, it is **considered a weaker form of evidence**.

Example of inquiry commonly used is asking the business owner how the company's financial and data security records are stored. The auditor takes the responses into account—but does not accept the answers alone as confirmation—to establish additional testing criteria since this method is often used in conjunction with other, more reliable methods.

- **Observation**

This method involves an auditor's observation of tasks, procedures and conditions and is most often used when there is no documentation of the operation of a control.

Traditionally, observation has been performed on-site during the evidence-gather phase of a SOC audit.

For example, management at an audited organization may state that certain noted records have been appropriately secured in a locked drawer. Then, in order to verify that certain stated records have been securely stored in locked cabinets, the auditor will watch an employee unlock the specified drawer during normal daily activities and take out the records.

- **Examination or Inspection of Evidence**

This testing method helps auditors determine whether manual controls are being consistently performed and properly documented.

For example, an auditor may check to make sure that backups are scheduled to run on a regular basis or that data classification controls. In these cases, the auditor can use inspection to verify that the control has been designed and is operating effectively. He or she will check to see if forms are being filled out correctly.

- **Re-performance**

Re-performance is used when inquiry, observation, and physical examination and inspection have failed to provide the requisite assurance that a control is operating effectively.

The auditor can leverage work done by an internal auditor and documented in work papers, so that only a sample of the work needs to be re-tested to verify.

The re-performance method is helpful in decreasing the workload for auditors and determining whether automated controls are operating effectively.

- **Computer-Assisted Audit Technique (CAAT)**

The CAAT method of testing is often used to analyze large volumes of data or a sample of compiled data. Using special software, CAAT testing runs a script over a ledger, spreadsheet, or an entire database, to spot trends, irregularities, and potentially fraudulent entries.

12. AUDIT SAMPLING

Audit sampling is an investigative tool in which less than 100% of the total items within the population of items are selected to be audited.

a. Purpose of Audit Sampling

No matter what kind of audit is being performed audit sampling needs to be used so that auditors can complete their audits without wasting resources in checking every single item. The objectives of audit sampling are as follows:

- Gather enough evidence to conclude an audit opinion
- Reduce the number of resources used
- Provide the basis for auditors to issue a conclusive audit opinion
- Detect any errors or fraud that can occur
- Prove that auditors have completed their audit fully in accordance with auditing standards
- Used as a tool for investigating
- Audit Sampling Importance.

While conducting audit, it is **not feasible to audit and check every single item** within the financial statements. It will be very costly and will take a lot of resources and time to do so. **Audit sampling enables auditors to make conclusions and express fair opinions based on predetermined objectives without having to check all of the items** within financial statements. The auditors **will only verify selected items**, and through sampling, **can infer their opinion on the entire population of items**.

There are two forms of sampling:

1. Statistical audit sampling

Statistical audit sampling **involves a sampling approach where the auditor utilizes statistical methods such as random sampling** to select items to be verified. Random sampling is **used when there are many transactions on record**.

For example, with statistical sampling, ten items are selected from the total population randomly. Every single item within the 100 has an equal probability of being selected and

tested for accuracy as a result. Again, it benefits auditors since they can still make an audit opinion but do not have to check all 100 transactions.

2. Non-statistical audit sampling

In contrast to statistical audit sampling, non-statistical audit sampling items are not chosen randomly. Instead, they are **chosen based on the auditor's judgment, and the result of the testing from the selections is not used to infer the conclusion for the entire population.** In the example earlier, ten inventory transactions can be used to infer the opinion on all 100 transactions. In non-statistical audit sampling, the auditors may choose to select items based on criteria such as: The value of items (e.g., items greater than Rs 10 lacs)

- i. An external auditor was engaged to conduct an audit of a manufacturing company's financial statements. As part of the audit, the auditor used statistical sampling techniques to select a sample of transactions to test for accuracy and completeness.
- ii. The auditor used a combination of random sampling and systematic sampling to select the sample. The sample was selected from the company's sales and purchases transactions, as these transactions were considered to be material and had a high risk of misstatement.
- iii. After selecting the sample, the auditor examined the transactions to verify their accuracy and completeness. The auditor found that a few of the transactions in the sample were not properly documented, and there were some discrepancies in the amounts recorded in the company's records compared to the supporting documents.
- iv. Based on the results of the sample, the auditor projected the findings to the entire population of sales and purchases transactions and concluded that there were material misstatements in the financial statements.
- v. The auditor then communicated the findings to the company's management and recommended adjustments to the financial statements. The management of the company agreed with the auditor's findings and made the necessary adjustments to the financial statements.
- vi. The auditor then issued an unqualified opinion on the financial statements, indicating that the financial statements were fairly presented in all material respects. **This case study demonstrates the importance of audit sampling in conducting an effective audit.**
- vii. By using statistical sampling techniques, the auditor was able to select a representative sample of transactions and test them for accuracy and completeness.
- viii. The results of the sample allowed the auditor to draw conclusions about the entire population of transactions and detect material misstatements in the financial statements.

13. TESTS OF INTERNAL CONTROLS

- i. **Internal controls** are **rules and procedures established by a company** to ensure business continuity, prevent fraud, and preserve the integrity and accuracy of financial reporting.
- ii. The purpose of internal controls testing is **to see if the controls are properly detecting or preventing material errors or purposeful misstatement** in financial reports.
- iii. Although control audits cannot completely detect all fraud, auditors can use controls testing to test operational controls for gaps, which can significantly reduce risk.
- iv. Testing reveals what situation the company is in: **If controls are found to be effective, control risk is low, if controls are identified as vulnerable or ineffective, control risk is high.**

Purpose of Internal Controls Testing

There are two primary purposes for internal controls testing:

1. **Shortening the audit process** – if a controls test shows that internal controls are effective, and are able to prevent errors or fraud in financial statements, additional audit actions will not be needed.
2. **Providing additional audit evidence** to demonstrate compliance, in situations where individual substantive procedures cannot provide sufficient evidence on their own.

• **Types of Audit Tests of Internal Controls**

As discussed earlier about testing methods used during audit procedures. There are below types of internal control tests, each one is progressive and more comprehensive:

1. **Inquiry**—auditors ask managers and employees about the controls they are implementing.
2. **Observation**—auditors observe activities and operations to see how controls are implemented. This is useful in cases where there is no documentation on how to operate the control unit. For example, if there is no formal procedure to ensure security cameras are installed, the auditor can simply observe if there are security cameras at the facility.
3. **Examination or inspection**—auditors determine if controls are really operational, using existing documentation and logs. For example, a test of controls can involve visiting a secured facility and ensuring that doors are locked and equipped with access control devices.

4. **Re-performance**—the previous three methods cannot fully guarantee the effective operation of the control. Re-performance involves the auditors actually trying to perform the control to see if it is effective. For example, the audit can run backups and try to restore the system to normal operation, or manually perform a financial calculation to ensure it is correct.
5. **Computer-aided audit tools (CAAT)**—auditors use technology to analyze large amounts of data automatically. A simple CAAT can be a spreadsheet, but there are specialized tools available that can test various types of internal controls. Most CAAT solutions are focused on export based, point in time sample testing across a complete inventory of all transactions.

- i. An external auditor was engaged to conduct an audit of a retail company's financial statements. As part of the audit, the auditor reviewed the company's internal controls to assess their effectiveness in preventing and detecting errors and fraud
- ii. The auditor found that the company had several weaknesses in its internal controls. Specifically, the company lacked proper segregation of duties, which meant that a single employee had control over several critical functions, including approving and recording transactions, and reconciling accounts.
- iii. The company also had inadequate documentation of transactions and did not have policies and procedures in place to ensure that transactions were properly authorized and recorded.
- iv. As a result of these weaknesses, the auditor was unable to rely on the company's internal controls to support the accuracy and completeness of the financial statements. The auditor communicated the weaknesses to the company's management and recommended improvements to the internal controls.
- v. The management of the company agreed with the auditor's findings and took corrective action to strengthen the internal controls. The company implemented a new policy of segregation of duties, ensuring that critical functions were assigned to different employees.
- vi. This case study highlights the importance of strong internal controls in preventing and detecting errors and fraud in financial reporting. By identifying weaknesses in the internal controls and recommending improvements, the auditor helped the company to strengthen its financial reporting processes and provide accurate and reliable financial statements.

14. SUBSTANTIVE TESTING

Substantive testing is an auditing technique that checks for any errors or material misstatements in a company's accounts, financial statements or supporting documents.

This traditional auditing method helps an auditor to form an overall opinion about the company's financial statements.

- **Who does substantive testing?**

- Either a **company's internal audit staff or hired external auditors** can conduct substantive testing for a company.
- Company's **internal audit staff provide confirmation for whether their internal record systems are performing correctly** and if the internal record systems are not performing properly, the internal audit staff can improve the system or eliminate the problem, so the company performs better in the next audit.
- External auditors often get hired to conduct substantive testing once a year**, usually at the end of the year.

- **How do substantive tests work?**

Here are the steps:

- A company makes assertions**

A company's management team makes implicit or explicit claims about their financial situation, and these auditing assertions get presented to an auditor.

There are five general categories of assertions that companies make during audits, which are:

Occurrence or existence: This assertion states that financial statements listing assets, liabilities and shareholder equity exist when the accounting period is over.

Disclosure and presentation: This is an assertion that the financial statements will include and present all financial information and financial disclosures in a clear manner that auditors can easily understand.

Obligations and rights: This assertion states that the company has usage rights or ownership of all the assets listed in the financial statements and that all liabilities belong to the company, not a third party.

Accuracy or valuation: This assertion states that all the calculations in the financial statements are accurate, classified appropriately and based on a proper valuation of balances, liabilities and assets.

Completeness: An assertion that the financial statements include and present all the required items, transactions and inventory, including third parties with temporary possession.

2. The auditor creates a plan

The auditor creates a structured audit plan for the company based on the assertions. The auditor identifies which auditing processes, including substantive tests, will best determine any errors or misstatements in the assertions.

There are three general activities that an auditor includes in their audit plan for substantive testing, which are:

- **Examine physical adjustments and journal entries** the company made while the company prepared the financial statements.
- **Match the underlying accounting records** with the company's financial statements and their supporting documents.
- **Test the different classes of account balances**, transactions and disclosures.

3. An auditor shares audit results with a company

The auditor creates an official report noting any errors or important mistakes discovered. This report is then shared with management, and if needed, the auditor may ask for additional testing.

• What happens when substantive testing finds an error?

If an auditor finds any errors in a company's financial statements or the supporting documents, the auditor may require the company to do further audit testing.

The auditor writes a management letter with a summary of the errors they found and shares the letter with the company and the audit committee.

There are errors or misstatements if:

- a. External auditors don't detect an error during audit procedures, which is called detection risk.
- b. Internal auditors or the internal record systems don't identify or fix an error, which is called control risk.
- c. The company or auditor doesn't detect initial errors when the financial process and reporting begin.

- **Examples of substantive testing**

Here is a list of common substantive auditing procedures and tests that auditors do:

- Verify that approved dividends exist by reviewing board minutes from the board of directors;
- Confirm that the balances in accounts payable are correct by contacting suppliers;
- Confirm that the balances in accounts receivable are correct by contacting customers;
- Check that assets obtained from a business combination have fair values assigned to them by confirming with experts;
- Watch the physical inventory count as it happens for each ending period;
- Test ending cash balances by issuing a bank confirmation;
- Contact lenders to confirm that loan balances are correct;
- Take fixed asset records and physically match them to fixed assets;
- Use inventory valuation calculations to confirm if inventory is valid;
- Recalculate the calculations that were already made by the client;
- Re-perform a company's procedures to make sure they perform as planned;
- Confirm loan balances are correct by contacting lenders;
- Test end cash balances by getting bank confirmation.

15. AUDIT TRAILS

Audit Trail is useful to trace all events right from transactions entered into the books of accounts to all the changes such as alteration, deletion, etc. that may take place.

Thoda Extra gyaannnn..... Swaad Anusaaar (Short Note)

Notification of Ministry of Corporate Affairs- Audit trail rule for businesses using accounting software from 1st April, 2023.

According to the same notification, businesses that fall under the purview of MCA and use accounting software for maintaining books of accounts should have an audit trail feature. The accounting software used by such businesses should create an edit log of each and every transaction with changes made in the books of accounts. The software should capture the date details when such changes (edits) are made and ensure the edit trail cannot be disabled.



Rule 3 (Manner of Books of Account to be Kept in Electronic Mode) of the Companies (Accounts) Rules, 2014, states that for the **financial year commencing on or after the 1st day of April, 2023**, every company which uses accounting software for maintaining its books of account, shall **use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled.**

• **How does audit trail work?**

1. Audit trails must have a few key details to provide comprehensive information about a transaction.
2. Every access made to the accounts and records of the company should be tracked.

3. Every edit made to any information must be recorded with the name of the person who did it and the time it was done.

4. If any information was deleted, that also should be recorded.

- **Accounting software provides the ideal example for audit trails.** Once you enter a transaction in the software, the software will maintain a record of it. Any further edits made to the details, such as a change in the amount or change in the name against which the entry is made, will also be tracked by the software along with the user who made the changes and the time it was changed. Even if some transaction were to be deleted, the software will track that as well and keep the record of everything since the original entry was made.

Following are the key financial details to track as part of the audit trail:

- Any changes involved in the transaction
- The person who partook in the transaction
- The time at which the transaction took place
- The time at which the modification or edit took place
- Example of audit trail.

- **What is the purpose of an audit trail?**

The trail is basically a way to ensure that there are no gaps in data that may lead to a blind spot, making it impossible to determine the cause of the error.

The main reason for documenting everything that a company or its employees do is to have a record that can be revisited if the need arises. In case of any discrepancy, you have a pathway that can lead to the erring or fraudulent transaction which is causing the discrepancy.

- **What are the benefits of an audit trail?**

1. **Increased transparency:** The audit trail system provides a detailed record of all transactions, making it easier for regulators and stakeholders to monitor the activities of companies and to detect any irregularities.
2. **Improved accuracy:** By requiring companies to maintain accurate electronic records, the audit trail system helps to prevent errors and omissions in financial reporting.

3. **Greater accountability:** The audit trail system holds companies and their employees accountable for their actions by providing a detailed record of all changes made to electronic records.
4. **Enhanced regulatory compliance:** The audit trail system helps to ensure that companies comply with various laws and regulations related to corporate governance and financial reporting.
5. **Foolproof:** There is also the advantage of proving that the company books are clean and in a healthy state which gives a big boost in the valuation of the company as well as generating funds through loans or by raising capital.

This case study revolves around an auditor's audit of a large manufacturing company in India. The auditor's review focuses on the electronic records maintained by the company, which are governed by the Audit Trail system set up by the Ministry of Corporate Affairs (MCA). The case unfolds as follows:

1. **Initial Review and Observations:** The auditor examines the electronic records and detects several entries that don't align with the company's financial statements. Furthermore, the auditor notices multiple alterations made to the electronic records without documented explanations for these changes.
2. **Investigation Process:** To investigate these discrepancies, the auditor turns to the Audit Trail system. This system offers a comprehensive log of all changes made to the electronic records, including timestamps and details of the individuals responsible for the changes. The auditor cross-references this information with the company's financial statements to trace the origin of the discrepancies.
3. **Findings:** Through this meticulous investigation, the auditor uncovers two significant issues. Firstly, the company has misreported its revenues by recording them in a different financial year than when they were actually earned. Secondly, there were unauthorized changes to the electronic records, seemingly aimed at concealing these irregularities.
4. **Reporting and Recommendations:** The auditor communicates these findings to the company's management and proposes corrective actions. The recommendation includes rectifying the discrepancies and updating the electronic records accordingly. The company's management cooperates with the auditor and takes steps to address the problems.
5. **Outcomes and Improvements:** As a direct consequence of the audit, the company enhances its internal controls and financial reporting processes to safeguard against similar issues in the future. The Audit Trail system, introduced by the MCA, proves invaluable in revealing these irregularities and ensuring the company's compliance and responsiveness in addressing them.

This case study underscores the pivotal role of the Audit Trail system established by the MCA in promoting transparency and accountability within corporate reporting, as well as in detecting financial discrepancies. The system serves as a robust tool for auditors, allowing them to spot deviations in electronic records and delve into the causes behind those discrepancies. Moreover, the system contributes to fostering good corporate governance and safeguarding the interests of stakeholders.

In summary, the case study highlights how regulatory measures, such as the Audit Trail system, can play a vital role in maintaining the integrity of financial reporting, uncovering irregularities, and fostering an environment of trust and accountability in the corporate world.

16. ANALYSIS OF AUDIT FINDINGS

i. Audit Finding:

A written summary of deviations from required provisions and identified concerns during the audit.

ii. Review by Lead Auditor:

The lead auditor reviews the completed audit report.

iii. Discussion with Department Head:

The lead auditor discusses the report contents with the relevant department head.

iv. Acceptance and Verification:

The department head accepts the report.

Signs the final audit report, verifying acceptance and taking responsibility for any required changes.

• Determine Plan of Action

i. The entire reason for conducting internal management system audits is to verify conformance and continually improve on the management system. Therefore, it is extremely important that all identified non-conformances are corrected in a timely manner.

ii. Some companies place all audited non-conformances into their corrective/preventive action process for tracking purposes. Others place only critical non-conformances into the corrective/preventive action process. Regardless of the mechanics of tracking the identified audited non-conformances, it is imperative that corrective action is taken.

iii. Once the corrective action is in place, the auditors should review the actions taken and verify the root cause was identified properly and resolved. An accept or reject decision can then be

rendered for the change action. If acceptable, no further action is required, and the issue is considered resolved.

- iv. If unacceptable, the department head must complete a new root cause analysis, develop a new action plan, and put the new action plan into place. The auditors will now review the new action plan and make a determination of acceptance or rejection.

SUMMARISED VERSION (MIND MAP)

1. INTRODUCTION

The Auditor needs to plan and execute audit procedures to gather enough and appropriate evidence for a reasonable opinion. When risks go up, the need for evidence increases. However, high-quality evidence reduces the need for additional confirmation. More low-quality evidence doesn't make up for the requirement of having enough evidence.

2. AUDITING STANDARD ON AUDIT PROCESS AND DOCUMENTATION (CSAS-2)

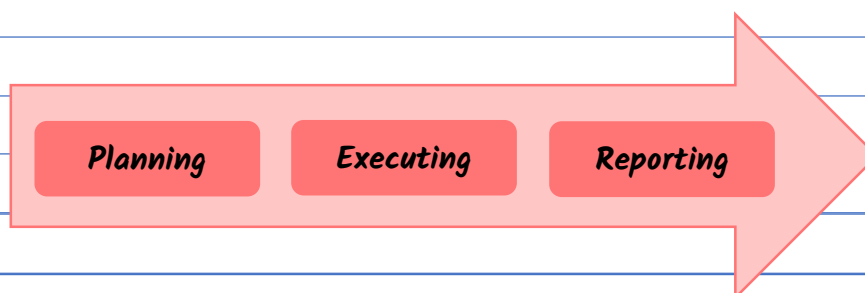
Auditing Standard CSAS-2 deals with responsibilities and duties of the Auditor with respect to Audit Process in conducting audit and maintaining proper audit documents.

The objective of the Standard is to prescribe principles for an Auditor:

- (i) to conduct audit as per the specified audit process;
 - (ii) to maintain documentation that provide:
 - (a) sufficient and appropriate record to form the basis for the Auditor's Report; and
 - (b) evidence that the audit was planned and performed in accordance with the applicable Auditing Standards and statutory requirements.
- "Audit Documents" means the working papers prepared or records obtained by the Auditor in connection with the audit.
 - "Audit Evidence" refers to relevant information and documents gathered in the course of the audit for arriving at the conclusion on which the Auditor's opinion is based.
 - "Management" includes Board of Directors and persons who have been entrusted with the responsibility of governance and compliances of the Auditee.

3. OVERVIEW OF THE AUDIT PROCESS

The audit process can be broadly grouped in three phases:



Audit Planning:

For an effective audit, a timely, well thought out and well executed planning efforts is essential.

The Audit planning consists of the following actions:

- 1. Understanding the company;*
- 2. Establishing audit objectives and scope;*
- 3. Determining Materiality;*
- 4. Assessment of Risk;*
- 5. Preparation of Audit plan;*
- 6. Preparation of detailed Audit Programme.*

Execution of Audit:

The effective Audit Execution is based on the Audit plan and the efficiency of the Audit team.

It covers the following actions:

- 1. Sampling of various transactions or items;*
- 2. Sampling for testing of controls;*
- 3. Identification of events;*
- 4. Performing controls testing procedures;*
- 5. Performing analytical procedures;*
- 6. Sampling for substantive test of details;*
- 7. Performing substantive test of details;*
- 8. Review of working papers;*
- 9. Management discussion on draft Report.*

Reporting:

In the reporting phase, the auditor covers evaluation of audit results, deriving conclusion, forming of opinion and prepare the audit report.

Understanding the Auditee and its operation

Understanding the legal requirements and Applicability of Law, Rules and Regulations

Overview and Assessment, Internal Control Mechanism and Identification of Material Event and Risk Areas

Risk Assessment considering the existing Internal Control Mechanism

Deciding the Audit Approach considering Reliance on the Internal Control and Procedures to be Adopted for Audit

Identification of the Audit Evidences

Designing the detailed Audit Procedure for various Transactions & Events based on the Materiality, Value and Nature

Perform Audit Procedures

Audit Conclusions based on the Audit Evidence

Forming of Opinion

4. AUDIT PLANNING

- i. The audit plan, describes the processes and activities that are to be carried out in connection with a particular audit and for the improving the quality of audit.
- ii. Audit plan is **very crucial and should be designed with due care.**
- iii. The Auditor should prepare an audit plan, which shall **include detailed layout for conducting audit procedures, timing, sample sizes, basis of selection of sample, etc.**
- iv. Audit plan addresses the specifics of what, where, who, when and how:
 - a. What are the audit objectives?
 - b. Where will the audit be done?
 - c. Whether there will be audit visits to other locations of the company?
 - d. When will the audit(s) occur?
 - e. Who constitute the audit team?
 - f. How will the audit be done? etc.
- v. The basic **purpose of an audit plan** is:
 - to **develop an audit process** which ensures that sufficient and appropriate evidence is gathered to support the audit opinion;
 - the audit **should be planned in a manner which ensures that the audit is carried out in an efficient and effective way in a timely manner;**
 - the audit plan **should be documented** and kept as audit working paper;
 - the audit planning process **should be framed on a thorough understanding of the Auditee, its business, sector in which it functions and its operation;**
 - to determine the **materiality for the audit.**
- vi. Audit planning means **establishing and developing an overall audit process, including but not limited to:**
 - a. Identification of broad audit areas;
 - b. Seeking previous audit findings and observations from the Management and the Predecessor or Previous Auditor, in case of change of Auditor;
 - c. Determination of subject matters and audit areas requiring special attention, when considered necessary;
 - d. Risk Assessment and Materiality;
 - e. Audit technique;

- Allocation of audit resources for the audit; and
- Preparation of audit schedule.

- **Essentials of Audit Planning**

Points to be considered by auditor:

Ensuring the quality of Audit: The Audit should be planned in such manner, which ensures the high quality of audit in economic, efficient, and effective way and in a timely manner.

Documented Audit Plan: The Audit plan should be documented and should be kept with the audit working papers.

Clubbing of inter related steps: The inter related steps and events should be clubbed together.

Finalization type of Audit Plan: While the elements of an audit plan may be similar across different entities being audited, the specific details can vary based on the nature, type, and objective of the audit or authentication assignment for each specific entity.

Independent review of Audit Plan : The audit plan should be checked by an experienced auditor who is usually not part of the assignment. Their experience can help adjust the plan to better meet the audit objectives.

Flexibility: The audit plan should be flexible enough to accommodate modifications.

Reaching conclusion: Auditing means gathering and analyzing enough facts and data to make trustworthy and accurate conclusions about what's being audited.

Training and communication to Audit Staff: The auditing staff should know the quality control policies and procedures of the firm. The hierarchy, responsibilities, and decision-making authority must be clearly defined and understood by the audit staff.

CASE STUDY

The provided case study outlines the process and steps involved in engaging a secretarial auditor and planning the audit for Sun Moon Ltd. Secretarial auditing involves examining a company's compliance with applicable laws, regulations, and corporate governance practices.

Here is a breakdown of the case study:

- a. **Engagement of Secretarial Auditor:** Sun Moon Ltd appoints M/s J J Associates, practicing company secretaries firm, as the secretarial auditor. A consent letter and a board resolution are obtained for the appointment.
3. **Intimation to Earlier Incumbent:** The new secretarial auditor informs the previous auditor about the change in writing.
4. **Acceptance of Appointment:** Sun Moon Ltd issues an appointment letter to M/s J J Associates along with the board resolution. The new auditor accepts or rejects the appointment in writing.
5. **Preliminary Discussions/Surveys:** The secretarial auditor gathers relevant information about the company, interacts with personnel, and may conduct surveys to understand the business nature and operations.
6. **Preliminary Meeting:** A meeting with senior management and administrative staff takes place. The scope, objectives, timeline, preliminary questionnaire, and initial observations are discussed. Audit activities and timeframes are outlined.
7. **Finalization of Audit Plan and Briefing the Staff:** An action plan is developed, including assigning roles, responsibilities, and fieldwork tasks. Controls are reviewed to determine high-risk areas and plan audit steps.
8. **Testing, Interviews, and Analysis:** The auditor employs various tools and technology to gather information about company operations. Controls identified during the preliminary review are evaluated, and compliance with policies, procedures, and laws is assessed through interviews, reviews, and analysis.

9. *Working Papers: Working papers serve as a vital tool for the audit, connecting management's records to the auditor's opinion. They provide support for the audit findings and conclusions.*
10. *Preliminary Report/Audit Summary for Discussions: Findings and recommended solutions are summarized and discussed with management. The audit report's content, including findings, conclusions, and recommendations, is prepared based on fieldwork.*
11. *Audit Report Submission: The final audit report is prepared, presenting findings and recommendations for improvements. The report includes the auditor's opinion on statutory compliance and whether the company is adhering to applicable corporate laws. Management responses are reviewed and discussed.*
12. *Final Meeting and Report: A final meeting between management and the auditor takes place to discuss the audit report, management responses, and any remaining issues. The final report is provided with or without qualifications based on the audit findings.*
13. *Review of Audit Plan: After completing the audit, the secretarial auditor evaluates the effectiveness of the audit plan, assesses the outcomes, and makes corrective measures for future audits.*

This case study highlights the detailed steps involved in secretarial audit engagement, from appointment to final report submission. It underscores the importance of thorough planning, effective communication, compliance assessment, and collaboration with management to ensure accurate and compliant financial reporting and corporate governance.

- **Developing the Audit Plan**

The Auditor establishes the overall audit strategy and guides the development of the more detailed audit plan

Details of Audit Plan

1. *Introduction – a short introduction about the audit;*
2. *Audit field – A description of the audit field, including the regulatory framework for the audit where relevant and recent significant changes and developments that may affect the audit;*
3. *Audit objectives – The audit objectives depend on the type of audit to be conducted;*
4. *Audit coverage – The audit coverage periods to be covered and locations to be visited; control systems to be tested and sample to be audited;*
5. *Materiality – Identification of materiality in terms of value, nature and context;*

6. **Risks** – A preliminary assessment of risks (e.g. changes in the regulatory environment or internal control systems and evaluation of inherent and control risk);
7. **Audit approach** – The audit approach, including the audit procedures to be carried out in order to provide the necessary audit evidence. This identifies the extent of planned reliance on control systems and the extent of substantive procedures;
8. **Organisation** – Organisation of audit work: resources (including recourse to the work of other Auditor and experts), timetable (including the reporting objectives of the audit), documentation in electronic audit support system.

Keypoints to be kept in mind

- i. The Auditor shall **adhere to the audit plan**.
- ii. The audit plan may be **modified**, if circumstances so warrant.
- iii. The audit plan should be **documented in audit file**, including significant changes made during the course of the audit and the reasons for such changes.
- iv. The Auditor should **approach the audit with professional skepticism**, enabling objective professional judgment. Applying professional skepticism improves the effectiveness of audit procedures and lowers the risk of reaching an incorrect conclusion when evaluating audit results.

CASE STUDY

The provided case study outlines the audit plan and process employed by the Case Western Reserve Office of Internal Audit Services. This process involves several sequential steps aimed at understanding, assessing, and managing risks within the university's management centers, operating units, and significant departments. Here's a breakdown of the steps:

Step 1: Planning In this phase, the auditor begins by reviewing previous audits conducted in the same area and relevant professional literature. The auditor also researches policies and statutes that apply. Based on this preliminary research, a basic audit program is created to outline the audit process.

Step 2: Notification The Office of Internal Audit Services informs the relevant departments about the upcoming audit. The notification includes the purpose of the audit. An opening meeting is scheduled to kick off the audit process.

Step 3: Opening Meeting This meeting involves management and administrative personnel from the audited area. The purpose and objectives of the audit are discussed, along with the audit program. The audit program might be adjusted based on the insights gained during this meeting.

Step 4: Fieldwork During this step, testing is performed as outlined in the audit program. The auditor also conducts interviews with the appropriate personnel in the department to gather more information.

Step 5: Report Drafting After the fieldwork is completed, a draft report is prepared. This report encompasses various sections, including the audit's objective, scope, relevant background information, and the findings and recommendations for any necessary corrections or improvements.

Step 6: Management Response The draft audit report is shared with the management of the audited area. Management provides their responses to the recommendations outlined in the report. They should also include an action plan detailing how they intend to address the issues identified.

Step 7: Closing Meeting A meeting is held with the department's management to discuss the draft audit report and management's responses. Questions are addressed, and any outstanding issues are clarified. Additionally, audit procedures not covered in the report are communicated during this meeting.

Step 8: Final Audit Report Distribution After the closing meeting, the final audit report is distributed to the personnel involved in the audit within the department. The report, along with management's responses, is also sent to higher-level executives, including the President, Chief Financial Officer, and the university's external accounting firm.

Step 9: Follow-up Approximately six months after the issuance of the audit report, a follow-up review is conducted. This review's purpose is to determine whether the corrective actions suggested in the audit report have been successfully implemented.

This case study illustrates the structured and comprehensive approach taken by the Office of Internal Audit Services to assess and manage risks within the university's various departments. The steps outlined ensure a thorough evaluation, documentation, and implementation of corrective actions to improve internal processes and controls.

5. RISK ASSESSMENT

Meaning of Risk

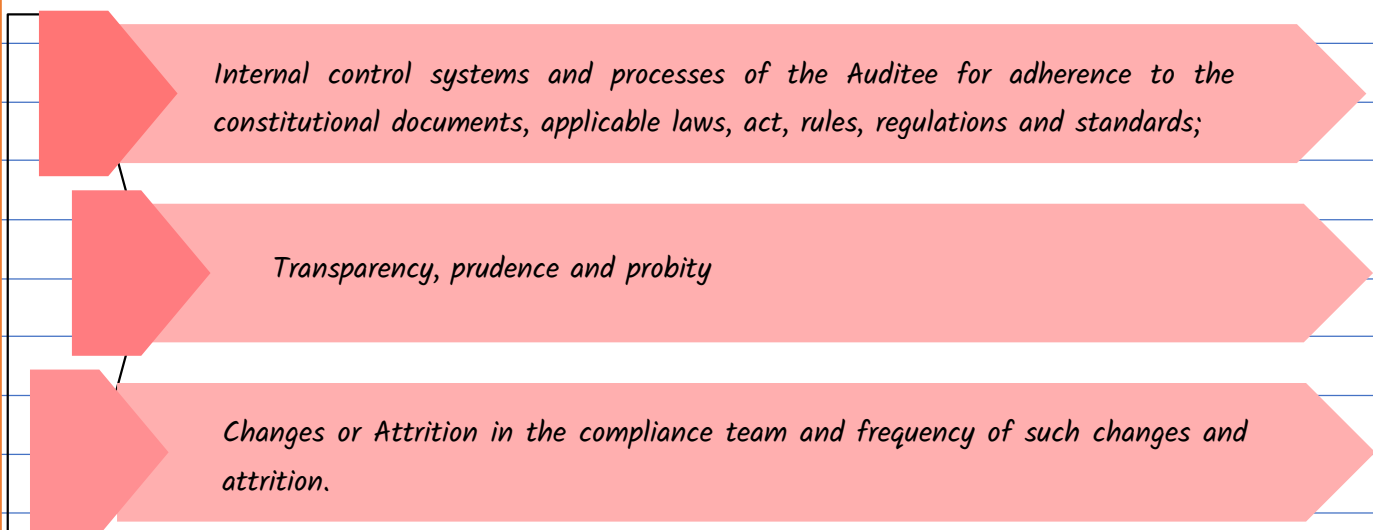
A risk is defined as 'threat or possibility that an action or event will adversely or beneficially affect an organization's ability to achieve its objectives'.

Meaning of Risk Assessment

A systematic process of evaluating the potential risks that may be involved in a projected activity or undertaking.

According to CSAS-2, The Auditor needs to assess the risk of the entity being audited in relation to the audit engagement. This assessment should consider the industrial and business environment, organizational structure, and compliance requirements, including regulatory changes and legal orders.

The Auditor should focus on evaluating high-risk areas and activities of the entity.:



Assessment of Audit Risk

The Auditor assesses the Risk and identifies the critical and high risk areas by:

- considering the underlying risk assessed by Management or internal and/or specific expert/agencies and analysis thereof;
- reviewing policies and procedures put in place to mitigate risk;
- having insight into the objectives, key performance indicators, risks and control measures, holding meetings with key executives of the Auditee.

CASE STUDY

The provided case study revolves around a practicing company secretaries firm, M/s ABC & Associates, and their client acceptance policy, focusing on risk assessment and materiality considerations. Let's break down the case study's key points:

Background of M/s ABC & Associates:

- M/s ABC & Associates is a medium-sized Practicing Company Secretaries Firm providing services in secretarial and internal auditing, corporate laws, securities laws, capital markets, and corporate governance.
- Their clients predominantly operate in the processed food industry.

Client Acceptance Policy:

- M/s ABC & Associates follows a strict Client Acceptance Policy that helps them decide whether to accept a new client or engagement.
- The policy is essential for quality maintenance, risk management, regulatory compliance, and protecting the firm's interests.
- A thorough due diligence process is conducted to evaluate risk characteristics of potential clients.
- Adequate resources and commitment to ensuring high-quality audit services are crucial considerations.
- The Managing Partner's approval is required for all new audit engagements.
- Clients are classified into risk categories: 'High Risk,' 'Moderate Risk,' or 'Low Risk.'
- A team is set up to recommend client acceptance decisions for FY 2023-2024.

Meeting with the Audit Committee Chairman:

- The Managing Partner of M/s ABC & Associates meets the chairman of the audit committee of 'XYZ Ltd,' a company planning to change its secretarial auditor.
- Communication with the predecessor auditor (if applicable) is required according to CSAS-1 guidelines.

Determining Materiality:

Steps involved in determining materiality are outlined:

1. Identifying business risks specific to the processed food service sector.
2. Evaluating factors crucial in assessing business risk and the risk of material misstatement.
3. Understanding inherent and business risks associated with a new client.
4. Establishing planning materiality for an audit client.
5. Providing support for materiality decisions.

XYZ Ltd Engagement and Risk Assessment:

After accepting 'XYZ Ltd' as a new client, financial statements from the last three years are provided for risk assessment purposes.

In summary, this case study underscores the meticulous client acceptance process adopted by M/s ABC & Associates, where they evaluate potential clients based on risk classifications and resource commitment. The case also highlights their interaction with a prospective client and the importance of communication with predecessor auditors. Additionally, the study emphasizes the significance of determining materiality in the audit process, especially when dealing with clients in specific industries like the processed food sector. The information gathered from XYZ Ltd's financial statements will be used to assess risks and tailor their audit procedures accordingly.

Components of Audit Risk

Auditing risk means that an auditor accepts/presumes some level of uncertainty in performing the audit work, which means that the auditor accepts the risk that the audit opinion given by the auditor might be wrong.

Only a very small degree of audit risk would be acceptable as otherwise the audit process may lose its purpose.

The audit risk has three components

- i. **Inherent Risk:** Inherent risk is the likelihood that a type of transaction could have errors or inaccuracies that might be significant, either on its own or when combined with errors in other

transactions. This is considered *without considering any internal controls*. For instance, it includes assessing whether related party transactions are genuine.

ii. **Control Risk:** Control Risk is the risk that *a misstatement that could occur in a class of transactions and that could be material individually* or when aggregated with misstatement on other transaction, will *not be prevented or detected and corrected* on a timely basis *by the internal control systems*. For example, delay in the filing of forms.

iii. **Detection Risk:** Detection Risk is the *risk that an auditor's substantive audit procedures will not detect a misstatement that exist* in class of transactions *that could be material*, individually or when aggregated with misstatement on other transaction. For example, while certification of e-form, the auditor has overlooked the compliance of the Secretarial Standards.

Thoda Extra gyaaannnn..... Swaad Anusaaar (Short Note)

Assessment of Risk

- The auditor should maintain the high level of the assurance/confidence while expressing the audit opinion.
- There is an inverse relationship between materiality and the level of audit risk that is, the higher the materiality level, the lower the audit risk and vice versa.



Risk Assessment Process overview:

IDENTIFY KEY RISK AREAS

Information should be gathered from all the departments with respect to:

- a. Financial significance
- b. Directional change, reorganizations, turnover
- c. Past internal audits
- d. Survey elected officials
- e. Interviews

- f. COSO's ERM PESTLE areas: (Political, Economic, Social, Technological, Legal Compliance, Environmental) Capital, People, Process, and Technology.

EVALUATE RISK

Evaluate and rank departments by both inherent risks and risks identified through analysis and interviews. Assess and prioritize major risks based on control objectives, considering vulnerabilities, likelihood, and the potential impact of a negative event.

PRIORITIZE IDENTIFIED RISKS

- Identify and link high-risk departments to control objectives.
- Prioritize remaining risks.
- Define the broad focus of internal audit projects based on prioritized risks.
- Develop an initial Internal Audit Plan considering key risks and feedback from management.

DEVELOP AND REFINE INTERNAL AUDIT PLAN

- Validate Internal Audit Plan internally.
- Present Internal Audit Plan to Audit Committee.
- Review and adjust Internal Audit Plan throughout the year

Sample Internal Audit Risk Assessment Questionnaire

- Risk Assessment completed during the last year
- Organizational Chart
- Any reviews conducted in the area of responsibility either internally or by external auditors and/ or consultants.
- A copy of any report with results of the review.
- What recent events have occurred in this unit (e.g. new degrees, centers, change in management, turnover of staff)?
- What do you have in place to manage and deal with these risks?

- g) What is the worst thing that has already happened in your unit?
- h) How do you measure your performance? Have you obtained the desired outcome in recent years?
- i) Who are your key stakeholders or external constituents (e.g. donors, legislatures?)
- j) Are there any particular areas within your unit or on campus which you currently have a concern about.
- k) Any areas or concerns that you would like reviewed by Internal Audit.
- l) What unique systems do you have and how critical are they to the functioning of your unit? Have you had any performance issues? Who supports these systems? Do you have any systems that contain confidential or critical information such as student, or employee information (eg. social security numbers, etc.)
- m) Describe or List any areas in which you are aware of fraud and abuse and the nature of the fraud and abuse.
- n) How can Internal Audit meet the expectations of your unit? Do you feel comfortable calling Internal Audit with a problem or concern?

6. INFORMATION ABOUT THE AUDITEE

- a. Nature of the business of the Auditee
- b. Sector in which the Auditee operates and how Government / Regulatory policies have evolved specific to such sector
- c. Size of the business of the Auditee including geographical locations; Organisation structures including Directors and KMPs
- d. Corporate structure, associates, joint ventures, subsidiaries
- e. Laws applicable to business of the Auditee
- f. Registrations and permissions obtained
- g. Court & regulatory orders enforced
- h. Media Reports

7. AUDIT CHECK-LISTS

- i. The Auditor shall use systematic and comprehensive audit checklists for carrying out the audit and to **verify the compliance requirements.**

- ii. It is a useful tool to *ensure that no compliance point is missed* or omitted while conducting audit.
- iii. The Audit checklist should *provide structure and continuity to an audit.*
- iv. Checklists provide a *means of communication* and a *place to record data for use for future reference.*
- v. Audit checklists should be developed to *provide assistance to the audit process* and should be reviewed and updated from time to time to meet the scope of audit and its effectiveness.
- vi. Audit *team should be trained in the use of a particular checklist* and be shown how to use it to obtain optimal information.
- vii. Audit checklists should:
 - a. *promote overall planning and timelines of the audit;*
 - b. *ensure comprehensive,*
 - c. *consistent and focussed audit approach;*
 - d. *avoid duplication of data verification and information;*
 - e. *ensure that audit scope is being followed;*
 - f. *serve as a memory aid and provide a repository for notes collected during the audit process.*

Illustration: Audit Findings are expressed in the following manner on the audit checklist:

- *Non - conformty (major)*
- *Non - conformty (minor)*
- *Opportunity for improvement*

Classification	Non-compliance with	Typical form	Reaction of the audited unit
Non-conformity (major)	Binding requirements that must be observed by the audited unit	<ul style="list-style-type: none"> • Systematic and relevant systematic deviations • Accumulation of minor non-Conformities • Relevant impact on occupational safety, health, 	<ul style="list-style-type: none"> • Immediate action • Corrective action • Cause analysis • Deadline • Responsible person • Follow up

	(laws, official regulations, other external requirements, customer requirements etc.)	environment, nearby areas or finances <ul style="list-style-type: none"> ● Relevant legal consequences are to be expected 	
Non-conformity (minor)		Individual or minor cases and/or minor deviations <ul style="list-style-type: none"> ● Minor impact on occupational safety, health, environment, nearby areas or finances ● Minor legal consequences are to be expected 	<ul style="list-style-type: none"> ● Corrective action ● Cause analysis ● Deadline ● Responsible person ● Follow up
Opportunity for improvement	Best practices	<ul style="list-style-type: none"> ● The binding requirements are observed ● There are no immediately recognizable negative effects ● Possible improvement of processes, procedure, effectiveness, efficiency 	Evaluation and feedback on further action

8. COLLECTION AND VERIFICATION OF AUDIT EVIDENCE (CSAS-2 PARA 5)

The Auditor shall verify compliance with applicable laws, act, rules, regulations and standards. Deviation, if any, shall be recorded. The Auditor shall satisfy himself about compliance of the Auditee with the applicable laws, rules and regulations. If any deviation is observed, then the appropriate noting of the same shall be made.

The Auditor shall obtain complete, relevant and necessary evidence to support the opinion. Audit evidence is obtained using a variety of techniques such as the following:

1. Documents/Records Scrutiny

This is predominant mode of obtaining audit evidence and involves scrutiny of a wide variety of documents e.g. board resolutions, agenda and minutes, notices, registers, records, procedure manuals, reports, etc. In auditing, it is often not possible, due to limited resources, to check every document or record. The Auditor, wherever necessary, may choose to sample a statistical representative number of documented results, such as monitoring big data or incident reports. An appropriate sampling method will manage any uncertainty to an acceptable level.

2. Testing, Interviews and Analysis

The Auditor should determine whether the controls identified during the preliminary review are operating properly and in manner described by the Auditee. Fieldwork typically consists of interviewing the staff of the Auditee whether formally or informally, reviewing procedure manuals and processes, testing and analyzing compliance with applicable policies and procedures and laws, rules, regulations and assessing the adequacy of controls. This exercise may result in significant findings, which the Auditor should consider while preparing the audit report.

3. Questionnaires

This involves seeking information from relevant persons within the Auditee through issue of a formal questionnaire to elicit further information and gather relevant audit evidence.

4. Third Party Confirmation

Third party confirmation is a type of inquiry and involves obtaining, independently of the Auditee, a reply from a third party with regard to some particular information – for example Registrar and Transfer Agents or other third party agencies.

5. Analytical Procedures

Analytical procedures involve comparing data, or investigating fluctuations or relationships that appear inconsistent in various records.

9. THIRD PARTY CONFIRMATION

The Auditor shall obtain confirmations from third party(ies), wherever required, with respect to information which is related to such party(ies).

Third party confirmation is a type of inquiry and involves obtaining, independently of the Auditee, a reply from a third party with regard to some particular information – for example Registrar and Transfer Agents or other third party agencies.

During the course of audit, if circumstances warrant, the Auditor shall obtain the information from the third parties. In such cases, a written request should be made to obtain the information. An external confirmation is audit evidence obtained as a direct written response to the Auditor from a third party in paper form, or through electronic or other medium. Requesting external confirmations is a commonly used audit procedure in an audit. It can be useful in obtaining audit evidence about significant transactions outside the normal course of business, and related party transactions. Circumstances may exist where it may be difficult to obtain responses to external confirmation requests. The auditor should plan alternative or additional procedures.

10. ANALYSIS OF AUDIT EVIDENCE

The Auditor shall evaluate the Audit Evidence to arrive at the conclusion. The Auditor shall verify compliance with applicable laws, rules and regulations and highlight deviations, if any. Further, the Auditor has to obtain competent, relevant and reasonable evidence to support his judgment as well as conclusions relating to the audit. The evidence gathering and evaluation is a simultaneous, systematic and an interactive process and involves:

Gathering evidence by performing appropriate audit procedures;

Evaluating the evidence obtained as to its sufficiency (quantity) and appropriateness (quality);

Re-assessing risk and gathering further evidence as necessary.

The evidence gathering and evaluation process should continue until the Auditor is satisfied that sufficient and appropriate evidence exists to provide a basis for the Auditor's conclusion. Audit evidence should be evaluated against the identified criteria. This involves consideration of evidence collected vis-à-vis the subject matter information as well as the written responses obtained from responsible officers of the Auditee.

Auditor should check that the audit evidence is relevant and reliable. While evaluating evidence, if the Auditor finds that Audit Evidence is conflicting, the Auditor shall assess the extent and credibility of conflicting evidence in order to reach a conclusion or collect more evidence to resolve the conflict. After evaluating the evidence and considering its materiality, the Auditor should decide how best to conclude in the light of the evidence collected, which would be the supporting key documents and arrive at audit conclusions. While evaluating evidence, Auditor can find that audit evidence is conflicting i.e. while some evidence supports the subject matter information other evidences seem to contradict it. In such circumstances, the Auditor needs to assess the extent and credibility of conflicting evidence, undertake alternate audit procedure to corroborate the evidences in hand for forming an appropriate opinion.

Price Waterhouse & Co. Vs. Securities & Exchange Board of India

The mentioned case law, "Price Waterhouse & Co. Vs. Securities & Exchange Board of India Securities Appellate Tribunal Mumbai Appeal No. 6 of 2018," revolves around the determination of evidence and intent in cases involving alleged fabrication, falsification, and manipulation of financial records.

It was held that there must be evidence to show that there was fabrication, falsification and fudging of the books of account of SCSL by the appellants and that the said fabrication, etc. was done with intent, knowledge, connivance and collusion with the management in order to play a fraud on the shareholders/investors. The evidence must be apparent and glaring and not on the basis of preponderance of probabilities. There must be direct evidence of falsification and fabrication of the books of account.

II. DOCUMENTATION

The Auditor shall adequately document the Audit Evidence in working papers, including the basis and extent of planning, work performed and the findings of audit.

The word "document" is used to refer to a written or printed paper that bears the original, official, or legal form of something and can be used to furnish decisive evidence or information. "Documentation" refers to the act or an instance of the supplying of documents or supporting references or records. Documentation of audit evidence supports audit conclusions and confirms that the audit was carried out in accordance with scope of audit.

The Audit documentation is important for several reasons including:

- Confirm and support the Auditor's opinion and reports;
- Increase the efficiency and effectiveness of the audit;
- Serve as a source of information for preparing reports and or answering any enquiries from the Auditee or from any other party;
- Serve as evidence of the Auditor's compliance with applicable standards;
- Facilitate planning and supervision;
- Help the Auditor's professional development;
- Help to ensure that delegated work has been satisfactorily performed;
- Provide evidence of work done for future reference;
- The user of the audit report rely upon the audit report with proper documentation;
- It confirms that the Auditor's report is in conformity with the applicable laws, rules, regulations and standards, etc.

The Audit Documents shall contain sufficient information to enable an Auditor, having no previous connection with the audit, to ascertain from such documents the significant findings and conclusions of the Auditor. Audit documents should be comprehensive, understandable with ease and contain all the significant information related to the scope covered under the audit.

According to the *Public Company Accounting Oversight Board (PCAOB): Audit documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached. Also, the documentation should be appropriately organized to provide a clear link to the significant findings or issues. Examples of audit documentation include memoranda, confirmations, correspondence, schedules, audit programs, and letters of

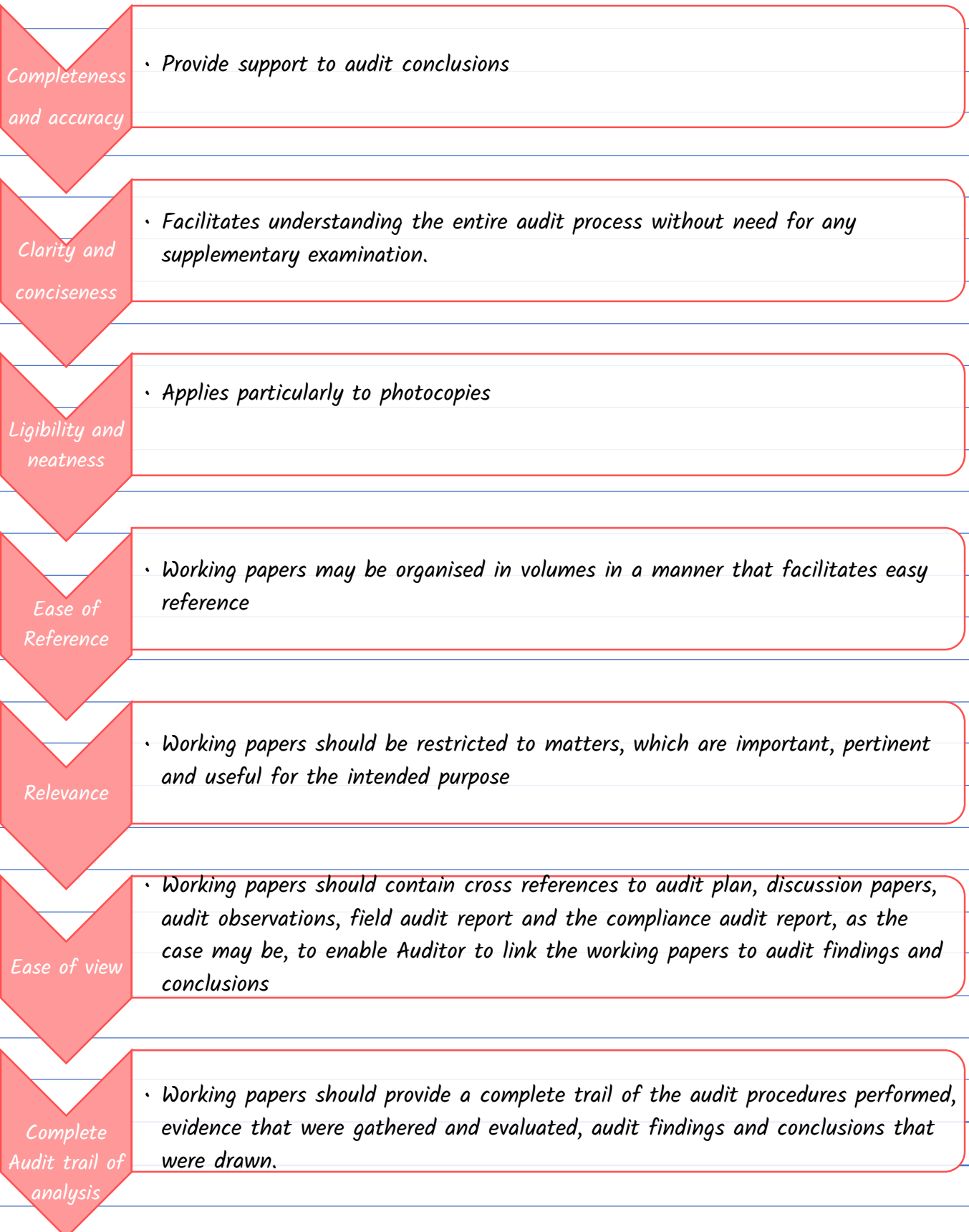
representation. Audit documentation may be in the form of paper, electronic files *The Public Company Accounting Oversight Board (PCAOB) is a nonprofit corporation established to oversee the audits of public companies. The PCAOB also oversees the audits of brokers and dealers registered with the U.S. Securities and Exchange Commission (SEC).

Audit Documentation shall take place throughout the audit process. Working papers shall be complete and appropriately detailed to provide a clear trail of the audit. Audit Documents shall be properly indexed, referenced with and supplemented by the set of working papers.

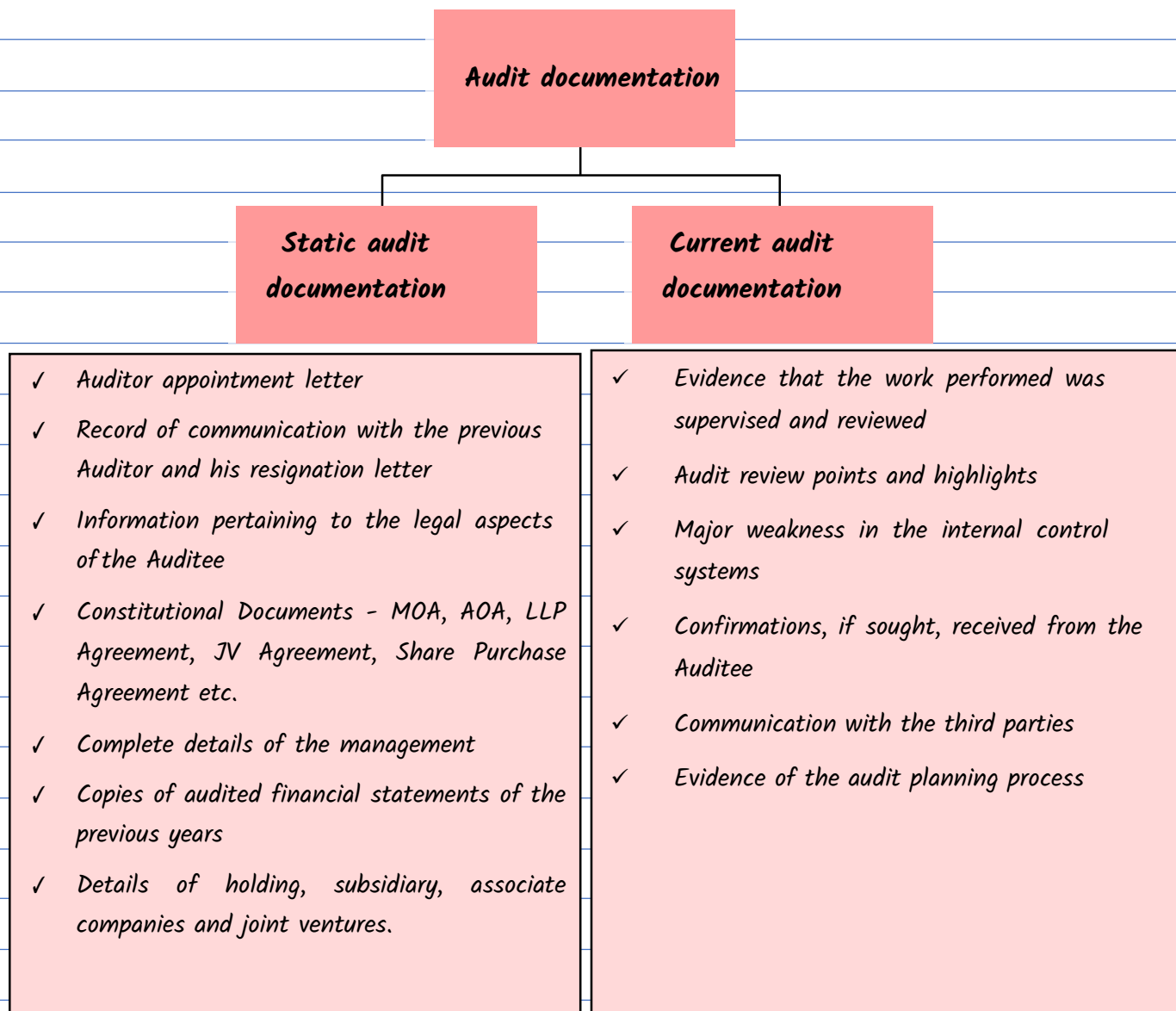
Re V. Shankar Vs. Securities and Exchange Board of India SAT

It was held that the Company secretary, as part of his duty and responsibility is only required to authenticate contents indicated in balance sheet or in offer document and is not required to go into veracity of buy back offer document and its legal compliances before authenticating such document and, therefore, company secretary could not be held guilty of making false or misleading open offer which had been approved by board of directors of company.

Some of the broad characteristics of Audit Documentation are set out below:



Audit documentation may be divided into two categories:



Documentation of discussions held with management related to significant matters, where written record is not available:

Relevant discussions with the Management along with confirmations if any obtained from the auditee shall be recorded as documentation of audit evidence supports audit conclusions and confirms that the audit was carried out in accordance with the scope of the audit.

12. RECORD KEEPING AND RETENTION

The Auditor shall establish policies and procedures for retention of Audit Documents. A well established policies and procedures should be in place for the documentation. Audit Documentation is essential for the following purposes:

- To comply with legal duties and requirements, either statutory or regulatory;
- To avoid liability, the improper destruction or alteration of documents in a litigation situation;
- To support or oppose a position in an investigation or litigation;
- To protect from unnecessary expense and time during discovery;
- To maintain control over discovery and e-discovery; and
- To keep documents confidential and avoid leakage to attackers or competitors.

The Audit Documents shall be collated for records within a period of 45 days from the date of signing of Auditor's Report. The documents should be maintained in a manner which is safe, secure and retrievable as and when required. The Audit Documents shall be maintained in physical or electronic form and retained for a period of 8 years from the date of signing of Auditor's Report.

SUMMARISED VERSION (MIND MAP)

I. INTRODUCTION TO PROCESS OF FORMING AN OPINION

- i. The Auditing Standard on Forming of opinion (CSAS-3), deals with basis and manner for forming Auditor's opinion on subject matter of the audit. This standard aims to promote consistency in opinion forming and reporting thereof to enable users of the report to identify the audit findings.
- ii. The evaluation under CSAS-2 refers to the evaluation of Audit Evidence to reach a conclusion, whereas this Standard deals with evaluation of conclusion(s) reached during audit process. This Standard also deals with the manner in which the opinion formed by the Auditor will be expressed in writing and circumstances and manner to disclaim the opinion and the reporting format.
- iii. Upon the performance of the audit and conclusion thereof, the auditor is required to submit a report stating that the affairs of the company are carried out in the fair manner and are free from material misstatement.
- iv. However, *the content of the opinion should clearly indicate whether it is unmodified or modified and if modified, whether it is modified as adverse or disclaimer of opinion.*
- v. The auditor *should form his opinion on considering all material aspects*, in accordance with the applicable reporting framework and the requirement of the audit and after obtaining reasonable assurance about whether the affairs of the company relating to the scope of audit as a whole are free from material misstatement or not.
- vi. In particular, the auditor shall evaluate whether, in view of the requirements of the applicable reporting framework:
 - (a) The Company has adequately disclosed all relevant information about its affairs;
 - (b) The Company has followed all procedures as required under the applicable laws;
 - (c) The Company is in compliance with the applicable laws;
 - (d) The Company is consistent with the applicable reporting framework;
 - (e) The information presented by the company is relevant, reliable, comparable, and understandable;
and
 - (f) The company has provided adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information.

2. FORMS OF OPINION

Unqualified / Unmodified Opinion

- i. The auditor shall report an unqualified opinion if the affairs of the company are found to be free from material misstatements.
- ii. An unqualified opinion contains no reservations concerning the company.
- iii. This is also known as a "clean" opinion which means that the affairs of the company are presented fairly.
- iv. The Auditor should express an unmodified opinion when based on Audit Evidence, the Auditor concludes that:
 - (a) there is due compliance with the applicable law in terms of timelines and process; and
 - (b) the records are free from misstatement and maintained in accordance with applicable laws.

"Records" include:

- (i) Memorandum and Articles of Association, byelaws or any other constitutional documents;
- (ii) Minutes, returns, forms, index and Registers;
- (iii) Books and papers include books of accounts, deeds, vouchers;
- (iv) Agreements, Memorandum of Understanding;
- (v) Other documents maintained by the Auditee either in physical or electronic form; and
- (vi) Correspondence.

Generally the Records means the Records for the audit period, however if an opinion forming warrants the review of prior period Records, the same may also be considered as Records.

- (c) the auditor concludes that the information on the affairs of the company in all material respects, are in accordance with the applicable reporting framework.

Misstatement

"Misstatement" means any information or statement which is false, incorrect, incomplete, misleading or misrepresents, omits or suppresses a material fact.

Causes of misstatement may include:

- (a) an inaccuracy in gathering or processing data or information;
- (b) an omission of a disclosure;

- (c) an incorrect or clear misinterpretation of the facts; or
- (d) Management's judgments that the Auditor considers unreasonable.

For Example:

1. XYZ an Auditee company has stated in its Annual Report that company has complied with all applicable regulations of SEBI during the Financial Years whereas the material non-compliances were not reported which impacts the Goodwill of the company, which can mislead the investors.
2. Company undertook a material related party transactions but it is not disclosed in the company's Annual Report.

In order to form unmodified opinion, Auditor shall conclude as to whether he has obtained reasonable assurance about whether the documents, books or statements as a whole are free from material misstatement, whether due to fraud or error.

An unmodified opinion is formed when based on all the Audit Evidences the Auditor states that there is due compliance of all the applicable laws, or any other law for the time being in force, or any rule or regulation **in terms of timelines and process**.

Compliance in terms of timelines: Compliance in terms of timelines implies that when the adherence of the applicable laws, act, rules or regulations are made within the specified time limits as provided in the law for the particular task or completing any business procedure etc.

Example:

As per law the due date of filing the Annual Returns, i.e., Form MGT-7 of the company with Registrar of Companies is given as sixty days from the date of Annual General Meeting of the company and company has also filed the said return within the prescribed limit of 60 days, that means company has adhered to the applicable laws properly and within the given timelines

Compliance in terms of process: Compliance in terms of process means that, when the business activities, say documentation, or any other transaction has been made, complying with the applicable laws and as per the procedure or process given for performing that activity/procedure or transaction etc. The process of doing or performing the task as per the given procedure in the applicable laws is known to be compliances made in "in terms of process".

Example:

If a company is required to shift its registered office from one place to another within same state and RoC, the a whole set of procedures given in Companies Act, 2013 is required to be followed e.g. conducting a Board Meeting for approval of shifting of Registered office, intimation to Registrar of Companies in Form INC-22 along with various documents as attachment within 15 days of passing the Board Resolution.

Modified Opinion

The Auditor should express modified opinion when the Auditor concludes that:

- (a) based on the Audit Evidence obtained, *there is non-compliance with the applicable laws in terms of timelines or process*; or
- (b) based on the Audit Evidence obtained, the *records* as a whole are *not free from misstatement* or are *not maintained in accordance with applicable laws* or
- (c) he is *unable to obtain sufficient and appropriate Audit Evidence to conclude* that there is *due compliance with the applicable laws* in terms of timelines and process; or
- (d) he is *unable to obtain sufficient and appropriate Audit Evidence to conclude* that the records as a whole are *free from misstatement*.

Adjudication Order in respect of CHD Developers Ltd. and 3 others in the matter of CHD Developers Ltd.

In this matter SEBI initiated adjudication proceedings against CHD Developers Ltd for violations of the SEBI LODR Regulations in respect of disclosure of material false information.

Based on audit procedures performed and management explanations provided, the Auditors had submitted a qualified opinion in their Report to the financial statements of the company and did not receive any explanation or evidence from the Company with respect to progress on the qualification made.

Instead, the report issued on June 29, 2019 had declared that the Auditors had given an unmodified opinion.

It was observed that as the company failed to disclose its audited financial results as well as the statement of impact of audit qualifications within the stipulated period of 60 days from the end of the financial year, it has violated the provisions of SEBI LODR Regulations.

If the information prepared in accordance with the requirements of a fair presentation framework is not sufficient and relevant enough so as to allow achieving of a fair presentation, the auditor should discuss the matter with management and, depending on the requirements of the applicable reporting framework and how the matter is resolved, should determine whether it is necessary to modify the opinion in the auditor's report. In case the auditor expresses a modified opinion or disclaims an opinion, **the text of the opinion shall be either in italics or bold letters.**

The Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report.

CASE STUDY

The provided case study involves a listed company, ABC Ltd., on the BSE India, and its secretarial audit conducted by M/s YY & Associates for the fiscal year 2021-2022. The secretarial audit report issued by M/s YY & Associates highlighted certain observations regarding the company's compliance with various regulations and acts. In response, the directors of ABC Ltd. furnished explanations to address these observations. Here's a breakdown of the key points:

Observations in the Secretarial Audit Report:

1. Non-Compliance with Composition of Board and Audit Committee:
 - The secretarial audit report mentioned that the composition of the board of directors did not comply with Regulation 17 and 25 of the Listing Regulations and Section 149(3) of the Companies Act, 2013.
 - Additionally, the composition of the Audit Committee was not in compliance with Regulation 18 of the Listing Regulations.
2. Non-Compliance with Composition of Risk Management Committee:
 - The audit report observed that the Risk Management Committee of the company had 50% of its members who were directors of the company, which was not in compliance with Regulation 21 of the Listing Regulations.

3. Non-Appointment of Chief Financial Officer (CFO):

- The audit report noted non-compliance with Section 203(4) of the Companies Act, 2013, regarding the non-appointment of a Chief Financial Officer (CFO) by the company.

Directors' Explanations:

1. Board and Audit Committee Composition:

- The directors explained that due to the stressed situation of the company, finding suitable persons as Independent Directors was challenging.
- With the appointment of new independent directors, including a woman independent director, the company achieved compliance with the relevant regulations and acts from March 16, 2022.
- The non-compliance with the Audit Committee composition was due to the resignation of two independent directors who were also Audit Committee members. This non-compliance was rectified with the reconstitution of the Audit Committee from October 15, 2021.

2. Risk Management Committee Composition:

- The directors clarified that although 50% of the committee members were directors, the committee composition was rectified to ensure stricter compliance with Regulation 21 of the Listing Regulations from October 1, 2021.

3. Appointment of Chief Financial Officer (CFO):

- The directors clarified that the company always had a Group Chief Financial Officer in place.
- The appointment of a CFO was made effective from June 1, 2021, thus rectifying the non-compliance with Section 203(4) of the Companies Act, 2013.

In summary, the case study showcases the interaction between the secretarial audit report's observations and the directors' explanations to address those observations. The directors provided justifications for the instances of non-compliance and demonstrated how the company took corrective actions to rectify these issues in order to achieve compliance with relevant regulations and acts. This emphasizes the significance of transparency, accountability, and timely corrective measures to ensure compliance with applicable laws and regulations.

The modification on Opinion can be in any one of the following three categories depending upon the nature and severity/ extremity of the matter under consideration:

The Qualified Opinion

The Adverse Opinion

**The Disclaimer of
Opinion**

Qualified Opinion

An Opinion can be considered as a qualified opinion when **the auditor specifically provides the specific instances** where the company has failed to do compliance as required under the law, or provides reasons for the not issuing the unqualified report on the affairs of the company.

Adverse Opinion

An Opinion can be considered as an adverse opinion where **the auditor concludes that the affairs of the company are not in line with its objectives**, government rules, and the company has neglected and grossly misstated its records.

An adverse opinion may be an **indicator of fraud**, and public entities that receive an adverse opinion are forced to take corrective measures.

Disclaimer of Opinion

Where the auditor is **unable to access the records of the company** on any grounds such as geographical reasons, regulatory, natural calamity or could not complete the audit due to absence of requisite records or insufficient co-operation from management, the auditor issues a disclaimer of opinion.

This opinion is formed when **auditor is not able to conclude if affairs of the company are conducted in true and fair manner**.

Modified opinion is always in either Italics or Bold.

Emphasis of Matter

Emphasis of matter (EOM) is included in the audit report **to make the reader aware about the specific instances which are not in the general course of business**.

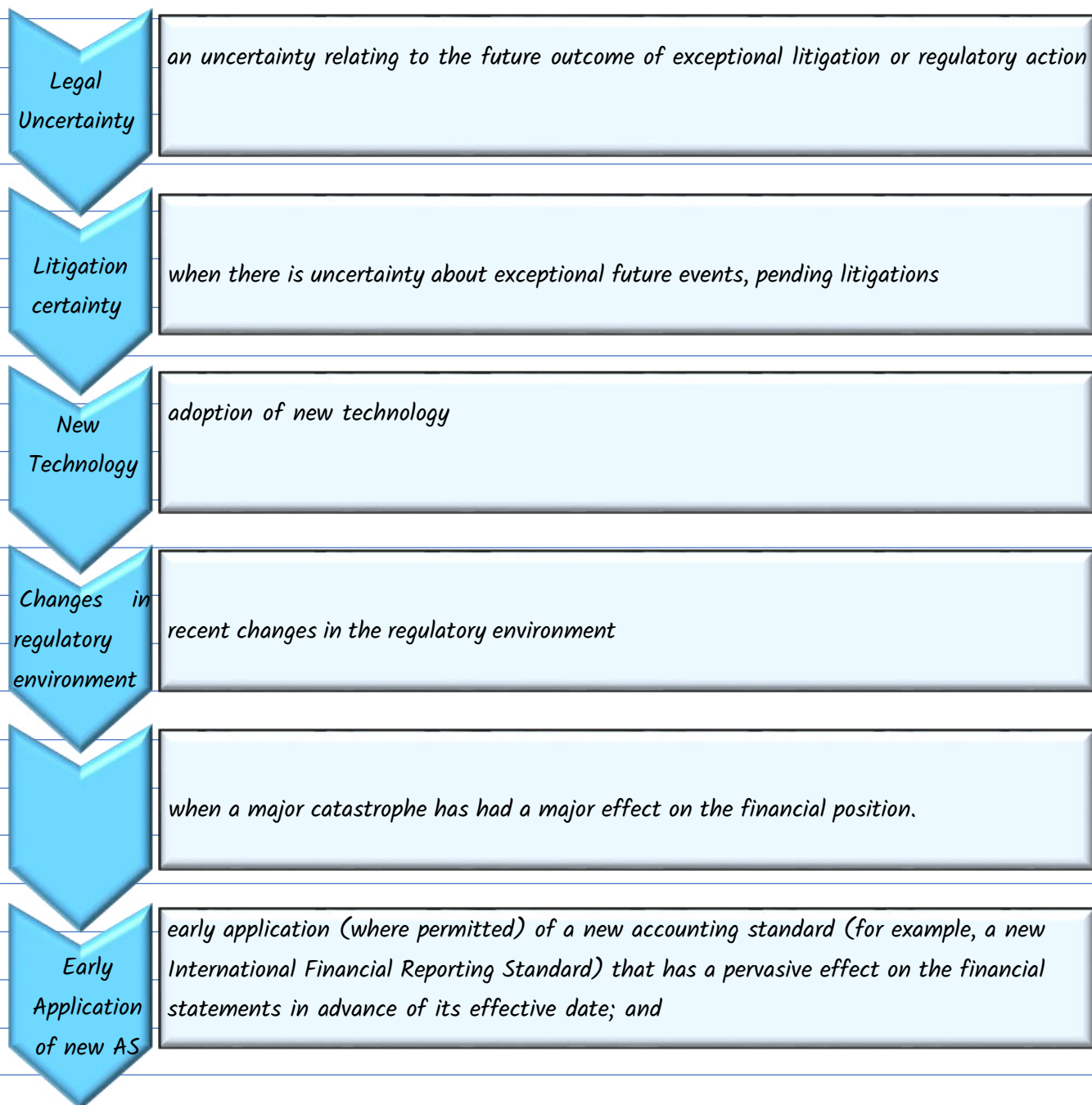
Ideally, such matters should be the part of the Directors Report or the Management Discussion and Analysis report prepared by the company. If the same is not disclosed by the company in the Directors report or in Management Discussion and Analysis Report, the auditor may opt to place the same in the Auditor's Report.

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The following are examples of the matters which should be considered as emphasis of matter:



3. MATERIALITY

- i. Materiality is a concept within auditing and accounting relating to the importance/significance of an amount, transaction, or discrepancy in the records of the company.
- ii. The assessment of **what is material is a matter of professional judgement.**
- iii. Materiality is the threshold above which missing or incorrect information is considered to have an impact on the decision making of the Auditor. Information is considered as material if its omission or misstatement could influence the opinion of the Auditor.
- iv. The auditor **has to ensure that material items are properly and distinctly disclosed by the company.** It is very important for the auditor to constantly judge whether a particular item is material or not.
- v. There is an **inverse relationship between materiality and the degree of audit risk.** The higher the materiality level, the lower the audit risk and vice versa.
- vi. The Auditor **shall consider materiality while forming his opinion and adhere to:**
 - a. The principle of completeness that requires the Auditor to consider all relevant Audit Evidence before issuing a report;
 - b. The principle of objectivity that requires the Auditor to apply professional judgement and professional sceptics minor dertoen sure that all reports are factually correct and that findings or conclusions are presented in a relevant and appropriate manner;
 - c. The principle of timeliness that implies preparing the report in due time; and
 - d. The principle of a contradictory process that implies checking the accuracy of facts and incorporating responses from concerned persons.
- vii. The concept of Materiality **is applied by the Auditor both in planning and performing the audit, and forming the opinion.** It consists of both quantitative and qualitative factors.
- viii. Determining Materiality **is a matter of professional judgement** and depends on the Auditor's interpretation of the user's needs. What is material for one Auditee may not reach the Materiality threshold for another.
- ix. Materiality **is important while conducting the audit process and also while forming the audit opinion** based upon the evaluation of conclusions drawn on the basis of the audit process.

4. PROCESS FOR FORMING OF OPINION

Forming of Opinion based on the audit observations is an important part of any audit, as through this process the outcome of audit are presented in the form of Audit Report to the intended users.

Principles for Auditors for forming opinion

- i. **Completeness**
- ii. **Objectiveness**
- iii. **Timelines**
- iv. **Contradictory process**

The Auditor shall consider Materiality while forming his opinion and adhere to:

- (a) The **principle of completeness** that requires the Auditor to **consider all relevant Audit Evidence before issuing a report-**
 - It requires that the Auditor should gather sufficient and appropriate Audit Evidences to provide the basis for the conclusion or opinion.
 - Auditor should not be selective in using the available evidence before forming opinion.
 - Auditor should use all the available evidence available to him, and only discard the contradictory information, if any, after applying principle of contradiction process.
- (b) The **principle of objectivity** that requires the **Auditor to apply professional judgement and skepticism** in order to ensure that all reports are factually correct and that findings or conclusions are presented in a relevant and appropriate manner;
 - The Auditor must remain objective throughout the whole process, such that his integrity must not allow any malpractice in the audit process. Objectivity is essential for any professional person exercising professional judgement. It basically refers to independence.
 - **Professional scepticism** is considered as corner stone of good auditing. Professional scepticism requires an Auditor to have an enquiring mind. Whatever documents and information are produced before the Auditor by Management/ Auditee should not be relied on the face of it. An Auditor should see to it that documents and information are reasonable, appropriate,

inconsonance with attending circumstances and knowledge of the Auditor from other sources as well.

- Auditor must obtain sufficient evidence from Auditee to support what Auditee says.

Threats to objectivity

- Auditor should identify the threats and consider them in the light of the environment in which he is working.
- He should also take into account the safeguards which assist them to withstand threats and risks to their objectivity.
- The easiest way of avoiding such threats would be for Auditor to decline to act in any circumstances where the slightest threat to objectivity might exist.
- Threats to objectivity might include the following:
 - Self-interest threat** - A threat to the Auditor's objectivity stemming from a financial or other self-interest conflict. This could arise, for example, from a direct or indirect interest in Auditee or from a fear of losing an audit work.

Example: The M/s ABC & Associates engaged its audit team for conducting audit of XYZ Ltd. However, the audit team has not received its audit fees from XYZ Ltd for its audit. In this case, the audit team may consider to issue a favorable audit report so that the company is able to secure a loan to settle the fees outstanding for their audit.

- Self-review threat** - The apparent difficulty of maintaining objectivity and conducting what is effectively a self-review, if any product or judgement of a previous audit assignment or a non-audit assignment needs to be challenged or re-evaluated in reaching audit conclusions.
- Advocacy threat** - There is an apparent threat to the Auditor's objectivity, if he becomes an advocate for (or against) the Auditee's position in any adversarial proceedings or situations..

Example: The auditor is assisting in selling XYZ Pvt Ltd and he is also serving as the auditor for the company. In this scenario, the auditor may issue a favorable report to increase the sale price of XYZ Pvt Ltd

d. **Familiarity or trust threat** - A threat that the Auditor may become over-influenced by the personality and qualities of the Directors and Management, and consequently too sympathetic to their interest.

Example: XYZ Pvt Ltd has been audited by M/s ABC & Associates for over 8 years and the audit partner of the firm regularly plays badminton with the CEO and CFO of XYZ Pvt Ltd. Then in this case, the audit partner of Ms/ ABC & Associates may have become too familiar with the client and, thus, lack objectivity in their work

e. **Intimidation threat** - The possibility that the Auditor may become intimidated by threat, by dominating personality, or by other pressures, actual or feared, by a director or manager or by some other party.

Example: XYZ Pvt Ltd is unhappy with the conclusions and qualifications made by M/s ABC & Associates in the audit report and sensitized to switch auditors next year. XYZ Pvt Ltd is the biggest client of the M/s ABC & Associates. In this case, the auditor's independence may be compromised, as XYZ Pvt Ltd is the biggest client of M/s ABC & Associates and they do not want to lose such a client. Therefore, the auditor may issue a report that calms XYZ Pvt Ltd.

Auditors should strive to develop the following characteristics in their audit firms, wherever possible to provide safeguards against these threats:

- Auditors should **behave with integrity** in all their professional and business relationships and to strive for objectivity in all professional and business judgements.
- Within every audit firm **there should be strong peer pressure towards integrity**. Reliance on one another's integrity should be the essential force which permits partners to entrust their public reputation and personal liability to each other.
- Audit Firms of all sizes **should establish strong internal procedures and controls over the work of individual Auditors**, so that difficult and sensitive judgements are reinforced by the collective views of other Auditors, thereby also reducing the possibility of litigation.

(c) The principle of timeliness that implies preparing the report in due time. Auditor must adhere to timeline agreed at the time of engagement for issuing the report and any deviation, from agreed timeline must be recorded with reason for such deviation.

(d) The principle of a contradictory process that implies checking the accuracy of facts and incorporating responses from concerned persons.

When two contradictory facts emerge on same subject matter of audit, Auditor must strive to find additional evidence/material which supports or negates one of the facts. This process of finding additional evidence/ material must continue till one of the facts is eliminated. In case Auditor is unable to find further evidence/ material and contradiction continues to persist, Auditor should bring out that fact clearly in his report and if circumstances warrants, disclaim opinion on that particular subject matter.

i. The Auditor should evaluate whether the evidence obtained is sufficient and appropriate so as to reduce audit risk to an acceptably low level.

ii. After evaluating the sufficiency and appropriateness of evidence to determine the assurance level of the audit, the Auditor should consider which conclusion is appropriate in light of the evidence obtained.

iii. After evaluation, Auditors need to weigh the extent and credibility of conflicting evidence in order to reach a conclusion or collect more evidence to resolve the conflict in such situations,

iv. Audit conclusion should clearly bring out the nature and extent of non-compliance, cause of such non-compliance, its Materiality and also the effect of non-compliance, if possible.

v. The audit conclusions in case of regularity issues should also indicate whether non-compliance is a solitary one-off case, or wide spread systemic issue in the Auditee.

1. Judgement, Clarification and Conflicting Interpretation (Not Important for Exam)

While forming an Audit opinion the Auditor may consider or refer the decided case laws or judgements, clarifications issued, opinions formed in similar type of audits while framing the final audit opinion.

Judgements

For example, while interpreting the issue of loans given by the Auditee company in terms of Section 185, the Auditor may refer to the decided case laws in this respect, e.g in Dr. Freddie Ardeshir Mehta v. Union of India, the terms “indirectly” and “loans”, has been explained as below:

- The word “indirectly” means providing loan through agencies or any other medium but does not include converting anything which does not qualify to be loan or loan represented by book debt or security or guarantee into loan, any loan represented by book debt or guarantee or security.
- The word “Loan” was defined by the court as a thing lent; something the use of which is allowed for a time, on the understanding that it shall be returned or an equivalent given; esp., a sum of money lent on these conditions and usually with interest. The essential requirement of a loan is the advance of money (or of some article) upon the understanding that it shall be returned, and it may or may not carry interest.
- The phrase “any loan represented by book debt” is inserted in order to plug the loophole used in the case of “Dr. Freddie Ardeshir Mehta v. Union of India” where court took the view that book debt can't be treated as loan and since the earlier Section 295 of Companies Act, 1956 does not explicitly include the phrase “any loan represented by book debt” hence any kind of credit facility extended by company to directors will not cover under the “Loan to director”.

Therefore, while auditing, the Auditor may refer to the interpreted words given in court judgements so as to interpret the meaning of the legal terms correctly and in their true sense and can frame the opinion accordingly and accurately.

Clarifications in respect of forming the audit opinion implies that in case the true or clear sense of law cannot be interpreted by the Auditor or if it was so interpreted, then contradictory interpretations amongst various Auditors or professionals seem to exist; in such a case Auditor may refer to the clarifications issued by various authorities e.g. Ministry of Corporate Affairs, Institute of Company Secretaries of India, CBDT, or any other Govt. body etc., to frame a reliable and accurate opinion.

Opinions formed by other Auditors, in similar types of Audits may also be referred by the Auditor to form a judgement and frame its opinion. Similar type of Audit may also depend on nature of business, transactions occurred and operation of scale of Auditee, etc.

Conflicting Interpretations may be sorted out by again referring to the decided judgements, clarifications issued by the Govt. Authorities, Regulators, etc.

2. Role of Precedence and Practices

- i. Auditor shall evaluate on the basis of general or ongoing practices or procedures that whether the Records maintained, statements prepared in all material respects, in accordance with the requirements of the applicable laws, rules and regulations.
- ii. The Practices and precedence used by Auditor for forming the Audit opinion may be as per the historical perspective i.e., methods used hitherto or generally used methods or practices or procedures be implemented for framing the opinion.
- iii. For Example: one of the method involves selecting a sample size of total work and activities of a firm for conducting the audit process, which simultaneously depends upon the firm's size, operation of work and no. of branches, etc., or another practice includes having an unbiased approach while conducting the audit process in order to frame the honest and unbiased opinion.

5. LIMITATION

- i. Limitation on the scope of audit means when the Auditor appointed for performing the Audit will not be able to obtain appropriate or complete Audit Evidences due to the restrictions or limitations imposed on the process of Audit which ultimately affects the Auditor's opinion. The Auditor's inability to obtain sufficient and appropriate Audit Evidence may arise from:
 - a. Circumstances beyond the control of the Auditee;
 - b. Circumstances relating to the nature or timing of the Auditor's work;
 - c. Limitations imposed by Management.
- ii. If, after accepting the Audit Engagement, the Appointing Authority imposes a limitation on the scope of the Audit which, in the opinion of the Auditor, is likely to result in the need to express a modified opinion or to disclaim an opinion, the Auditor shall request the Appointing Authority to remove the limitation.

- iii. If the **Appointing Authority refuses** or fails to remove the limitation, **the Auditor shall communicate the matter to the Management** and determine whether it is possible to **perform alternative procedure to obtain sufficient and appropriate Audit Evidence.**
- iv. If the Auditor is **unable to obtain sufficient and appropriate Audit Evidence**, the Auditor shall determine the implications as follows:
- (a) If the Auditor concludes that the possible effects of unavailable Audit Evidence could be **non-material**, the Auditor shall **modify the opinion**; or
- (b) If the Auditor concludes that the possible effects of unavailable Audit Evidence could be **material**, the Auditor shall express **disclaimer of opinion.**
- i. If after obtaining the Audit engagement, **the Appointing Authority imposes a limitation on the scope of Audit**, which is likely to affect the Auditor's opinion, **the Auditor shall request the Authority to remove the limitation.**
- ii. If **Management refuses** the Auditor's request to remove a limitation that Management has imposed on the scope of the audit, **the Auditor should communicate the matter with those charged with governance.**
- iii. When a limitation on the scope of the audit imposed by Management is **not removed**, the Auditor **should determine whether it is possible to perform alternative procedures** to obtain sufficient appropriate Audit Evidence on which to base an unmodified opinion.
- iv. If the Auditor is **unable to obtain sufficient appropriate Audit Evidence**, the Auditor should **determine the implications as follows:**
- if the possible effects of the scope limitation are material but not pervasive to the business procedures, documents, or underlying transactions, the Auditor should modify the opinion;
 - if the possible effects of the scope limitation are both material and pervasive to the compliance of laws, rules and regulations or underlying transactions or other business procedures/activities so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the Auditor should disclaim an opinion.

6. THIRD PARTY REPORT OR OPINION

- i. "Third Party" means any person who does not have a direct connection with the audit but whose inputs or opinion might influence the audit conclusion and includes an expert

- ii. Sometimes due to circumstances like geographical constraints or want of expertise on any specific subject matter an Auditor may be required to rely on the Third-Party reports.
- iii. *The Third-Party reports may be arranged by the Auditee or Auditor directly.*
- iv. Third Party Report or Opinion is used as one of the external sources of obtaining the Audit Evidences that would help in building the strong and quality Audit Opinion.

The Auditor shall *adhere to the following while forming an opinion based on Third party reports or opinions:*

- (a) The Auditor shall *indicate the fact of use of Third party report or opinion and shall also record the circumstances necessitating the use of Third party report or opinion;*
- (b) The Auditor shall *indicate the fact if Third party report or opinion is provided by the Auditee;*
- (c) The Auditor shall *consider the important findings/observation of Third party;*
- (d) The Auditor shall, if necessary and feasible, *carry out a supplemental test to check veracity of the Third party report or opinion.*

While using the work of Third Party, the Auditor should:

- (a) Consider the independence and objectivity of the Third Party;
- (b) Take account of the Third Party's professional competence for the specific audit;
- (c) Consider the scope of the Third Party's work;
- (d) Determine the cost-effectiveness of using such work;
- (e) Perform procedures too btain sufficient appropriate Audit Evidence that the work of the Third Party is adequate in the context of the specific audit (which may require access to the Third Party's working papers); and
- (f) Consider the significant findings of the other Auditor when analysing and interpreting the results of that work. Where these findings are significant to the opinion, Auditor should discuss these findings with the Third Party and consider whether it is necessary to carry out additional audit testing him.
- (g) When using the work of Third Party, Auditor should carefully consider that, the Third Party may only recognise a duty of care to the addressee of the audit report.

7. MANAGEMENT REPRESENTATION LETTER

- i. The auditor may obtain a management representation letter from the auditee company on matters which are not capable of direct verification by the Auditor.
- ii. The letter **may be signed by Managing Director/Company Secretary/Senior Management** who would normally have authority to issue the same. The Auditor can use this letter of representation as part of his audit evidence.
- iii. Mere getting certification or written representation from management may defeat the purpose of the audit, hence, it is advised to exercise all possible care, reasonable skill & due diligence

Specimen Management Representation Letter for Secretarial Audit

M/s ABC & CO,
Company Secretaries,
2YZ Road, India

Date:

Dear Sir,

This representation letter is provided in connection with your audit of the Secretarial Records maintained under The Companies Act, 2013 (the Act) and the rules made thereunder; (ii) The Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made thereunder; (iii) The Depositories Act, 1996 and the Regulations and Bye-laws framed thereunder; (iv) Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings; The Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992 ('SEBI Act') and other applicable laws including labour laws like Factories Act, Payment of Gratuity Act etc for the year ended on 31st March, 20 Environmental Laws and Competition Laws for the purpose required in it. We the undersigned acknowledge our responsibility for maintaining the Secretarial records referred above and confirm, to the best of our knowledge and belief, the following representations:

Company Law

1. The Company has maintained books of accounts as required under Section 128 of the companies Act, 2013.
2. The Company has complied with all the provisions of the Secretarial Standards.
3. The Company has complied with all the provisions of Companies Act, 2013 relating to Statutory Audit/ Cost Audit/Internal Audit.
4. No request for transfer or transmission of shares have been received by the company during the year other than as recorded.
5. Statutory Registers were kept open for public inspection during working hours on all working days.
6. Notice of Board meetings were duly sent to all the Directors.
7. Notes and notes to agenda were duly sent to all the Directors.
8. No resolutions were passed by way of circulation during the year under review other than those recorded in the minutes.
9. The views of all the dissenting Directors (if any) on important matters have been captured and recorded in the minute.
10. The venue and time of Board meeting was finalized with the consultation of all board members.
11. Draft minutes and final minutes were properly sent to all the Directors.
12. Company has not obtained any secured loan from any financial institution/banks other than those mentioned in the register of charges.
13. Notice of annual general meeting has been duly sent to all the members, Directors, Statutory Auditor and Secretarial Auditors.
14. No show cause notice has been received by the company under the Acts referred above or any other laws applicable on the company.
15. There are no pending litigation and claims other than those reported in the Financial Statements - balance sheet by way of contingent liability.
16. No event other than reported to you specifically has occurred during the year which has a major bearing on the company's affairs in pursuance of the laws, rules, regulations, guidelines, standards, etc. referred to above. We have provided to you all relevant information and have given access to all data and records.

17. The company has altered the memorandum/articles of Association and have recorded the alterations in all copies of the Memorandum/Articles of Association.
18. Wherever the Share Certificates were issued in the physical form, they were issued in accordance with the provisions of the Companies Act, 2013 and the rules thereunder.
19.

Securities Laws

1. All price sensitive Information was furnished to the stock exchanges from time to time.
2. All investors complains directly received by the company are recorded on the same date of receipt.
3. The Company has complied with provision of SEBI (LODR) Regulations, 2015.
4.

Specific Applicable Laws

Labour Laws

1. All the premises and establishments have been registered with the appropriate authorities.
2. The Company has not employed any child labour/bonded labour in any of its establishments.
3. The company is ensuring the compliance of PF/ESI and other social security measures with respect to the contract employees. One of the responsible officers of the company carries out the survey regarding the compliance of this.
4. The company has held its internal complaints committee meeting regularly under POSH.
5.

Environmental Laws

1. The Company is not discharging the contaminated water at the public drains/rivers. The company has efficient water treatment plants at its factory premises (if applicable).
2. The company has been disposing the hazardous waste as per applicable rules. Competition Law.

Competition Law

List of other laws generally applicable to the company. We are attaching herewith the list of laws:

1. *Applicable specifically to the Company.*
2. *Other Laws applicable to the Company*

Date:

[For XYZ Limited]

Place:

Director

Opinion obtained by Management

In the certain situations, upon the qualifying remarks of the auditors, the management of the company may submit its replies which may be supported by the opinion provided by the third party. In such cases the reliance on such opinion should be made by the auditor based on his professional judgement and the company may provide the explanation on such qualifications in the Directors report. Upon consideration of the information produced by the company as audit evidence, the auditor should evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to:

- (a) *Test the accuracy and completeness of the information, or test the controls over the accuracy and completeness of that information; and*
- (b) *Evaluate whether the information is sufficiently precise and detailed for the purposes of the audit.*

Exit Conference

While concluding the audit, the auditor should conduct a meeting with the management of the company or with the group supervisory officers. Audit observations are ideally shared with officials in advance, allowing them an opportunity to discuss findings and address any concerns related to the audit observations.

8. EVALUATION OF AUDIT EVIDENCE AND FORMING OPINION

- i. *The Audit evidence plays a significant role in forming of Opinion. Based on such evidence the auditors form their opinion in the report, accordingly the auditor should obtain competent, relevant and reasonable evidence to support his judgement and conclusions.*
- ii. *The competent evidence is information which is quantitatively sufficient and appropriate to achieve the auditing results and is qualitatively impartial to inspire confidence and reliability.*

iii. *The Reliable audit evidence is evidence that is impartial. The reliability of audit evidence is dependent upon its nature, its source and the method used to obtain it.*

iv. *While collecting the audit evidence the auditor should consider the below:*

Reliability of Documentary Evidence

Documentary evidence is more reliable than oral evidence.

Evidence on Direct Personal Knowledge

Evidence of which the auditor has direct personal knowledge is the most reliable evidence.

Evidence from External Source

Independent evidence obtained from external sources is more reliable than internal evidence, if that evidence is truly Independent and complete.

Reliability of Visual Evidence

Visual evidence is highly reliable for conforming the existence of assets, but not their ownership value.

Examining figures less reliable

Drawing conclusions solely through examining relationship between figures in the account (analytic Review) is less reliable evidence.

Oral Evidence Least reliable

Oral evidence must be considered as the least reliable, whenever feasible, auditor should attempt to obtain documentary confirmation of oral evidence.

Reliability of information generated within entity

The reliability of information generated within the auditee entity is a function of the reliability of internal control systems within the entity.

Photocopies less reliable

Photocopies are less reliable than the originals, the source of photocopies should be identified by noting the source and as far as possible the photocopies should be certified.

Accepted Evidences

Evidence, which is accepted by the auditee entity, is always reliable.

Gain increased assurance

The auditor may gain increased assurance when audit evidence obtained from different source is consistent.

- **Sharing draft report with management with category of risk involved with each remark and qualification**

After the exit meeting and the completion of the audit procedures, the auditor should prepare an executive summary of audit findings, which explains the key audit issues, the category of risk, their resolution, agreed adjustments.

After discussing the executive summary the audit certificate should be signed by the auditor and by the management or person authorized by the management of the company.

The executive summary should include:

- (i) a summary of the auditee's operations and purpose;
- (ii) a summary of the regularly framework within which the auditee operates;
- (iii) an explanation of the audit approach and the balance between test of controls and substantive procedures;
- (iv) a summary of the key risk identified;
- (v) a commentary on key balances;
- (vi) a commentary on the accounting policies and significant account areas;
- (vii) a summary of the result of audit procedures;
- (viii) details of areas where difficult questions of principle or judgement were involved;
- (ix) matters brought forward from previous year audit;
- (x) a summary of other important matters for attention;
- (xi) outstanding matters, for example, outstanding reappointment orders or letter authorizing agreed amendments to the financial statement;
- (xii) a summary of matters carried forward to the next years audit; and
- (xiii) a conclusion on the appropriate form of audit certificate.

Different stages of communication and discussion should be as under:

1. **Preliminary Draft:** At the conclusion of fieldwork, the auditor should **draft the report and present it to the entity's management** for auditee's comments.
2. **Exit Meeting:** The auditor should **discuss with the management the findings**, observations, recommendations and text of draft and obtain their comment on the draft, achieve consensus and reach an agreement on the audit findings.

3. **Formal Draft:** The auditor should *prepare a formal draft, in view of the outcome of the exit meeting and other discussions*. Upon review of such changes by the auditor and the management, the final report should be issued.
4. **Final Report:** The *report should be submitted* to the appointing authority or such members of management, as directed.

9. AUDITOR'S RESPONSIBILITY

- i. The Auditor's Report shall include a section with the heading "Auditor's Responsibility". Auditor's Report shall state that the responsibility of the Auditor is to *express the opinion on the compliance with the applicable laws and maintenance of Records* based on audit and that *the audit was conducted in accordance with applicable Standard*.
- ii. Auditor's Report shall state that *due to the inherent limitations* of an audit including internal, financial and operating controls, *there is an unavoidable risk that some misstatements or material non-compliances may not be detected*, even though the audit is properly planned and performed in accordance with the standards.
- iii. The Auditor has a responsibility to perform procedures to identify, assess and respond to the risks of material misstatement or non-compliance arising from the Auditee's failure appropriately to account for or disclose an event or transaction.
- iv. Auditor's Report includes *a separate section with heading "Auditor's Responsibility"* that will state or *express the opinion of the Auditor about the following:*
 - a. *Whether the audit has been conducted as per the applicable Auditing Standards.*
 - b. *Whether the Auditor has obtained reasonable assurance about whether the statements prepared, documents or records maintained by the Auditee are free from misstatement.*
 - c. *That Auditor has the responsibility to only express his opinion on the evidences collected, information received and records maintained by the Auditee or given by the Management.*
 - d. *Whether the Auditee has followed applicable laws, act, rules or regulations in maintaining their records, documents, statements, or have complied with applicable laws or rules while performing any corporate action*

10. FORMAT OF REPORT

- i. The report shall be *addressed to the Appointing Authority* unless otherwise specified in Audit Engagement Letter or provided in the applicable law.

- ii. Where specific formats (like MR-3 for Secretarial Audit Report) are prescribed, those formats shall be followed for reporting.
- iii. If any information cannot be conveniently captured within the paragraphs of the report, it shall be given in the form of annexure(s).
- iv. **Signature block** shall mention the name of the Audit Firm, the name of the Auditor, along with certificate of practice number, the membership number of the Auditor specifying whether associate or fellow member. The auditor shall clearly mention date and place of signing the report. In case report is signed by two different persons on different dates or different places; same shall be mentioned in the report.
- v. The report is addressed to the **Appointing Authority** or otherwise, as may be prescribed in applicable law, acts rules or regulations. The Appointing Authority **would be the Board of Company, in case Auditee is a Company** and in other cases, it would be **the persons who have been entrusted with the responsibility of governance and compliances of the Auditee**. Further, the Appointing Authority may also include **Court, Tribunal or Regulators** or any officer thereof, depending upon the type of Auditee's entity as explained in the Guidance Note on CSAS-1.
- vi. The Audit Report must be prepared in detail to showcase the true and fair view of the affairs of the company, however, it should be precise, accurate, clear and should be unbiased with suggestions and opinions.
- vii. The **detailed Audit Report** means that **Auditor must try to explain and point out each and every minute compliance, non-compliance or any improvement in the business procedures**, documents, statements or any transactions or any other area that has been audited so as to form an accurate Audit opinion and in case the provided format of Audit Report as per the laws, rules or regulations is not enough to provide detailed statement, the Auditor shall attach additional annexures or pages to give full disclosures and opinions thereon.
- viii. The Audit Report must be signed by one or more Auditors as the case may be at the end of the Audit Report along with the name of their Firm, Firm's Registration No., Designation of the Auditor in the Firm (like partner, proprietor etc.), Certificate of Practice No. and Membership No. of the Auditor, whether the Auditor is a Fellow or Associate member of the Institute. The report must mention the correct date and place of signing and if two Auditors are signing the same report at different date and place then, the same shall be mentioned.

- ix. Further, as per Peer Review Guidelines of the ICSI, it is mandatory to mention the Peer Review Certificate Number in Secretarial Audit Report/Annual Secretarial Compliance Report and the signature of the PCS should be in following format:

Pre requisite for the Reporting:

An Audit report should be:

- **Accurate** - Free from errors and distortions and faithful to the underlying facts.
- **Objective** - Fair, impartial, and unbiased and is a result of a fair minded and balanced assessment of all significant and relevant information.
- **Clear** - Easily understandable and logical, avoiding unnecessary technical language and providing all significant and relevant information.
- **Concise** - To the point, avoid unnecessary elaboration, superfluous detail, redundancy, repetitiveness and wordiness.
- **Constructive** - Helpful to the engagement client and the organization and leads to improvements where needed.
- **Complete** - Lacking nothing that is essential to the target audience and includes all significant and relevant information and observations to support recommendations and conclusions.
- **Timely** - Opportune and expedient, depending on the significance of the issue, allowing management to take appropriate corrective action.

Submission of Audit Report

- i. After considering the clarifications/replies of the management, the auditor should prepare the audit report in prescribed format.
- ii. Sometimes the report is addressed to the members but is to be submitted to the Board.
- iii. The report shall contain the opinion on the statutory compliances examined by the Auditor and shall state whether in his opinion the company is carrying out/not carrying out due compliances of the applicable provisions of the various laws.
- iv. The report shall be provided with or without qualifications.

Signing of Audit Report

- i. The auditor's signature is either in the name of the audit firm, the personal name of the auditor or both.
- ii. In addition to the auditor's signature, in certain jurisdictions, the auditor may be required to declare in the auditor's report the auditor's professional accountancy designation or the fact that the auditor or firm, as appropriate, has been recognized by the appropriate licensing authority in that jurisdiction.
- iii. However, in case of secretarial audit report the report should be signed by the secretarial auditor who conducted or under whose supervision the secretarial audit was conducted indicating his FCS/ACS number along with certificate of practice number issued by the Institute of Company Secretaries of India.
- iv. In case of PCS firm, the secretarial audit report may be signed by the partner who conducted or under whose supervision the secretarial audit was conducted indicating his FCS/ACS number along with his certificate of practice number. The secretarial audit report cannot be signed by an employee of the PCS firm even if he/she may be a member of the ICSI holding certificate of practice number.

Reporting with Qualification

1. A qualification, reservation or adverse remarks, if any, should be stated by the auditor at the relevant places in his report in bold type or in italics.
2. If the auditor is unable to express an opinion on any matter, he should mention that he is unable to express an opinion on that matter and the reasons therefor.
3. If the scope of work required to be performed is restricted on account of restrictions imposed by the company or on account of circumstantial limitations (like certain books or papers being in the custody of another person who is not available or a government authority), the report should indicate such limitations.
4. If such limitations are so material that the Auditor is unable to express any opinion, the Auditor should state that in the absence of necessary information and records, he is unable to report on compliance(s).

5. The *Board of directors*, in its report prepared under section 134(3) of the Companies Act, 2013, shall provide an explanation in full on any *qualification or observation or other remarks* made by the Company Secretary in practice in the secretarial audit report.

SUMMARISED VERSION (MIND MAP)

1. INTRODUCTION

- i. The term “Secretarial Audit” refers to the mechanism which is connected with the audit of the non-financial aspects of the company.
- ii. Secretarial Audit is not just an audit of the diligent compliance or that of the adherence to the law in true letter and spirit but has proved to be a strong founding pillar of the governance framework of the Indian.
- iii. The Secretarial Audit is an independent verification of the records, books, papers and documents by a Company Secretary to check the compliance status of the company according to the provisions of various statutes, laws and rules & regulations and also to ensure the compliance of legal and procedural requirements and processes followed by the company.
- iv. The implementation of Secretarial Audit and the Annual Secretarial Compliance Report was an important milestone for the Profession of Company Secretaries. It opened up new vistas for Practising Company Secretaries.

2. SECRETARIAL AUDIT & COMPANY SECRETARY IN PRACTICE (PCS)

- i. A Company Secretary in practice is a professional who is well-versed in matters of statutory, procedural and practical aspects of laws applicable to companies, both listed and unlisted public and private companies.
- ii. As per section 204 of Companies Act, 2013, only a member of the Institute of Company Secretaries of India holding certificate of practice (Company Secretary in Practice) can conduct Secretarial Audit and issue the Secretarial Audit Report to the company.

3. SECRETARIAL AUDIT-LEGAL PROVISIONS

- i. The emergence of secretarial audit can be tracked under the Companies (Amendment) Act, 1988 which amended Section 161 of the Companies Act, 1956. This amendment introduced the requirement of certification of annual return of listed Companies by a Practising Company Secretaries.
- ii. Thereafter, Companies (Amendment) Act, 2000 amended Section 383A of the Companies Act, 1956. By this amendment, it was mandated that companies which had a paid-up share capital of Rs.10 lakh or more and which did not require to employ a Whole-time Company Secretary had to obtain a Certificate from a Practising Company Secretaries on an annual basis regarding the

compliance of the various provisions of the Act. This certificate was to be attached with the Board's Report.

- iii. In 2002, **Naresh Chandra Committee Report on Corporate Audit and Governance recommended introduction of Compliance Audit.**
- iv. In the year 2003, **the Ministry of Corporate Affairs (MCA) introduced the Companies (Amendment) Bill, 2003**, which introduced the concept of Secretarial Audit by giving powers to Central Government to order, at any time, the secretarial compliance audit of the company for any period.
- v. Similarly, the Concept Paper published by MCA in 2004, contemplated to enact a new Company Law in which the concept of the Secretarial Compliance Audit was included. Later on, **Corporate Governance Voluntary Guidelines, 2009** was released in December 21, 2009, which insisted on adoption of Secretarial Audit for public companies and private companies, particularly the bigger ones.
- vi. The 21st report of the Parliamentary Standing Committee on Finance on the Companies Bill, 2009 also specified about Secretarial Audit.
- vii. At last, **Secretarial Audit for bigger Companies has been notified from 1st April 2014 under the Companies Act, 2013 (the Act).** As the Public shareholders subscribe to the shares of listed entities and public companies, it is necessary that the interest of the public is protected from the impact of non-compliances of the various provisions of the Act and other Corporate Laws.

4. THE COMPANIES ACT, 2013

- i. Section 204(1) of the Companies Act, 2013 read with rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides that:
 - i. Every Listed Company;
 - ii. Every public company having a paid-up share capital of Rs. Fifty crore rupees or more; or
 - iii. Every public company having a turnover of two hundred fifty crore rupees or more
 - iv. Every company having outstanding loans or borrowings from banks or public financial institutions of one hundred Crore Rupees or more.

Secretarial Audit Report will be attached to the Board's Report in form MR-1

- ii. Section 204 (2) - It shall be the *duty of the company to give all assistance and facilities to the company secretary in practice*, for auditing the secretarial and related records of the company.
- iii. Section 204 (3) - The Board of Directors, in their report made u/s 134, shall *explain in full any qualification or observation or other remarks made by the company secretary in practice in his report under sub-section (1)*.
- iv. Section 204 (4) - If a company or any officer of the company or the company secretary in practice, contravenes the provisions of this section, the company, every officer of the company or the company secretary in practice, who is in default, *shall be liable to a penalty of 2,00,000 rupees*.

Applicability of Section 204 to a Company which is a subsidiary of a Public Company:

Section 2(71) of the Companies Act, 2013 defines a "Public Company" as a company which -

(a) is not a private company; and

(b) has a minimum paid-up share capital as may be prescribed.

A company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.

Example:

PPP Pvt Ltd. was incorporated in the year 2010 as Private Company. Its paid up capital is Rs 35 crore, but the annual turnover for the financial year ended on 31st March, 2023, first time crossed from Rs 240 crores to Rs 300 crores. SSS Ltd, a public company, controls the composition of the Board of Directors of PPP Pvt Ltd, hence in terms of Section 2(87) of Companies Act, 2013, PPP Pvt Ltd is treated as subsidiary company of SSS Ltd. A newly appointed Company Secretary of PPP Pvt Ltd suggested the Board of Directors to get the

Secretarial Audit of this company. Whether the Secretarial Audit of a Private Limited Company is mandatory as per the provisions of the Companies Act, 2013.

In view of this, it is clear that Section 204 is applicable to a private company which is a subsidiary of a public company, and which falls under the prescribed class of companies. Although, the companies which are not covered under section 204 may opt for conducting Secretarial Audit voluntarily as it provides an independent assurance of the compliances of applicable laws by the company.

5. SECRETARIAL AUDIT AND SECRETARIAL COMPLIANCE REPORT UNDER THE SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

Uday Kotak Committee on Corporate Governance, in its report dated October 05, 2017, recommended that-

- (a) Secretarial Audit to be made compulsory for all listed entities under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, in line with the provisions of the Companies Act, 2013.
- (b) Secretarial Audit to be extended to all material unlisted Indian subsidiaries in line with the recommendations of the Committee on strengthening group oversight and improving compliance at a group level for listed entities.

Accordingly, SEBI in 2019 notified the following provisions to be included in the SEBI (LODR) Regulations, 2015:

- Regulation 24A: Secretarial Audit: Every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex with its annual report, a secretarial audit report, given by a company secretary in practice.

The term 'Material Subsidiary' means a subsidiary, whose income or net worth exceeds ten per cent (10%) of the consolidated income or net worth, respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

Amendment to the provision in 2021:

- i. Regulation 24A: Every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex a secretarial audit report given by a company secretary in practice, in such form as specified, with the annual report of the listed entity.
- ii. Every listed entity shall submit a secretarial compliance report in such form as specified, to stock exchanges, within 60 days from end of each financial year.
- iii. The listed entities and their material subsidiaries shall provide all such documents/information as may be sought by the PCS for the purpose of providing a certification under the Regulations and this circular.
- iv. SEBI has mandated the issuance of Annual Secretarial Compliance Report by a Company Secretary in Practice to the listed entities to enable them to undertake certifications in accordance with the Regulations and this circular in letter and in spirit.
- v. Annual Secretarial Audit shall cover a broad check on compliance with all laws applicable to the entity, listed entities shall additionally, on an annual basis, require a check by the Company Secretary in Practice on compliance of all applicable SEBI Regulations and circulars / guidelines, consequent to which, the Company Secretary in Practice shall submit a report to the listed entity in the manner specified in this circular.
- vi. The Annual Secretarial Compliance Report is applicable to all Listed Entities.
- vii. The Annual Secretarial Compliance Report postulates for an independent verification of the records, books, papers and documents by a Company Secretary in Practice to check the compliance status of the company with the provisions of all applicable SEBI laws, Regulations and circulars/ guidelines issued thereunder.

Exemptions:

As per regulation 15 of the SEBI (LODR) Regulations, 2015 the compliance specified in regulations 24A, shall not apply, in respect of -

- a. Listed entity having paid up equity share capital not exceeding rupees ten crore and net worth not exceeding rupees twenty five crore, as on the last day of the previous financial year:
- b. Once the above regulations become applicable to a listed entity, they shall continue to remain applicable till such time the equity share capital or the net-worth of such entity reduces and remains below the specified threshold for a period of three consecutive financial years.

- c. Listed entity which has *listed its specified securities on the SME Exchange.*

6. AUDITING STANDARD ON SECRETARIAL AUDIT (CSAS-4)

- i. The Auditing Standard on Secretarial Audit (CSAS-4) formulated by Auditing Standards Board (ASB) of the Institute of Company Secretaries of India (ICSI) and issued by the Council of ICSI, is effective from 1st July, 2019 on recommendatory basis and mandatory with effect from 1st April, 2021.
- ii. The Standard shall apply to Secretarial Audit undertaken under Section 204 of the Companies Act, 2013 and Regulation 24A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.
- iii. The Standard deals with basis and manner for carrying out the Secretarial Audit.
- iv. The objective of the Standard is to lay down the principles for evaluation of statutory compliances and corporate conduct in relation thereto.
- v. It is **not mandatory to apply the standard in following cases:**
 - a. Annual Secretarial Compliance Report issued in terms of SEBI
 - b. Secretarial Audit entrusted on a voluntary basis by an Auditee to an Auditor

An Auditor while accepting Secretarial Audit, **shall also comply with the principles laid down in CSAS-1 to CSAS 3.** For example, M/s. ABC & Associates, a practicing company secretaries firm, accepts an audit assignment on 20th April, 2021 for the FY 2021-2022. The firm should adhere to the principles laid down in the CSAS-1 (Audit Engagement) while accepting the audit assignment, the Auditor should plan, proceed and perform the audit assignment as per the CSAS-2 (Audit Process and Documentation) and give his opinion based on the Audit Process performed by him in line with the principles given in CSAS-3 (Forming of Opinion).

7. CONCEPT & ADVANTAGES

CONCEPT

- i. Secretarial audit gives assurance to the regulators, generate confidence amongst the shareholders, the creditors and other stakeholders in companies.
- ii. It is a tool of risk mitigation and will allow companies to effectively address compliance risk issues.

BOX PAGE 457

- iii. *Once the Secretarial Audit Report is submitted by the secretarial auditor, the Government as well as other stakeholders can gauge in first instance the level of compliances or non-compliances by the company concerned.*
- iv. *Corrective actions will be taken to keep a check on the fraud as well as reduce the number of prosecutions by the Government and consequent litigation on account of non-compliance with the provisions of corporate and securities laws, thereby resulting in healthy and orderly development of the corporate sector. This will lead to reduction of investor grievances and enhance various stakeholders' confidence.*
- v. *In addition to the Government and shareholders, introduction of secretarial audit would be in the interest of companies themselves. Secretarial audit besides ensuring compliance with laws act as an aid to the management by proving to be a strong internal control device. It can relieve the company and their directors from consequences of unintended non-compliance of law.*
- vi. *Proactive Secretarial Audit on a continuous basis would help the company in initiating corrective measures and strengthening its compliance mechanism and processes. It is advisable that the Secretarial Audit is carried out periodically (quarterly / half year / annually)*

Few risks of non-compliance with laws and regulations: Failure to obtain proper approvals/permissions/ Licenses

Failure of legal compliance	<i>Failure to keep proper books and records or non-compliance with the provisions of corporate laws and securities laws, executing certain unviable or undesirable corporate actions or transactions with related parties or loan to directors, issue, allotment and transfer of security or otherwise, without proper authority of the board of directors or the general meeting or the memorandum of association, etc., could lead to the ability by third parties to play with the stakeholder's limited liability protection.</i>
Failure to obtain proper approvals/permissions/ Licenses	<i>Failure to obtain proper approvals/permissions/licenses could lead to fines, penalties or/and imprisonment in some cases, even closure of the business by government or governmental agencies.</i>
Regulatory actions	<i>Failure to comply with certain laws and regulations may lead to initiation of action by the regulators like MCA, SEBI, RBI or others authorities, which may jeopardize the very stability of the financial and manufacturing operations.</i>
Non-compliances of Environment Laws	<i>Failure to adopt proper environment law compliance and policies which are reviewed periodically could give rise to governmental and civil liability, besides causing risk to the environmental sustainability.</i>
Failure to keep accurate records	<i>Failure to keep accurate records and minutes of its decision-making procedures, proves that directors are not exercising informed judgment, and may subject the company and its board to liability to its shareholders and investors.</i>
Failure to monitor the company's reporting requirements	<i>Failure to monitor the company's reporting requirements may put the company into a position of default with lenders or investors.</i>
PCS as extended Arm	<i>Company secretary in practice acts as an extended arm of the regulators in ensuring the compliances. Detecting and reporting any non-compliance before it takes seriously alarming shape.</i>

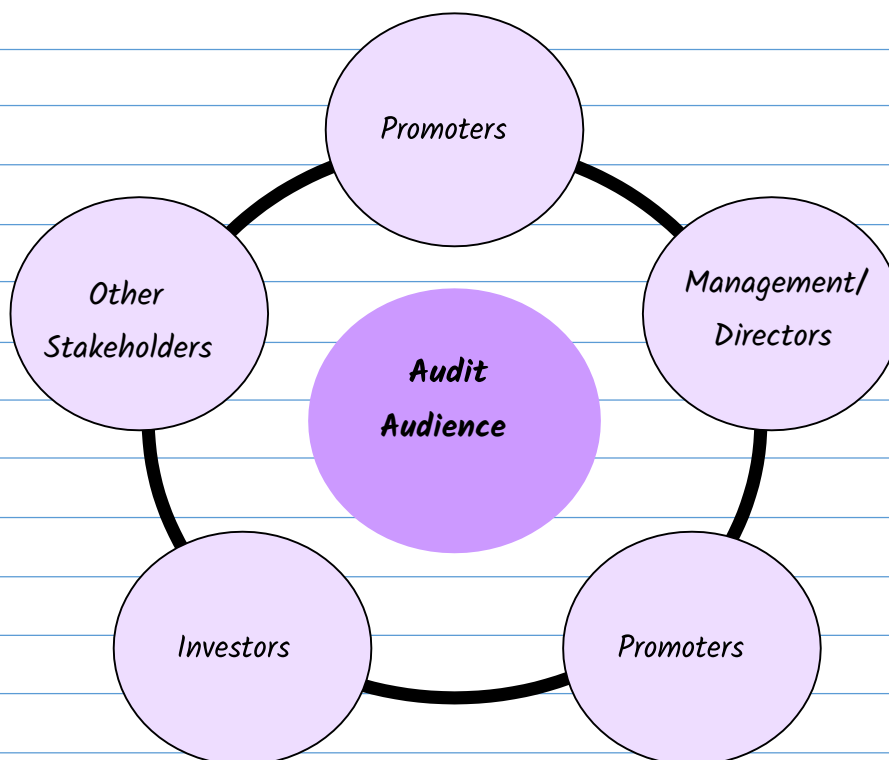
The inclusion of Secretarial Audit Report in the Directors' Report would go a long way in reassuring public, financial institutions and all others dealing with the company about the quality of corporate governance in the corporate entity concerned. Companies entering into joint ventures and foreign collaborations will need such an audit to assure foreign partners that the laws of the land are duly complied with. A secretarial audit will serve as a first line due

diligence. The secretarial audit will provide an in-built mechanism for enhancing corporate compliances generally and help restore the confidence of investors in the capital market through greater transparency in the corporate functioning.

8. ADVANTAGES

Secretarial Audit facilitates monitoring compliances with the requirements of law through a formal compliance management programme which can produce following positive results to the stakeholders of a company:

- i. Better compliance of laws leading to reduction in number of frauds and consequent prosecutions. Protecting the interest of stakeholders and strengthening their faith in the corporates.
- ii. Protecting the company/directors from the consequences of unintended non-compliance of laws.
- iii. Independent assurance and comfort to independent/non-executive/nominee directors that the affairs of the company have been conducted as per law.
- iv. Instilling professional discipline and self-regulation.
- v. Reducing workload of regulators due to better and timely compliances.
- vi. Enhancing quality of services to investors.
- vii. Any qualification in the Report will immediately alert the investor.



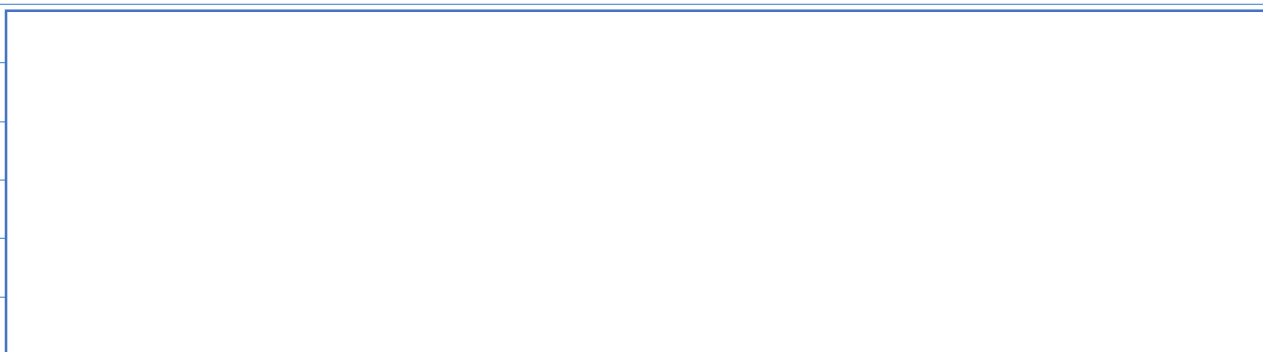
- (a) **Promoters:** Secretarial audit assures the promoters of a company that those in-charge of its management are conducting its affairs in accordance with the requirements of laws and the owner's stake is not being exposed to unintended risks.
- (b) **Non-executive/Independent directors:** Secretarial audit provides comfort to the non-executive/independent directors that appropriate mechanisms and processes are in place to ensure compliance with laws applicable to the company, thus mitigating any risk from a regulatory or governance perspective.
- (c) **Government authorities/regulators:** It also facilitates reducing the burden of the regulators in ensuring compliances and they can take timely actions against the offenders.
- (d) **Investors:** Secretarial audit helps the investors in taking informed investment decision, as it evaluates the company in terms of compliance and governance norms being followed by the company.
- (e) **Other Stakeholders:** It is an effective due diligence exercise for the prospective investors or joint venture partners. Further financial institutions, banks, creditors and consumers can measure the law abiding nature of company management.

9. RISK OF SECRETARIAL AUDITOR

Section 204(4) - Punishment for Contravention:

- i. If a company or any officer of the company or the company secretary in practice, contravenes the provisions of section 204, shall be **liable to a penalty of two lakh rupees**.
- ii. In case the Practising Company Secretary failed to comply with the provisions of section 143 is liable for a penalty:
 - (a) in case of a **listed company**, be liable to **a penalty of five lakh rupees**; and
 - (b) in case of **any other company**, be liable to a **penalty of one lakh rupees**.

Section 447- Punishment for fraud:



Section 448 - Punishment for false statement:

- i. If in any return, report, certificate, financial statement, prospectus, statement or other document required for the purposes of any of the provisions of this Act which is false in any material particulars, knowing it to be false or which omits any material fact, knowing it to be material, he **shall be liable under section 447**.
- ii. Also, as per section 451 of the Companies Act 2013, **punishment is provided for repeated default:**

If a company or an officer of a company commits an offence punishable either with fine or with imprisonment and where the **same offence is committed for the second or subsequent occasions within a period of three years**, then, that company and every officer thereof who is in default shall be punishable **with twice the amount of fine** for such offence in addition to any imprisonment provided for that offence.

Professional misconduct as per Company Secretaries Act, 1980:

- i. Company Secretary in whole time employment and as well as Practicing Company Secretary both are liable for disciplinary action for professional misconduct under provisions of Company Secretaries Act, 1980.
- ii. In addition to the penal provisions contained in the Companies Act, 2013, the Institute of Company Secretaries of India (ICSI), has also made penal provision which are contained in Part I of First and Second Schedule of Company Secretaries Act, 1980 which provides the professional misconduct in relation to Company Secretaries in Practice.
- iii. Section 21C of the Act provides that where the Disciplinary Committee is of the opinion that a member is guilty of a professional or other misconduct mentioned in the Second Schedule or both the First Schedule and the Second Schedule, it shall afford to the member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely:
 - (a) Reprimand the member;
 - (b) Remove the name of the member from the Register permanently or for such period, as it thinks fit;
 - (c) impose such fine as it may think fit, which may extend to Rs 5 lacs.

CASE LAW: Non-Reporting of related party transaction led Secretarial Auditor to pay penalty

On receipt of a whistle blower complaint an inquiry was ordered by MCA of M/s Sun Pharmaceutical Industries Ltd under section 206(4) of the Companies Act, 2013. During the inquiry it was observed by the inquiry officer that Secretarial Auditor of the company has not reported "Aditya Medisales Ltd." as related party and as per section 204 of Companies Act, 2013 it is the duty of Secretarial Auditor.

The Practicing Company Secretary has to examine the transactions during the period of audit to identify whether any fraud element is present in the transaction. ICSI has also issued Guidance Note for Secretarial Audit which provides that Secretarial Auditor is need to adhere the checklist to review the related party transaction.

After considering the facts and submissions, the adjudicating officer had reasonable cause to believe that the Secretarial Auditor of the company has failed to discharge their duty as per

provisions of section 143(14) read with section 188 and 204 of the Companies Act, 2013 read with ICSI Guidance Note on Secretarial Audit issued by ICSI and imposed a penalty on Secretarial Auditor.

10. CODE OF CONDUCT

A Code of Conduct is a necessary component of any profession to maintain standards for the individuals within that profession to adhere. It brings about accountability, responsibility and trust to the individuals that the profession serves.

The fundamental principles which should govern the conduct of a professional with others have been broadly identified as to encompass;

- i. Integrity;
- ii. Independence;
- iii. Competence;
- iv. Objectivity;
- v. Ethical behaviour;
- vi. Conformance to the prescribed technical standards; and
- vii. Confidentiality of information acquired in the course of professional work.

In order to evoke the necessary interest and awareness among the members and to create the necessary climate for laying down the right type of conduct which should govern the profession, the ICSI organised in February 1976, a National Convention, primarily to evolve the necessary framework for a code of conduct. After the conclusion of that Convention, the Council of the Institute appointed a Code of Conduct Committee with the task of formulating a model code of conduct.

The Council of the Institute accepted the recommendations of the Code of Conduct Committee which inter alia prescribed:

- (a) rules applicable to all members; and
- (b) rules applicable to members in service or in practice.

The code of conduct acquired statutory status with the conversion of the Institute into a statutory body under the Company Secretaries Act, 1980 ('the Act'), with effect from 1st

January, 1981. In the year 2006 substantial amendments were made to Act and also to the First and the Second Schedules to the Act which encompass in detail, various instances of professional misconduct on the part of the members of the Institute in practice as well as in service.

II. SCOPE OF SECRETARIAL AUDIT

Examination & Specific Reporting on Compliance under:	Examination & Specific reporting on Compliance of other laws as may be Applicable specifically to the Company	Further Reporting	Further Reporting
The Companies Act, 2013 and the Rules made thereunder	E.g. Banks-all laws applicable to banking Industry	Whether there are Adequate systems and processes in the Company	Constitution of Board of Directors
Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made thereunder	Companies in petroleum sector- All laws applicable to petroleum Industry	commensurate with its size & operation to monitor and ensure compliance with applicable laws including general laws like labour law, environmental laws.	Notices, Agenda and Minutes of Board Meetings etc.
Depositories Act, 1996 and the Regulations framed thereunder			Board processes
Foreign Exchange Management Act, 1999			
Regulations and Guidelines under the SEBI Act, 1992 as enlisted in Form MR-3			
Secretarial Standards issued by ICSI			
Listing Agreement entered into by the company with Stock Exchange(s) if any			

The scope of Secretarial Audit comprises verification of the compliances according to the provisions of following enactments, rules, regulations, notifications and guidelines:

- (i) The Companies Act, 2013 (the Act) and the Rules made thereunder:

- (ii) The Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made there-under;
- (iii) The Depositories Act, 1996 and the Regulations and Bye-laws framed there-under;
- (iv) Foreign Exchange Management Act, 1999 and the rules and regulations made there-under to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings;
- (v) The following Regulations and guidelines as prescribed under the Securities Board of India Act, 1992 (SEBI Act):
 - a. The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
 - b. The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015;
 - c. The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018;
 - d. The Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014
 - e. The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;
 - f. The Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993
 - g. The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021;
 - h. The Securities and Exchange Board of India (Buyback of Securities) Regulations, 2018;
 - i. The Securities and Exchange Board of India (Listing Obligations and Disclosures Requirements), Regulations, 2015.
- (vi) Mention the other laws as may be applicable specifically to the company.

'Other areas' which need to be checked

Secretarial Auditor needs to examine and report on the compliance with the applicable clauses of the following:

- (i) Secretarial Standards issued by The Institute of Company Secretaries of India.
- (ii) The Listing Agreements entered into by the Company with the respective Stock Exchange(s), if applicable;

Secretarial Audit report also requires reporting on whether –

- i. The **Board of Directors of the Company is duly constituted** with proper balance of Executive Directors, Non-Executive Directors, Independent Directors, and Women Director.
- ii. The **changes in the composition of the Board of Directors** that took place during the period under review were carried out in compliance with the provisions of the Act.
- iii. Adequate **notice is given to all directors** to schedule the Board Meetings, agenda and detailed notes on agenda were sent at **least 07 days in advance**.
- iv. **Majority decisions are carried through while the dissenting members' views are captured and recorded as part of the minutes.**
- v. **There are adequate systems and processes in the company** commensurate with the size and operations of the company to monitor and ensure compliance with all applicable laws including general rules like labour laws, competition law, environmental laws, regulations and guidelines.

Secretarial Auditor is required to **report and provide details of specific events and actions that occurred during the reporting period** having major bearing on the affairs of the company in pursuance of above referred laws/ rules & regulations.

12. SECRETARIAL AUDIT – THE PROCESS

Secretarial Audit is a process to check compliance with the provisions of all applicable laws and rules/ regulations/ procedures; adherence to good governance practices with regard to the systems and processes of seeking and obtaining approvals of the Board and/or shareholders, as may be necessary, for the business and activities of the company, carrying out activities in a lawful manner and the maintenance of minutes and records relating to such approvals or decisions and implementation.

A. Appointment of Secretarial Auditor

As per **Rule 8 of the Companies (Meetings of Board and its powers) Rules, 2014, read with Section 179 of the Companies Act, 2013**, secretarial auditor is required to **be appointed by means of resolution passed at a duly convened board meeting** and as per the auditing standard issued by ICSI.

B. Communication to earlier Incumbent

- i. Company Secretary shall mandatorily communicate to the earlier incumbent about the proposed engagement in writing by registered/ speed post or any other mode of delivery, as may be recognized by the Institute of Company Secretaries of India.
- ii. The Council of ICSI at its meeting held on 16th March, 2019 has made amendments in Guidelines where the Council has approved some services in respect of which it shall be mandatory to communicate to the previous incumbent (Company Secretary) before accepting the assignment.

C. Acceptance of Appointment

A formal letter for appointment should be issued by the company to the secretarial auditor along with the copy of the board resolution for appointment. The secretarial auditor should confirm acceptance of appointment in writing.

D. Preliminary Discussions/Surveys

It is important to have relevant information about the company. The secretarial auditor is expected to take general overview of the obtain of the company and interact with the personnel involved to know about the nature of the business. He may opt for surveys for generating information about the company.

E. Preliminary Meeting

- i. The preliminary meeting with the senior management and the administrative staff involved in the audit will give a fair idea of what is expected and the manner in which audit activities are to be undertaken.
- ii. At this stage, a time frame of the secretarial audit is decided.
- iii. The secretarial auditor shall discuss the scope and objectives of the audit, gather information on important Board processes, evaluate existing control systems and prepare the audit plan.

F. Finalization of Audit Plan and Briefing the Staff

- i. Auditor will make an audit plan which involves briefing the audit staff as to allotment of work, fieldwork responsibilities and other roles.

- ii. The audit plan should comprehensively outline the fieldwork and usage of auditing tools.
- iii. It is essential that the audit plan adheres to the timelines.
- iv. Detailed checklist for each aspect of secretarial audit should be prepared and audit staff should be properly sensitized before commencement of audit.

G. Testing, Interviews and Analysis

- i. The secretarial auditor may use a variety of tools and technology to gather information about the company's operations.
- ii. The secretarial auditor should determine whether the controls identified during the preliminary review are operating properly, and in the manner described by the Company.
- iii. Fieldwork typically consists of interviewing with staff of the company whether formally or informally, reviewing procedure manuals and processes, testing and analysing compliance with applicable policies and procedures and laws, rules, regulations and assessing the adequacy of controls. This exercise may result in significant findings which the secretarial auditor may bear in mind while preparing the secretarial audit report.

H. Working Papers

Working papers are a vital tool of the audit process, in which auditor expresses his opinion. They connect the management's records and information to the auditor's opinion.

I. Audit Summary for Discussions

It is recommended that the findings during the course of audit are summarized and presented for initial discussions with the management for their views/ clarifications/replies.

J. Submission of Secretarial Audit Report

After considering the clarifications/replies of the management, the secretarial auditor shall prepare the secretarial audit report in Form MR - 3. The report is addressed to the members but is to be submitted to the Board and will contain the opinion on the statutory compliances examined by the auditor and shall state whether in his opinion the Company is carrying out/not carrying out due compliances of the applicable provisions of the various laws.

K. Auditing Standards

Secretarial Audit should be conducted in accordance with the Auditing Standard issued by the Institute of Company Secretaries of India.

13. IDENTIFICATION AND SEGREGATION OF APPLICABLE LAWS

SECRETARIAL AUDIT – TO ENSURE COMPLIANCE OF SPECIFIC LAWS AND GENERAL LAWS

The Auditor shall take note of the industry specific laws and other laws as may be applicable to the auditee based on the identification/ segregation by the Management and his own verification.

Industry specific laws

- i. Identification of all laws applicable to the auditee, as well as industry specific laws and the segregation thereof, is the primary responsibility of the auditee.
- ii. Auditor's role is to verify that the laws identified and segregated by the management are appropriate and sufficient having regard to the business of the auditee and the auditee should communicate the same to the secretarial auditor.
- iii. The Auditor shall exercise his professional judgment to verify that the identification and segregation of the laws made by the Management, as may be applicable specifically to the auditee, is correct.
- iv. In case, the Auditor is not satisfied by the identification and segregation made by the Management, or no such identification and segregation has been made, he should seek explanation from the management to form the opinion and report accordingly.

Applicable Laws

"Other laws as may be applicable specifically to the company" shall mean all the laws, rules and regulations that are applicable specifically to the company. The Secretarial Auditor may take note of all such laws, rules and regulations identified by the management of the company.

Principles for making such segregation

Segregation of laws applicable on the Company into the industry specific and general is done on the basis of following factors:

- i. Registration with various authorities such as SEZ, Sectoral Regulators, etc.
- ii. Segments such as Manufacturing/ Trading/ Service/ E-commerce and Industry classification thereof
- iii. Status of company such as listed/ unlisted h Geographic location of registered office, units/ divisions/ plants/ branches, etc.
- iv. However, for identification of laws applicable on the company, in addition to above following factors shall also be considered
- v. Key financial parameters such as Turnover, Paid-up Share Capital, Net Worth, Borrowings, etc.
- vi. Type/Class of company such as Private, Public, Holding, Subsidiary, Foreign, Nidhi, Producer, Section 8, etc.
- vii. Agreements governing rights, obligations of shareholders such as Joint venture agreements, shareholders agreements etc.
- viii. Number, class and category of employees/ workers such as women, contractual employees, etc.

Adequacy of systems and processes

The Form MR-3 provides for reporting on the status of the compliance along with the comments on the adequacy of the systems and procedures in the company to manage the compliance of the laws, rules, regulations and guidelines applicable to the company under the following paragraph of the report.

This part of the Secretarial Audit report specifically refers to the compliance of the other applicable laws apart from the Laws covered in the Form MR- 3 and Laws specifically applicable to the company.

REPORTING OF GENERAL LAWS

As stated above, the Secretarial Auditor should verify and report that adequate system and processes are in place to monitor and ensure compliance with general laws like labour laws, competition law, and environmental laws.

14. VERIFICATION OF CORPORATE CONDUCT AND COMPLIANCE OF LAWS

Identification of Events/ Corporate Actions

The Auditor shall identify *events/ corporate actions that took place during the audit period* by reviewing the website of the regulators, website of the Auditee, statutory records including books and papers, interaction with the Management and in any other appropriate manner.

Events/ corporate action

- i. A **corporate action** is an *event initiated by a company that brings or could bring an actual change to the working of the company*, for example, change in the borrowing limits, issuance of the securities-equity or debt, appointment of the KMPs, etc., as approved by its board of directors and/or shareholders.
- ii. An **action-based event** may be defined as *any activity that amends the functioning of an organization and impacts its stakeholders, including Shareholders, both common and preferred, as well as Lenders*. For Example:
 - a. Events/ actions altering the Charter documents of the company;
 - b. Changes in the Capital structure of the company;
 - c. Change in the Affairs/ Management of the company;
 - d. Change in the Licensing or permission for the business operation of the company;
 - e. Casual Vacancy of statutory auditor/ director/ KMP;
 - f. Borrowing in excess of limits specified in Section 180 of the Companies Act, 2013.

Identification of Events/Corporate Events

The Auditor is expected to identify the Corporate Actions from which a compliance requirement may arise, which can be identified from following:-

- a. Financial statements;
- b. Agenda and Notes on Agenda of Board/ Committee/ Members' Meetings;
- c. Minutes of the Board/ Committees/ Members' Meetings;
- d. Reporting and Filing to the regulators;
- e. Annual Report;
- f. Statutory Disclosures on website of the company, website of the Ministry of Corporate Affairs and on any other platform such as Stock Exchange;

- g. Third party sources which may include registrar and transfer agents, banks, financial auditor, stakeholders etc.

Verification of Compliance

- i. The Auditor shall verify all event and calendar-based compliances from the Records of the Auditee, database or website of the regulators and other relevant sources.
- ii. The Auditor shall use systematic and comprehensive audit checklists for carrying out the audit and verifying the compliance requirements.
- iii. The Auditor shall compile and validate the checklists for use in the audit process on the basis of information gathered about the Auditee and scope of the audit. It is a useful tool to ensure that no compliance point is missed or omitted while conducting the audit.
- iv. Audit checklists should be reviewed and updated from time to time to meet the scope of audit and its effectiveness.
- v. The Auditor should verify the compliances of applicable laws and rules based on the information gathered by the Auditor.

15. BOARD COMPOSITIONS

The Auditor shall verify compliance of the Companies Act, 2013, SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, Agreement with Lenders/ Investors, Articles of Association and provisions of other Acts/ Rules/ Regulations specific to the industry, Guidelines and Policies of the Government for promotion of particular industry or location-specific industry, board decisions, shareholders decisions, as may be applicable to the Auditee with regard to:

2. The overall composition of the Board including the minimum and maximum strength of the Board.

Various provisions mandating the Board Composition

There are certain companies which are governed by the Specific Acts and legislations, as applicable in addition to the Companies Act, 2013 with certain exemptions, for example., Banking Companies, Insurance Companies, State Financial Corporations, Public Sector Undertakings, in such cases the Auditor shall ensure the Board Composition is as per the requirements of the applicable laws and acts to the Auditee.

Role of Auditor in the verification of Board Composition

The Auditor should identify the laws and rules that govern the company and check the compliances of the Board Composition in accordance with those applicable laws and rules. For example, a Banking Company is regulated by the Banking Regulation Act, 1949, therefore, the Auditor should ensure that the Board Composition is in compliance of the Banking Regulation Act, 1949 or any other law specifically applicable to the Auditee in addition to the basic governing laws enumerated under the Companies Act, 2013 or SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

The Auditor should examine the applicability of the various laws and regulations applicable to the Auditee **to verify the requirement of a minimum and maximum number of directors on the Board of the Auditee.**

3. Optimum Combination of the Board include a proportion of executive, non-executive, independent, non-independent, retiring, non-retiring, women and nominee directors.

Various provisions mandating optimum combination

The optimum combination of the Board should be as per the provisions laid down in various Statutes such as the Companies Act, 2013, the SEBI (Listing Obligation and Disclosure Requirement) Regulations, 2015, the Banking Regulation Act, 1949, the Insurance Act, 1938, etc., as may be applicable to the company.

Provision wrt to Board Composition under Companies Act, 2013:

- i. As per section 149(2), **Every Company shall have at least 01 director who stays in India for a total period of not less than 182 days during the financial year.** In the case of a newly incorporated company the requirement under this sub-section shall apply proportionately at the end of the financial year in which it is incorporated.
- ii. As per section 149(3), **Every Listed Public Company shall have at least one-third of the total number of directors as independent directors** and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.
- iii. As per second Proviso to Section 149(1) read with Rule 3 of The Companies (Appointment and Qualification of Directors) Rules, 2014 of the Companies Act, 2013, the following classes of companies are required **to appoint at least 01 Woman Director:**

- (i) Every Listed Company;
- (ii) Every Other Public Company having –
 - (a) paid-up share capital of 100 crore Rupees or more; or
 - (b) turnover of 300 crore Rupees or more.

- iv. For the appointment of Woman Director, paid up share capital or turnover, as the case may be, as on the last date of latest audited financial statements has to be taken into account.
- v. Similarly, Regulation 17 of SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015 provides Board Composition as under:
 - 1. **The composition of the Board of Directors of the listed entity shall be as follows:**
 - (a) Board of Directors shall have an optimum combination of executive and non-executive directors with at least 01-woman director and not less than 50% of the Board of Directors shall comprise of non-executive directors.
 - (b) The Board of Directors of the top 500 listed entities shall have at least 01 independent woman director by April 1, 2019 and the Board of Directors of the top 1000 listed entities shall have at least 01 independent woman director by April 1, 2020.
 - (c) Where the Chairperson of the Board of Directors is a non-executive director, at least onethird of the Board of Directors shall comprise independent directors and where the listed entity does not have a regular non-executive Chairperson, at least half of the Board of Directors shall comprise independent directors.
 - (d) Where the regular non-executive chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of the Board of Directors or at one level below the Board of Directors, at least half of the Board of Directors of the listed entity shall consist of independent directors.
 - (e) The Board of Directors of the top 1000 listed entities (with effect from April 1, 2019) and the top 2000 listed entities (with effect from April 1, 2020) shall comprise of not less than six directors.
 - (f) Where the listed company has outstanding Superior Voting Rights (SR) equity shares, at least half of the Board of Directors shall comprise of independent directors.

Requirements of NSE Prime Companies

NSE prime allow listed company to choose higher governance standards than what is required under the law.

Composition:

- a. The Board of Directors shall consist of a minimum of 8 directors.*
- b. The Chairperson of the Board of Directors shall not be a relative of the Managing Director or Chief Executive Officer of the NSE Prime Company.*
- c. Where the public shareholding is in excess of 50%, more than half of the Board of Directors shall comprise Independent Directors; and in case of any fractions, the same shall be rounded to the higher number.*
- d. Where the public shareholding is 50% or less, at least half of the Board of Directors shall comprise Independent Directors; and in case of any fractions, the same shall be rounded to the higher number.*
- e. With effect from July 01, 2025, at least 2 directors shall be women, with at least one such Woman Director also being an Independent Director.*

Role of Auditor in the verification of optimum combination

Laws specifically applicable to the company may also mandate to have optimum combination of directors. The Auditor should also verify the compliance thereof and report deviations, if any.

3. Eligibility criteria including disqualifications of directors

Various provisions mandating qualifications/ disqualification

The conditions for qualifications/ disqualification of a director prescribed in the Companies Act, 2013 or any other industry specific Act or law, need to be checked while verifying the Board Composition of the company. For example, Section 164 of the Companies Act, 2013 lays down the provisions for disqualifications for the appointment as Director on the board of the company. Further, the Auditor also needs to check the eligibility criteria including disqualifications of the directors as may be prescribed in any other industry specific Act or laws applicable to the company.

4. **Constitution and Composition of Committees of the Board**

Various provisions mandating Board Committees

The constitution of various Committees and the terms of reference of the Committees can be as per various regulatory requirements. For example, for banking companies, stipulated Committees shall mean committees constituted in compliance with the Banking Regulation Act, 1949, Circulars issued by the Reserve Bank of India (RBI) and the Government of India (GOI) from time to time.

There are certain mandatory committees that are required to be constituted by certain class or classes of companies as per the Companies Act, 2013, SEBI (Listing Obligation and Disclosure Requirement) Regulations, 2015 and certain industry/ sector specific laws. Such mandatory committees include:

- Audit Committee
- Nomination and Remuneration Committee
- Stakeholders Relationship Committee
- CSR Committee
- Risk Management Committee (Note: Secretarial Standard - 1 is not applicable as it is not a Board's Committee under the Companies Act, 2013)
- Internal Committee constituted under the POSH Act

Role of Auditor in verification of Board Committees

The Auditor needs to check whether the constitution of committees, as constituted by the auditee, is as per the laws, act, rules, regulations and standards applicable to the Auditee.

Preferable Board size as per Proxy Advisors Guideline

1. Iias: Iias prefers a Board size of 6-15 members. Board size should be commensurate with the size and operations of the company. Iias believes that, given the nature and quantum of work involved, three directors may not be optimal. Their guidelines are therefore aligned with the Kotak Committee threshold of at least 6 directors. On the other hand, consensus on many critical issues may be difficult to achieve if Board size exceeds 15 members.

2. *InGovern: InGovern prefers a Board size of 7-15 members. A Board size outside of this range is considered less effective either due to low diversity of expertise and opinion, and low representation of Independent Directors on Key Committees or a big Board size of greater than 15 members present the disadvantages of delayed decision making that come along an uncontrollable size and risk of having majority of promoters and related parties on board, InGovern too is not in favour of huge Board size.*
3. *SES: SES prefers a Board size of 6-15 members. If the proposed Board size is outside this range, SES expects that the company must provide a rationale for the same*

16. BOARD PROCESSES

- i. *The Board of directors plays a crucial role in Corporate Governance and act as fiduciaries. Accordingly, the law foists on the directors duties and liabilities as instruments that modulate their conduct.*
- ii. *Directors are, however, entitled to various protective measures in the form of mitigating factors either conferred upon them by law or through practical mechanisms they may establish. The Section 118(10) mandates on every company to observe the Secretarial Standards on the meeting of the Board of Directors (SS-1) as specified by the Institute of Company Secretaries of India (ICSI).*
- iii. *The SS-1 helps in providing clarity in certain areas where the law is either silent or ambiguous. Wherever the law is silent, certain good governance practices have been recommended and where it is ambiguous, the standards try to bring in more clarity and adhere the common board processes across country.*
- iv. *To ensure the effective board processes, the auditors shall verify that the decisions of the Board and its Committees are taken and recorded in compliance with applicable laws, rules, regulations, guidelines, standards and defined internal processes.*
- v. *Various provisions mandating Board Processes Provisions w.r.t Board processes may include:*
 - a. *Meetings of Board and Committees*
 - b. *Meetings of Committees that exercise powers of the Board under Section 179 of Companies Act, 2013*
 - c. *Meeting of Members*
 - d. *Board's performance evaluation and training*

- e. Appointment and Resignation of the members of the Board.

Role of Auditor in the verification of Board Processes

- i. The Auditor shall verify notice of the meetings, minutes, and supporting records, including the agenda, to satisfy himself whether the Auditee has complied with the applicable laws, rules, regulations, guidelines, standards and defined internal processes.
- ii. Some corporates have manuals for Board Processes, the Auditor should verify whether the Auditee has complied with the policy and processes laid down in the manual of the Auditee.
- iii. The Board of Directors, plays a crucial role in ensuring the company follows transparent, ethical, and responsible governance. To achieve this, the company's board processes, which involve decision-making by the Board and its committees, must be strong and effective.

CASE STUDY

Mr. CS is appointed as a Company Secretary of Flowers Pvt Ltd. Mr. CS have to conduct the audit for the financial year 2022-23. Mr. CS is required to draft the guidelines for verification of Board Composition & Board Process as per the CSAS-4 (Auditing Standard on Secretarial Audit).

Board Composition the auditor shall verify:

1. Overall composition of the Board including the minimum and maximum strength of the Board as per provisions of the Companies Act, 2013, SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, Articles of Association and provisions of other Acts/rules/regulations as may be applicable to the Company.
2. Optimum combination of Executive, Non-executive, Independent, Non-independent, retiring, non-retiring, woman, nominee in the Board as per provisions of the Companies Act, 2013, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Articles of Association, agreement with Lenders/Investors and provisions of other Acts/rules/regulations as may be applicable to the company.
3. Eligibility criteria including qualifications of Directors in accordance with the provisions/principles laid down in the Companies Act, 2013, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Articles of Association and provisions of other Acts/rules/regulations as may be applicable on the Company

4. *The constitution and composition of Committees of the Board*

17. SYSTEM AND PROCESS

System and process broadly refer to the framework of legal and procedural compliances of the Auditee including but not limited to internal regulations, control, guidance and governance.

Meaning of systems and processes

- i. *A **system** is the core element, that company management has and/or implements in its business. It's something that helps the business run.*
- ii. *The **processes** are all the things that company management do in order to make any given system work most efficiently.*
- iii. *System and process in the context of Secretarial Audit includes internal policies, decisions or procedures, etc. laid down by the Auditee for ensuring the compliance of the various laws, rules, standards and guidelines as may be applicable to the company.*
- iv. *The Auditor should check the Auditee's policies, decisions, and procedures to ensure they are followed. This includes confirming that the systems and processes are suitable for the Auditee's size and operations, ensuring compliance with relevant laws, rules, regulations, standards, guidelines, and internal processes.*
- v. *The Auditor shall assess the efficacy and adequacy of the system and processes of the Auditee commensurate with its size and operation for verifying compliance of applicable laws, rules, regulations, standards, guidelines, and defined internal processes, if any by:*
 - a. *Reviewing records maintained by the Auditee.*
 - b. *Understanding compliance responsibility centers, control points, matrix, the flow of information, escalation of non-compliances to different levels, reporting of any non-compliance.*
 - c. *Assessing compliance mechanism and understanding its extent, coverage and severity mapping.*
 - d. *The Auditor shall also assess compliance manual/ standard operating procedures, if any, available with the Auditee.*
 - e. *Analysing instances of show cause notices received, prosecution initiated, fine or penalties levied, imprisonment ordered, qualification, adverse remark or observations in the statutory, internal or industry specific audit, orders passed by regulatory bodies or judicial/ quasi-judicial authorities.*

Companies which observe best practices for Board Process

Bharti Airtel Limited –

- a. The company submits audited quarterly results to the Stock Exchange.
- b. Separate meeting of Independent Directors on a quarterly basis.
- c. The evaluation of the Board of Directors is done by an external agency
- d. Linkage of remuneration of MD & CEO and Senior Management with ESG/sustainability targets.

Hindustan Unilever Limited The Board of directors has adopted 'Corporate Governance Code' a statement of practices and procedures to be followed by the company and its officers and employees.

Mahindra Logistics Limited

- a. The company has voluntarily adopted the practice of scheduling its AGM within 5 month of end of financial year as a good governance measure.
- b. The company, voluntarily as a good governance practice, observes a 'silent/quiet period' for 15 days prior to the announcement of quarterly and annual financial results.
- c. The company has structured system-based PAN India compliance mechanism, with process management and end-to-end visibility for its compliance process.

AU Small Finance Bank Limited The Executive Directors are duty bond with Malus and Claw back clause, which activates in the event of subdued or negative financial performance of the Bank.

18. DETECTION OF FRAUD

- i. According to **Section 143 of Companies Act, 2013** it is the duty of auditor to report fraud.
- ii. The Auditor shall exercise **professional judgment** and **maintain professional scepticism throughout the planning and performance of the audit to detect and report the fraud**. Here, professional scepticism means, an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.
- iii. **Professional scepticism** includes being alert to, for example:
 - Audit evidence that contradicts other audit evidence obtained.
 - Information that brings into question the reliability of documents and inquiries to be used as audit evidence.

- iv. **Professional Judgment** involves using the knowledge and experience gained from accounting or auditing training to make informed decisions based on ethical standards in specific circumstances.
- v. During the course of the audit, if the Auditor suspects commission of any fraud, he shall endeavour to collect further evidence for the same.
- vi. Suspicions may arise through a review of internal control systems, reports from whistleblowers, and feedback from other auditors.

- **'Suspicion'** is a state of mind more definite than speculation, but falls short of knowledge based on evidence. It must be based on some evidence, even if that evidence is tentative – simple speculation that a person may be engaged in fraud is not sufficient grounds to form a suspicion. Suspicion is a slight opinion but without sufficient evidence.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth, is an example of suspicion

- vii. The Auditor may communicate directly with the internal auditors and statutory auditors to verify whether they have suspected/identified any fraud during the course of their audit.
- viii. During the course of the audit, if the auditor suspects any commission of fraud, he shall endeavour to collect further evidence for the same.
- ix. The auditor shall ensure to collect sufficient evidence which substantiates his suspicion of the commission of the fraud against the Company by the employees and officers of the company.
- x. The auditor shall ensure that he has sufficient reason to believe that there is commission of fraud and should have justifiable grounds for the same.

Transaction which may involve the fraud

In the past, "Fraud" has been noticed in many cases of scams in the following kinds of transactions:-

- Related Party Transactions

- Excessive Managerial remuneration
- Insider Trading
- Inter Company transactions
- Mergers/demergers/acquisitions
- IPO frauds

Other means of corporate fraud are the inadequate disclosures, false or misleading information, theft of assets, false expenses, corruption, theft in formation, fraudulent applications, misuse of assets, dishonest business partners, fraudulent billing.

These areas are not exhaustive but only some examples are given so as to guide fraud detection.

19. REPORTING OF FRAUD

A very significant duty has been cast on the Company Secretary in Practice under section 143 of the Companies Act, 2013. It provides that if the Company Secretary in Practice, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government, or to the Audit Committee or the Board.

Duty of Report Fraud to Central Government

The section 143(12) read with the Companies (Audit and Auditors) Rules, 2014 provides that if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud which involves or is expected to involve individually **an amount of rupees one crore or above**, is being or has been committed against the company by its officers or employee, **the auditor shall report the matter to the Central Government.**

Duty of Report Fraud to Audit Committee/ Board

In case of a fraud **involving lesser than rupees one crore**, the auditor **shall report the matter to audit committee or to the board** immediately but not later than **two days of his knowledge of the fraud** and he shall report the matter specifying the following: -

- (a) Nature of fraud with description;

- (b) Approximate amount involved; and
- (c) Parties involved.

Disclosures in the Board's Report

The following details of each of the fraud reported to the Audit Committee or the Board during the year to be disclosed in the Board's Report: -

- (a) Nature of fraud with description;
- (b) Approximate amount involved;
- (c) Parties involved, if remedial action not taken; and
- (d) Remedial actions taken.

Consequence on failure in Reporting of fraud

In case, Company Secretary in Practice does not comply with the provisions of section 143(12), he shall be punishable with fine which shall be liable to a penalty of five lakh rupees in case of a listed company, and one lakh rupees in case of any other company.

Who is considered as an Auditor for Fraud Reporting?

The auditor includes the-

- **Statutory Auditors** of the company appointed under section 139 of the Companies Act, 2013;
- **Company Secretary in Practice conducting Secretarial Audit** under section 204 of the Companies Act, 2013;
- **Cost Accountant in practice conducting Cost Audit** under section 148 of the Companies Act, 2013 and the **Branch Auditors**.

However, the **Internal Auditor** or such other professionals appointed under any other statutes rendering other services to the company such as a tax auditor appointed under Income Tax Act, **GST auditors** appointed under the respective GST legislations are not covered under section 143 of the Companies Act, 2013.

Difficulties in estimating the quantum of fraud

- a. By and large the Auditor including the Secretarial Auditor goes by the estimates or reasonable range provided by the management for the purpose of estimating the quantum of the fraud amount and reporting. Depending upon the complexity and duration of the fraud, at times it could be difficult for the auditing personnel to determine the quantum of fraud and loss suffered.
- b. In the event, *after some time, it is discovered that the quantum of fraud has exceeded the threshold limit of one crore, then subsequent reporting may be required and thus the Secretarial Auditor may have to report to the Central Government within 45 days of the determination of the revised fraud estimate or loss which crossed one crore limit.*
- c. In view of the above, the estimation of the amount of fraud is very critical and if the estimation goes wrong even after taking reasonable care, then it will impact the decision whether to report to the concerned Authorities or otherwise.
- d. Since the provision says that in case of fraud exceeding one crore is only required to be reported to Central Government and fraud involving less than a crore is required to be reported only to Audit Committee / Board. Hence, the secretarial auditor is required take extreme care in estimating the quantum of fraud.

Whether regulatory non-compliance would come under the purview of fraud reporting?

It may be noted that as per Ministry of Corporate Affairs notification there is no distinction between fraud and regulatory non-compliance as long as the quantum of fraud loss can be reasonably quantified due to regulatory non-compliance.

Where the secretarial auditor discovers instances involving bribery, money laundering, corruption or other regulatory non-compliance committed by either by the company or its employees or its management, then the secretarial auditor is duty bound to communicate the same to the Audit Committee / Board and depending upon the quantum he is also required to report to the Central Government if the determination of fraud exceeds the threshold limit of one crore.

20. PROCEDURE FOR REPORTING OF FRAUD

(i) Reporting of frauds by auditor involving amount more than Rs. 1 crore

If an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually **an amount of rupees one crore or above**, is being or has been committed against the company by its officers or employees, **the auditor shall report the matter to the Central Government**. Auditor should report such frauds as soon as possible but not later than 60 days of his knowledge about the frauds

STEP-I - Report to Board & Audit Committee

Auditor shall **forward his report to the board of directors or the audit committee**, as the case maybe, **within 2 days of his knowledge of the fraud**, seeking their reply or observations within 45 (forty-five) days;

STEP-II - Report to Central Government after reply of board

On receipt of such reply or observations, **the auditor shall forward his report and the reply or observations of the board or the audit committee along with his comments** (on such reply or observations of the board or the audit committee) **to the central government within 15 fifteen days** of receipt of such reply or observations;

STEP-III - Report to Central Government if no reply received

In case the **auditor fails to get any reply or observations from the board or the audit committee within the stipulated period of forty-five days**, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the board or the audit committee for which he failed to receive any reply or observations within the stipulated time.

(ii) Reporting of frauds by auditor involving amount less than Rs. 1 crore

In case of **fraud involving an amount less than Rs. 1 Crore**, the auditor shall report the matter of fraud to the audit committee or to the board within 2 days of his knowledge of the fraud. The report should specify the nature of the fraud with description, approximate amount of the

fraud and parties involved in the fraud. In such case, the Board shall disclose in its report (Board's Report) the nature of fraud with description, approximate amount of the fraud, parties involved in the fraud and remedial action taken. Name of parties should be disclosed only when the board or audit committee has not taken any remedial action against the fraud.

CASE LAW

Globe Motors Limited v. Mehta Teja Singh & Company

The Delhi High court observed that although an agreement in which a director was interested could not be said to be invalid in view of compliance with the requirements of the Act, yet it is only a formal aspect of compliance with the statutory provisions; the basic question is as to the conduct of the director and whether it satisfies the test considering their fiduciary relationship to the company. Justice Sachar further observed that the directors are expected to display utmost good faith towards the company in their dealings with the company or on behalf of the company; they should not use the company's money or other property or information or other matters in their possession in order to gain any advantage to themselves. Therefore, a practicing company secretary should not be satisfied only with compliance during secretarial audit. He needs to look beyond and satisfy himself that the transactions which have taken place during audit period do not contain any fraud element

21. FRAUD V/S NON-COMPLIANCE

The term fraud can be defined as act or course of deception, an intentional concealment, omission, or perversion of truth, to

5. gain unlawful or unfair advantage,
6. induce another to part with some valuable item or surrender a legal right, or
7. inflict injury in some manner.

Wilful fraud is a criminal offense which calls for severe penalties, and its prosecution and punishment. However, incompetence or negligence in managing a business or even a reckless waste of firm's assets does not normally constitute a fraud.

Non-Compliance:

The term *non-compliance* refers to failure to comply with the laws, rules regulations etc., the term non-compliance is commonly used in regard to a failure to meet the compliance requirements or failure to doing compliance be it the failure in following procedures, filing of information, eligibility conditions, reporting etc.

The *relationship between Fraud and non-compliance* can be constructed as the non-compliance in the company may lead to a fraud, however it may also be noted that the fraud can also be made in the compliant company.

22. IDENTIFICATION AND REPORTING OF THE EVENTS/ACTIONS HAVING MAJOR BEARING ON AUDITEE'S AFFAIRS

An event/action may be considered as having major bearing on Company's affairs includes the following situations:

1. The Auditor shall assess and identify the material action or events having bearing on the Auditee's affairs in pursuance of the applicable laws, act, rules, regulations, guidelines, standards, etc. and report accordingly.
2. The *identification of the corporate actions or events* having bearing on the Auditee's affairs in terms of applicable laws, act, rules, regulations, guidelines, standards, etc. is a subjective matter and needs to be concluded keeping in mind various parameters. Such parameters may include the following:
 - a. The consideration involved in the transaction as a percentage of the consolidated turnover, net worth or profit;
 - b. The transaction whether or not in the ordinary course of business;
 - c. The transaction representing a significant shift from the company's strategy;
 - d. The omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date.
3. Further, **following are indicative actions and/or events may be considered to have a bearing on the Auditee's affairs:**
 - a. Future plans of Merger or Amalgamation.
 - b. Revision in Rating(s).

- c. Fraud/ defaults by promoter or key managerial personnel or by listed entity or arrest of key managerial personnel or promoter.
- d. Agreements [viz. shareholder agreement(s), joint venture agreement(s), family settlement agreement(s) (to the extent that it impacts management and control of the listed entity), agreement(s)/ contract(s) with media companies)], which are binding and not in normal course of business, revision(s) or amendment(s) and termination(s) thereof.
- e. Corporate Debt Restructuring.

4. The Auditor shall disclose the material non-compliances and transactions as observed during the course of Audit.

Further, the SEBI (LODR) Regulations, 2015 include the following events which are considered as having bearing on affairs of the company:

1. default in timely payment of interests/preference dividend or redemption or repayment amount or both in respect of the non-convertible debt securities and non-convertible redeemable preference shares and also default in creation of security for debentures as soon as the same becomes apparent;
2. any attachment or prohibitory orders restraining the company from transferring non-convertible securities from the account of the registered holders along-with the particulars of the numbers of securities so affected, the names of the registered holders and their demat account details;
3. any action which shall result in the redemption, conversion, cancellation, retirement in whole or in part of any non-convertible securities;
4. any action that shall affect adversely payment of interest on non-convertible debt securities or payment of dividend on non-convertible redeemable preference shares including default by issuer to pay interest on non-convertible debt securities or redemption amount and failure to create a charge on the assets;
5. any change in the form or nature of any of its non-convertible debt securities or non-convertible securities that are listed on the stock exchange(s) or in the rights or privileges of the holders thereof and make an application for listing of the securities as changed, if the stock exchange(s) so require;

6. any changes in the general character or nature of business/activities, disruption of operation due to natural calamity, and commencement of commercial production/commercial operations;
7. any events such as strikes and lock outs which have a bearing on the interest payment/dividend payment/ principal repayment capacity;
8. details of any letter or comments made by debenture trustees regarding payment/non-payment of interest on due dates, payment/non-payment of principal on the due dates or any other matter concerning the security, listed entity and/or the assets along with its comments thereon, if any;
9. delay/default in payment of interest or dividend/principal amount/redemption for a period of more than three months from the due date;
10. failure to create charge on the assets within the stipulated time period;
11. any instance(s) of default/delay in timely repayment of interests or principal obligations or both in respect of the debt securities including, any proposal for re-scheduling or postponement of the repayment programmes of the dues/debts of the Company with any investor(s)/lender(s).
12. any major change in composition of its board of directors, which may amount to change in control as defined in Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
13. any revision in the rating;
14. the following approvals by board of directors in their meeting:-
 - (a) the decision to pass any interest payment;
 - (b) short particulars of any increase of capital whether by issue of bonus securities through capitalization, or by way of right securities to be offered to the debt security holders, or in any other way;
15. all the information, report, notices, call letters, circulars, proceedings, etc. concerning non-convertible debt securities;
16. fraud/defaults by promoter or key managerial personnel or director or employees of listed entity or by listed entity or arrest of key managerial personnel or promoter.

23. IMPACT OF AUDIT REPORT

- i. Secretarial Audit helps the investors in taking informed investment decision, as it evaluates the company in terms of compliance and governance norms being followed by the company.
- ii. The Secretarial Audit Report should be prepared in accordance with the Auditing Standards issued by the Institute of Company Secretaries of India and be signed by the Secretarial Auditor who has been engaged by the company to conduct the Secretarial Audit and in case of a firm of Company Secretaries, by the partner under whose supervision the Secretarial Audit was conducted.
 - a. An effective mechanism to make sure of the compliance with the legal and procedural Requirements.
 - b. Provides a level of confidence to the directors & Key Managerial Personnel etc.
 - c. Secretarial Audit ensures legal and procedural requirements so directors can concentrate on important business matters.
 - d. Strengthen the goodwill of a company for their regulators and stakeholders.
 - e. Secretarial Audit is an effective governance and compliance risk management tool.
 - f. It helps the investor in analysing the compliance level of companies, thereby increases the reputation.

Annexure -A

FORM NO. MR-3

SECRETARIAL AUDIT REPORT FOR THE FINANCIAL YEAR ENDED

[Pursuant to section 204(1) of the Companies Act, 2013 and rule No.9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014]

To,

The Members,

..... Limited

I/We have conducted the secretarial audit of the compliance of applicable statutory provisions and the adherence to good corporate practices by..... (name of the company). (hereinafter called the company). Secretarial Audit was conducted in a manner that provided me/us a

reasonable basis for evaluating the corporate conducts/ statutory compliances and expressing my opinion thereon.

Based on my/our verification of the (name of the company's) books, papers, minute books, forms and returns filed and other records maintained by the company and also the information provided by the Company, its officers, agents and authorized representatives during the conduct of secretarial audit, I/We hereby report that in my/our opinion, the company has, during the audit period covering the financial year ended on, complied with the statutory provisions listed hereunder and also that the Company has proper Board-processes and compliance mechanism in place to the extent, in the manner and subject to the reporting made hereinafter:

I/we have examined the books, papers, minute books, forms and returns filed and other records maintained by ("the Company") for the financial year ended on, according to the provisions of:

- (i) The Companies Act, 2013 (the Act) and the rules made thereunder;
- (ii) The Securities Contracts (Regulation) Act, 1956 ('SCRA') and the rules made thereunder;
- (iii) The Depositories Act, 1996 and the Regulations and Bye-laws framed thereunder;
- (iv) The Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings;
- (v) The following Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992 ('SEBI Act'):
 - a. The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
 - b. The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;
 - c. The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
 - d. The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;

- e. *The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;*
- f. *The Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with client;*
- g. *The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009;*
and
- h. *The Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998.*

(vii) (Mention the other laws as may be applicable specifically to the company) I/we have also examined compliance with the applicable clauses of the following: (i) Secretarial Standards issued by The Institute of Company Secretaries of India. (ii) The Listing Agreements entered into by the Company with Stock Exchange(s), if applicable; During the period under review the Company has complied with the provisions of the Act, Rules, Regulations, Guidelines, Standards, etc. mentioned above subject to the following observations:

I/we further report that :

The Board of Directors of the Company is duly constituted with proper balance of Executive Directors, Non-Executive Directors and Independent Directors. The changes in the composition of the Board of Directors that took place during the period under review were carried out in compliance with the provisions of the Act.

Adequate notice is given to all directors to schedule the Board Meetings, agenda and detailed notes on agenda were sent at least seven days in advance, and a system exists for seeking and obtaining further information and clarifications on the agenda items before the meeting and for meaningful participation at the meeting.

Majority decision is carried through while the dissenting members' views are captured and recorded as part of the minutes.

I/we further report that there are adequate systems and processes in the company commensurate with the size and operations of the company to monitor and ensure compliance with applicable laws, rules, regulations and guidelines.

Note: Please report specific observations / qualification, reservation or adverse remarks in respect of the Board Structures/system and processes relating to the Audit period.

I/we further report that during the audit period the company has..... (Give details of specific events / actions having a major bearing on the company's affairs in pursuance of the above referred laws, rules, regulations, guidelines, standards, etc. referred to above) For example:

- (i) Public/Right/Preferential issue of shares / debentures/sweat equity, etc.
- (ii) Redemption / buy-back of securities.
- (iii) Major decisions taken by the members in pursuance to section 180 of the Companies Act, 2013.
- (iv) Merger / amalgamation / reconstruction, etc.
- (v) Foreign technical collaborations.

Place:

Signature:

Date:

Name of Company Secretary in Practice/Firm:

ACS/FCS No. C P No.:

Note: Parawise details of the Audit finding, if necessary, may be placed as annexure to the report.

Annexure-B

Format of Annual Secretarial Audit Compliance Report - ICSI

Secretarial Compliance Report of [.] [Name of the listed entity] for the year ended ____

I/We have conducted the review of the compliance of the applicable statutory provisions and the adherence to good corporate practices by (hereinafter referred as 'the

listed entity'), having its Registered Office at Secretarial Review was conducted in a manner that provided me/us a reasonable basis for evaluating the corporate conducts/statutory compliances and to provide my/our observations thereon. Based on my/our verification of the listed entity's books, papers, minutes books, forms and returns filed and other records maintained by the listed entity and also the information provided by the listed entity, its officers, agents and authorized representatives during the conduct of Secretarial Review, I/we hereby report that the listed entity has, during the review period covering the financial year ended on _____ complied with the statutory provisions listed hereunder in the manner and subject to the reporting made hereinafter:

I/We _____ have examined:

- (a) all the documents and records made available to us and explanation provided by [] [Name of the listed entity] ("the listed entity"),
- (b) the filings/ submissions made by the listed entity to the stock exchanges,
- (c) website of the listed entity,
- (d) any other document/ filing, as may be relevant, which has been relied upon to make this report,

for the financial year ended [] ("Review Period") in respect of compliance with the provisions of :

- (a) the Securities and Exchange Board of India Act, 1992 ("SEBI Act") and the Regulations, circulars, guidelines issued thereunder; and
- (b) the Securities Contracts (Regulation) Act, 1956 ("SCRA"), rules made thereunder and the Regulations, circulars, guidelines issued thereunder by the Securities and Exchange Board of India ("SEBI");

The specific Regulations, whose provisions and the circulars/ guidelines issued thereunder, have been examined, include:-

- (a) Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015;
- (b) Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018;

- (c) Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
- (d) Securities and Exchange Board of India (Buyback of Securities) Regulations, 2018;
- (e) Securities and Exchange Board of India (Share Based Employee Benefits and Sweat Equity) Regulations, 2021;
- (f) Securities and Exchange Board of India (Issue and Listing of Non-Convertible Securities) Regulations, 2021;
- (g) Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015;
- (h) (other regulations as applicable) and circulars/ guidelines issued thereunder;

a. (**) The listed entity has complied with the provisions of the above Regulations and circulars/ guidelines issued thereunder, except in respect of matters specified below:

Sr. No.	Com-pliance Requirement (Regulations/ circulars/ guidelines including specific clause)	Regu-lation/ Circular No.	Deviations	Action Taken by	Type of Action	Details of Violation	Fine Amount	Observations/ Remarks of the Practising Company Secretary	Management Response	Remarks
					Advisory/ Clarification/ Fine/ Show Cause Notice/ Warning, etc.					

b. The listed entity has taken the following actions to comply with the observations made in previous reports:

Sr. No.	Compliance Requirement (Regulations/circulars/guidelines including specific clause)	Regulation/Circular No.	Deviations	Action Taken by	Type of Action	Details of Violation	Fine Amount	Observations/Remarks of the Practicing Company Secretary	Management Response	Remarks
					Advisory/Clarification/ Fine/Show Cause Notice/Warning, etc.					

II. Compliances related to resignation of statutory auditors from listed entities and their material subsidiaries:

Sr. No.	Particulars	Compliance Status (Yes/No/NA)	Observations/Remarks by PCS*
1.	Compliances with the following conditions while appointing/re-appointing an auditor		

	<p>i. If the auditor has resigned within 45 days from the end of a quarter of a financial year, the auditor before such resignation, has issued the limited review/ audit report for such quarter; or</p> <p>ii. If the auditor has resigned after 45 days from the end of a quarter of a financial year, the auditor before such resignation, has issued the limited review/ audit report for such quarter as well as the next quarter; or</p> <p>iii. If the auditor has signed the limited review/ audit report for the first three quarters of a financial year, the auditor before such resignation, has issued the limited review/ audit report for the last quarter of such financial year as well as the audit report for such financial year.</p>		
2.	Other conditions relating to resignation of statutory auditor		
	<p>i. Reporting of concerns by Auditor with respect to the listed entity/its material subsidiary to the Audit Committee:</p> <p>a. In case of any concern with the management of the listed entity/material subsidiary such as non-availability of information / noncooperation by the management which has hampered the audit process, the auditor has approached the Chairman of the Audit Committee of the listed entity and the Audit Committee shall receive such concern directly and immediately without specifically waiting for the quarterly Audit Committee meetings.</p>		

Sr. No.	Particulars	Compliance Status (Yes/No/ NA)	Observations/ Remarks by PCS*
	<p>b. In case the auditor proposes to resign, all concerns with respect to the proposed resignation, along with relevant documents has been brought to the notice of the Audit Committee. In cases where the proposed resignation is due to non-receipt of information / explanation from the company, the auditor has</p>		

	<p><i>informed the Audit Committee the details of information/ explanation sought and not provided by the management, as applicable.</i></p> <p><i>c. The Audit Committee / Board of Directors, as the case may be, deliberated on the matter on receipt of such information from the auditor relating to the proposal to resign as mentioned above and communicate its views to the management and the auditor.</i></p> <p><i>ii. Disclaimer in case of non-receipt of information: The auditor has provided an appropriate disclaimer in its audit report, which is in accordance with the Standards of Auditing as specified by ICAI / NFRA, in case where the listed entity/ its material subsidiary has not provided information as required by the auditor.</i></p>		
3.	<i>The listed entity / its material subsidiary has obtained information from the Auditor upon resignation, in the format as specified in Annexure-A in SEBI Circular CIR/CFD/CMDI/114/2019 dated 18th October, 2019.</i>		
Sr. No.	Particulars	Compliance Status (Yes/No/ NA)	Observations/ Remarks by PCS*
1.	<p><i>Secretarial Standards:</i></p> <p><i>The compliances of the listed entity are in accordance with the applicable Secretarial Standards (SS) issued by the Institute of Company Secretaries of India (ICSI).</i></p>		
2.	<p><i>Adoption and timely updation of the Policies:</i></p> <ul style="list-style-type: none"> <i>● All applicable policies under SEBI Regulations are adopted with the approval of board of directors of the listed entities</i> <i>● All the policies are in conformity with SEBI Regulations and have been reviewed & updated on time, as per the regulations/circulars/guidelines issued by SEBI.</i> 		

3.	<p><i>Maintenance and disclosures on Website:</i></p> <ul style="list-style-type: none"> ● <i>The Listed entity is maintaining a functional website</i> ● <i>Timely dissemination of the documents/ information under a separate section on the website</i> ● <i>Web-links provided in annual corporate governance reports under Regulation 27(2) are accurate and specific which re- directs to the relevant document(s)/ section of the website</i> 		
4.	<p><i>Disqualification of Director:</i></p> <p><i>None of the Director(s) of the Company is/ are disqualified under Section 164 of Companies Act, 2013 as confirmed by the listed entity.</i></p>		
5.	<p><i>Details related to Subsidiaries of listed entities have been examined w.r.t.:</i></p> <p>(a) <i>Identification of material subsidiary companies</i></p> <p>(b) <i>Disclosure requirement of material as well as other subsidiaries</i></p>		
6.	<p><i>Preservation of Documents:</i></p> <p><i>The listed entity is preserving and maintaining records as prescribed under SEBI Regulations and disposal of records as per Policy of Preservation of Documents and Archival policy prescribed under SEBI LODR Regulations, 2015.</i></p>		
7.	<p><i>Performance Evaluation:</i></p> <p><i>The listed entity has conducted performance evaluation of the Board, Independent Directors and the Committees at the start of every financial year/during the financial year as prescribed in SEBI Regulations.</i></p>		
8.	<p><i>Related Party Transactions:</i></p> <p>(a) <i>The listed entity has obtained prior approval of Audit Committee for all related party transactions; or</i></p> <p>(b) <i>The listed entity has provided detailed reasons along with confirmation whether the transactions were subsequently approved/ratified/rejected by the Audit Committee, in</i></p>		

	<i>case no prior approval has been obtained.</i>		
9.	<i>Disclosure of events or information: The listed entity has provided all the required disclosure(s) under Regulation 30 along with Schedule III of SEBI LODR Regulations, 2015 within the time limits prescribed thereunder.</i>		
10.	<i>Prohibition of Insider Trading: The listed entity is in compliance with Regulation 3(5) & 3(6) SEBI (Prohibition of Insider Trading) Regulations, 2015.</i>		
11.	<i>Actions taken by SEBI or Stock Exchange(s), if any: No action(s) has been taken against the listed entity/ its promoters/ directors/ subsidiaries either by SEBI or by Stock Exchanges (including under the Standard Operating Procedures issued by SEBI through various circulars) under SEBI Regulations and circulars/ guidelines issued thereunder except as provided under separate paragraph herein (**).</i>		
12.	<i>Additional Non-compliances, if any: No additional non-compliance observed for any SEBI regulation/ circular/guidance note etc.</i>		

Note:

1. *Provide the list of all the observations in the report for the previous financial year along with the actions taken by the listed entity on those observations.*
2. *Add the list of all observations in the reports pertaining to the periods prior to the previous financial year in case the entity has not taken sufficient steps to address the concerns raised/ observations. E.g. In the report for the financial year ended 31st March, 2023, the PCS shall provide a list of:*
 - *all the observations in the report for the year ended 31st March, 2022 along with the actions taken by the listed entity on those observations.*

- the observations in the reports pertaining to the year ended 31st March, 2022 and earlier, in case the entity has not taken sufficient steps to address the concerns raised/ observations in those reports.)

Assumptions & Limitation of scope and Review:

1. Compliance of the applicable laws and ensuring the authenticity of documents and information furnished, are the responsibilities of the management of the listed entity.
2. Our responsibility is to report based upon our examination of relevant documents and information. This is neither an audit nor an expression of opinion.
3. We have not verified the correctness and appropriateness of financial Records and Books of Accounts of the listed entity.
4. This Report is solely for the intended purpose of compliance in terms of Regulation 24A (2) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and is neither an assurance as to the future viability of the listed entity nor of the efficacy or effectiveness with which the management has conducted the affairs of the listed entity.

Place:

Signature:

Date:

Name of the Practicing Company Secretary

ACS/ FCS No.:

CP No. :

UDIN :

PR No. :

SUMMARISED VERSION (MIND MAP)

1. INTRODUCTION

Historically, internal auditing was confined to ensure that, the accounting and allied records have been properly maintained, the assets of the organization have been properly safeguarded and that the policies and procedures laid down by the management have been complied with. Post liberalization of economy, the growth and expansion made it increasingly difficult for organizations to maintain control and operational efficiency. The economic conditions further expanded organizations' responsibilities for scheduling, managing with limited materials and labourers, complying with government regulations, and an increased emphasis on cost efficiency. It was difficult for management to observe all the operating areas or be in touch with everybody. This requires companies to appointed auditing personnel for report on affairs of the company, which are known as 'Internal Auditors'.

The operations of the Companies which have huge and sophisticated business structure and have decentralization of their business activities among the various functional heads and division or wherein the top management is remotely concerned with the day-to-day activities of the concern. Now a day, the role of internal auditing has a great significance in the performance of the company.

With the changes in the economic conditions, now the scope of internal auditing is not confined to financial transactions it is extended up to the minute activities of the company, which may or may not be the cost centre but have an impact on the efficiency of the company.

2. DEFINITION OF INTERNAL AUDIT

As defined by the Institute of Internal Auditors (IIA)

Internal auditing is an **independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.**

Independence is established by the organizational and reporting structure. Objectivity is achieved by an appropriate mind-set.

The internal audit activity evaluates risk exposures relating to the organization's governance, operations and information systems, in relation to:

1. Effectiveness and efficiency of operations;
 2. Reliability and integrity of financial and operational information;
 3. Safeguarding of assets;
 4. Compliance with laws, regulations, and contracts.
-
- i. Based on the results of the risk assessment, the internal auditors evaluate the adequacy and effectiveness of how risks are identified and managed in the above areas.
 - ii. They also assess other aspects such as ethics and values within the organization, performance management, communication of risk and control information within the organization in order to facilitate a good governance process.
 - iii. The objectivity, skills, and knowledge of competent internal auditors can significantly add value to an organization's internal control, risk management, and governance processes. Similarly an effective internal audit activity can provide assurance to other stakeholders such as regulators, employees, providers of finance, and shareholders.

Nature of Internal Audit:

- i. **A Management tool:** Internal Audit serves as a management tool conducted by either the organization's employees or an external professional firm. Its purpose is to assess the effectiveness of internal checks and controls within the organization. The reporting authority is generally board of directors and audit committee.
- ii. **A continuous Exercise:** Internal Audit is a continuous and systematic process of examining and reporting the operations and records of a concern by its employees or external agencies specially assigned for this purpose. It is, in essence, auditing for the management and its scope may vary depending upon the nature and size of the concern.
- iii. **A Control System:** It is a control system concerned with examination and appraisal of other control mechanisms.

- iv. **A Risk Management Tool:** Internal audit involves facilitating the development of a risk management process, ensuring it meets key objectives, and evaluating the process. It plays a similar role in creating and evaluating the business continuity planning process, as well as the information security and privacy system.

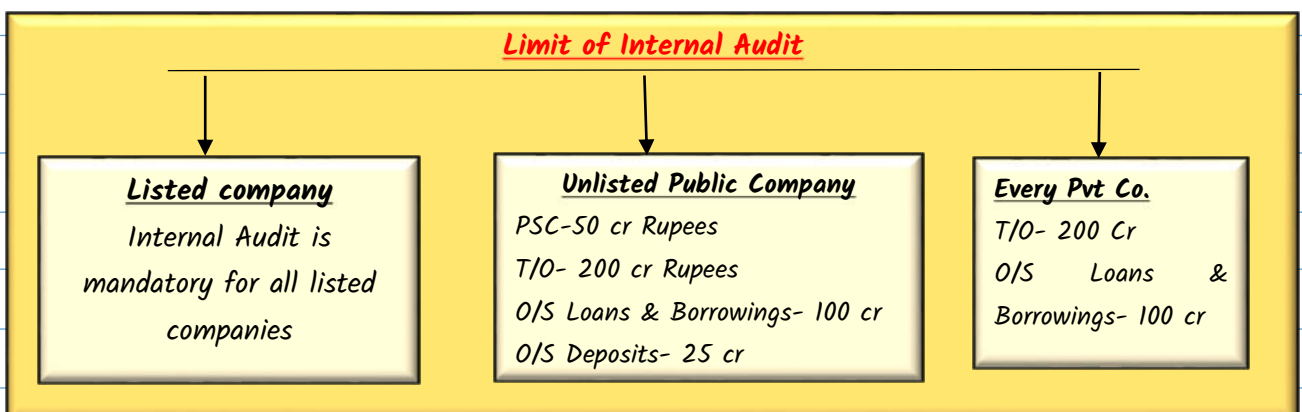
CASE STUDY

HDFC Bank's Risk Management Framework: Robust and stress-tested framework

Our robust Risk Management framework and the independence of our risk management function set us apart as a responsible banker. It enables the execution of our strategic priorities without taking on undue financial and non-financial risks. Our risk policies and processes and their effective implementation through technology and governance enabled us to endure and even grow in these highly uncertain and disruptive times. Stress testing is one of the key risk management tools we use to mitigate and manage the existing as well as emerging risks

3. INTERNAL AUDIT UNDER THE COMPANIES ACT, 2013

- i. The concept of the internal audit has been recognized as a statutory exercise under Section 138 of the Companies Act, 2013, and has been made mandatory.
- ii. As per Rule 13 of Companies (Accounts) Rule, 2014, the following class of companies shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate, namely:



ABC Pvt. Ltd. having Rs. 90 lacs paid-up capital, Rs. 5 crores reserves and turnover of last three consecutive financial years, immediately preceding the financial year under audit, being Rs. 50 crores, Rs. 175 crores and Rs. 300 crores, but does not have any internal audit system. In view of the management, the internal audit system is not mandatory. Comment?

Solution:

Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act, 2013, read with rule 13 of Companies (Audit and Auditors) Rules, 2014, every private company shall be required to appoint an internal auditor or a firm of internal auditors, having-

- a. *turnover of two hundred crore rupees or more during the preceding financial year; or*
- b. *outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.*

Conclusion: In the instant case, ABC Pvt. Ltd. is having a turnover of Rs. 300 crores during the preceding financial year which is more than two hundred crore rupees. Hence, the company has the mandatorily statutory requirement to appoint an Internal Auditor and mandatorily conduct an internal audit.

Will the Partnership firm / Proprietary firm mandatorily required appointing an Internal Auditor?

Solution:

No, the Partnership firm / Proprietary firm is not mandatorily required to appoint an Internal Auditor. However, voluntary the Partnership firm / Proprietary firm can appoint an internal auditor of the organization.

The Management of XYZ Pvt. Ltd appointed Luthra and Co. (Chartered Accounting Firm) as an internal auditor of the company who is also a statutory auditor of the XYZ Pvt. Ltd. Is the appointment of Luthra and Co. (Chartered Accounting Firm) as an Internal Auditor of XYZ Pvt. Ltd. is valid?

Solution:

As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company. The internal auditor may or may not be an employee of the company. However, Statutory Auditor shall not be appointed as internal auditor of the Company.

Therefore, the appointment of Luthra and Co. (Chartered Accounting Firm) as an internal auditor of XYZ Pvt. Ltd. is not valid as Luthra and Co. is also a statutory auditor of XYZ Pvt. Ltd

The audit committee of the company or the board shall, in consultation with the internal auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

The Companies Act, 2013 does not prescribes any specific time frame for conducting internal audit but it is considered a good practice to conduct the audit on a quarterly basis so that the compliances are monitored properly and there are no frauds or deviations in the company.

Penal Provisions for default/non-compliance

As per section 450 of the Companies Act, 2013, if a company or any officer of a company or any other person contravenes any of the provisions of this Act or the rules made thereunder, for which no penalty or punishment is provided elsewhere in this Act, the company and every officer of the company who is in default or such other person shall be liable to a penalty of ten thousand rupees, and in case of continuing contravention, with a further penalty of one thousand rupees for each day after the first during which the contravention continues, subject to a maximum of two lakh rupees in case of a company and fifty thousand rupees in case of an officer who is in default.

Is there any penalty for non-compliance with respect to appointment of internal auditor?

Solution:

Yes, If a company or any other officer of the company, contravenes the provisions of this section, then the company or any officer of the company who is in default is liable for punishment with a penalty of up to Rs.10,000. In case of continuation of default in complying

with the above section further fine of Rs.1,000 per day will be imposed subject to a maximum of Rs. 2,00,000 in case of a company and Rs. 50,000 in case of an officer who is in default or any other person.

CASE STUDY

M/s. Indu Nissan Oxo Chemical Industries Limited,

1. The Ministry of Corporate Affairs has ordered to inquiry of the subject company under section 206 of the Companies Act 2013. During the course of an inquiry, it was observed that the company is the eligible company to appoint an internal auditor and the company failed to appoint an internal auditor which is the mandatory requirement under section 138 of the Companies Act 2013.
2. ROC issued a show cause notice to the company and its directors. The company replied that the company has been shut down since 1999 and it had been a sick unit since the year 2002.
3. The company was also registered with Board for Industrial and Financial Reconstruction (BIFR) under the Sick Industrial Companies (Special Provisions) Act 1985.
4. The ROC issued Personal hearing notice to give a reasonable opportunity of being heard to the company and its directors.
5. On the scheduled date of the hearing neither the company nor KMP had appeared for the hearing and also not submitted any reply / letter, in spite of further reminder / written notice issued to the company / its director.
6. Hence, the Registrar of Companies / Adjudicating Officer proceeded on the matter in the absence of a reply of the company / non- appearance of any of the company officials even after providing the sufficient opportunity to the Company / director.
7. The Registrar of Companies / Adjudicating Officer came to the conclusion that the company and its director committed the default of section 138 by not appointing an internal auditor for a period of seven years and therefore, it is concluded that the company and its director in default were liable for penalty under section 454 of the Companies Act 2013 for default under section 138 of the Companies Act 2013.
8. Since, none of the representatives of the company were present for personal hearing despite constant reminders, Registrar of Companies / Adjudicating Officer went ahead on this matter

ex-parte and passed the adjudicating order as per the provisions of Section 454 (3) of the Companies Act 2013.

9. The Registrar of Companies / Adjudicating Officer imposed penalty on the company and its directors amounting to Rs. 1.4 lacs

ROLE OF COMPANY SECRETARY AS AN INTERNAL AUDITOR

A Company Secretary as an Internal Auditor allocated in the act, is expected to:

- i. Ensure proper following of accounting standards and conventions by the company.
- ii. Ensure audit of the company's financial statements and books of accounts.
- iii. Ensure management of compliance timely and properly and true representation of management funding and financial risk in business.
- iv. Ensure safely keeping of records of meetings held in the company.
- v. Provide required advisory on finance usage and corporate litigation.
- vi. Ensure proper management of capital, debt and tax planning.
- vii. Prepare cost structures and representing efficiency indicators of the business.
- viii. Design audit methodologies and reporting criteria.

4. APPOINTMENT OF INTERNAL AUDITOR

- i. Section 179 of Companies Act, 2013 read with Rule 8 (4) of the Companies (Meeting of the Board and its Power), Rules 2014 provide that the appointment of the internal auditors shall be done only through a resolutions passed by the board of directors at the meetings of the board.
- ii. The resolution for appointment of the Internal Auditor shall be filed with the Registrar of Companies within 30 days from the passing of the said resolution pursuant to the provisions of Section 117 & 179 of the Companies Act, 2013.
- iii. Thus, the appointment of internal auditor can be made only at the meeting of the board and whenever an internal auditor is appointed in a company, the resolution should be filed with the concerned Registrar of Companies vide e-Form MGT-14 within 30 days from the date of passing of the said resolution.

- iv. In case of **Private Companies**, an **exemption** has been granted from filing of e-Form MGT-14, for resolution passed in pursuance of sub-section (3) of section 179 of the Companies Act 2013.

Certain best practices adopted by companies in terms of Internal Audit (2022):

- i. **Bharti Airtel Limited:** The Company has 100% Independent Audit Committee. The Company has a robust Internal Assurance Group (IAG) led by Chief Internal Auditor supported by reputed independent firms.
- ii. **Cipla Limited:** Independent Assurance Report on the non-financial/ sustainability performance. The audit committee reviews and approves the non-audit services availed from the Statutory Auditor and confirmed that such services did not affect the independence of the auditor in any manner.
- iii. **UNO Minda Limited:** The company rotates Internal Auditors at regular intervals
- iv. **ONGC Videsh Limited:** Statutory Auditors and Internal Auditors are invited for their remarks and observations at the quarterly audit committee meetings.
- v. **Tata Chemicals Limited:** The company conducts internal audit through an independent external agency on a continuous basis

Terms of reference

The overall scope of internal audit should be formalized in terms of reference which is referred to as an audit manual, and approved by the board, normally through the audit committee. These should then be communicated to the functional heads within the organisation. Internal audit's terms of reference or manual should provide clarity about its:

1. Strategy and Objectives
2. Roles and Responsibilities within the organisation
3. Scope of Work
4. Accountability of the Audit Committee
5. Reporting lines for line management purposes
6. Accessibility to the board and the audit committee
7. Unfettered access to all information, people and records across the organisation

Internal Auditor's Skills

- i. Internal auditors **should develop and maintain a healthy level of professional skepticism and objectivity** to assist in evaluating information and making judgments.
- ii. Internal auditors **should possess exceptional verbal and written communication skills.**
- iii. They should be **proficient in negotiating and reasoning** with a variety of departments and groups over which internal audit may have no formal authority.
- iv. **Personal integrity, professional due diligence and curiosity are important traits** for individuals tasked with conducting internal audit work.

General Skills

- a. Technical Standards
- b. Positive attitude and Interpersonal Skills
- c. IT Skills
- d. Interviewing Skills
- e. Audit Documentation Skills
- f. Reporting Skills

Specific Skills

- a. Planning Audit Engagements
- b. Team building
- c. Managing Audit Engagements
- d. Making Professional Presentations
- e. Knowledge management

General Skills

- i. **Technical Standards:** The internal auditor should have adequate knowledge of the applicable Indian Accounting Standards and also in-depth knowledge on how to apply them in practice.
- ii. **Positive Attitude and Interpersonal Skills:** The internal auditor should possess positive and objective attitude, free of any prejudice and should possess good interpersonal and communication skills.
- iii. **IT Skills:** With the growing use of technology in business operations, internal auditors need to be familiar with IT. They should understand how technology is used in the organization and be skilled in using IT tools for effective internal audits.
- v. **Interviewing Skills:** Interviewing is the process of obtaining information through verbal interaction with clients. It involves detailed questioning on various processes and procedures to ascertain whether the client's organization complies with the established standard operating

procedure and practices and whether there is favorable or adverse variance from the standards, and in case of adverse variance what measures have been initiated by the management to ensure prevention of such adverse variances in future.

- vi. **Audit Documentation Skills:** Audit documentation is the process of compiling and filing of the findings of audit. It includes gathering necessary documents as evidence to support audit findings, organizing the analysis and supporting documents logically, and compiling information for structured presentation.
- vii. **Reporting Skills:** The audit report is the outcome of any audit task. Hence, it's crucial to write the report objectively, addressing process gaps appropriately. Each observation should present the facts about the issue, its impact, the cause, and suggestions for corrective actions and improvements.

Specific Skills

These skills would be required at senior levels and will assist the senior internal audit personnel in discharging the supervisory and management role efficiently and effectively.

- i. **Planning Audit Engagements:** This involves the ability to plan audit engagements on the basis of a comprehensive risk assessment prior to commencement of audit. The individual has to be experienced in the conduct of a brainstorming discussion on risk assessment and should have the necessary experience and capability to identify the significant issues that might come up during the audit.
- ii. **Team Building:** This involves collecting people and coordinating amongst them to ensure that they work as a unified team. It involves identification of team leaders, delegation of authority, motivating the team and communicating to them the results expected.
- iii. **Managing Audit Engagements:** This involves administration of the audit assignment, including the task of meeting auditees, understanding their expectations, communicating the engagement plan to them, selecting the right team, etc.
- iv. **Making Professional Presentations:** An experienced internal auditor should be able to make effective presentations to the Audit Committee. This would involve selecting and presenting the major issues that warrant senior management attention in a clear and unambiguous manner.

v. **Knowledge Management Skills:** An internal auditor has sufficient information or obtains information about the external environment of the company, example, the industry, the regulators, the customers, etc.

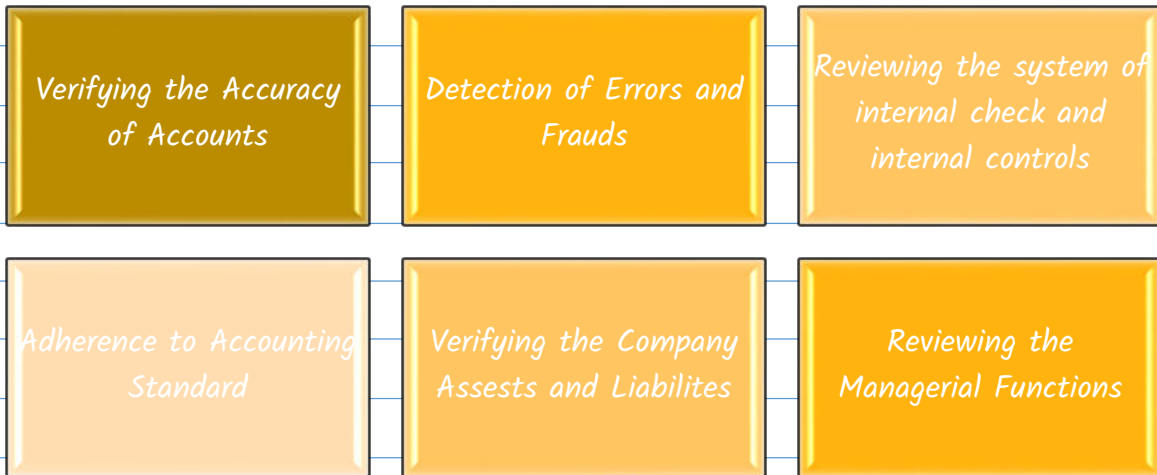
The internal auditor needs to have skills to effectively manage the knowledge, for example, deciding on issues such as:

- i. collating the knowledge.
- ii. how and where to apply the knowledge.
- iii. assessing which team member needs what type and quantum of knowledge.
- iv. assessing when the knowledge has become obsolete and needs updating.
- v. establishing the relationships between various pieces of knowledge and assessing how the same affects the internal audit.
- vi. deciding on manner and channels of flow of information.
- vii. Benchmarking Skills

Besides the above skills, an Internal Auditor should also possess following skills:

1. Analytical/Critical thinking skills
2. Data mining and Analysis Skills
3. Good Business Acumen and the ability to understand different business needs
4. He should have the ability to trace out facts and figures
5. Should be methodical and tactful while dealing with people and processes
6. Should be a hard worker, always cautious, vigilant and inquisitive
7. Should be courageous, assertive and determined with the ability to take independent decisions
8. Should lead by being punctual, reliable and updated with the latest knowledge and skill set.

5. OBJECTIVES OF INTERNAL AUDIT



The **main objective of the internal audit process is to provide an assurance on the organisation's risk management, internal control environment and governance framework through review and appraisal of:**

- (a) Operational control framework including fundamental and basic systems in all areas of the business.
- (b) The adequacy of risk identification, assessment and mitigation in the organisation. This shall include fraud risks.
- (c) Extent, adequacy, relevance of, and compliance with existing policy, plans and procedure documents within the organisation.
- (d) The extent of compliance with relevant statutory requirements.
- (e) Status of implementation of internal / external audit recommendations.
- (f) Evaluating internal control

Internal control is broadly defined as a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of the following core objectives for which all businesses strive:

- Effectiveness and efficiency of operations;
- Reliability of financial and management reporting;
- Compliance with laws and regulations;
- Accomplishment of established goals for operations;
- Safeguarding of assets;

- (g) Determines the risk area of the organisation;
- (h) Establishes the risk management framework;
- (i) Identifies potential threats and assesses risks;
- (j) Decides on response to risks like implementation of control;
- (k) Monitors and coordinates the risk management processes and the outcomes;
- (l) Provides assurance on the effectiveness of risk management processes;

6. SCOPE OF INTERNAL AUDIT

Internal Auditor evaluate the adequacy and effectiveness of organization's system of internal control and the quality of actual performance'

According to the Institute of Internal Auditors, internal audit involves the following areas of operations, which can be discussed as follows:

1. Review of Internal Control Systems and Procedures

- a. The internal auditor should determine whether the internal control system is in consonance with the organizational structure. As far as possible, control should be in built in the operating functions, if they are cost effective.
- b. Each control should be reviewed and analysed in terms of its costs and benefits. Additionally, it's important to verify if internal controls were consistently utilized during the intended reliance period. If there's a breakdown in controls for a specific part of the intended reliance, that area requires special attention

2. Reliability and Integrity of Financial and Operating Information

- a. The internal auditor should review the information systems to evaluate the reliability and integrity of financial and operating information given to management and to external agencies such as governmental bodies, trade organisations and labour unions.
- b. He should examine the accuracy and reliability of financial and operational records.
- c. He should review the frequency and timeliness of the reports keeping in view the statutory time limits in the case of reports to government agencies.
- d. He should examine whether the information mentioned in the report is meaningful to the user which should be evaluated with reference to their costs.

- e. The internal auditor **should examine whether the reporting is by exception** i.e. the reports highlight the significant and distinctive features.
- f. Internal Auditors **should review the reliability and integrity of financial and operating information** and the means used to identify, measure, classify and report such information.

3. Economical and Efficient Use of Resources

- a. The internal auditor **should check whether proper operating standards and norms have been established for measuring economical and efficient use of resources.** They should be detailed enough to be identifiable with specific operating responsibilities and should be capable of being used by operating personnel for monitoring and evaluating their performance.
- b. The internal auditor **should review the methods of establishing the operating standards and norms.** He should carefully examine the assumptions made while setting the standards to ensure that they are appropriate and necessary.
- c. The **variances should be examined** to evaluate whether or not the standards and norms are practical and should examine whether analysis of variances is communicated to those concerned in time. It should be examined that while communicating the variances serious matters are highlighted.
- d. Internal auditor also examined **if there are any underutilised resources or understaffing and overstaffing.** Such instances may consist of under-utilized machines, unoccupied storage space, huge cash or bank balances, idle man power etc.
- e. While commenting on staffing, the internal auditor **should pay special attention to non-productive work being performed.** This would require an enquiry into the job descriptions of employees combined with an intelligent observation of the work being done.
- f. Finally the internal auditor should **review all procedures with reference to their costs and benefits.** One of the factors resulting in inefficiency is that in many cases procedures become hindrance to operations.

4. Compliance with Laws, Policies, Plans, Procedures, and Regulations

- a. It is essential that the **various functional segments of an enterprise comply with the relevant policies, plans, procedures, laws and regulations** so that the operations are carried out in coordinated manner.

- b. Internal Auditor *should review the systems established to ensure compliance with those policies, plans and procedures, law and regulations* which could have a significant impact on operations and should determine whether the organization is in compliance thereof
- c. The internal auditor should examine whether *the management has a system by which its policies, plans and procedures are communicated to all concerned.*
- d. He should also examine the *system of periodical review of existing policies* particularly when there is a change in the method and nature of operations of the enterprise
- e. By combining the results of his review of the adequacy of the systems with the result of his compliance tests, the internal auditor should be able to evaluate the effectiveness of the former.

5. Review of Organizational Structure

- a. The internal auditor *should conduct an appraisal of the organisation structure* to ascertain *whether it is in harmony with the objectives of the enterprise* and whether the assignment of responsibilities is in consonance.
- b. It is also important to review *whether responsibility and authority are in harmony with the grouping pattern.*
- c. The internal auditor should examine the organisation chart to find out whether the structure is simple and economical and that no function enjoys an undue dominance over the others.
- d. He should see *whether the lines of authority and responsibility are clearly defined and communicated to all the organisational levels.*
- e. There should be *a proper balance between the span of control of different executives at different levels.* He should examine whether there is a unity of command i.e., whether each person reports only to one superior. Where dual responsibilities cannot be avoided, the primary one should be specified and the specific responsibility to each senior fixed.
- f. He should examine whether there is a *sufficient flexibility in the day to day working of the organisation* and that initiative is not being stifled by a strict adherence to rules.

6. Accomplishment of Established Goals for Operations

- a. The internal auditor should review the overall objectives of the enterprise to evaluate whether they are clearly stated and are attainable. The translation of such overall objectives into specific objectives for each department and programme should be reviewed.
- b. The internal auditor should examine whether to the extent possible, objectives are expressed in precise quantifiable terms (both monetary and non-monetary) to facilitate detailed planning and execution
- c. There should also be sufficient flexibility in the plans to permit such improvements in their implementation, as would benefit the enterprises as a whole.
- d. The internal auditor should examine whether departmental plans are supported by top management. The departmental plan summaries should be sent to concerned managers. These should be discussed and communicated at meetings at which all managers participate.
- e. Internal Auditor should review operations and programmes to ascertain whether results are consistent with established objectives and goals and whether the operations or programmes are being carried out as planned.

7. Review of Custodianship and Safeguarding of Assets

- a. The Internal Auditor should verify the existence of the assets and also review the control system to ensure that all assets are accounted fully.
- b. He should review the means used for safeguarding assets against losses e.g. fire, improper or negligent activity, theft and illegal acts etc.
- c. He should review the control systems for intangible assets e.g. the procedures relating to credit control.
- d. He should also review the adequacy of the insurance cover for the various risks involved.

7. INTERNAL AUDIT CORE PRINCIPLES

- 1 Demonstrates integrity.
- 2 Demonstrates competence and due professional care.
- 3 Independent and objective exercise.
- 4 Aligns with the strategies, objectives, and risks of the organisation.
- 5 Is appropriately positioned and adequately resourced.
- 6 Demonstrates quality and continuous improvement.
- 7 Communicates effectively.
- 8 Provides risk-based assurance.
- 9 Insightful, proactive, and future-focused.
- 10 Promotes organisational improvement.

CASE STUDY- The story of internal controls and Netflix

- i. This case emphasizes the need for a robust compliance program. The Committee of Sponsoring Organizations (COSO) of the Treadway Commission identifies internal controls' five integral components: the control environment, risk assessment, control activity, information and communication, and monitoring activities. Performing periodic evaluations of the program, a subset of the monitoring component, is critical to ascertain if internal controls are present, designed appropriately and functioning properly and effectively

- ii. Like most companies, Netflix maintains a Code of Ethics; Code of Conduct; and a Gifts, Travel and Entertainment policy that addresses and prohibits employee conflicts of interest and requires the disclosure of actual or apparent conflicts of interest.
- iii. Although these policies are essential, it is equally important to build a culture that emphasizes ethical behavior, operationalizes procedures and monitors compliance with the program. Often, the failure to monitor provides employees with the opportunity to engage in misconduct and exposes the company to unnecessary risk and potential liability.
- iv. From 2011 until 2014, Kail was Netflix's VP in charge of IT operations. He approved contracts to purchase IT products and services from smaller outside vendors and authorized the corresponding payments as part of his role. However, he selected the IT contracts according to the kickbacks he would receive rather than on their merit.
- v. As the evidence at trial demonstrated, Netflix's internal control failures allowed Kail to employ a "pay-to-play" scheme. As part of his scheme, he approved millions of dollars in contracts for goods and services, and in exchange, he received over \$500,000 and stock options from nine tech companies.
- vi. Kail's actions impacted Netflix's operations and compliance objectives, hurt the company's shareholders and tarnished Netflix's reputation.
- vii. On December 14, 2021, Mr. Michael Kail, was sentenced to 30 months after his conviction for fraud and money laundering

RECOMMENDED CONTROLS TO PREVENT AND DETECT FRAUD AND EDUCATE TO IMPROVE THE ORGANIZATION'S FRAUD AWARENESS

1. Segregation of duties:

Ensure that **no single person has control over multiple aspects of a process or transaction**. For example, the person who approves a purchase should not be the same person who pays for it. **Maker, Checker and Approver is an excellent tool to prevent errors and frauds.**

- #### **2. Rotation of duties:**
- Ensure that there is **periodical rotation of duties for key positions**, else huge fraud can be perpetrated by one employee and will not be noticed. Punjab National Bank fraud also happened due to absence of mandatory job rotation or transfer of few employees of the branch.

3. **Mandatory vacation:** Having a HR policy for giving mandatory vacation to key employees helps the employees to come fresh after vacation and also prevents employees from hiding their tracks of crime.
4. **Treat employees well:** If employees are treated well by recognising their work and giving appropriate rewards, they feel motivated rather than being underpaid or being ignored for promotion.
5. **Regular audits:** Conduct regular internal audits especially at remote locations where there are significant projects being executed or manufacturing facilities are run to identify potential fraud and ensure compliance with internal controls.
6. **Background checks:** Conduct thorough background checks on employees, especially those in positions of trust or responsibility.
7. **Whistleblower hotline:** Implement a confidential hotline for employees to report suspicious activity without fear of retaliation.
8. **Use of technology:** Implement fraud detection software and use data analytics to identify patterns of suspicious activity.
9. **Fraud awareness training:** Provide *periodical training to all employees on the types of fraud that can occur, how to identify it, and how to report it.* Also ensure that adequate documents are kept in HR as evidence to prove that the employee participated in the training and understood it. This will help on a later date if the fraudulent employee feigns ignorance.
10. **Code of conduct:** Establish a code of conduct that clearly defines ethical behavior and expectations for employees.
11. **Management oversight and Tone at the top:** Ensure that *management regularly reviews and approves transactions and financial statements.* Ensure that independent directors are really independent.
12. **Reinforce accountability:** Hold employees accountable for their actions and ensure that consequences are enforced when necessary.
13. **Document retention:** Establish policies for the retention and destruction of records to ensure that important documents are not lost or destroyed.

8. INDEPENDENCE OF INTERNAL AUDITOR

- i. **Independence** is the freedom of internal auditor to carry out the responsibilities without being biased
- ii. **Objectivity** allows internal auditors to perform engagements in such a manner that no quality compromises are made. **Objectivity requires that judgment of internal auditors should not be influenced by others.**
- iii. **Achieving independence and objectivity in work is one of the critical preconditions that internal auditors need to meet to serve the purpose.** Independence means ensuring the possibility of objective performance of internal auditor's duties, and is linked to the organizational positioning of internal audit in the company, reporting relationships with boards of directors, audit committee, or other governing bodies separated from the management, authority for the evaluation of information, reports, and the like.
- iv. Under the statutory provisions of Companies Act, 2013, **internal auditor may or may not be an employee of the company**, but he evaluates the functioning of the management at different levels. Therefore, to be efficient and effective, **the internal auditor must have adequate independence.**
- v. It may be noted that by its very nature, the internal audit function **cannot be expected to have the same degree of independence as is essential when the external auditor expresses his opinion on the financial information.** To ensure his independence he is made responsible directly to the board of directors through audit committee. Such a channel of communication provides **an independent mode** whereby an internal auditor can communicate and share his views on the scope of internal audit, findings, etc.
- vi. **If internal auditor is made subordinate to lower level management, his independence will be effected which will affect his functioning and effectiveness.**
- vii. The following **factors impairing the independence of internal auditors:**
 - i. **Business relationship:** involves common commercial or financial interest between the auditor and client. This shall **create self-interest or advocacy threats towards audit independence.** Therefore, the business relationship shall be restricted as much as possible.
Example (Not Important for Exam): The wife of auditor is the supplier of the client. The auditor here has indirectly created business relationship between him and the client.

- ii. **Employment with audit client:** Any kind of employment relationship with the Auditee Client gives the impression that the audit is not performed independently. Such relationships create **self-review threats, familiarity threats, and intimidation threats.**
- iii. **Prior work with audit client:** The senior personnel may have had prior work experience with the audit client. But if the clients had a good relationship it will create **a familiarity threat and self-interest threat** which will impact the audit independence and objectivity.
- iv. **Gift and hospitality:** The auditors should not accept any gifts (or kind) from the auditee as such gift and hospitality ought to create familiarity and self-interest threats.
- v. **Family and personal relationships:** There may exist family and personal relationships between member of audit team and audit client. This creates self-interest and familiarity threats towards audit independence.
- vi. **Non-audit services to audit clients:** Offering non audit services to audit clients creates self-review threats to auditor's independence inherent in the model of business of audit firms.

CASE STUDY: Toshiba-Internal Audit Failure

- i. In July 2015, Toshiba Corp president Mr. Hisao resigned after investigations found that the company inflated earnings by \$1.2 billion during the period 2009-2014. The company Toshiba was one of the early adopters of corporate governance reforms initiated in Japan.
- ii. The investment committee observed:
 - a. The fault in internal audit in Toshiba was that it focused on consultation service rather than assurance service.
 - b. In Toshiba, the audit committee was neither capable nor independent. Internal Audit can function independently only if audit committee is capable, independent and effective, and internal auditor reports to the audit committee. The three external members of audit committee had no knowledge of finance and accounting. The ex-CFO, who was the CFO during the timeframe when accounting irregularities occurred, was the only whole time member of the audit committee.
 - c. A corporate culture existed in Toshiba whereby employees could not act contrary to the intent of their superiors. In such a culture an upright internal auditor cannot survive, particularly if he is not independent of the management.

9. INTERNAL AUDIT TECHNIQUES

i. **Review of Operating Environment**

For carrying out the audit effectively, it is necessary for an internal auditor to understand how the company operates by referring to departmental employees, external auditors report, and risk specialists. A firm's operating environment describes management's ethical qualities, leadership style and business practices.

ii. **Review Controls**

An auditor applies generally accepted auditing standards (GAAS) to detect mechanisms, procedures, tools and methodologies that build controls. An internal auditor refers to previous year works to determine company's departmental and inquire from segment employees who perform such controls on a regular basis

iii. **Test Controls**

- An internal auditor tests a business organization's controls, policies and guidelines to ensure that such controls are adequately designed and are operating effectively.
- Controls are mechanisms and methodologies a corporation's management puts into place to prevent losses due to error, fraud, theft or breaks in technology systems.

iv. **Account Details**

- An internal auditor performs tests of account details to ensure that financial statements of a business entity are not "materially misstated."
- An auditor tests the account details and account balances if a firm's controls and processes are not adequate or not functioning properly.

10. INTERNAL AUDIT PROCESS: STEP WISE APPROACH

Step 1

- Establish and communicate the scope and objectives for the audit to appropriate management.

Step 2

- Develop an understanding of the business area under review. This includes objectives, measurements and key transaction types. This involves review of documents and interviews. Flow charts and narratives may be created if necessary.

Step 3

- Describe the key risks facing the business activities within the scope of the audit.

Step 4

- Identify control procedures used to ensure each key risk and transaction type is properly controlled and monitored.

Step 5

- Develop and execute a risk-based sampling and testing approach to determine whether the most important controls are operating as intended.

Step 6

- Report issues and challenges identified and negotiate action plans and solutions with management to address the problems.

Step 7

- Follow-up on reported findings at appropriate intervals. Internal audit departments maintain a follow-up database for this purpose.

11. EVALUATION OF INTERNAL AUDIT FUNCTION BY AN AUDITOR

The internal audit function greatly assist the Secretarial auditor in determining the extent to which he can place reliance upon the work of the internal auditor.

The important aspects to be considered in this context are:

- Organisational Status** - Whether internal audit is undertaken by an outside agency or by an internal audit department within the entity itself. The internal auditor reports to the management, in an ideal situation he reports to the highest level of management and is free of any other operating responsibility. Any constraints or restrictions placed upon his work by

management should be carefully evaluated. In particular, the internal auditor should be free to communicate fully with the external auditor.

- ii. **Scope of Audit Function** - The external auditor should ascertain the nature and depth of coverage of the assignment which the internal auditor discharges for management. He should also ascertain to what extent the management considers, and where appropriate acts upon internal audit recommendations.
- iii. **Technical Competence** - The external auditor should ascertain that internal audit work is performed by persons having adequate technical training and proficiency. This may be accomplished by reviewing the experience and professional qualifications of the persons undertaking the internal audit work.
- iv. **Due Professional Care** - The external auditor should ascertain whether internal audit work appears to be properly planned, supervised, reviewed and documented. An example of the exercise of due professional care by the internal auditor is the existence of adequate audit manuals, audit programmes and working papers.
- v. **Monitoring of internal control:** The internal audit function may be assigned specific responsibility for reviewing controls, monitoring their operation and recommending improvements thereto.
- vi. **Examination of financial and operating information:** The internal audit function may be assigned to review the means used to identify, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
- vii. **Review of operating activities:** The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non-financial activities of an entity.
- viii. **Review of compliance with laws and regulations:** The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.
- ix. **Risk management:** The internal audit function may assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.

- x. **Governance:** The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

REPORT WRITING – COMMUNICATING ENGAGEMENT RESULTS

The essential part of internal audit is the dissemination of the results of internal audit and reporting the findings to management as it reports the noncompliance and highlights the aspects which need to be improved.

Objectives of Reporting

The objective of reporting results is to highlight the effectiveness of internal controls and risk management processes to enhance governance in line with the Internal Audit Charter.

The objectives of issuing Internal Audit Reports on significant internal audit assignments are to:

- (a) Share with the auditee, details of all significant findings based on audit procedures undertaken
- (b) Allow management to understand the issues and take corrective actions
- (c) Leads to improved performance and control framework
- (d) The follow-up process monitors the progress of agreed upon management action plans and reports this progress to senior management and the audit committee.

An Internal Audit report is basically a four step process comprising of:

i. What is Wrong?

Disclosure of findings and processes involved in arriving at such finding.

ii. Why it is Wrong?

Description of the findings-the root cause analysis.

iii. How to correct it?

Recommendations and Suggestions.

iv. What will be done?

Auditee's views and comments.

12. ROLE OF INTERNAL AUDIT IN ORGANIZATION CONTROL MECHANISM

1. Internal Control

As per Section 134 of the Companies Act, 2013, the term "Internal Financial Controls" means the policies and procedures adopted by the company for ensuring, orderly and efficient conduct of business, including adherence to company's policies, safeguarding of its assets, prevention and detection of frauds and errors, accuracy and completeness of the accounting records, and timely preparation of reliable financial information.

Objectives

- (i) To ensure that the transactions are executed in accordance with management's general or specific authorization;
- (ii) To make sure that all the transactions are promptly recorded in the correct amount in the appropriate accounts and in the accounting period in which executed, so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets;
- (iii) To ensure assets are safeguarded from unauthorised access, use or disposition; and
- (iv) To make sure that appropriate action is taken with regard to any differences between the recorded assets are compared with the existing assets at reasonable intervals.

EXAMINE THE EFFECTIVENESS AND EFFICIENCY OF INTERNAL CONTROLS

- i. Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements.
- ii. Implementation of a control means that the control exists and that the entity is using it.
- iii. An entity's system of internal control contains manual elements and often contains automated elements. The use of manual or automated elements in internal control also affects the manner in which transactions are initiated, recorded, processed, and reported. An entity's mix of manual and automated elements in internal control varies with the nature and complexity of the entity's use of information technology.

CASE STUDY - WorldCom Scam, USA

Background:

In 1983, Bernard Ebbers and 3 other investors formed Long Distance Discount Services, Inc. based in Jackson, Mississippi and in 1985, Ebbers was named chief executive officer. The company acquired over 60 telecommunications firms and in 1995, it changed its name to WorldCom. The company became a public company as a corporation in 1989 as a result of a merger with Advantage Companies Inc. The company name was changed to LDDS WorldCom in 1995. The company grew rapidly in the 1990s, after completing several mergers and acquisitions.

Accounting Manipulation:

- i. Ebbers, CFO Scott Sullivan, Controller David Myers and general accounting director Buford "Buddy" Yates used fraudulent accounting methods to disguise WorldCom's decreasing earnings in order to maintain the company's stock price by capitalizing expenses, it exaggerated profits.
- ii. In 1999, revenue growth slowed and the stock price began falling.
- iii. In 2000, WorldCom began classifying operating expenses as long-term capital investments. Hiding these expenses in this way gave them another \$3.85 billion.
- iv. Broadly financial statement fraud was accomplished primarily in two ways:
 - a. Booking "line costs" (interconnection expenses with other telecommunication companies) as capital expenditures on the balance sheet instead of expenses.
 - b. Inflating revenues with bogus accounting entries from "corporate unallocated revenue accounts"

Role of Internal Auditors as a Whistleblower

- i. Tips were sent to Internal Auditor about the manipulation.
- ii. Cynthia Cooper, WorldCom's vice president - internal audit, instructed her internal audit team to audit all capital expenditures.
- iii. Internal audit team found \$500 million computer expenses having been entered in the books without any documents. There was also another \$2 billion in questionable entries.
- iv. WorldCom's audit committee was asked for documents supporting capital expenditures, it could not produce them.

- v. Senior vice president and controller admitted to the internal auditors that they weren't following accounting standards and admitted to inflating its profits by \$3.8 billion over the previous five quarters.
- vi. When internal audit team informed about what happened, both the company's current auditor, KPMG, and its former auditor, Andersen, agreed that accounting entries were not in accordance with Generally Accepted Accounting Principles (GAAP)
- vii. After review by the company's audit committee, WorldCom's board accepted the resignation of senior vice president and controller.
- viii. A little over a month after the internal audit began, WorldCom filed for bankruptcy.

Internal Control Mechanism

- ii. *It is important to constitute and maintain an audit committee that shall provide assistance to the board of directors in fulfilling their oversight responsibility to the shareholders relating to:*
 - a. The integrity of the financial statements and the financial reporting process and principles;
 - b. Internal controls;
 - c. The qualifications, independence, remuneration, and performance of the independent auditors;
 - d. Staffing, focus, scope, performance, and effectiveness of the internal audit function;
 - e. Risk management; and
 - f. Compliance with legal, regulatory, and corporate governance requirements.
- iii. The board defines clearly the roles and responsibilities of the audit committee. Management however, has primary responsibility for financial statements and reporting process, internal controls, legal and regulatory compliance and risk management.
- iv. *The internal auditor should examine and contribute to the ongoing effectiveness of the internal control system through evaluation and recommendations.* However, the internal auditor is not vested with management's primary responsibility for designing, implementing, maintaining and documenting internal control.
- v. The internal auditor should focus towards improving the internal control structure and promoting better corporate governance. The role of the internal auditor encompasses:
 - Evaluation of the efficiency and effectiveness of controls
 - Recommending new controls where needed or discontinuing unnecessary controls

- Using control frameworks
- Developing Control self-assessment

Companies Act 2013 provides that

- Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, include evaluation of internal financial controls and risk management systems.
- The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.
- Section 134(5) requires directors to state their responsibility on internal financial controls in case of listed companies and auditors are required to report on the adequacy and operating effectiveness of such controls in case of all companies.

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, specifies:

- Ensuring the integrity of the listed entity's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law.
- Regulation 18 of Audit Committee:
Role of the audit committee and the information to be reviewed by the audit committee shall be as specified in Part C of Schedule II including
 - evaluation of internal financial controls and risk management systems;
 - reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems
- Compliance Certificate by Chief Executive Officer and Chief Financial Officer to state: Responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems pertaining to financial reporting

2. Risk management

- i. Risk management *minimises the probable loss through the effective and efficient management.* It evaluates risks in terms of probability of occurrence and its impact.
- ii. Internal auditor monitors and evaluates the effectiveness of the organization's Risk management processes. Risk management relating to an organization objective, and identification, analysis, and response to those risks that could potentially impact its ability to realize its objectives.
- iii. Generally, *the risks fall under strategic, operational, financial reporting, and legal/regulatory categories.* Management performs risk assessment activities as part of the ordinary course of business in each of these categories. Examples include: strategic planning, marketing planning, capital planning, budgeting, hedging, incentive payout structure, and credit/lending practices. The finance department access the risk relating to account preparation, financial reporting and disclosures, corporate legal adviser often prepares comprehensive assessments of the current and potential litigation a company faces. Internal auditors may evaluate each of these activities, or focus on the processes used by management to report and monitor the risks identified. For example, internal auditors can advise management regarding the reporting of forward-looking operating measures to the board, to help identify emerging risks.

3. Corporate Governance

- i. Internal auditing activity as it relates to corporate governance *is generally informal, accomplished primarily through participation in meetings and discussions with members of the board of directors.*
- ii. The *internal auditor is often considered one of the "four pillars" of corporate governance, the other pillars being the board of directors, management, and the external auditor.*
- iii. *A primary focus area of internal auditing as it relates to corporate governance is helping the audit committee of the board of directors (or equivalent) perform its responsibilities effectively.* This may include reporting critical internal control problems, informing the committee privately on the capabilities of key managers, suggesting questions or topics for the audit committee's meeting agendas, and coordinating carefully with the external auditor and management to ensure the committee receives effective information.

A. SATYAM SCAM

BACKGROUND

- Satyam Computer Services Limited was founded in 1987 in Hyderabad, by Ramalinga Raju. Raju served as Chairman, his brother, B. Rama Raju, served as the Managing Director and Chief Executive Officer. It specialised in outsourcing IT and business process services.
- The company was listed on stock exchanges around the world, including the New York Stock Exchange and the Bombay Stock Exchange.
- On 16 December 2008, the Satyam board made the decision to invest \$1.6 billion in Maytas Properties and Infrastructure without the agreement of their shareholders. Later it came to light that this was a last ditch attempt to fill the fictitious assets of Satyam with real ones acquired through Maytas. This move was highly criticised by investors and led to the downfall in company's stock on the New York Stock Exchange. As a result, the board of Satyam reversed the decision.
- Due to Audit Failure, Satyam Scam went on for number of years involving manipulation of Balance Sheet and Financial Statements.

Accounting Manipulation

- Revenues, operating profits, interest liabilities and bank balances were grossly inflated to show the company in good health.
- Every attempt made to eliminate the gap failed.
- On 7th January 2009, the chairman of Satyam, Raju resigned, confessing that he had manipulated the accounts in several forms.
- Raju made shocking disclosure to the Board of Directors of Satyam that the financial statement contained
 - Inflated Cash and Bank Balance of Rs.50.4 Billion.
 - Non-existent accrued interest of Rs.3.76 Billion.
 - An understated liability of Rs.12.30 Billion on account of funds arranged by Raju.
 - An overstated Debtors position of Rs.4.90 Billion
- Satyam overstated its income nearly every quarter over the course of several years in order to meet analyst expectations. Fake invoices and bills were created using software applications such as 'Ontime'

- He falsified the bank accounts to inflate the balance sheet with balances that did not exist.
- Raju created 6000 fake salary accounts and took the money from these accounts after it had been deposited. The cash so raised was used by Maytas (reverse name of Satyam) to purchase several acres of land across Andhra Pradesh to ride on a booming realty market.

Role of Internal and External Auditors

- Internal audit system in Satyam was ineffective as they did not discover that true financial information of the company has been hidden.
- Satyam had claimed \$1.04 billion on its balance sheet in non-interest bearing deposits
- Pricewaterhouse (Pw) completely relied on the fixed deposit receipts and bank statements provided by the Chairman's office, without confirming the bank deposit independently.
- Pw failed to fulfill its role as an auditor as they should have noticed this large amount of bank balance and carried out further verification and substantive testing
- PwC audit fees increased by 5.7 times over a period of four years (from 2004 to 2008). These inflated audit fees suggests that auditors may have been bribed in order to keep the fraud from being discovered and to allow Satyam to continue their accounting irregularities.

VERDICT

- On 9 April 2015, Raju and nine others were found guilty of collaborating to inflate the company's revenue, falsifying accounts and income tax returns, and fabricating invoices, among other findings, and sentenced to seven years imprisonment by Hyderabad court.
- Tech Mahindra, the information technology (IT) arm of Mahindra and Mahindra Ltd (M&M), completed merger process with Satyam Computer Services, creating the fifth-largest IT company based in India, four years after acquiring the Hyderabad-based firm.

B. OLYMPUS CORPORATION FRAUD, JAPAN

BACKGROUND

- Olympus was established on 12th October 1919. It initially specialized in microscope and thermometer businesses.
- In 1949, the name was changed again to Olympus Optical Co., Ltd. in an attempt to enhance its corporate image

- In 2003, the company made a fresh start as Olympus Corporation. In Greek mythology, Mt. Olympus is the home of the twelve supreme gods and goddesses. Olympus was named after this mountain to reflect its strong aspiration to create high quality, world famous products. Tsuyoshi Kikukawa was the board chairman and CEO.

ACCOUNTING MANIPULATION

- British-born Michael Woodford was an Olympus veteran of 30 years, and previously executive managing director of Olympus Medical Systems Europa. As European Director in 2008, Woodford had noticed the “strange goings-on at the company” such as the Gyrus acquisition, which should have been within his scope but was instead handled from Tokyo. Woodford had set out to resign over the matter but stayed with Olympus after being reassured on the acquisition and being promoted to oversee Olympus’ European businesses and appointed to the main Olympus board.
- FACTA a Japanese monthly news magazine features economic information for readers and provides investigative reports. In August 2011 issue said that Olympus had acquired from 2006 to 2008 three small companies, Altis, Humalabo, News Chef, for US\$773 million and all three companies continued to post losses.
- Olympus had issued more than \$600 million in preference shares “directly to AXAM Investment Limited, a company registered in the Cayman Islands, which is described as ‘the portfolio manager for AXES Investment Limited LLC.’ Woodford wanted to know why Olympus had paid AXAM so much money to apparently “advise” Olympus on the acquisition of Gyrus. KPMG report, stated that Olympus hadn’t accounted for the shares given to AXAM, and “in our opinion proper accounting records have not been maintained.
- Olympus defended itself against allegations of impropriety when Woodford confronted Tsuyoshi Kikukawa, chairman of the Olympus board. Kikukawa called a special board meeting in October at company headquarters in Tokyo. The meeting began at 9:07. Kikukawa fired Woodford and didn’t allow him to respond. The meeting ended at 9:15 a.m.

CEO BLOWING THE WHISTLE ON HIS OWN COMPANY

- As a CEO, Woodford commissioned PricewaterhouseCoopers (PwC) to investigate the relationship and transactions with AXES/AXAM surrounding the acquisition of Gyrus.

- The PwC report stated that there appears to be potential misstatements made in Gyrus' 2009 audited accounts and potential unlawful financial assistance provide by Gyrus to Olympus in relation to the transaction.
- After reaching London, Woodford then delivered the six letters and the replies together with the PwC report to the Britain's Serious Fraud Office, the FBI, the U.S. Department of Justice; the Japan Securities, Exchange and Surveillance Commission; the Tokyo Metropolitan Police; and the Tokyo Prosecutors Office. Stating Olympus needs a complete and utter forensics accounting.
- On 26 October, 2011 Kikukawa was replaced by Shuichi Takayama as chairman, president, and CEO.
- On 8 November 2011, the company admitted that the company's accounting practice was "inappropriate" and that concealment of more than 117.7 billion yen (\$1.5 billion) money had been used to cover losses on investments dating to the 1990s.
- The company blamed the inappropriate accounting on former president Tsuyoshi Kikukawa, auditor Hideo Yamada and executive vice-president Hisashi Mori

VERDICT

- In July 2013, Kikukawa and Mori were both sentenced to 3 years in prison, 5 years suspended.
 - The auditor who had been party to the fraud was sentenced to 2.5 years in prison, 4 years suspended.
 - Olympus was fined 700 million yen (\$7 million USD).
- In April 2014, six banks filed a civil suit against Olympus over the fraud, seeking an additional 28 billion yen in damages.

13. APPRAISAL OF MANAGEMENT DECISIONS

- i. The management for the company **owns the responsibility for establishing and maintaining a system of internal controls** within an organization.
- ii. Management is **charged with this responsibility on behalf of the organization's stakeholders and is held accountable for this responsibility by an oversight body** (e.g. board of directors, audit committee, elected representatives).
- iii. The objective assessment of internal controls and risk management processes by the internal audit activity provides management, the oversight body, and external stakeholders with

independent assurance that the organization's risks have been appropriately mitigated. Because, internal auditors are experts in understanding organizational risks and internal controls available to mitigate these risks, they assist management in understanding these topics and provide recommendations for improvements.

iv. *Internal audit has become an important management tool for the following reasons:*

1. *Internal auditing is a specialized service to look into the standards of efficiency of business operation.*
2. *Internal auditing can evaluate various problems independently in terms of overall management control and suggest improvement.*
3. *Internal audit's independent appraisal and review can ensure the reliability and promptness of MIS and the management reporting on the basis of which the top management can take firm decisions.*
4. *Internal audit system makes sure the internal control system including accounting control system in an organization is effective.*
5. *Internal audit ensures the adequacy, reliability and accuracy of financial and operational data by conducting appraisal and review from an independent angle.*
6. *Internal audit is an integral part of "management by system".*
7. *Internal audit can break through the power ego and personality factors and possible conflicts of interest within the organization.*
8. *It ensures compliance of accounting procedures and accounting policies.*
9. *Internal auditor can be of valuable assistance to management in acquiring new business, in promoting new products and in launching new projects for expansion or diversification of business.*

The main objective of appraisal of management decision is to see how decisions are taken by the management:

- *Whether the decisions are taken after following the decision-making process.*
- *Whether such decisions meeting the organisation objectives.*
- *Whether such decisions are documented in a fair manner.*

Steps in appraisal of management decision.

In appraisal of management decision the following step should be considered by the auditor:

1. Whether the management decision are well defined or not.
2. Whether the Objectives and desired output has been set out clearly and relate explicitly with the policy or strategy adopted by the company to help in post event evaluation of the management decisions. Ideally the objectives of the every management decision should be specific, measurable, agreed, realistic and time-dependent.
3. While taking decision, whether the management has considered the effect of the associated risk; time availability; scale and location; scope for alternative arrangements with other public bodies; degree of involvement of regulators and civic bodies; capacity of the market to deliver the required output; alternative asset uses; use of new or established technology; and environmental issues.
4. In case of the major investment decision, whether the various possible options were considered.
5. Whether such potential options are analyzed reviewed in terms of value, costs, benefits, risk and uncertainties of options.
6. Whether the options are selected after due analysis and a consensus decision is taken after a manager has analyzed all the alternatives,
7. Whether the selected alternative implemented efficiently.
8. Ongoing review of management decision control and evaluation system actions need to be monitored.

14. PERFORMANCE ASSESSMENT

- i. The first step in conducting assessment of the Internal Audit function **involves reviewing the management's expectations and achievements.** This may also include remediation measures for better results, if necessary, and should be reported to the board/audit committee.
- ii. Performance measurement **ensures high standards for audit strategy, execution, and reporting.**
- iii. It **helps organizations align their audit strategy with the overall business strategy,** thereby linking the audit's performance to the organization's mission and objective. This ensures that concerned stakeholder audit needs are fulfilled.
- iv. Key benchmarks of performance assessment are mentioned below:
 - Effectiveness of audit in covering key areas;

- *Feedback of audit findings during audit;*
- *Duration and timeliness of the audit;*
- *Accuracy of audit findings;*
- *Value of the audit recommendation;*
- *Value added by the internal audit function.*

Keeping Track of Performance

- Internal Auditors should understand the business environment, its changes, and how people contribute to creating value. In today's scenario management of the organization want auditors to clearly understand the nuances of business. This is necessary not only to assess the business operations but also to stimulate a healthy relationship.*
- Another essential point is to integrate the Internal Audit function with corporate governance. The Internal Audit function in an organization should become an integral part of governance with focus to provide independent advice to management on the organization's ability to meet its governance obligations.*
- The success of the audit program relies not only on technical expertise but also on accuracy. Transparency in auditing and the measurement system is crucial for building trust which is a key factor for success.*
- Finally, the Internal Audit function needs to focus on improving business performance by being fully integrated into the business and adding value by supporting strategic business objective. With such a vital role to play in corporate governance and business performance, it is critical for the Internal Audit team to maintain oversight of the traditional requirements, and, at the same time, evolve with the demands of the role. **The auditors would need to align people, process, and systems with the overall organizational objective, allowing the executive management to confidently answer the critical questions that investors are asking today.***

SUMMARISED VERSION (MIND MAP)

1. INTRODUCTION

The Institute of Company Secretaries of India (ICSI) is the only recognized professional body in India to develop and regulate the profession of Company Secretaries in India. It is a premier national professional body set up under an act of Parliament, the Company Secretaries Act, 1980. ICSI has been contributing to the initiatives of Government of India that have potential to excel the social-economic growth of India. ICSI functions under the jurisdiction of the Ministry of Corporate Affairs, Government of India.

The Institute of Company Secretaries of India (ICSI) conducts various examinations and also prescribes standards for adherence by its members.

The concept of whole-time practice, which gained its initial recognition in 1988, got further momentum after the enactment of the Companies (Amendment) Act, 2000 which required Compliance Certificate to be issued by Practising Company Secretary for certain class of companies. Members in practice are also being recognised for issuing certificates under various laws in India. The Companies Act, 2013, also introduced concept of Secretarial Audit to specified class of companies, which shows confidence of the Regulators on the Profession of Company Secretaries in India.

The performance of any professional can only be judged and enhanced to that level of excellence only by evaluation by a competent professional. The Council of the Institute of Company Secretaries of India (ICSI), therefore, in its 202nd meeting held on 25th and 26th August, 2011 decided to introduce Peer Review for Practising Company Secretaries to periodically review the Practice Units and evaluate the quality, systems process, procedures and practices, so that excellence in their performance can be monitored and maintained.

ICSI Guideline No. 1 of 2011 – Guidelines for Peer Review of Attestation Services by Practising Company Secretaries notified in the official Gazette of India dated October 18, 2011 and made effective from October 1, 2011. These Guidelines were revised by the Council in its 229th Meeting held on March 19-20, 2015; 254th (Adj.) meeting held on 1st September, 2018 and in 287th (Special) Meeting held on 26-27 August, 2022.

2. PEER REVIEW

Peer Review is a process used for examining the work performed by one's equals (peers) and to understand the systems, practices and procedures followed by the Practice Unit and to give suggestions, if any, for further improvement.

Professional peer review mainly focuses on the performance of professionals, with a view to improving quality, upholding standards, or providing certification. Professional Peer Review activity is widespread in the field of accounting, law, engineering (e.g., software peer review, technical peer review, etc.)

3. PROFESSIONAL PEER REVIEW

Professional Peer Review focuses on the performance of professionals, with a view to improving quality, upholding standards, or providing certification. Professional Peer Review activity is widespread in the field of accounting, law, engineering (e.g., software peer review, technical peer review, etc.), aviation, and even forest fire management.

4. PEER REVIEW FOR COMPANY SECRETARIES

- i. Peer Review mainly *considers examination of the systems and approach of a Practice Unit (PU) by another member of the Institute* with the objective of identifying the areas, where the member may require guidance in improving the quality of his performance and adherence to the requirements of various technical standards.
- ii. A Peer Review *examines whether a Practice Unit has adequate policies and procedures* (including documentation systems) in place *to comply with the ICSI Auditing Standards, Guidance Notes, Manuals, References and advisories* issued by the ICSI and other legal requirements for maintaining the quality of the Services/ work they perform
- iii. The primary objective of peer review is promotion of continuing quality improvement in an atmosphere of openness and mutual trust that contributes to enhancing transparency and comparability.

5. OBJECTIVES OF PEER REVIEW

The main objectives of Peer Review are to ensure that while rendering Professional Services, the members of the Institute of Company Secretaries of India (ICSI) in practice:

- i. Confirmation of compliance
- ii. Corrective actions
- iii. Enhancement of quality of professional services
- iv. Enhanced credibility
- v. Trust of Clients

The main objective of Peer Review is to ensure that in carrying out their Services, the PCS has complied with the ICSI Guidance on Office Administration and Systems in the office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, References and advisories issued by the Institute and has in place proper systems (including documentation systems) for maintaining the quality of professional assignments undertaken by it.

6. BENEFITS OF PEER REVIEW

There are significant benefits which a Practice Unit will obtain in undergoing a Peer Review. These may be summarised below:

1. A successful Peer Review will provide comfort to the Practice Unit that it has adhered to various statutory, documentary and other regulatory requirements.
2. If deficiencies are noticed and corrective measures suggested, the Practice Unit will have an opportunity to correct the deficiencies and thereby enhance professional competence.
3. If a Peer Review Certificate is issued to the Practice Unit it enhances credibility of the Practice Unit in the eyes of the general public.
4. Since a Chinese Wall exists between the Peer Review Process and the Disciplinary Proceedings, the Practice Unit will benefit from Peer Review without any apprehension of any disciplinary proceedings being initiated against for any deficiencies noticed on its part.
5. Clients of the P.U. will benefit from knowing that their Practice Unit is periodically reviewed by the ICSI.
6. Furthermore, the benefits of getting Peer Reviewed Units can be seen by Guidelines issued by Council of the Institute from time to time.
7. To ensure the quality of services rendered by members of the Institute to their clients and to the society as a whole, the Council has decided that only Peer Reviewed Practice Units shall be permitted to undertake the following assignments:

- (a) **Secretarial Audit Report** under section 204(1) of the Companies Act, 2013 /Regulation 24 A(1) of the Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.
- (b) **Annual Secretarial Compliance Report under Regulation 24A (2)** of the Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.
- (c) **Certification of Annual Return.**
- (d) **Compliance Certificate** under the Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.
- (e) **Certification under Regulation 40(9) of Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.**
- (f) **Quarterly Certificate for Reconciliation of Share Capital** under Regulation 76 of Securities & Exchange Board of India (Depository Participants) Regulation, 2018. The effective date of applicability for the above services for listed companies is 1st April,2022 and for all companies whether listed or otherwise it is 1st April, 2023.
- (g) **Internal Audit of Operations of the Depository Participants** w.e.f. 1st April, 2020.
- (h) **Diligence Report for Banks** in case of Consortium Lending/ Multiple Banking Arrangements w.e.f 1st July, 2020.
- (i) **Due Diligence and Certification** under the Securities and Exchange Board of India (Delisting of Equity Shares) Regulation,2021 w.e.f. 10th June, 2021.

Further the Council has decided that the PCS shall mandatorily mention the Peer Review Certificate number while signing / certifying the above documents in the following format:

	For XYZ & Associates
	Company Secretaries
	Name
	FCS/ACS
Date:	CP
Place:	PR 1231/2023

7. AUTHORITY TO ADMINISTER PEER REVIEW

- i. The Council of the Institute of Company Secretaries of India is constituted under the Company Secretaries Act, 1980, for discharging the functions assigned to the Institute under the Act.
- ii. Section 15(I) of the Act provides that "The Institute shall function under the overall control, guidance and supervision of the Council and the duty of carrying out the provisions of the Act shall be vested in the Council", and enumerates various other duties of the Council.
- iii. With a view to regulate the profession of Company Secretaries, the Council has issued guidelines for Peer Review of Attestation and Audit Services by Company Secretaries in Practice.
- iv. The guidelines serve as a mechanism intended to further enhance the quality of professional work of Company Secretaries in Practice (PCS) over a period of time.

The Guidelines on Peer Review are issued in relation to conduct of Peer Review of members rendering services:

- a. Establish a suitable mechanism to ensure the quality of professional services and guide members as deemed appropriate by the Council.
- b. Provide guidance in relation to the statutory powers and obligations with respect to the parties involved in Peer Review
- c. Prescribe the scope of Peer Review and the procedures to be adopted during the process of Peer Review; and
- d. Establish the expected conduct of members during a peer review.

8. SCOPE OF PEER REVIEW

At present the following Attestation and Audit Services are covered under the purview of Peer Review:

- i. Certification of Annual Return in Form MGT-8
- ii. Issuance of Secretarial Audit Report in terms of Section 204 of the Companies Act, 2013 read with Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014;
- iii. Issuance of Secretarial Audit Report to material unlisted subsidiaries of listed entities (whose equity shares are listed) in terms of Regulation 24A of SEBI (LODR) Regulations, 2015;

- iv. Issuance of Annual Secretarial Compliance Report to Listed entities (whose equity shares are listed)
- v. Certification under SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015, that none of the directors on the board of the company have been debarred or disqualified from being appointed or continuing as directors of companies by the Board/ Ministry of Corporate Affairs or any such statutory authority.
- vi. Certification under Regulation 40(9) of SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015, certifying that all certificates have been issued within thirty days of the date of lodgement for transfer;
- vii. Conduct of Internal Audit of Operations of the Depository Participants registered with [National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL)] under the Bye Laws issued by NSDL and CDSL;
- viii. Certification under Regulation 76 of SEBI (Depositories and Participants) Regulations, 2018 for Reconciliation of Share Capital Audit;
- ix. Acting as Compliance Auditor under third party certification/Audit Scheme (Amendment), 2016 in the State of Haryana;
- x. Diligence reporting for Banks in case of multiple banking/consortium lending arrangements in terms of the circular issued by RBI;
- xi. Conduct of Internal Audit of the stock brokers/sub brokers
- xii. Compliance Certificate regarding compliance of conditions of Corporate Governance;
- xiii. Signing of Annual Return in Form MGT-7;
- xiv. Due Diligence Report under Regulation 10 (3) of the SEBI (Delisting of Equity Shares) Regulations, 2021;
- xv. Certificate relating to shares held by inactive shareholders;
- xvi. Compliance Certificate under Regulation 10(b), 13, 26, 27, 36 of SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021;
- xvii. Scrutiniser's report pursuant to Section 108 of the Companies Act, 2013 read with Rule 20(4)(ix) and Rule 20(4)(xii) of Companies (Management and Administration) Rules, 2014;
- xviii. All other Reports, Returns and Certificates in respect of which generation of UDIN is mandatory in terms of the ICSI Unique Document Identification Number (UDIN) Guidelines, 2019.

9. POWERS OF THE PEER REVIEW BOARD

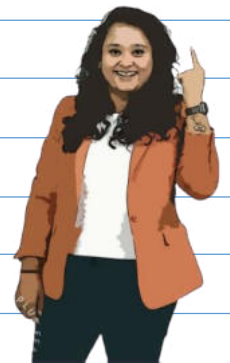
“Council of the Institute of Companies Secretaries of India has issued guidelines on Peer Review, which lays down the framework for conduct of Peer Reviews by setting up the Peer Review Board.”

The **duties of the Board** shall include:

- i. To call for information from Practice Units in such form, as it deems fit.
- ii. To maintain a panel of Peer Reviewers.
- iii. To define the terms of appointment of the Reviewers.
- iv. To **send a Panel of at least 5(five) Peer Reviewers** (from the panel maintained in terms of these Guidelines) **to the Practice Unit and allow them to choose any one Reviewer** from the panel so forwarded and **if the Practice Unit is unable to choose any one Reviewer, to send another Panel of 5 Peer Reviewers.**

Thoda Extra gyaaannnn..... Swaad Anusaaar

If the PU does not choose any one name from the panel of 5 or 10 Peer Reviewers (as the case may be), then the Practice Unit may make a specific request to the Board to provide names of Reviewers from outside the State / Region where the Practice Unit has its place of business, in which case the PU shall, in addition to the payment of fees to the Reviewer, bear extra costs that would be incurred for travelling, stay and other expenses.



Thoda Extra gyaaannnn..... Swaad Anusaaar

In case no peer reviewers are available in the city or in close proximity to the PU, the PU may choose any reviewer from out of the panel maintained by the Committee, in which case the PU shall be liable to pay the travelling, stay and other expenses to the Peer Reviewer in addition to the Peer Review fee



- v. To examine the aspects of basis of selection of records pertaining to the services in terms of the appropriate regulatory requirements.
- vi. To arrange for such training programs for Reviewers and orientation programmes for practice unit as may be deemed appropriate.
- vii. To prescribe the system, practice and procedure to be observed in relation to Peer Review; and
- viii. On considering the Report of a Reviewer, to do any or all of the following:
 - ix. to issue recommendations to the Practice Unit;
 - x. to order a further Peer Review to be carried out.
- xi. After considering the report of the Reviewer and compliance of recommendations by the Practice Unit, wherever deemed appropriate by the Committee, to issue Peer Review Certificate either in physical or digital mode.
- xii. To guide the members on best practices on Peer Review including issuance of advisories to the Peer Reviewer and the Practice Unit.
- xiii. Such other action(s) as may be necessary for the fulfilment of these Guidelines.

Where deemed appropriate, **the Board shall have the powers to make recommendations to the Council on:**

- i. Measures for improvement of quality of professional services by members.
- ii. Guidance to be provided to the members for further improvement in quality of Attestation and Audit Services.

10. GUIDELINES FOR MANDATORY PEER REVIEW FOR CERTIFICATION AND AUDIT SERVICES

The Council has issued Guidelines for Mandatory Peer Review for certification and Audit Services as under:

- a. Secretarial Audit Report under section 204(1) of the Companies Act, 2013 /Regulation 24 A(1) of the Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.
- b. Annual Secretarial Compliance Report under Regulation 24A (2) of the Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.
- c. Certification of Annual Return in terms of Section 92(2) of the Companies Act, 2013.

- d. Compliance Certificate under Schedule V, Clause E of the Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.
- e. Certification under Regulation 40(9) of Securities & Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulation, 2015.
- f. Quarterly Certificate for Reconciliation of Share Capital under Regulation 76 of Securities & Exchange Board of India (Depository Participants) Regulation, 2018. The effective date of applicability for the above services for listed companies is 1st April, 2022 and for all companies whether listed or otherwise it is 1st April, 2023.
- g. Internal Audit of Operations of the Depository Participants w.e.f. 1st April, 2020.
- h. Diligence Report for Banks in case of Consortium Lending/ Multiple Banking Arrangements w.e.f 1st July, 2020.
- i. Due Diligence and Certification under the Securities and Exchange Board of India (Delisting of Equity Shares) Regulation, 2021 w.e.f. 10th June, 2021.

II. AUTHORITY OF THE GUIDELINES ON PEER REVIEW

The guidelines on Peer Review shall apply to all or any of the following cases:

- (a) Whenever Peer Review is mandated on the Instructions of Government/ Regulators / Statutory Bodies;
- (b) Whenever Peer Review is requested voluntarily by the Practice Unit;
- (c) Whenever Peer Review is conducted on the basis of random selection;
- (d) Upon the recommendation of the Committee of Discipline or Disciplinary Committee of ICSI / Quality Review Board / Council of ICSI.

12. QUALIFICATIONS FOR A PEER REVIEWER

To be empanelled as Peer Reviewer, an individual shall-

- (a) be a member with at least 10 years of post-qualification experience as Company Secretary and out of the 10 years of post-qualification experience, should have been in practice for a continuous period of not less than five years at the time of empanelment;
- (b) be currently holding Certificate of Practice as issued by the Institute;
- (c) have undergone the Training Programme for Peer Reviewers and qualified the Certification Programme for Peer Reviewers organized by the Institute;

A member shall not have: -

- (a) disciplinary action / proceedings pending against him during the past 3 years;
- (b) been found guilty of professional or other misconduct by the Committee of Discipline / Disciplinary Committee, at any time, as the case may be;
- (c) been convicted by a Competent Court whether within or outside India, of an offence involving moral turpitude and punishable with imprisonment.

The Board may examine the quality of the report and shall have powers to remove the Reviewer from the panel of Peer Reviewers, in case the quality of the review/report fails to match the desired standards.

13. EMPANELMENT OF PEER REVIEWERS

The Board has prescribed a format for inviting applications from members fulfilling the criteria and willing to be empanelled as Reviewers.

The application form seeks to collate information on professional experience, educational qualifications, practice areas, etc. which would enable the Board to assess the core competence of the applicant for empanelment as Reviewer.

When a Peer Review is required to be conducted, the Board would endeavour to match the relevant experience and standing of the Reviewer with the profile of Practice Unit which is being reviewed.

14. THE REVIEWER'S APPROACH FOR PEER REVIEW

- (a) The **approach of the Reviewer** should be **courteous, professional and helpful** throughout the review process.
- (b) He should be **appreciative of good practices** while suggesting areas of improvement.
- (c) He should **adopt a collaborative approach with the Practice Unit** during the review process and should ensure minimum disruption to the Practice Unit during the peer review.
- (d) He should be able to **provide practical and insightful comments** in a discussion mode as a Peer during the review process.
- (e) He should try and give **value addition to Practice Unit** and not merely adopt a tick box approach.

15. PRE-REQUISITES FOR REVIEWER

The nature and complexities of Peer Review requires the exercise of professional judgment. The reviewer should: -

- (a) Be well acquainted with the technical aspects of the Attestation and Audit Services.
- (b) Know the provisions of Code of Conduct of ICSI.
- (c) Have studied various cases decided on Code of Conduct of ICSI.
- (d) Get himself/herself acquainted with decisions of various courts on 'cases relating to deficiency in service'.
- (e) Be aware of relevant provisions of Company Secretaries Act 1980, Company Secretaries Regulations, 1982, Consumer Protection Act, Evidence Act, Indian Penal Code, etc.
- (f) Have studied the ICSI Auditing Standards, Guidance Notes, Manuals, Referencers, Notifications, Guidelines and advisories issued by Council of ICSI from time to time.
- (g) Be aware of evolving standards and best practices in the field.
- (h) Be good at drafting, written and spoken English.
- (i) Display professional and courteous behaviour while on peer review visit.
- (j) Understand his limitations.
- (k) Be clear about what is outside the scope of Peer Review.

16. PEER REVIEW PROCESS

Once a practice unit is selected for review, its engagement records pertaining to the immediately preceding financial year shall be subject to review.

The Review shall focus on:

- i. Compliance with ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, References and advisories issued by the Institute;
- ii. Quality of Reporting;
- iii. Office systems and procedures; and
- iv. Training Programs for staff (including trainees), including appropriate infrastructure.

Engagement records of immediately preceding financial year shall be subject to peer review

17. TRAINING AND DEVELOPMENT OF REVIEWERS

- i. To ensure that the objective of Peer Review is attained in letter and spirit, adequate training facilities (either offline or online or both) shall be provided, from time to time, to the Reviewers and also to other persons who assist the Board in the manner considered appropriate by the Board.
- ii. Reviewer shall be expected to be fully familiar with all procedures, ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute, guidelines and other decisions as may be issued by the Board from time to time.
- iii. A Reviewer may be required to assess his/her capability to perform Peer Review exercise. He/she should also consider carefully the number and availability of trained staff in deciding whether he/ she would be in a position to perform Peer Review of a Practice Unit.

To equip the Reviewers with the required inputs for Peer Review, the Institute undertakes Training Programmes for Reviewers on regular basis. Institute has also developed a Training Module to guide the Reviewers.

18. VALIDITY OF REVIEWERS EMPANELMENT

The Peer Review Empanelment *is valid for five years* from the date of approval. After this period, Reviewers need to undergo the Peer Reviewer Training Programme again and qualify the Certification Programme provided by the Institute.

19. STATEMENT OF CONFIDENTIALITY

- i. The *process* of Peer Review *requires high level of integrity on the part of the Peer Reviewer and Qualified Assistant(s)* who may assist Reviewer during the Review.
- ii. Before accepting to undertake Peer Review assignment, *the Reviewer and Qualified Assistant(s)* are required to sign the *Statement of Confidentiality* and shall send the same to the Peer Review Board.

- iii. *Strict confidentiality provisions shall apply to all those involved in the Peer Review process, namely, Reviewers, Qualified Assistant(s), members of the Board, the Council, or any person who assists any of these parties. Those persons subject to the secrecy provision:*
1. *Shall at all times after their appointment preserve and aid in preserving secrecy with regard to any matter coming to their knowledge in the performance or in assisting in the performance of any function, directly or indirectly related to the process and conduct of Peer Review;*
 2. *Shall not at any time communicate any such matter to any other person; and*
 3. *Shall not at any time permit any other person to have any access to any record, document or any other material, if any, which is in their possession or under their control by virtue of their being or having been so appointed or their having performed or having assisted any other person in the performance of such a function.*

Non-compliance with the secrecy provisions in the above clause shall amount to professional misconduct as defined under Section 22 of the Company Secretaries Act, 1980.

20. METHODOLOGY TO BE FOLLOWED BY REVIEWER

(a) Offsite Review

This involves carefully reviewing the information provided by the PU in the Questionnaire. Based on this, the auditor forms their own observations regarding areas where improvement is possible. Additionally, they make notes on other aspects that should be discussed in a personal meeting with the PU.

(b) Onsite Review

Verify information provided by the PU, conduct test checks for attestation assignments, interact with PU staff and trainees as part of peer review, and request records for clients to ensure proper systems and procedures are followed.

21. COMPLIANCE WITH PEER REVIEW GUIDELINES

- i. *Practice Units are required to comply with the provisions of these Guidelines as those who fail to comply will be required to undergo appropriate review of their quality controls by the Board.*

- ii. Practice Units failing to comply with these Guidelines shall also be *liable for disciplinary action* as provided under the Company Secretaries Act, 1980.
- iii. Both the Peer Reviewers as well as the Practice Units shall *adhere to the timelines for Peer Review* as mandated by the Board from time to time.

22. OBLIGATIONS OF THE PRACTICE UNIT

The Obligations of the Practice Unit include the following:

- i. The Practice Units are *supposed to practice under the name duly approved and allotted by the ICSI* as per the name approval Guidelines as amended from time to time.
- ii. The Practice Unit under review *shall provide access to any record or document* as may be asked by the Reviewer.
If a Reviewer believes that any person possesses or controls a record or document containing relevant information to the Peer Review, they may:
 - a. Produce or provide access to any record or document specified by the Reviewer, or any record of a specified class, which is believed to be relevant to the Peer Review. This should be done within a reasonable timeframe as required by the Reviewer.
 - b. If requested by the Reviewer, provide explanations or additional details regarding anything produced in compliance with the mentioned requirement, as specified by the Reviewer; and
 - c. Provide to the Reviewer all assistance in connection with Peer Review which he is expected to provide.
- iii. Where any information or matter relevant to a Practice Unit is not recorded legible form, the Practice Unit shall provide and present to the Reviewer a reproduction of any such information or matter, or of the relevant part in a legible form, with a suitable translation in English if the matter is in any other language, and such translation is requested for by the Reviewer.
- iv. In case the Practice Unit has more than one office, the Practice Unit shall ensure that the Reviewer is given access to all documents relevant to review no matter in which office of the Practice Unit, these documents may be available in.
- v. A Practice Unit must permit the Reviewer to inspect, examine, or take necessary information from records or documents. However, to maintain client confidentiality, the Reviewer should not request client names or make copies or extracts from client files or records acquired during the peer review for their working papers.

For the purpose of this clause a person means an individual / Sole Proprietor / Partner of a partnership firm / designated partner of a LLP to which the particular review relates or any person employed by or whose services are engaged by such unit.

23. VALIDITY OF PEER REVIEW CERTIFICATE

- i. The validity of the Peer Review Certificate shall be five years from the date of issue.*
- ii. The Board may suo motu or otherwise at the request of the Practice Unit, initiate the Peer Review process even before the expiry of the validity of the Peer Review Certificate.*
- iii. In case the PU is reviewed within two years of its formation, the validity of the Peer Review Certificate shall be for two years.*

24. REVIEW FRAMEWORK

Essentially, a Peer Review entails a review of engagement records and related financial / other statements to ascertain whether the Practice Unit is adhering to ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute.

Where a Practice Unit is not following any of the ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute, in certain situations, suggestions and recommendations for improvement may be made, and possibly followed by a further review, in keeping with the primary thrust of Peer Review.

25. REPORTING

- i. At the end of an on-site review, the Reviewer shall, before making his report to the Board, communicate a preliminary report to the Practice Unit, in case the Reviewer observes any deficiency in the systems and procedures of the Practice Unit.*
- ii. The Reviewer shall report on the areas where systems and procedures had been found to be deficient or where he has noticed noncompliance with reference to any other matter.*

- iii. *In arriving at this conclusion, the Reviewer shall be expected to examine the materiality of the non-compliance or deficiency, the number of occasions when such non-compliance was noticed and its overall impact on the quality of professional service rendered by the Practice Unit.*

What are the basic components of a Reviewer's Report?

Solution:

The basic components of a Reviewer's Report are:

- a. *Scope of Peer Review*
- b. *Reference to the quality control standards*
- c. *A statement indicating that the quality control is the responsibility of the reviewed firm*
- d. *Limitations if any on the review conducted*
- e. *A reference to the preliminary report;*

Can a Reviewer give qualifications in his Review Report?

Solution:

Under following situations, a reviewer can qualify the report:

- a. *Non-compliance with quality control policies and procedures*
- b. *Any deficiency found in quality control procedures*
- c. *Non-adherence to ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute*
- d. *No internal control systems prevail in the PU*
- e. *Current and permanent files were not maintained as per standards laid down*
- f. *Adequate training programmes were not organized for the staff*

26. QUESTIONNAIRE FOR PRACTICE UNIT

- i. The Peer Review process requires each Practice Unit (PU) to provide some basic information about the PU to the Reviewer in the questionnaire specifically designed by the Committee for the purpose.
- ii. The questionnaire would enable the Reviewer to make a fair assessment as to the key control areas prevalent in the Practice Unit and the degree of reliance that can be placed on the internal control mechanism and records maintained by the Practice Unit.
- iii. Non-existence of any of the internal control measures as elucidated in the questionnaire does not necessarily mean that the Practice Unit has failed in any aspect related to quality of services.
- iv. All the responses to the questionnaire would be kept strictly confidential by the Reviewer and his team and no information contained therein would be shared with any third party.
- v. The Reviewer places a great deal of reliance on the responses provided by the Practice Unit in the questionnaire while designing his / her review plan. Care should therefore be taken by the Practice Unit while answering the question.

27. COST OF PEER REVIEW

The cost of Peer Review, payable to the Reviewer, shall be borne by the Practice Unit.

The cost of Peer Review shall be paid by the Practice Unit within 30 days from the date of receipt of Invoice from the Peer Reviewer.

28. REVIEW PROCESS

1. Preparation

A practice unit will be notified in writing about an impending peer review and will be sent a Questionnaire for completion. The PU is required to send the duly filled in Questionnaire to the Committee.

Return of completed Questionnaire - The practice unit shall have to complete and return the Questionnaire to the Secretariat within 7 days of the receipt. The information will be used for the planning of the review.

- i. The Board will send a Panel of at least 5 (five) Peer Reviewers (from the panel maintained in terms of these Guidelines) to the Practice Unit and allow the Practice Unit to choose any one Reviewer from the panel so forwarded and if the Practice Unit is unable to choose any one Reviewer from the panel so sent, to send another Panel of 5 Peer Reviewers.
- ii. If the PU does not choose any one name from the panel of 5 or 10 Peer Reviewers (as the case may be), then the Practice Unit may make a specific request to the Board to provide names of Reviewers from outside the State / Region where the Practice Unit has its place of business, in which case the PU shall, in addition to the payment of fees to the Reviewer, bear extra costs that would be incurred for travelling, stay and other expenses.

How much will it cost PU to get Peer Reviewed?

PU shall pay to the Peer Reviewer, a fee of Rs. 10,000/- or an amount as may be prescribed by the Peer Review Board from time to time. In case Reviewer has to conduct second review, the same rate would apply to the second review also.

To whom shall the fee for Peer Review be paid?

The cost of Peer Review shall be paid by the PU directly to the Reviewer within 30 days from the receipt of Invoice raised by the Peer Reviewer by crossed account payee cheque/Demand Draft/NEFT/RTGS/IMPS or any other electronic mode.

2. Planning

On acceptance of the Peer Review by the selected Reviewer, the Practice Unit will be notified. The Reviewer may also require the Practice Unit to provide other information as he considers necessary to facilitate the selection of a sample of services engagements, which is representative of the Practice Unit's client portfolio, for review.

Sample of Attestation services Engagements

- (a) From the complete Services, client list, an initial sample will be selected by the Reviewer.

- (b) The Peer Reviewer shall choose **not less than 10% of the actual attestation assignments** undertaken by the PU under each category **or five assignments under each category**, whichever is more.
- (c) **In case the sample size is smaller than this, the reasons** therefor shall be specifically stated in the Peer Review Report.
- (d) **Practice Units** will be **notified** of the selection in writing **preferably 2 (two) weeks in advance**, requesting the relevant records of the selected Attestation and Audit Services, to be made available for review.
- (e) At the **execution stage**, the **initial sample** may be **reduced to a smaller actual sample for review**.
- **Confirmation of visit**
 - i. Determine on-site review dates in consultation with the Practice Unit.
 - ii. Allow flexibility to accommodate busy periods for Practice Units.
 - iii. Mutually agree on on-site review dates to ensure completion within 21 days of the Peer Reviewer's appointment by the Committee.

3. Execution

- (a) On site review Peer review visits will be conducted at the practice unit's head office or other officially noted/ recorded place of office.
- (b) The complete on-site review of a practice unit may take one or two full days depending upon the size of the practice unit and scope of the peer review. This is based on the assumption that the practice unit concerned has made all the necessary information and documentation available to the reviewer for his review. However, in any case this **on-site review should not extend beyond three working days**.
- (c) **Initial meeting:**
 - i. An initial meeting will be held between the reviewer and the sole proprietor/ partner(s) of the practice unit designated to deal with the review (designated partner).
 - ii. The **primary purpose of this meeting is to discuss the agenda of the peer visit and confirm the accuracy of the responses given in the Questionnaire**.
 - iii. The reviewer should have a full understanding of the system and be able to form a preliminary evaluation of its adequacy at the conclusion of the meeting.

- iv. During the meeting, a decision can also be taken on the evaluation method and the person(s) in the office of the PU to be interviewed and who will be able to assist the Reviewer in completing the Peer Review Process during his/her visit.

(d) Compliance Review-General Controls

- i. The reviewer may carry out a **compliance review of the General Controls and evaluate the degree of reliance to be placed upon them** because this directly affects the attestation services engagements to be reviewed.
- ii. The following five key controls will be considered as General Controls:
- b. Independence
 - c. Maintenance of Professional Skills and standards
 - d. Outside Consultation
 - e. Staff Supervision and Development
 - f. Office Administration
- Practice units are expected to address each of the five key control areas.
- iii. In each key control area there shall be supplementary questions and matters to consider. These are intended to ensure that the controls that are expected to be maintained, are installed and operated within practice units.
- iv. All questions in the questionnaire may not necessarily be relevant to particular types of practice units because of its size, nature and type of its practice. However, practice units should still assess their internal control systems to ascertain whether they address the objectives under the five key control areas.
- v. The Reviewer should evaluate these general controls to understand the functioning of the office of the Practice Unit.

4. Selection of attestation services engagements to be reviewed

- i. The number of attestation services engagements to be reviewed depends upon:
- a. The **number of practicing members involved** in attestation services engagements in the practice unit;
 - b. The **degree of reliance placed**, if any, on general quality controls; and

- c. The **total number of attestation services engagements undertaken by the practice units** for the period under review.
- ii. Engagements to be reviewed should form a well-rounded sample from different types of companies. If the reviewer finds that the initial sample doesn't adequately represent the practice unit's attestation services client portfolio, they can choose additional engagements either from the initial sample or the complete list of attestation services clients.
- iii. The Reviewer should not undertake Peer Review of attestation engagements which have been the subject matter of disciplinary proceedings nor should the Practice Unit influence the Reviewer to select such engagements for Peer Review.

5. Review of records

The reviewer may adopt a **compliance approach or substantive approach** or a combination of both in the review of attestation services engagement records.

(a) Compliance approach - services engagements

- The compliance approach is to **assess whether proper control procedures have been established by the practice unit to ensure that attestation services are being performed in accordance with Auditing Standards, Guidance Notes, Manuals, References and advisories issued by the Institute.**
- If the size of the Practice Unit is small or medium (a matter left to the judgement of the Reviewer), the Compliance Approach may not be appropriate. In such a case, the Reviewer may choose the Substantive Approach for conduct of Review.

(b) Substantive approach - Attestation services Engagements

If the reviewer decides not to rely on the practice unit's general controls or believes that the compliance standard is unsatisfactory, a substantive approach will be used. This involves reviewing attestation working papers to ensure that the work aligns with the Technical Standards.

6. Reporting

i. Preliminary Report of Reviewer

The Reviewer shall report on the areas where systems and procedures had been found to be deficient or where non-compliance with reference to any other matter was noticed in a preliminary report to the practice unit

The Practice Unit shall make submissions or representations, in writing to the Reviewer, concerning the preliminary report within 7 (seven) days from the date of receipt of preliminary report from the Reviewer.

ii. Final Report of Reviewer

- (a) The Reviewer will submit a Final Report to the Board with a copy to the Practice Unit (the Reviewer's Report), incorporating the findings. The Final Report will be examined/inspected by the Board in terms of the degree of compliance with the ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute by the reviewed Practice Unit.
- (b) The model forms of such Final Reports shall be communicated to the Reviewer by the Board.
- (c) The Board may, if deems fit, issue Peer Review Certificate to the Practice Unit. OR
- (d) The Board, having regard to the Report and any submissions or representations attached to it, may:
- make recommendations to the Practice Unit concerned regarding the application by it of ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute;
 - if it is of the opinion that:
 - ✓ In case the review is related to a firm, any one or more or all of the partners in the firm may have failed to observe, ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute;
 - ✓ In case the review is related to a member practicing on his own account, the member may have failed to observe, maintain or apply, as the case may be, ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute; then, the Board may;
 - Issue instructions to the Reviewer to carry out, within such period as may be specified in the instructions (which period shall not commence earlier than six months after the date on which

the instruction is issued), a further Peer Review as regards the Practice Unit to which the report relates; and

- Specify in the instruction, the matters as regards to which the review is to be carried out;

(d) The Board will make recommendations to the Practice Unit where:

1. based on the report of the Reviewer, *it appears that the Practice Unit has satisfied all key control objectives*, which the Board has determined and/or prescribed in respect of maintenance of/ adherence to Technical Standards *but where further improvements could be made to internal quality control systems*; and
2. based on the report of the reviewer, *it appears that the Practice Unit has satisfied the major key control objectives but some weaknesses exist in other areas*. The Practice Unit is expected to consider the recommendations for rectifying the weaknesses thus identified and informed by the Board and take all necessary actions to ensure that all key control areas are addressed.

(e) A *follow up review* will be required where the *Practice Unit has not satisfied the Committee that all the key control objectives have been maintained*. In such cases the Board will also make recommendations, which it expects the practice unit to implement in order to ensure the maintenance of professional standards. The implementation of these recommendations will be examined during the follow up review.

29. OFFICE SYSTEM AND PROCESS

The peer review is expected to examine the office systems and procedures with regard to compliance Professional services. The reviewer shall verify whether the practice unit has adequate office systems and procedures in place. However, the extent and scale of these systems may vary from one practice unit to another, depending upon the size and scale of practice of the practice unit.

The reviewer shall particularly examine the following aspects, besides forming his own judgment during the review:

1. Whether the practice unit has a document management system which should ideally include the filing system, record storage and retrieval system (whether in hard copy or soft copy),

2. Whether allocation of attestation assignments among the staff/trainees are commensurate with the capability of the staff, whether the assignments are properly carried out and the attestation services are verified by the proprietor or partner of the practice unit or a qualified assistant in the office of the practice unit before authentication.

What does Qualified Assistant mean?

Solution:

Qualified Assistant means a person assisting the Reviewer for carrying out peer review and who:

- is a member of the Institute
- has not been held guilty of misconduct under the Company Secretaries Act, 1980
- is a partner or Associate of the Peer Reviewer

Training programs for staff (including apprentices) concerned with attestation functions, including appropriate infrastructure

Proper training and capacity development of the apprentice staff/trainee(s) and other staff in the office of the practice unit is very essential to maintain the quality of professional services. As it may become difficult for company secretaries in Practice/Partner(s) of the PU to attend all the services rendered by their PU, most practice units generally rely on the trainees for execution of the professional services. In this context, the peer reviewer may examine whether:

- The trainees are maintaining a training diary to record the work done every day, the diary is being examined by the proprietor/partner/qualified assistant of the practice unit periodically
- Whether any staff induction process is in place.
- Whether the staff are periodically encouraged to attend any training program or any other capacity building programme, including any in-house mechanism for their professional development.
- Whether the office of the practice unit is equipped with a library or reference material relating to professional services.
- Whether the overall décor/appearance of the office of the practice unit is satisfactory.

The list furnished above is only illustrative. The peer reviewer may like to examine any other matters also. However, in doing so, the peer reviewer shall keep in mind the size of the practice unit and its scale of operations.

30. REFERRAL OF DISPUTES AND APPEAL

Where a dispute arises over the powers of Reviewers or the process or conclusions reached after the review or to any other matter related to the review, the Practice Unit, the Reviewer or both may refer the dispute, in writing, to the Board, within 2 (two) months of occurrence.

Where a dispute is referred, after considering any submissions or representations (which shall be made in writing) made by the relevant Practice Unit and/or the relevant Reviewer, the Board:

- Shall decide the dispute within 6 (six) months of the reference and communicate such decision to each of the parties to the dispute, simultaneously;
- May issue directions relating to the matter in dispute to such Practice Unit or the Reviewer concerned and require such Unit or Reviewer to comply with them within 30 (thirty) days and send a report to the Board of the said compliance within 15 (fifteen) days of such compliance;
- Shall convey its decision in these regards to each of the parties within 15 days from the date of the decision.

Where either of the parties are dissatisfied with the decision of the Board, it may refer the matter to the Council within 2 (two) months.

31. QUALITY REVIEW BOARD

- i. Quality Review Board (QRB) is constituted by Government of India to review and enhance the quality of the services rendered by the members of the ICSI.
- ii. The Board aims to standardize the practices followed by the Company Secretaries and enhance the quality of the services rendered by the members of ICSI on continuous basis.
- iii. The Company Secretaries Act, 1980 provides for the regulation of the profession of Company Secretaries in India. The Act was amended in the year 2006 and sections 29A to 29D were inserted making provision for the establishment of Quality Review Board.

- iv. Accordingly, the Government of India, Ministry of Corporate Affairs constituted QRB of the Institute of Company Secretaries of India for promoting "Quality" considerations in rendering various professional (both statutory and non-statutory) services by the Members of the Institute.

32. THE COMPANY SECRETARIES (AMENDMENT) ACT, 2006

The below sections were inserted by the Company Secretaries (Amendment) Act, 2006 in the Company Secretaries Act, 1980.

Establishment of Quality Review Board (Section 29A)

- a. The Central Government shall, constitute a Quality Review Board consisting of a **Chairperson and four other members**.
- b. The Chairperson and members of the Board shall be appointed from amongst the **persons of eminence having experience in the field of law, economics, business, finance or accountancy**.
- c. **Two members** of the Board shall be **nominated by the Council** and **other two members** shall be **nominated by the Central Government**.

Functions of Board (Section 29B)

The Board shall perform the following functions, namely: —

1. to **make recommendations** to the Council with **regard to the quality of services** provided by the members of the Institute;
2. to **review the quality of services provided by the members of the Institute** including secretarial Audit services; and
3. to **guide the members of the Institute to improve the quality of services** and adherence to the various statutory and other regulatory requirements.

Procedure of Board (Section 29C)

The Board shall meet at such time and place and follow in its meetings such procedure as may be specified.

Terms and conditions of service of Chairperson and members of Board and its expenditure (Section 29D)

- 1. The terms and conditions of service of the Chairperson and the members of the Board, and their allowances shall be such as may be specified.*
- 2. The expenditure of the Board shall be borne by the Council.*

33. QUALITY MANAGEMENT SYSTEM

Quality Assurance (QA) and Quality Control (QC) both terms are the integral part of the quality management systems. Effective Quality Management Systems (QMS) contribute enormously to the success of a Practicing Unit, whereas when it is poorly understood, the QMS are likely to be weak and ineffective in ensuring the timely delivery and incompetent in satisfying the customer's requirements.

34. QUALITY ASSURANCE

Quality Assurance is focused on planning, documenting and agreeing on a set of guidelines that are necessary to assure quality which are issued by the various regulators on time to time. For Example instruction kit of various e-forms where the purpose of the Instruction kit is to provide guidance on the requirement of the form and to have correct record in place. Normally the QA guideline provides Do's and Don'ts, instructions, verification methodology, possible errors and defect along with the remedial action required for the same.

The quality assurance could also be considered as a tool of risk mitigation.

35. QUALITY CONTROL- DETECTION AND IMPROVEMENT

Quality Control can be referred as the examination of Output, Review of the work and assignment already taken place, on the various parameter like time involved, number of resubmissions, deficiency, cost, manpower, expertise engaged etc.

Guide to Conduct Quality Review

The Quality Review is focused towards evaluation and review of quality of services rendered by members and adherence to various statutory and other regulatory requirements.

It involves assessment of the work of the member while rendering professional services so as to enable QRB to assess:

- (a) **compliance** with statutory and regulatory requirements;
- (b) the **quality control framework adopted by the member**; and
- (c) the **quality of reporting**

Appointment of Quality Reviewers

The Quality Reviewers are being appointed by the QRB on the basis of their experience in terms of seniority and the relevant work exposure.

- I. An individual desiring to be empanelled, shall:
 - (a) Be a Fellow member of ICSI; and
 - (b) Possess at least **fifteen (15) years of post-membership experience as Company Secretary in Practice or employment** in the Secretarial Department of a Company or as a combination of practice and employment in the Secretarial Department of a Company; and
 - (c) Be **currently in practice of the profession of company secretaries**. 'or'
- II. An individual desiring to be empanelled shall:
 - (a) Be empanelled as Peer Reviewer in terms of the Guidelines for Peer Review of Attestation and Audit Services by Company Secretary in Practice and has **completed minimum 5 assignments of Peer Review**.

The member shall **not have been found guilty under the Company Secretaries Act, 1980** or regulations made thereunder by Board of Discipline / Disciplinary Committee during the previous 5 years.

Manner of Selecting Practice Units for Quality Review

The Board is empowered to decide the Practice Unit(s) to be reviewed. The selection of a Practice Unit for review is based on objective criteria as may be determined by the QRB.

Communication with Practice Unit under Review (PU)

- i. On selection of a Practice Unit (PU) for review, intimation is sent regarding its selection with request to provide basic information related to the services rendered and other details.
- ii. Once the basic information is received from PU, the Quality Reviewer (QR) is assigned and the basic information of the PU is shared with the Reviewer.
- iii. The Reviewer should send a communication to the PU specifying aspects such as:
 - a. Date of commencement of the review;
 - b. Expected date of completion of review;
 - c. Documents required for review;
 - d. Identification and contact details of the Reviewer;
 - e. Composition of the review Team, if any; and
 - f. Any other detail as may be required for the purpose of review.
- iv. It is also advisable that for a smooth conduct of the review, the Reviewer and the PU reach an understanding on the following matters:
 - Details and duration of visit at the Office of PU so as to ensure minimum disruption to the PU. Main contact person/s in the PU for Reviewer's requirements relating to the review.
 - Normal lead time required for production of documents, resolution of queries, etc.
 - Logistical arrangements, as available within the PU, for conduct of review.
 - Any other support/coordination required by Reviewer from PU and vice versa.
 - The frequency and timing of communications related to issues or findings noted by the Reviewer.

Submission of Report

- i. The Reviewer is **required to submit a preliminary report within three weeks from the date of assignment to the Practice Unit** on the review of the quality of audit and attestation services rendered by the Practice Unit.
- ii. Any **observation indicating a non-compliance** with the applicable technical standard(s) should be **included in the preliminary report** for seeking views / comments of PU thereon.
- iii. The Board may, upon request, **extend the time limit for submission of preliminary review report.**

- iv. *The Reviewer, based upon consideration of the responses received from Practice Unit on the preliminary report, shall issue the final report to the Board on the basis of his findings on the quality of services rendered by PU.*

Consideration of the Reports of the Quality Review Board

The Quality Review Reports as submitted by Reviewer are considered by the Board. The Board on receiving final report from Reviewer may take any of the following actions:

- Consider and take on record of the report received;*
- Issue instructions to the Practice Unit, wherever it is required;*
- Ask for more clarifications from the Reviewer / Practice unit, as it may deem fit;*
- Make recommendations to the Council with regard to the best practices to be adopted.*

36. QUALITY CONTROL IN QUALITY REVIEW

Part - A:

Expectations from Practice Unit: *The Regulators are reposing more faith on services of the professionals like ours. It is the responsibility of we professionals to maintain the recognition secured from the Regulators. For maintaining and enhancement of the standards of the quality of services rendered, a Practice Unit is expected to have a system of quality control in place.*

1. Leadership Responsibilities

The firm should assign responsibility for each assignment to one of its partners or the team leader who shall be responsible for overall quality of such assignment.

The proprietor / partner(s) of the PU shall be responsible for quality maintenance and quality improvement of which recommended features are:

- a. Communication of the quality control policies and procedures to all team members / relevant personnel. The methods for communication, scope and frequency thereof should be established.*
- b. Establishing a process that encourages personnel to communicate their views or concerns on quality control matters.*

- c. Clearly establishing responsibilities of the proprietor / partner(s) of the PU and other senior personnel for quality control.
- d. Documenting quality control policies and procedures of the firm and its circulation to all relevant personnel.

2. Ethical requirements

Ethical requirements include:

- a. **Independence:** The PU shall not try to acquire the assignments on the basis of personal relations with clients. Independence is required for fair dealing with the clients; otherwise the quality of services may be threatened.
- b. **Familiarity Threat:** A familiarity threat arises when, by virtue of a close or long-term relationship with a client, its directors, officers or employees, the PU or person on an engagement team may become too casual and sympathetic to the client's interests, compromising the quality of service and independence of the PU.
- c. **Integrity:** While carrying out the assignments, firm should ascertain the integrity aspects of the client. It is associated with soundness or moral principles and character in dealings with others.
- d. **Objectivity:** The test of objectivity shall be whether the professional assignments were carried out in an impartial and fair manner without fear, favour or prejudice. The PU should base his assessment and opinion purely on facts, evidences, sound analysis and judgment.
- e. **Professional competence and due care:** The PU shall have enough Professional competence to deal with the assignments. The PU shall ensure possession of appropriate qualifications, experience, ability of the personnel to whom responsibilities of an assignment is given.
- f. **Confidentiality:** Confidentiality is the spirit of any profession and as a Company Secretary; complete confidentiality of information obtained during assignment is the basic requirement.
- g. **Professional conduct:** Company Secretaries are looked upon as trustworthy guardians, caring for interest of all stakeholders, guides to corporate world in secretarial leadership. The professional conduct of the PU must also be illustrative.
- h. **Technical standards:** The PU should be fully conversant with various pronouncements by the regulatory bodies and should keep updated with the technical standards which may be prescribed from time to time and applicable to the PU.

Human Resources: In case of a professional firm, human resource is the prime asset responsible for success or failure of the firm. The constitution of the team and members which make the team is the major determinant in rendering the quality of professional services and hence, the recruitment of right person to the right place is the pre-requisite to deliver quality services to the clients.

Performance Evaluation

- Performance Evaluation is necessary for developing and maintaining competence and commitment to deliver quality services.
- The PU shall make personnel aware of its expectations regarding performance
- The PU shall have an established mechanism for evaluation of performance of its personnel.

Monitoring

- Monitoring refers to a process which is an ongoing exercise for evaluation of PU's quality control systems which also includes periodic inspection of completed assignments on sample basis to provide the PU with reasonable assurance that its quality control systems are operating effectively.
- A PU shall monitor its personnel, performance procedures, system for reporting and soon as an ongoing exercise.

Part - B : Responsibility of the Quality Reviewer (QR)

A quality review is an engagement that needs to be carried out in a manner that ensures that the work performed by the Quality Reviewer and the review team meet the professional standards established by ICSI. Any shortcomings in the quality of the Review process would defeat the very purpose of the process of the quality review established by the Quality Review Board. It is, therefore, of utmost importance that ensuring quality in an assignment given by the Board, remains priority for a Quality Reviewer. The quality of a Review is directly affected by factors such as:

- Knowledge and experience of the Quality Reviewer and his team

- Time devotion
- Composition of the Review team
- Understanding of the objective and scope of work
- Monitoring, direction and supervision of the Review team In fact, maintaining the quality in a Review as also the final report of the Review, is and remains the responsibility of the Quality Reviewer.

Planning the Quality Review

A well planned review engagement ensures that a review is performed in an effective manner. It involves establishing the overall strategy for the review and developing the review plan. A well planned review helps the reviewer to, inter alia:

- Devote appropriate attention to important areas of review;
- Identify and resolve problems on timely basis;
- Facilitate direction and supervision of the team members and their work.

The nature and extent of the planning required for a review will vary according to the size of the PU, nature and complexity of the quality control system in PU and the engagements under review, the experience and competence of the review team and any changes that may occur subsequently in the circumstances of the review.

The initial planning activities relating to the review would include:

- Performing procedures regarding the acceptance of the review assignment;
- Evaluating compliance with independence requirements;
- Establishing an understanding of the terms of the assignment.

The Reviewer should establish an overall review strategy that would set the scope, timing and direction of the Quality Reviewer, and guide the development of plan to conduct the quality review. In establishing the overall review strategy, the Reviewer needs to consider the following:

- Characteristics of the review assignment that would determine the scope of the review, viz., evaluation of design and implementation of systems and evaluation of compliances;
- Reporting objectives of the review, to plan the timing of the review and the nature of the communication required with the PU;

- Factors that, in the Reviewer's judgment, are significant in directing the review team's efforts; and
- Ascertain the nature, timing and extent of resources necessary to perform the review assignment.

Since quality review is essentially an "on-site" engagement, it is important that the on-site visit to the PU is also properly planned

This planning would include:

- Preparing the checklists of the activities during review process.
- Preparing a list of documents that would be required from PU for quality review.
- Coordinating with the PU as to the timing of the visit and the authorised coordinating person/s at PU so as to ensure minimum disruption to the PU.

CONDUCTING THE QUALITY REVIEW

The Reviewer is required to examine the procedures and implementation thereof in the Practice Unit being reviewed, for ensuring:

1. Compliance with ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute; and
2. Implementation of a system of controls with reference to the applicable standards.

Based on the procedures performed during the review, the Reviewer also concludes to the effect that nothing has come to the notice of the Reviewer's attention that causes the Reviewer to believe that the PU has not complied with the applicable ICSI Guidelines, other laws and regulations.

A quality review of the services rendered by the PU in terms of the 'Terms of Reference for Quality Reviewers' issued by the QRB and as amended from time to time ("the Procedures") involves interviewing, making enquiries and performing such other procedures to examine whether the PU has complied with the ICSI Guidelines relating to the services rendered, the

professional and other standards as issued by the Institute of Company Secretaries of India (ICSI) and considered relevant laws and regulations.

Obtaining an Understanding of the Engagement

In order to achieve the objectives of the review, the Quality Reviewer, should, prior to commencement of on-site review:

- (a) go through the questionnaire as submitted by Practice Unit in respect of which review has been initiated for the period under review and ask for further information, which could enhance understanding of the systems and procedures followed by PU; and
- (b) obtain the relevant knowledge in which the Practice Unit has rendered services, including the applicable laws and regulations, during the period to which the audit and attestation engagement relates.

PU's Responses to the Quality Review Questionnaire

- i. QRB has developed Quality Review Questionnaire for use by Quality Reviewer.
- ii. The Questionnaire work as an aid for the Quality Reviewer and contain questions relevant for determining compliance with the requirements of the ICSI Guidelines and the system and procedures followed by PU.
- iii. PUs are also required to submit their responses to each of the questions given in the Quality Review Questionnaire.
- iv. Prior to commencement of on-site review, Quality Reviewer must obtain the responses from PU for each of the question.

Obtaining an Understanding of the Practice Unit

Prior to the commencement of the review, it is important for the Reviewer to obtain an understanding of the PU. This involves obtaining an understanding of the aspects including:

- (a) Size of the practice;
- (b) Legal form (CP holder/sole proprietorship/partnership/LLP);
- (c) Service verticals within the PU;

- (d) Geographical spread of PU;
- (e) Governance structure in the PU, with respective roles and responsibilities of the partners and other staff;
- (f) Policies and procedures designed and implemented by PU to ensure compliance;
- (g) The methodology being used by the PU.

While Reviewer can obtain the understanding of the PU either on site or prior to commencement of the review, it is recommended that the relevant inquiries in this regard are made prior to the commencement of the on-site review. While preparing the quality review documentation, the Reviewer, therefore, may have regard to the aspects such as:

- a) reference to the source of the general and internal control;
- b) if procedures were implemented, then a walk through, if any, performed to determine implementation;
- c) in respect of the concerned assignment, a reference to the relevant working papers;
- d) matters examined; and
- e) conclusions reached (duly supported with the basis of conclusion).

Evaluating the Findings of Quality Review

The Reviewer is responsible to evaluate whether the evidence obtained during the review is sufficient to support the report to be issued pursuant to the review engagement.

The review may indicate

- a. deficiencies in the policies and procedures instituted by the PU; or
- b. the procedures performed by the PU were not designed or performed appropriately to provide it with sufficient appropriate evidence that the PU has complied with the applicable technical standards; or
- c. deficiencies in the procedures performed by PU to ensure that the services rendered by the PU were appropriate in the circumstances.

As and when the Reviewer has collated the findings which are required to be evaluated, they should communicate those findings to the PU and allow reasonable time to respond to the queries. It is essential for the review team to consider the information and explanations made available by the PU in response to the findings.

The presence of one or more of the following events would indicate possibility of existence of a material deficiency in policies/ procedures:

- (a) Identification of non-compliances, whether or not material, on the part of the senior management of PU;
- (b) Non-compliances with the established policies/procedures in previous periods;
- (c) Identification by the review team of a material noncompliance in the current period in the circumstances that indicate the non-compliance would not have been detected by the PU's systems of control; and
- (d) Ineffective oversight by the senior management of the PU's external reporting on compliances with all or some elements of the systems of control. It may be noted that the above is only an inclusive list of such events.

Documenting a Finding

The Reviewer should give attention to the manner in which a finding is documented. The Reviewer should ensure that each of the documented finding has the following characteristics:

- (a) All relevant facts and background information necessary to understand the finding or the issue being raised by the Quality Reviewer are present;
- (b) Requirements of the ICSI Guidelines or other relevant laws/regulations that have not been complied with;
- (c) Factors mitigating the effect of the finding, if any;
- (d) Explanations/responses provided by the PU; and
- (e) Conclusions reached by the Quality Reviewer.

It has been observed that sometimes there is an inconsistency between the findings reported by the Quality Reviewer and the responses given by the PU on the engagement documentation available with the PU. In order to avoid any such situation, the Reviewer and the PU should discuss all the issues, make note of all the documentation and working papers available with the PU and also minute the discussion which may be signed by both the Reviewer and the PU.

REPORTING

- i. The Reviewer, after completion of the review, *is required to submit a preliminary report to the PU, on the review of the quality of professional services rendered by the PU, within three weeks from the date of assignment.*
- ii. Any *observation* indicating a non-compliance with the technical standard(s), *should also be included in the preliminary report for seeking final views/comments* of PU thereon.
- iii. The Reviewer, based upon his consideration of the responses received from the PU, shall submit *a final report to the QRB within a period of three months* from the date of assignment by the Quality Review Board.

A clean final report indicates that the Reviewer is of the view that the affairs are being conducted in a manner that ensures the quality of services rendered. However, a Reviewer may qualify the report due to one or more of the following in respect of the particular engagement:-

- non-compliance with ICSI Guidance on Office Administration and Systems in the Office of PCS, ICSI Auditing Standards, Guidance Notes, Manuals, Referencers and advisories issued by the Institute;
- non-compliance with relevant laws and regulations;
- quality control system design deficiency;
- non-compliance with policies and procedures; or
- non-existence of adequate training and capacity building programmes for self and staff.

Cost of the Quality Review

- i. The Quality Review Board shall pay to the Quality Reviewer *a fee of Rs. 25,000/- per quality review* subject to submission of satisfactory Quality Review Report.
- ii. The Quality Reviewer shall bear the cost of local transport, food, communications, printing, cost of submission of report etc.- for Quality Review Assignments within or under the radius of 50 Kms. of the city of residence of Reviewer
- iii. In case the Quality Review Assignment is beyond 50 Kms. of the city of residence of Reviewer, the Quality Reviewer shall be reimbursed over and above the fee of Rs.25,000/-, cost of to and fro travel to the station nearest to the Practice Unit subjected to Quality Review from the

place of his residence, accommodation and other expenses in accordance with the travel policy approved by the Board.

- 1. Mr. X has reviewed M/s. ABC & Co. having three partners Mr. A, Mr. B and Mr. C. Neither Mr. A, Mr. B nor Mr. C will be able to do review of Mr. X. same is the case with Sole Proprietor / members practicing in Individual capacity.*
- 2. If the client of M/s XYZ ask Board to get the Practice Unit Peer Reviewed and then in this case cost of Peer Review shall be borne by the client .*
- 3. Mr. R (Peer Reviewer) received a Peer Review Assignment then in this case he can also refuse to accept / perform the Peer Review assignment after giving a valid reason to the Board. The refusal of assignments can be made on the following grounds: - Conflict of Interest between the Reviewer and PU - Ill Health - Other work or pre-occupations - Reviewer feels that he cannot act independently in that Firm/or with Reviewee due to past connections or so.*
- 4. Mr. Q (Peer Reviewer) received a Peer Review Assignment in this case he shall be allowed to take assistance from any one Qualified Assistant. The Qualified Assistant should be member of the Institute and has undergone adequate training in the manner considered appropriate by the Board in terms of clause 15.1 of the Guidelines.*
- 5. Mr. X has reviewed M/s. ABC & Co. having three partners Mr. A, Mr. B and Mr. C . Mr. X shall be bound by Confidentiality Agreement with the Peer Review Board. If the Reviewer misuses the information disclosed by PU, he may be subject to disciplinary action by the Institute*

SUMMARISED VERSION (MIND MAP)

I. OVERVIEW AND INTRODUCTION: DUE DILIGENCE

- a) Due diligence refers to investigation into the affairs of an entity prior to its acquisition, restructuring, fund raising or other similar transaction.
- b) Companies, before entering into any business relationship, conduct background checks on clients, customers, suppliers, etc. This is done to ensure that the parties involved have provided the necessary information for the transaction and to thoroughly understand a business's capabilities and past performance.
- c) It is process of gathering information about the target company, its business and the environment in which it operates.
- d) **“Due diligence” is an analysis and risk assessment of an impending business transaction.**
- e) It is the careful and methodological investigation of a business to ensure that information is accurate, and there is no information that may later affect the outcome of the transaction.
- f) A Due diligence is an interactive process that includes:
 - a. Inquiring financial and operational data
 - b. Analysing financial and operational data
 - c. Interpreting financial and operating data
 - d. Assessment of risks and opportunities
- g) The due diligence covers the activities relating to pre-transaction, during the transaction and post transaction exercise with all relevant aspects of the past, present, and predictable future of the any business.
- h) In any transaction, the seller does investigation of a buyer to ensure that the buyer has adequate resources to complete the transaction, as well as other business aspect covering the technical and human resource, cultural, taxation etc. which would affect the company after entering into the transaction.

CASE STUDY-Amazon Due Diligence

Amazon began due diligence to buy MX Player In March 2023, Amazon.com Inc. made advanced talks to acquire MX Player, the video streaming platform owned by Times Internet. Amazon owns the subscription streaming service Prime Video and an ad-supported MiniTV service in India. Amazon launched the free MiniTV service in May 2021 within the Amazon shopping app

for phone users. In 2018, Bennett Coleman & Co Ltd (BCCL)-owned Times Internet, acquired MX Player for ₹1,000 crore (around \$140 million at that time) to mark its entry into video streaming. The US e-commerce giant has hired one of the Big Four accounting firms to carry out due diligence of MX Player exclusively, and the process is expected to take 30-40 days. As per the anticipations of experts, a deal could happen within two months if all goes well. Earlier, Times Internet was asking for over \$100 million for MX Player, while Amazon's internal team valued it at around ₹500 crore (\$60 million). The deal is likely to be in the range of ₹600-900 crore.

2. KEY POINTS DESCRIBING DUE DILIGENCE

- It is not limited to accounting analysis but has a business oriented approach;
- It analyses the information on the basis of the actual facts;
- Considers the industry of the target company;
- Examines the business affairs having a significant impact on the prospects of the business;
- Explores significant business practices and business models;
- Examination of relevant aspects of the past, present and near future of the business;
- Assesses the advantages and risks associated with a particular transaction.

3. NEED FOR DUE DILIGENCE

The objective of due diligence may be to:

- i. Identify the significant matters
- ii. Discover Threats and Weakness
- iii. Collect material information
- iv. Developing shareholder's confidence
- v. Ensures security in a particular transaction
- vi. Good investment decision



- i. Generally, the SWOT analysis of any business carried out as a part of due diligence to reveal the strengths and weaknesses of not only the financials but also intangibles.
- ii. To perform effectively, the potential buyer needs to be clear about the goals and motives for acquiring the target company, as well as the value the buyer is attempting to create with the purchase.
- iii. A thorough due diligence helps to reveal any of the negatives, but the process of due diligence rarely goes smoothly because of one major stumbling block and that is availability of information.
- iv. The target company is rarely eager to reveal to the other party that it is up for sale and wants to keep this information confidential from its competitors, customers and employees. So getting any information from these sources can be tricky, depending upon what the potential buyer wants to gain from the transaction.
- v. The buyer who aims to get new market of customers with the transaction wants to make sure that the target company has a good relationship with existing customers. But, during due diligence, the target company does not want any contact with its existing customers for fear that customers might leave because of the impending sale.
- vi. Because of the confidential nature of transactions, not all the information that is necessary to make a good decision can be revealed. This is why services of experts are hired in due diligence before beginning the process so the buyer receives reliable guidance.
- vii. Once a purchase price is agreed upon, the prospective buyer usually enters into a conditional agreement with a due diligence clause with the target business, in which the buyer has a limited period to conduct due diligence.
- viii. During this time, the potential buyer requests full access to all relevant materials in the target business, customer, vendor, financial and other information in order to conduct a thorough investigation. To ensure buyer does not use this information for their benefit, a confidentiality agreement is signed to protect the target businesses' interests.

- ix. *If the information found is not acceptable to the potential buyer, there might be re-negotiation of the initial terms.*
- x. *Again after due diligence, the goal is to either reaffirm the purchase price or renegotiate, depending on what was discovered under Due diligence. But the ultimate goal is to make a rational decision based on the facts.*

Transactions that require proper due diligence:

- i. *Joint Enterprise Collaborations*
- ii. *Partnerships*
- iii. *Mergers and Acquisitions*
- iv. *Strategic Alliance*
- v. *Business Coalition*
- vi. *Outsourcing Agreement*
- vii. *Technology or Product Licensing*
- viii. *Joint venture through Technical or Financial Collaboration*
- ix. *Venture Capital Investment*
- x. *Public Issue etc.*
- xi.

CASE STUDY- PhonePe's due diligence on ZestMoney

In April 2023 the Walmart-backed PhonePe has called off its deal with Zest Money over due diligence concerns. The due diligence that PhonePe carried for nearly six months while evaluating the much-anticipated acquisition of ZestMoney did not meet its bar. ZestMoney facilitates Buy Now Pay Later (BNPL) loans by disbursing the purchase amount from the lending partner directly to the merchant, allowing the customer to repay the lender in installments. PhonePe initiated talks to acquire ZestMoney to bolster its digital lending forays.

CASE STUDY- Hindustan Motors, European partner complete due diligence for EV project

In October 2022, Hindustan Motors Ltd and its European partner have completed due diligence for the proposed electric two-wheeler project. The Joint Venture (JV) is likely to launch the electric vehicles in the next financial year at Hindustan Motors' Uttarpara plant in West Bengal. According to the company's statement, after the formation of JV, around six months are

required to start a pilot run. The structure of the JV is being finalised, including the proportion of equity to be held by the partners.

4. NEED FOR DUE DILIGENCE

- a. To confirm that the business is what as it appears;
- b. To create a trust between two unrelated parties;
- c. To access the risks and opportunities of a proposed transaction;
- d. To reduce the risk of post transaction;
- e. To investigate into the affairs of business as a prudent business person;
- f. To confirm all material facts related to the business;
- g. Representation & warranties for indemnification;
- h. h Negotiation price concessions;
- i. To verify that the transaction complies with investment or acquisition criteria;
- j. To investigate & evaluate a business opportunity;
- k. To determine compliance with relevant laws and disclose any regulatory restrictions on the proposed transaction;
- l. To evaluate the condition of the physical plant and equipment; as well as other tangible and intangible assets;
- m. To ascertain the appropriate purchase price and the method of payment;
- n. To determine details that may be relevant to the drafting of the acquisition agreement.
- o. To discover liabilities or risks that may be deal-breakers;
- p. To analyze any potential antitrust issues that may prohibit the proposed M&A;
- q. To evaluate the legal and financial risks of the transaction.

5. SCOPE OF DUE DILIGENCE

- i. Scope of due diligence is transaction based and is depending on the needs of the people who are involved in the potential investments, in addressing key uncovered issues, areas of concern/ threat and in identifying additional opportunities.
- ii. Due diligence would include thorough understanding of all the obligations of the target company: debts, rights and obligations, pending and potential lawsuits, leases, warranties, all high and

impact laden contracts - both inter-corporate and intra-corporate. The investigation or inspection would cover below mentioned aspects:

- a. To determine tax structure and its implications;
- b. To assist in determining the final value of financial investment;
- c. To determine overvalued assets or under recorded liabilities, hidden assets or liabilities;
- d. Ensuring the all applicable law compliances;
- e. Ascertaining the penalties in case of non- compliances of statutory laws applicable to the company;
- f. Assessing the quality of management and identification of key employees of the Target Company;
- g. To assess the commercial and technical feasibility;
- h. To assess the resource availability of the business;
- i. To synergise between the organisations (In case acquirer company and target company);
- j. Litigation and assessment of feasibility of pursuing litigation;
- k. Financial statements;
- l. Assets - real and intellectual property, brand value etc.;
- m. Unpaid tax liens and/or judgments;
- n. Past business failures and consequential debt;
- o. Exaggerated credentials/Fraudulent claims;
- p. Misrepresentations or character issues;
- q. Cross-border issues - double taxation, foreign exchange fluctuation, sovereign risk, investment climate, cultural aspects.
- r. Reputation, goodwill and other intangible assets.

CASE STUDY-Silicon Valley

- i. Silicon Valley has gained a reputation for being home to numerous "unicorn" companies, startups valued at over \$1 billion. While these companies may appear to be the future of tech innovation, they often have inflated valuations that are not supported by their financial performance. This is partly due to a lack of due diligence from investors who are eager to get in on the ground floor of the next big thing.

- ii. Despite the importance of Due Diligence, many investors in Silicon Valley have been criticized for neglecting due diligence in their eagerness to invest in the next “unicorn” startup. Through this case the importance of due diligence is re-iterated. Proper due diligence can help investors make informed decisions and avoid costly mistakes, leading to more sustainable growth and long-term success.

6. ADVANTAGES OF DUE DILIGENCE

- a. It analyses who administers, owns and run the organisation.
- b. It examines the company and the market in a contrast way to assess the volatility of the market.
- c. It researches about the competitors of the target company existing in the market.
- d. It reviews the financial statements of the company such calculating debt equity ratio, etc.
- e. It examines the rise or fall in revenue/profits of the company.

CASE STUDY – Zee Entertainment – Sony India Merger

- i. Zee Entertainment Enterprises Limited (ZEEL) and Sony Pictures Networks India (SPNI), two of India’s biggest media conglomerates, have taken the first steps towards a multibillion-dollar merger. The Zee board of directors approved the merger between the two companies. The agreement has the potential to make the newly created company one of the country’s largest and most sought after.
- ii. Sony Pictures Entertainment would invest \$1.575 billion in the newly consolidated firm as part of the acquisition.
- iii. On September 22nd, Zee’s board of directors gave in-principle permission for the execution of a non-binding term sheet with SPNI. In addition, the two parties will sign a non-compete agreement.
- iv. With the Zee-Sony merger, viewers of the Sony network in India will gain access to over 260,000 hours of Zee television content and also its film library with rights to more than 4,800 movie titles across languages.
- v. On the cost front, the merged entity will have an advantage. In terms of content offering, Sony is strong in General Entertainment and Sports and Zee has an edge in regional content.

vi. With this merger Zee has gained access to Sony's 10 sports channels

7. BENEFITS OF DUE DILIGENCE

- i. Administration & ownership: Analysing who runs the organisation
- ii. Capitalisation: Contrastive Analysis of market and company
- iii. Competitive environment: Researching about the competitors in market
- iv. Reviewing Financial Statements: Interpretation of debt and equity ratios
- v. Revenue and Profits
- vi. Ascertaining the growth of the company

8. FACTORS TO BE KEPT IN MIND WHILE CONDUCTING DUE DILIGENCE

1. Objectives and purpose

A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction because the entire aim of due diligence is to provide the party proposing the transaction with sufficient information to make a reasoned decision as to whether or not to complete the transaction as proposed.

The following factors may be kept in mind in this regard:

- (i) Be **clear about your expectations** in terms of revenues, profits and the probability of the target company to provide you the same.
- (ii) Consider whether **you have resources to make the business succeed** and whether you are **willing to put in all the hard work**, which is required for any new venture.
- (iii) Consider whether the **business gives you the opportunity to put your skills and experience to good use**.
- (iv) **Learn** as much as you can **about the industry you are interested in** from media reports, journals and people in the industry.

2. Planning the schedule

Once it is decided for a particular business, make sure of the following things:

- a. Steps to be followed in due diligence process
- b. Areas to be checked
- c. Aspects to be checked in each area

d. Information and other material to be requested from the seller

3. Negotiation for time

Sometime sellers might rush the process but when the seller gives a short review period, negotiations can be made for adequate time to have a complete review on crucial financial and legal aspects.

4. Risk Minimisation

All the information should be double checked- financials, tax returns, patents, copyrights and customer base to ensure that the company does not face a lawsuit or criminal investigation. Since, due diligence exercise deals with the overall business, it is important to consider aspects such as:

- background of promoters
- performance of senior management
- team organizational strategy
- business plans
- risk management system
- technological advancement
- infrastructure adequacy
- optimum utilization of available resources.

5. Information from external sources

The company's customers and vendors can be quite informative. It may be found from them whether the target company falls in their most favored clients list. Any flaws that the audit uncovers help to re-negotiate down the sale price.

6. Limit the report with only material facts

While preparing the report it is advisable to be precise and only the information that has a material impact on the target company is required to be included.

7. Structure of information

Once the due diligence process is over, while preparing the report, information has to be structured in an organized manner in order to have a better correlation on related matters.

Challenges in conducting due diligence

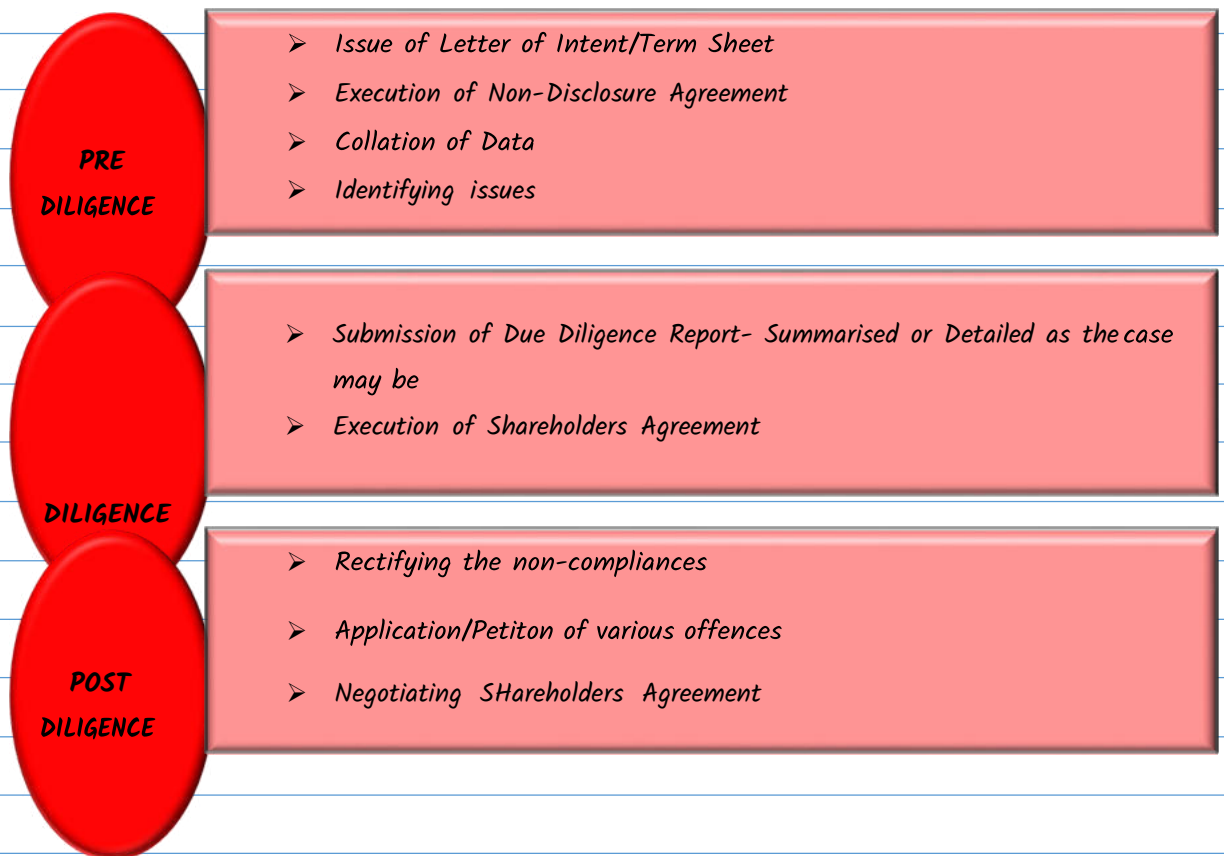
A professional may face many challenges while conducting due diligence, few examples of which are following:

- i) **Non-availability of the information or incomplete information:** For eg. Non availability of evidence related to compliances. While dealing with difficulty, he can try to find the alternate source of getting the information.
- ii) **Lack of time:** Many a times a professional cannot check all the information due to paucity of time. A professional may confine the scope of checking in this scenario.
- iii) **Non-cooperation by the employees:** It is possible that few of the employees may start noncooperating as this may lead to focus on their mistakes. Reporting to the concerned authority may be a good solution in this scenario.

9. PROCESS AND STAGES OF DUE DILIGENCE

A due diligence process can be divided into three stages i.e.

- (i) Pre Diligence,
- (ii) Diligence, and
- (iii) Post Diligence



1. STEP 1: Pre diligence

A pre diligence is primarily the activity of management of paper, files and people.

i. Signing the Letter of Intent (LOI):

The first and foremost step for the management of the target company, is that the investor is to sign a Letter of Intent (LOI) or a term sheet which underlines the various terms on which the proposed deal is going to be concluded. It includes:

Scope

- Areas to be covered;
- Manner of maintenance and collection of data;
- Final work product-
 - Due Diligence Report
 - Only Executive Summary
 - Comprehensive Bible with Executive Summary, detailed report on all segments, data sheets
- Timelines - Time within which the exercise is to be complete.

ii. **Execution of the Non-Disclosure Agreement (NDA)/ Engagement letter:**

After the receipt of the LOI the investors sign an NDA with the various agencies who is going to conduct the due diligence, be it finance, accounting, legal or a secretarial diligence.

iii. **Receipt of documents from the company and review of the same with the checklist of documents already supplied to the company:**

The company would usually receive a checklist from the agency conducting the diligence. The checklist is invariably exhaustive in nature, and therefore, the company may either collate and compile the documents in-house or outsource this to an external agency.

iv. **Identifying the issues:**

The next step is to identify the issues existing therein that may be relevant.

v. **Organising the papers required for a diligence:**

The next is to organise all the paper, documents and information requisite for conducting due diligence.

vi. **Creating a data room:**

While the data is being collated care should be taken to ensure that there are no loose ends that may probably arise.

Key points to be considered in regard to data room:

Some of the important things that one should take cognizance of from the corporate viewpoint are the following:

- Do not delay deadlines (leads to suspicion).
- Mark each module of the checklist provided separately.
- In case some issues are not applicable spell it out as "Not Applicable".
- In case some issues cannot be resolved immediately, admit it.
- Put a single point contact to oversee the process of diligence.
- Keep a register, to track people coming in and going out.
- An overview on the placement of files.
- Introduction to the point person.

During the diligence, care should be taken to adhere to certain hospitality issues, like:

1. Be warm and receptive to the professionals who are conducting diligence.
2. Enquire on the Due Diligence team.
3. In case of any corrections - admit and rectify.

Getting Ready Components of the Deliberative Overview

- (a) Transaction Structure i.e. concerned parties, whether structured as share or asset purchase, tax considerations, restrictive covenants, etc.;
- (b) Transaction Funding i.e. how is funding contemplated and preliminary consideration of any significant issues in respect thereof;
- (c) Regulatory Issues such as restriction on foreign holding, subsidiaries, approvals, competition law issues and foreign exchange considerations;
- (d) International Aspects including the question of engaging overseas professional advisers;
Timelines i.e. determination of time schedules for various stages of the contemplated Transaction;
- (e) Confidentiality Agreements i.e. whether Target seeks powers to restrict the release of certain information or data and review of covenants in relation thereto (Particularly in a listed company);
- (f) Exclusivity or Lock-In Arrangements as per negotiations between the parties;
- (g) Data Room Guidelines regarding the due diligence process on Target entity;
- (h) Overall Due Diligence Strategy and consideration of the due diligence checklist as is usually circulated prior thereto; and
- (i) Specialized Issues such as industry-segment and relevant sector-specific issues including any specialized legislative requirements and such other details.

2. STEP 2: Diligence Report

After the diligence is conducted, the professionals submit a report which in common parlance which is called as Due Diligence report which would typically consist of the following three sections: -

- a. **Executive Summary:** This draws to the attention of the Acquirer, any items of concern or otherwise requiring attention and could usually start with the most critical points or deal breakers.
- b. **Main Body:** This would ideally follow the order and headings of the terms of reference or the checklist.
- c. **Appendices:** This section includes data sheets and/or documentation which are relevant to a critical issue.

OUTCOMES OF DUE DILIGENCE REPORTS

- **Deal Breakers:** In their report, the findings can be very glaring and may **expose various non-compliances that may arise** - any criminal proceedings or known liabilities.
- **Deal Diluters:** The findings arising out a diligence may contain violations which may **have an impact in the form of quantifiable penalties** and in turn may result in **diminishing the value of company.**
- **Deal Cautioners:** It covers those findings in a diligence which may not impact the financials, but there exist certain non-compliances which though **rectifiable, require the investor to tread a cautious path.**
- **Deal Makers:** are those reports wherein the diligence team have not been able to come across any violations, leading them to submit what is called a 'clean report'.

3. Post Diligence

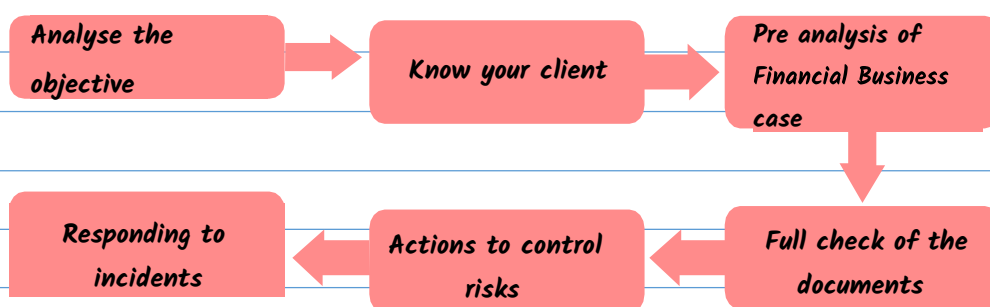
Post diligence result in rectification of non-compliances found during the course of due diligence.

10. TECHNIQUES OF DUE DILIGENCE AND RISK ASSESSMENT

Due diligence and risk assessment and control represent separate and distinct processes that take place prior to the commencement and throughout the duration of a commercial agreement respectively. The Due diligence and risk assessment and control processes are central to good business practice. These processes are particularly important in taking leadership in the market and charge premium rate services. Where services are delivered to clients through Associates, which can, on occasion, include many different parties, the professional should prior to

contracting with such party write down the expectation from such party in the process of due diligence.

All parties in the Due diligence team should be confident that the established team is for good positive business and industry-wide growth. Such processes are built on the following cornerstones:



Evaluation of the objective of the plan: The first step is to determine the main objective of the project which helps in ascertaining the exact information required that align with organisation's strategy.

Know your client - All businesses have risks, and these can vary significantly dependent on the nature of the company and the services being operated. It is important to know your client so you can properly identify the risks involved and assess how to manage them. This is not to limit or prevent commercial relationships forming but to ensure they are properly managed whether an issue ultimately arises or not.

Examination of Financials of the organisation: It examines the financial records of the organisation that helps in assessing the financial performance, asset health and stability of the organisation. Some of the Items inspected here include:

- Balance sheets and income statements
- Inventory schedules
- Future forecasts and projections
- Revenue, profit, and growth trends

- *Stock history and options*
- *Short and long-term debts*
- *Tax forms and documents*
- *Valuation multiples and ratios in comparison to competitors and industry benchmarks.*

Inspection of documents: *The next step is to review all the documents/information records made available to get a better understanding of the organisation and it help to determine the growth and value of the business of the organisation.*

Actions taken to control any risk: *once risks are identified, industry members must make a proper assessment of the issues that would arise if incidents occur and take proportionate steps to minimise the likelihood of such issues resulting in consumer harm. Good process planning and/or staff training may have a positive impact on a company's ability to respond effectively when incidents do occur.*

The formulation of an action plan could be based on the following:

- *To periodically test and/or monitor certain 'risks' that would normally be associated to a particular service category (e.g. for a subscription service, it may be prudent to test the clarity of promotions, whether reminder messages have been sent, with delivery confirmation noted, and that 'STOP' commands have been properly processed);*
- *The frequency of such testing should reflect the risk posed by both the client and the service type. For example, a client with no breach history, or where none of the directors are linked to other companies with breaches, and low- risk service types (such as football score updates), would require far less monitoring than a client with an extensive breach history that provides a high- risk category of service (e.g. a subscription-based lottery alerts system with a joining fee);*
- *'Mystery shopper' testing could be used as and when appropriate;*
- *Internal mechanisms to enable 'whistle-blowing' by staff, where appropriate;*
- *Putting in place internal checks that correlate with unusual patterns of activity which may indicate consumer harm (e.g. spikes in traffic and/or consumer complaints made directly to the provider about one specific service);*

- Having a procedure to alter and address instances of non-compliant behaviour; Monitoring of the client's service to ensure that any directions given by the Phone-paid Services Authority have been complied with;
- Producing a compliance file, comprising of a written record of the assessment, the subsequent action plan and evidence of any monitoring and/or testing required by the plan having taken place. This record does not necessarily need to be lengthy (although this will depend on the client and the actions taken under the plan) but should be made available to the Phone-paid Services Authority upon request.

Responding to incidents - even where a business makes significant effort to comply with regulations and legal requirements, they may not be immune to problems arising. Providers ought to be prepared to respond calmly and proactively to incidents, working closely with the regulator and other parties in the value chain to identify, mitigate and correct any fallout, providing support to consumers. Breaches ought to be identified and acknowledged quickly when they arise so that they can be remedied and services are therefore delivered to a high standard to consumers.

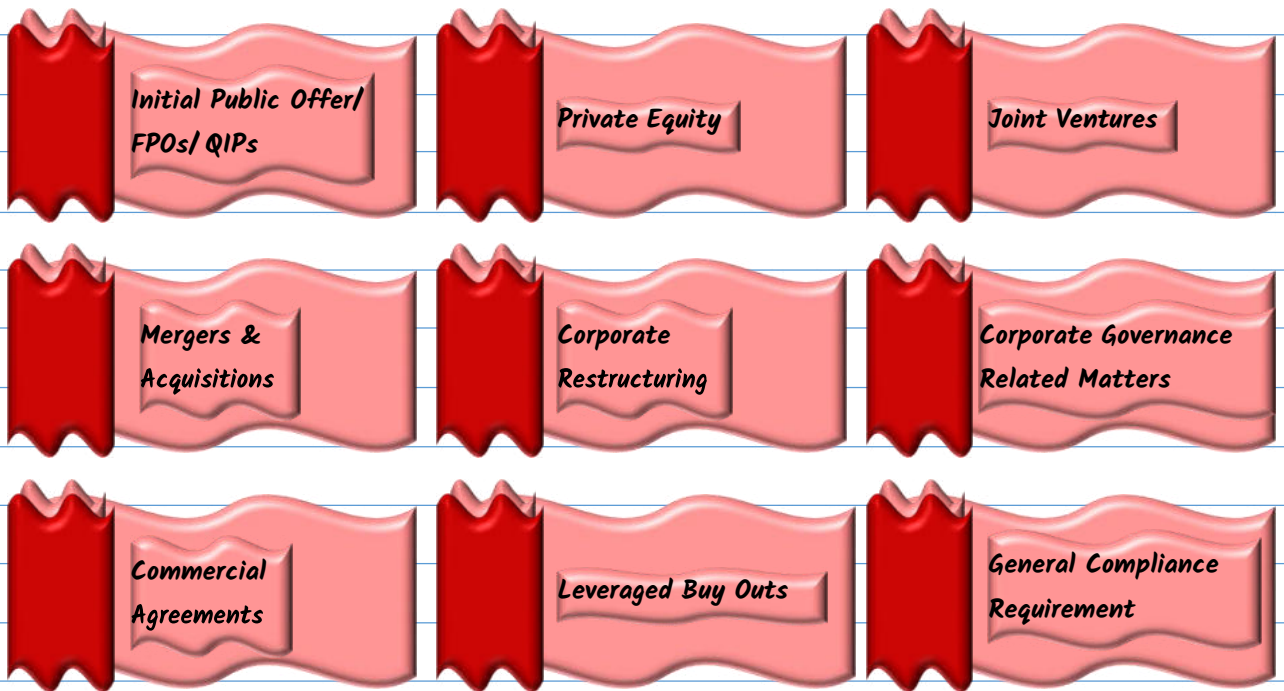
II. TYPES OF DUE DILIGENCE

LEGAL DUE DILIGENCE

- i. A legal due diligence covers the legal aspects of a business transaction, liabilities of the target company and other related issues.
- ii. Legal due diligence covers intra-corporate and intercorporate transactions.
- iii. It includes preparation of regulatory checklists, meeting with personnel, independent check with regulatory authorities etc and verification of following document.
 - a. Copy of Memorandum and Articles of Association;
 - b. Minutes of Board Meeting for the last three years;
 - c. Minutes of all meetings or actions of shareholders;
 - d. Copy of share certificates issued to Key Management Personnel;
 - e. Copy of all guarantees to which company is a party;
 - f. All material contracts;

- g. Copies of all loan agreements, bank financing agreements, line of credit to which company is a party;
- h. Status of the order, awards issued by the various regulators and courts;
- i. Status of Pending litigations;
- j. Organisational chart;
- k. Returns filed with ROC;
- l. Search/status report if any;
- m. Details of branches and subsidiaries;
- n. Registrations documents under various laws;
- o. Documents/reports filed with stock exchanges;
- p. Related party transactions;
- q. Contracts and loans with directors;
- r. Borrowings and investment of the company;
- s. Matters like IPO, FPO, Prospectus, etc. in compliance with SEBI regulations;
- t. Maintenance of statutory registers, minute books, etc.;
- u. Public deposits;
- v. Distribution of dividend.

TRANSACTIONS COVERED UNDER LEGAL DUE DILIGENCE



12. SCOPE OF LEGAL DUE DILIGENCE

Legal Due Diligence assesses the regulatory compliances applicable to the company under various laws such as:

- Company Law
- Income Tax Law
- Labour Law
- RERA Act S
- EBI Act, their rules and regulations
- Insurance Act
- RBI Act
- FEMA Act
- Intellectual Property Law etc.

DUE DILIGENCE FOR MERGER & AMALGAMATION

- i. The due diligence provides an assurance in taking decisions considering the factors which may be a potential deal-killers/shapers and provide assurances that the acquisition is the right decision at the right price.
- ii. Due diligence also provides management an insight, holistic view of the target company that helps in the easy integration of the target's people and business.
- iii. Due diligence in mergers not only requires the assessment of the financial, legal, and regulatory exposures but also requires insights into the target company's structure, operations, culture, human resources, supplier and customer relationships, competitive positioning and future outlook.

Due Diligence Process in the M&A Strategy

Stages	For Buyer	For Seller
Preparation Stage	<ul style="list-style-type: none"> ● M&A strategy formulation ● Preparation of list of potential Targets ● Appoint external advisor for evaluation of targets ● Short list targets ● Create due diligence team 	<ul style="list-style-type: none"> ● Structure a business plan ● Preparation of list of potential buyers ● Appoint external advisor ● Shortlist buyers
Pre Diligence	<ul style="list-style-type: none"> ● Approach targets ● Negotiation of initial terms ● Execute non-disclosure agreement ● Compliation of list of data required 	<ul style="list-style-type: none"> ● Approach buyers ● Negotiate initial terms ● Execution of non disclosure agreement ● Creation of data room
Due Diligence	<ul style="list-style-type: none"> ● Inspection of data room ● Analysis of private documents ● Evaluation of risk and return ● Structure the terms and conditions 	<ul style="list-style-type: none"> ● Assistance in data room ● Setting deadlines for offer
Negotiations	<ul style="list-style-type: none"> ● Make final offer ● Negotiate and agree on terms 	<ul style="list-style-type: none"> ● Compile final offers ● Select best offer ● Negotiations

Post Diligence	<ul style="list-style-type: none"> • Post merger integration and cultural adjustments 	<ul style="list-style-type: none"> • Termination of data room and ownership exchange
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DUE DILIGENCE FOR TAKEOVERS

- i. Takeover of companies whose securities are listed on one or more recognized stock exchanges in India is regulated by the provisions of the Listing Agreements with various stock exchanges and the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
- ii. The compliances under the regulations include event based/continual disclosures, open offer requirements including public announcement, escrow account, obligations of acquirer/target company/merchant banker, undertaking/ authorization, offer price etc.
- iii. Taking over a company brings inevitable risk, some of which can cause great detriment to the company. Due diligence allows the company to avoid a tragic end after being taken over.
- iv. The Takeover Due diligence is generally conducted in different domains; Financial, Legal, Taxation, social life, environment, etc.
- v. The Takeover Due diligence covers the history of the company, past performance, the present, and the future of a company.
- vi. Takeover due diligence is useful in allowing the buyer to confirm his or her decision of the sale, or in negotiating the conditions of the sale.
- vii. Takeover due diligence is important for an organisation as it gives an overall view of target enterprise, according to which the buyer will be able to analyze the potential of the target company while understanding the risks related in taking it over.
- viii. This due diligence will be performed once an agreement is signed or after the letter of intent. It will allow verification of the elements being negotiated between the parties, producing an accurate reflection of the current state of the target company.

CASE STUDY

In the case of *Nirma Industries and Anr. v. Securities Exchange Board of India*, Nirma Industries sought withdrawal of an open offer under Regulation 27(d) of the Takeover Regulations on the ground that the promoters of the target company had committed a fraud and had embezzled funds. Nirma Industries applied to SEBI to allow the withdrawal of the open offer. The Supreme Court however rejected all the contentions of Nirma Industries and held that an investing company is responsible for its own decision to invest and should carry out appropriate diligence. The Court stated that Nirma Industries were aware of various litigations, the plea of ignorance of litigation and dangers of investment was thereby denied

DUE DILIGENCE FOR ISSUE OF SECURITIES

A public company may issue securities to public through prospectus - Public offer by complying with the provisions of companies Act 2013, Prospectus and Allotment of Securities or through private placement, Prospectus and Allotment of Securities or through a rights issue or a bonus issue in accordance with the provisions of the Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder, the key regulation governing the issue of securities and preparation of financial information are:

- The SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009/2018
- The SEBI (Listing Obligation and Disclosure Requirement) Regulations, 2015

A private company may issue securities by way of rights issue or bonus issue in accordance with the provisions of the Act or through private placement.

The scope and comprehensiveness of the Issue of Securities due diligence is important not only from a legal standpoint to avoid liability but also from a reputational perspective as the reputation of the company and its promoters and other participants may be significantly vanished, if on a later date it appears that the company and other participants failed to uncover and disclose to prospective investors critical issues relating to the issuer or the Securities.

While the specific requirements in connection with issue of securities are different under the Companies Act, 2013 and SEBI Laws & Regulations made thereunder, any non-compliance in these regulations are generally impose liability if the offering memorandum or prospectus

contains a materially incorrect or misleading statement or omits a material fact, however in certain conditions the complete issue of securities stand cancelled. The violation of any applicable liability provisions may result in liability for offering participants, in particular the issuer and the underwriters. These liability provisions emphasize the need for careful preparation of all materials to be used in issue of securities offerings, in particular the offering memorandum or prospectus.

INTELLECTUAL PROPERTY LAW

- i. The company which owns Intellectual Property (IPs) use there IPs to monetize their business.
- ii. These IPs are something that differentiates their product and service from their competitors.
- iii. The main objective of intellectual property due diligence is to ascertain the nature and scope of target company's right over the intellectual property to evaluate the validity of the same and to ensure whether there are no infringement claims.
- iv. Few of the items that need to be seen while conducting due diligence is:
 - a. A schedule and copies of all consulting agreements, agreements regarding inventions, licenses, or assignments of intellectual property.
 - b. Schedule of patents and its application.
 - c. Schedule of copyrights, trademarks and brand names.
 - d. Pending patents clearance documents.
 - e. Any pending claims case by or against the company in violation of intellectual property.
 - f. Details of Indian and international patents with the company.
 - g. Details of threatened claims if any.

ENVIRONMENT LAW

List of important statutes for environment protection in India:

- The National Green Tribunal Act, 2010
- The Air (Prevention and Control of Pollution) Act, 1981
- The Water (Prevention and Control of Pollution) Act, 1974
- The Environment Protection Act, 1986
- The Wildlife Protection Act, 1972
- The Forest Conservation Act, 1980

- *Public Liability Insurance Act, 1991*
- *The Biological Diversity Act, 2002.*
- *Environmental due diligence analyses environmental risks and liabilities associated with an organisation.*
- *Environmental due diligence provides the acquirer with a detailed assessment of the historic, current and potential future environmental risks associated with the target organisation's sites and operations.*
- *It involves risk identification and assessment with respect to:*
 - *Details of environmental permits and licenses.*
 - *Hazardous substances used in the Company's operations.*
 - *Copies of all correspondence with environment authorities.*
 - *Litigation or investigations if any on environmental issues.*
 - *Contingent environmental liabilities or continuing indemnification obligations, if any.*
 - *Review of the environmental setting and history of the site.*
 - *Assessment of the site conditions.*
 - *Operations and management of sites.*
 - *Confirm legal compliance and pollution checks from regulatory authorities etc.*

Things to be reviewed by the management

- *List of environmental permits and licenses and validities of the same.*
- *All correspondence and notices with EPA, state, or local regulatory agencies.*
- *Whether the company's disposal methods of various by products are in sync with the regulated guidelines.*
- *Whether there are any contingent environmental liabilities or continuing indemnification obligations.*

LABOUR LAWS

List of major labour laws in India:

- *Employees Compensation Act, 1923*
- *Payment of Wages Act, 1936*

- Minimum Wages Act, 1948
 - Factories Act, 1948
 - Maternity Benefits Act, 1961
 - Payment of Bonus Act, 1965
 - The Payments of Gratuity Act, 1972
 - Employees State Insurance Act, 1948
 - Industrial Disputes Act, 1947
 - Trade Unions Act, 1926
 - The Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013
- i. The purpose of a labour due diligence is to **identify gaps before an authority audit, any non-compliances relating to the inappropriate application of labour law regulations and to allow company to correct errors and deficiencies.**
- ii. The scope of the labour law due diligence **extends to all the labour & employment related central, state and local laws, rules and regulations applicable to the company.**
- iii. During the payroll and labour due diligence **the auditor should examine and review the following areas:**
- Labour law regulations and agreements;
 - Employment contracts, amendments to employment contracts;
 - Information, job descriptions;
 - Legal declarations/agreements regarding termination of employment;
 - Maintenance of records Labour law regulations and agreements;
 - Employment contracts, amendments to employment contracts;
 - Information, job descriptions;
 - Legal declarations/agreements regarding termination of employment;
 - Maintenance of records.

COMPETITION LAW

- i. Due diligence on competition law aspects is an **examination of the actual operations and practices of an enterprise to determine the extent of its compliance with the competition law**

and to identify potential risks and liabilities and assess the adherence to and effectiveness of the company's competition law compliance policy and training program.

- ii. Primary components of Competition Law due diligence are:
 - a. An **examination of selected company documents.**
 - b. **Interviews** with selected company personnel.
 - c. **Identify specific business activities** that potentially could create antitrust exposure for the company.
 - d. The **results of the due diligence may suggest an enterprise to have an effective competition law compliance programme.**
 - e. The **results of the due diligence may result in variation of deal value**, withdrawal of deal and also make suggestions to structure a compliance program.
 - f. **How to go about the process of due diligence of competition law.**

Due diligence of competition law may be made under the following heads:

1. Due diligence of various agreements (both existing and proposed)
2. Due diligence on dominance and its likely abuse if any, (existing)
3. Due diligence on combinations (i.e. effect of proposed Mergers & Acquisition).

Due Diligence of various agreements includes:

- a. Agreements relating to production, supply and distribution of goods or services
- b. Agreement if any with competitor relating to production, marketing or bidding, price etc.
- c. Agreements with customers and distributors.
- d. Purchase agreements.
- e. Non-compete covenants.
- f. Technology transfer/technical know-how agreements.
- g. Concession agreements

Due diligence on abuse of dominance, if any includes

- a. Examination as to the existence of dominance.
- b. Examination of relevant market, whether product or geographical Areas.
- c. Cases of abuse if any

Due diligence on regulation of combinations

- a. Nature of combination
- b. Acquisition of share, voting rights, assets or control or merger/amalgamation etc
- c. Examination of total value of Assets or Turnover and the valuation methodology.
- d. Status of merger notification to be filed with CCI
- e. Status of dominance after merger

FEMA DUE DILIGENCE

- i. Foreign Exchange Management Act (FEMA) is the legislation which governs the foreign currency in India.
- ii. The **main aim of FEMA is to facilitate external trade, balance the payments, promote the orderly development**, and maintain the foreign exchange market in India.
- iii. The FEMA Due diligence helps to avoid damaging circumstances and is helpful in ensuring compliance of Foreign Exchange laws.
- iv. The FEMA Due diligence covers all types of cross border transactions - import, export, debt funding, equity capital infusion, transfer of shares etc.

The following are covered under the FEMA Due diligence:

- Capital Accounts transactions
- Current account transaction
- Currency Transactions
- Regulations Master Directions and Circulars issued by RBI
- FDI Policy, approvals
- Setting up of Business through Liaison office, Branch office, project office, wholly owned subsidiaries, joint ventures, foreign institutional investors, and foreign venture capital investor, Non-Resident of India/ person of Indian origin.

FCRA DUE DILIGENCE

- a. The FCRA legislation state that an **organization cannot receive funding from a foreign source, unless it is registered under the Foreign Currency (Regulations) Act, 2010 or has obtained special government approval for a specific project.**

- b. The registered NGOs need to comply with various post-registration requirements, as detailed in the provisions of the Act and its rules of enforcement.
- c. NGOs in India are categorized under three legal categories: society, trust, and a limited company.
- d. The Income Tax Department (IT Department) and Ministry of Home Affairs regulate registration and require all NGOs to file annual tax returns and submit audited account statements to their respective agencies.
- e. The most important reporting requirement under the FCRA is the submission of annual returns.
- f. All NGOs are required to submit their annual returns to the central government (MHA) within nine months from the closure of the previous financial year.

OTHER BUSINESS LAWS

The business in India is regulated through various laws and regulations that secures sustainable development of the business and society as well. Apart from corporate and taxation laws there are other laws and regulations that keep a check on the business organisation.

- Registrations and approvals from various statutory authorities.
- Compliance under pollution control laws.
- Issues relating to immovable properties, title deeds, etc.
- Compliance under FEMA and Insurance Laws etc.
- Factories Act, 1948.
- Real estate and construction law.
- Labour and employment law.
- International business law.

FINANCIAL DUE DILIGENCE

- Financial Due Diligence checks whether the financials showcased in the Information Memorandum is correct or not.
- It involves review of the company's projection and basis of such projections, capital expenditure plan, schedule of inventory, debtors and creditors, etc.
- It also provides a deep understanding of all the:

- i. Company's financials, including but not restricted to audited financial statements for last three years, recent unaudited financial statements with comparable statements of last year,
- ii. review of accounting policies,
- iii. review of internal audit procedures, quality and sustainability of earnings and cash flow, condition and value of assets, potential liabilities, tax implications of deal structures,
- iv. examination of information systems to establish the reliability of financial information, internal control systems etc.

The Financial Due Diligence can further **extended to tax due diligence** which covers the Diligence on various taxes the company is required to pay. The tax due diligence comprises an analysis of:

- tax compliance
- tax contingencies and aggressive positions
- transfer pricing
- identification of risk areas
- tax planning and opportunities.

COMPONENTS OF FINANCIAL DUE DILIGENCE

- Sustainable / normalised earnings
- Sales trends – by segment product geographies diligence Sales trends – by segment, product, geographies
- Customer / product profitability
- Overheads – fixed vs. variable
- Balance sheet – fixed assets, borrowings, working capital
- Unrecorded liabilities
- Commitments, contingencies
- Accounting policies
- Management BOD control environment Corp Governance
- Relationship between profit and operating cash flows
- Reliance on debt funds and usage of debt
- Debt repayment and potential debt trap

- Working capital lock up.

FOCUS AREAS OF FINANCIAL DUE DILIGENCE

QUALITY OF EARNINGS, GROSS MARGIN & CASH FLOWS

QUALITY OF ASSETS- WORKING CAPITAL

NET DEBT

POTENTIAL LIABILITIES & COMMITMENTS

SEPARATION/ STRUCTURING/ INTEGRATION ISSUES

RELATED PARTY TRANSACTIONS

Quality of earnings, gross margin & cash flows

- Identification of seasonable sales
- Growth rate in gross margins
- Change in margins with cost variances
- Impact of standalone costs
- Impact of foreign exchange rate fluctuations
- GAAP Applications
- Revenue Recognitions
- Recurring /non-recurring expenses
- Cash flows from operations - stability, timing and certainty
- Capitalisation of assets/ WIP

- *Assets on lease/used but not owned /owned but not used.*

Quality of assets - working capital

- *Inventory Turnover ratio,*
- *Current Ratio,*
- *Debtors outstanding for more than and less than six months*
- *Cheques issues but not cleared*
- *Valuation of WIP*
- *Seasonal impact on working capital*

Net Debt

- *Transactions on cash/credit basis*
- *Debt-like items (pension underfunding, severance and other non-operating liabilities)*
- *Loan Agreements*
- *Complying with Debt Restructuring schemes.*

Potential liabilities & commitments

- *Contingent liabilities and off balance sheet items*
- *Pension and related obligations*
- *Conservative Policy*
- *Aggressive Policy*
- *Off Balance sheet items*

Separation/ Structuring/ Integration Issues

- *Changes in supply chain management*
- *MIS and accounting systems*
- *Standalone considerations (impact of economies of scale, support functions)*
- *Synergies*
- *Transition services agreement*

Related Party Transactions

- *Transaction at arm length basis*
- *Resources and cost sharing with related parties*
- *Financing arrangements with related parties*

BANK DUE DILIGENCE

The Bank conduct due diligence whenever the company intends to borrow the money from the bank. The main objective of conducting due diligence by the bank are:

- Verification of details of directors/promoters*
- Statutory and procedural compliances by the company*
- Examining the existing or previous charges created by the company in respect of loans and their satisfaction.*
- Knowing the defaulting status of the directors, etc.*

Period of Reporting Annex.

The Diligence Report shall be made on a **half yearly basis.**

Right to Access Records and Methodology for Diligence Reporting

- PCS should have access at all times to the books, papers, minutes books, forms and returns filed under various statutes, documents and records of the company which he considers essential for the purposes of Diligence Reporting.*
- The PCS shall be entitled to require from the officers or agents of the company, such information and explanations as the PCS may think necessary for the purpose of such Reporting.*
- However, depending on the facts and circumstances he/she may obtain a letter of representation from the company in respect of matters where verification by PCS may not be practicable, for example matters like —*
 - show cause notices received;*
 - persons and concerns in which directors are interested, etc.*

Reporting with Qualification

- The qualification, reservation or adverse remarks, may be stated by the PCS in **bold or in italics.***

- ii. If the PCS is **unable to form any opinion with regard to any specific matter**, the PCS shall **state clearly the fact that he is unable to form an opinion** with regard to that matter and the reasons thereof.
- iii. If the scope of work required to be performed, is restricted on account of **limitations imposed by the company or on account of circumstantial limitations** the Report shall indicate such limitation.
- iv. If such **limitations are so material** as to render the PCS incapable of expressing any opinion, the PCS should state that:
“in the absence of necessary information and records, he is unable to report compliance(s) or otherwise by the Company”.
- v. PCS shall have due regard to the circulars and/or clarifications issued by the Reserve Bank of India from time to time. It is recommended that a specific reference of such circulars at the relevant places in the Report shall be made, wherever possible.

Professional Responsibility and Penalty for False Diligence Report

Company Secretaries must take adequate care while issuing Diligence Report. Any failure or lapse on the part of a Practising Company Secretary (PCS) in issuing a Diligence Report may not only attract penalty for false Reporting and disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980 but also make him liable for any injury caused to any person due to his / her negligence in issuing the Diligence Report.

Disqualifications of Secretary in Whole-Time Practice

With a view to ensure that PCS shows utmost integrity and independence of judgement in the performance of his/her duties, it is desirable that he/she, should not accept any assignment for giving Diligence Report to a Bank, if he/ it is-

- (a) a body corporate;
- (b) an officer or employee of the company;
- (c) a person who is a partner, or who is in the employment, of an officer or employee of the company;

- (d) a person who is indebted to the company for an amount exceeding one thousand rupees, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding one thousand rupees;
- (e) a person holding any security of that company which carries voting rights.

Format of Diligence Report (ANNEXURE 3 TO RBI CIRCULAR)

To

The Manager,

----- (Name of the Bank)

I/We have examined the registers, records, books and papers of Limited having its registered office at as required to be maintained under the Companies Act, 1956 / 2013 (the Act) and the rules made thereunder, the provisions contained in the Memorandum and Articles of Association of the Company, the provisions of various statutes, wherever applicable, as well as the provisions contained in the Listing Agreement/s, if any, entered into by the Company with the recognized stock exchange/s for the half year ended on

In my/our opinion and to the best of my/our information and according to the examination carried out by me/ us and explanations furnished to me/us by the Company, its officers and agents. I/We report that in respect of the aforesaid period:

1. The management of the Company is carried out by the Board of Directors comprising of as listed in Annexure, and the Board was duly constituted. During the period under review the following changes that took place in the Board of Directors of the Company are listed in the Annexure, and such changes were carried out in due compliance with the provisions of the Companies Act, 1956 (Now Companies Act 2013).
2. The shareholding pattern of the company as on was as detailed in Annexure During the period under review the changes that took place in the shareholding pattern of the Company are detailed in Annexure
3. The company has altered the following provisions of

- (i) The Memorandum of Association during the period under review and has complied with the provisions of the Companies Act, 1956 (Now Companies Act, 2013) for this purpose.
- (ii) The Articles of Association during the period under review and has complied with the provisions of the Companies Act, 1956 (Now Companies Act, 2013) for this purpose.
4. The company has entered into transactions with business entities in which directors of the company were interested as detailed in Annexure
5. The company has advanced loans, given guarantees and provided securities amounting to Rs. to its directors and/or persons or firms or companies in which directors were interested, and has complied with Section 295 of the Companies Act, 1956. (Now to be in compliance with Section 185 of Companies Act, 2013).
6. The Company has made loans and investments; or given guarantees or provided securities to other business entities as detailed in Annexure and has complied with the provisions of the Companies Act, 1956. (Now to be in compliance with Section 186 of Companies Act, 2013).
7. The amount borrowed by the Company from its directors, members, financial institutions, banks and others were within the borrowing limits of the Company. Such borrowings were made by the Company in compliance with applicable laws. The break up of the Company's domestic borrowings were as detailed in Annexure (Now to be in compliance with Section 180 of Companies Act, 2013).
8. The Company has not defaulted in the repayment of public deposits, unsecured loans, debentures, facilities granted by banks, financial institutions and non-banking financial companies. (Section 73- 76 of Companies Act 2013)
9. The Company has created, modified or satisfied charges on the assets of the company as detailed in Annexure Investments in wholly owned Subsidiaries and/or Joint Ventures abroad made by the company are as detailed in Annexure (Now to be in compliance with Section 77-87 of Companies Act, 2013).
10. Principal value of the forex exposure and Overseas Borrowings of the company as on are as detailed in the Annexure under.
11. The Company has issued and allotted the securities to the persons-entitled thereto and has also issued letters, coupons, warrants and certificates thereof as applicable to the concerned persons and also redeemed its preference shares/debentures and bought back its shares within

the stipulated time in compliance with the provisions of the Companies Act, 1956 (now to be in compliance with relevant sections of Companies Act, 2013) and other relevant statutes.

12. The Company has insured all its secured assets. (Now to be in compliance with relevant provisions of Chapter IV of Companies Act, 2013.)
13. The Company has complied with the terms and conditions, set forth by the lending bank/financial institutions at the time of availing any facility and also during the currency of the facility.
14. The Company has declared and paid dividends to its shareholders as per the provisions of the Companies Act, 1956. (Now to be in compliance with relevant sections of Chapter VIII of Companies Act, 2013).
15. The Company has insured fully all its assets.
16. The name of the Company and or any of its Directors does not appear in the defaulters' list of Reserve Bank of India.
17. The name of the Company and or any of its Directors does not appear in the Specific Approval List of Export Credit Guarantee Corporation.
18. The Company has paid all its Statutory dues and satisfactory arrangements had been made for arrears of any such dues.
19. The funds borrowed from banks/financial institutions have been used by the company for the purpose for which they were borrowed.
20. The Company has complied with the provisions stipulated in Section 372A of the Companies Act in respect of its Inter Corporate loans and investments. (Now to be in compliance with Section 186 of Companies Act, 2013).
21. It has been observed from the Reports of the Directors and the Auditors that the Company has complied with the applicable Accounting Standards issued by the Institute of Chartered Accountants in India.
22. The Company has credited and paid to the Investor Education and Protection Fund within the stipulated time, all the unpaid dividends and other amounts required to be so credited.
23. Prosecutions initiated against or show cause notices received by the Company for alleged defaults/ offences under various statutory provisions and also fines and penalties imposed on the Company and or any other action initiated against the Company and for its directors in such cases are detailed in Annexure

24. The Company has (being a listed entity) complied with the provisions of the Listing Agreement (Now to be in compliance with the SEBI (LODR) Regulations, 2015).
25. The Company has deposited within the stipulated time both Employees' and Employer's contribution to Provident Fund with the prescribed authorities.

Signature:

Name of Company Secretary/Firm:

C.P. No.:

Place:

Date:

CERTAIN OTHER TYPES OF DUE DILIGENCE

Ethical Due Diligence

- i. Ethical Due Diligence measures ethical character of the company and identify the possibilities of ethical risks, which involves reputation, governance, ethical values etc.
- ii. It helps an organization to decide whether the partner is ethically viable.
- iii. Carrying out the assessment of a company's ethics as part of a due diligence can add considerably to the depth of insight into the target company. For an ethics assessment to add this value, it is crucial that it is an accurate and reliable assessment.

Strategic Due Diligence

Strategic due diligence tests the strategic rationale behind a proposed transaction and analyses whether the deal is commercially viable, whether the targeted value would be realized.

Strategic due diligence focuses on determining how much adequate, realistic, and attainable is a deal's value. Strategic due diligence is broader and considers micro and macro-environmental factors of a business, connecting the legal and financial consideration with a long-term focus. Essentially strategic due diligence determines the question, "Whether a business plan can hold up to the market realities?"

Operational Due Diligence

- i. Operational Due Diligence diagnoses the organization's historical and current operational performance, cost structure, map of potential synergies.
- ii. It aims at the assessment of the functional operations of the target company, connectivity between operations, technological upgradation in operational process, financial impact on operational efficiency etc.
- iii. Operation due diligence involves verifying operational matters such as the various facilities, office layout, sitting capacity etc..

Benefits of Operational Due Diligence:

- It also uncovers aspects on operational weakness, inadequacy of control mechanisms etc.
- It also gives a better picture of the kind of cost the buyer is going to incur in case they plan to go for expansion.
- It verifies the various facilities owned by the target company and whether all costs are captured in the financials or not.

Human Resource Due Diligence

Human Resource Due Diligence evaluates the company's organizational structure, HR practices and policies, collective agreements, compensation programs, ratios of labour turnover and demographic analysis of the Company.

Elements of Human Resource Due Diligence

- i. List of employees, their positions and salaries.
- ii. All employment contracts with non-disclosure, non-solicitation and non-competition agreements between the company and its employees. In case there are few irregularities regarding the general contracts, focus must be given.
- iii. Analysis of total employees, including current positions, vacancy, due for retirement and serving notice period.
- iv. Analysis of employee problems for alleged wrongful termination, harassment, discrimination and any legal case pending about the same.
- v. Analysis of current salaries, bonuses paid during last three years and years of service.

- vi. A list and description of all employee health benefits and welfare insurance policies or self-funded arrangements.
- vii. HR policies regarding annual leave, sick leave and other forms of leave.
- viii. In case there are labor disputes, requests for arbitration, or grievance procedures currently pending and its financial impact needs to be seen.
- ix. Employee Benefit Schemes and schedule of grants of such scheme.
- x. Details of options given/vested under ESOP scheme.
- xi. Employee harassment reports if any.
- xii. Cultural issues in case of cross border transactions.

CASE STUDY- Microsoft

- i. Microsoft was running into serious internal problems with its organizational structure and human resources. It wasn't until the new CEO Satya Nadella took charge and started to undertake some major restructuring for this massive company. At a very high level, we can see some of the fruits of Nadella's ideas by looking at Microsoft's stock price.
- ii. After being named CEO in February 2014, Satya Nadella undertook a major restructuring of the tech giant to eliminate its destructive internal competition.
- iii. Microsoft products and platforms would no longer exist as separate groups. Instead, all employees would start focusing on a limited set of common goals — and bringing them all together.
- iv. In September 2016, Nadella created a new AI and Research Group by merging their original research group with the Bing, Cortana, and Information Platform teams. This move brought roughly 5,000 engineers and computer scientists together to focus on artificial innovation across all Microsoft product lines.

Information Technology Due Diligence

- a. Information security due diligence is often undertaken during the information technology procurement process to ensure that risks are uncovered.
- b. The regular review internal information security system helps to identify security gaps, as well as ensure that the company is acting with an acceptable standard of care
- c. It provides with the following benefits:

- i. A clear understanding of technological capability of the organisation.
- ii. Identification and assessment of the risks associated with technology adapted by the organisation.
- iii. Impact of the information technology on the particular business transaction.

The information security due diligence covers the following:

- i. Information Security Measure
- ii. Data Protection/ sharing policy
- iii. Network and System design
- iv. Wireless and Remote Access facility
- v. Incident management

Essentials of Information Technology Due Diligence

- Analysing IT processes and systems of the organisation
- Determining the current cost and investment in IT
- Assessing the infrastructure of the company establishes IT Security
- Analysing the efficiency of Business systems and softwares

NON DISCLOSURE AGREEMENT

A non-disclosure agreement is defined as a legally enforceable contract that creates a confidential relationship between a person who holds some kind of trade secret and a person to whom the secret will be disclosed.

The Confidentiality agreements serve three important functions:

- **Protect sensitive information.** By signing an NDA, participants promise to not divulge or release information shared with them by the other people involved. If the information is leaked, the injured person can claim breach of contract.
- In the case of new product or concept development, a confidentiality agreement can **help the inventor keep patent rights.** A properly drafted NDA can help the original creator hold onto the rights to a product or idea.

- Confidentiality agreements and NDAs expressly outline what information is private and what's fair game.

Content of the Non-Disclosure Agreements

1. **Definitions and exclusions of confidential information;** Definitions of confidential information spell out the categories or types of information covered by the agreement. This specific element serves to establish the rules-or subject/consideration-of the contract without actually releasing the precise information.
2. **Obligations from all involved people or parties; and time periods.** Nondisclosure agreements often exclude some information from protection. It also provides the time periods which provides that the party receiving the information stays mum for a number of years. This specific information is usually up for negotiation.

Sample Non-Disclosure agreement is placed below:

XYZ Limited

Non-Disclosure Agreement

This Agreement is entered into effective as of _____ between _____ (the "Company") and _____, ("Recipient"). Recipient is acting as an expert advising the Company in connection with a [_____], and for that purpose, the Company may make certain Confidential Information (as defined below) available to the Recipient (the "Purpose").

As a condition to, and in consideration of, the Company's furnishing of Confidential Information to the Recipient, the Recipient agrees to the restrictions and undertakings contained in this Agreement.

IT IS HEREBY AGREED AS FOLLOWS.

1. Definitions

In this Agreement:

1.1 Confidential Information:

- a. means any information disclosed by one Party (the "Disclosing Party") to any other Party (the "Receiving Party") or which is otherwise communicated to or comes to the attention of

the Receiving Party whether such information is in writing, oral or in any other form or media and whether such disclosure, communication or coming to the attention of the Receiving Party occurs prior to or during this Agreement; and

b. includes without limit:

- (i) any information which can be obtained by examination, testing or analysis of any hardware, any component part thereof, software or material samples provided by the Disclosing Party under the terms of this Agreement;
- (ii) all information disclosed by one Party to any of the other Parties relating directly or indirectly to the Purpose;
- (iii) the fact that the Parties are interested in or assessing the Purpose and/or are discussing the Purpose with each other; and
- (iv) the terms of any agreement reached by the Parties or proposed by any of the Parties (whether or not agreed) in connection with the Purpose;
- (v) all knowledge, information or materials (whether provided in hardcopy or electronic or other form or media) whether of a technical or financial nature or otherwise relating in any manner to the business affairs of the Disclosing Party (or any parent, subsidiary or associated company of that party) software, samples, devices, demonstrations, knowhow or other materials of whatever description, whether subject to or protected by copyright, patent, trademark, registered or unregistered design.

2. Undertakings

Subject to clause 3 below and in consideration of the disclosure of Confidential Information by the Disclosing Party, the Receiving Party agrees:-

- (i) to keep confidential and not disclose to any third party, copy, reproduce, adapt, divulge, publish or circulate any part of or the whole of any Confidential Information without the prior written consent of the Disclosing Party; and
- (ii) to restrict access to the Confidential Information disclosed to it under this Agreement to those of its employees and officers who need to know the same strictly for the Purpose; and
- (iii) not to use Confidential Information disclosed to it under this Agreement for any purpose other than the Purpose; and

- (iv) not to combine any part of or the whole of the Confidential Information with any other information; and
- (v) not to disclose the whole or any part of the Confidential Information to any third party without (a) the prior written consent of the Disclosing Party and (b) prior to disclosure to such third party procuring that the third party is bound by obligations which are no less onerous than those contained in this Agreement; and
- (vi) to procure that each employee and officer to whom Confidential Information is disclosed under this Agreement is, prior to such disclosure, informed of the terms of this Agreement and agrees to be bound by them; and
- (vii) to procure that the Confidential Information in its possession is stored securely and that physical access to it is controlled.

3. Exceptions

- 3.1 The protections and restrictions in this Agreement as to the use and disclosure of Confidential Information shall not apply to any information which the Receiving Party can show:-
- (a) is, at the time of disclosure hereunder, already published or otherwise publicly available; or
 - (b) is, after disclosure hereunder published or becomes available to the public other than by breach of this Agreement; or
 - (c) is rightfully in the Receiving Party's possession with rights to use and disclose, prior to receipt from the Disclosing Party; or
 - (d) is rightfully disclosed to the Receiving Party by a third party with rights to use and disclose; or
 - (e) is independently developed by or for the Receiving Party without reference or access to Confidential Information disclosed hereunder.
- 3.2 The Receiving Party shall not be in breach of Clause 2 if it can demonstrate that any disclosure of Confidential Information was made solely and to the extent necessary to comply with a statutory or judicial obligation.

4. No title of Use

Nothing contained in this Agreement shall be construed as conferring upon the Receiving Party any right of use in or title to Confidential Information received by it from the Disclosing Party, other than as expressly provided.

5. No Obligation to Disclose, No Representations

Nothing in this Agreement shall be construed as?

(i) creating an obligation on any of the Parties to disclose particular information; or

(ii) creating an obligation on the parties to negotiate; or

(iii) as a representation as to the accuracy, completeness, quality or reliability of the information.

6. Term & Termination

6.1 Subject to clause 3, the obligations contained in clause 2 shall continue to apply for so long as the Receiving Party has in its possession or has procured that any third party authorized under this Agreement has in its possession any Confidential Information.

6.2 The Receiving Party shall, on the request of the Disclosing Party, return to the Disclosing Party (whose property they shall remain) all documents and things containing Confidential Information, together with all relevant samples and models which it has in its possession pursuant to this Agreement.

7. Miscellaneous

7.1 No Party shall assign its rights and/or obligations pursuant to this Agreement without the prior written consent of the other Party.

7.2 No failure or delay by either party in exercising any rights, power or legal remedy available to it hereunder shall operate as a waiver thereof.

7.3 In the event any one or more of the provisions contained in this Agreement shall for any reason be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision of this Agreement but this Agreement shall be construed as if such invalid, illegal or unenforceable provision had never been set forth

herein, and the Agreement shall be carried out as nearly as possible according to its original terms and intent.

- 7.4 This Agreement shall be construed and governed in all respects in accordance with the laws of India and the Parties hereby submit to the jurisdiction of the Indian courts.
- 7.5 The signing of this Agreement shall not be construed as the forming of an agency, joint venture, employment or partnership.

Signed for and on behalf "XYZ Limited"

Signed for and on behalf "ABC Limited"

By its duly authorized representative

By its duly authorized representative

(Signature) -----

(Signature) -----

(Name) -----

(Name) -----

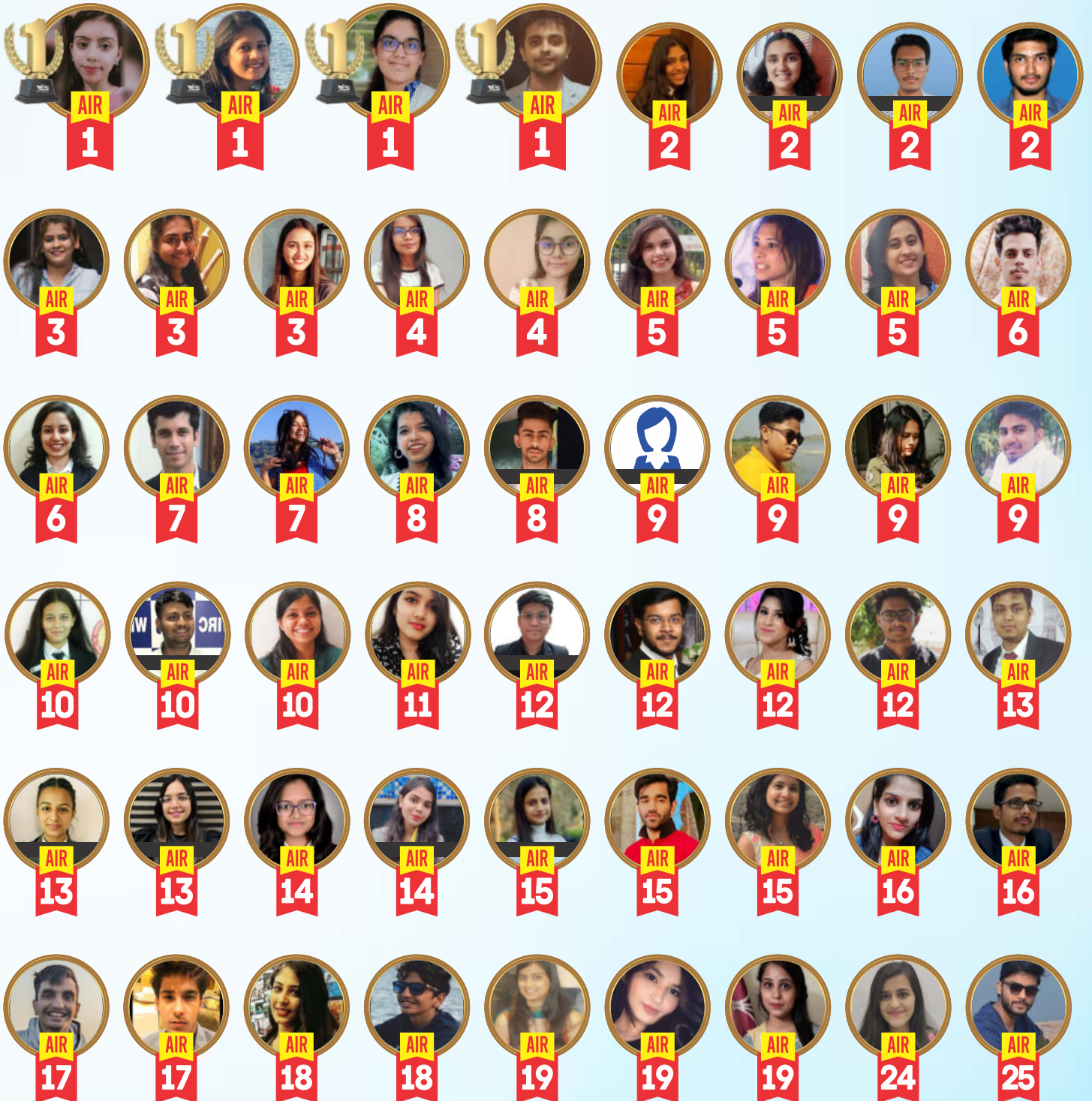
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(Date) -----

Universe of
ALL INDIA RANKERS



& many more



CS Muskan Gupta

Muskan is a graduate from ILS Law College, Pune. She Qualified as a Company Secretary at the age of 21 with AIR 15 in Foundation Programme. She has completed her masters in Constitutional Laws from Bhartiya Vidyapeeth, Pune.

She has worked with esteemed lawyers and firms and has always shown great interest in subjects like Crpc, CPC, Constitution of India and Corporate Laws.

She has authored and published research papers in the field of Intellectual Property Rights, Cyber Law, Corporate Laws, etc. She has an inherent passion for teaching and firmly believes-

"Keep working hard, until you are insanely proud of yourself"