

CA-FINAL
ADVANCED
AUDITING &
PROFESSIONAL
ETHICS
(APPLICABLE FOR MAY,2022 EXAMS & ONWARDS)

CA. ROHIT GROVER,FCA
MODULE-III

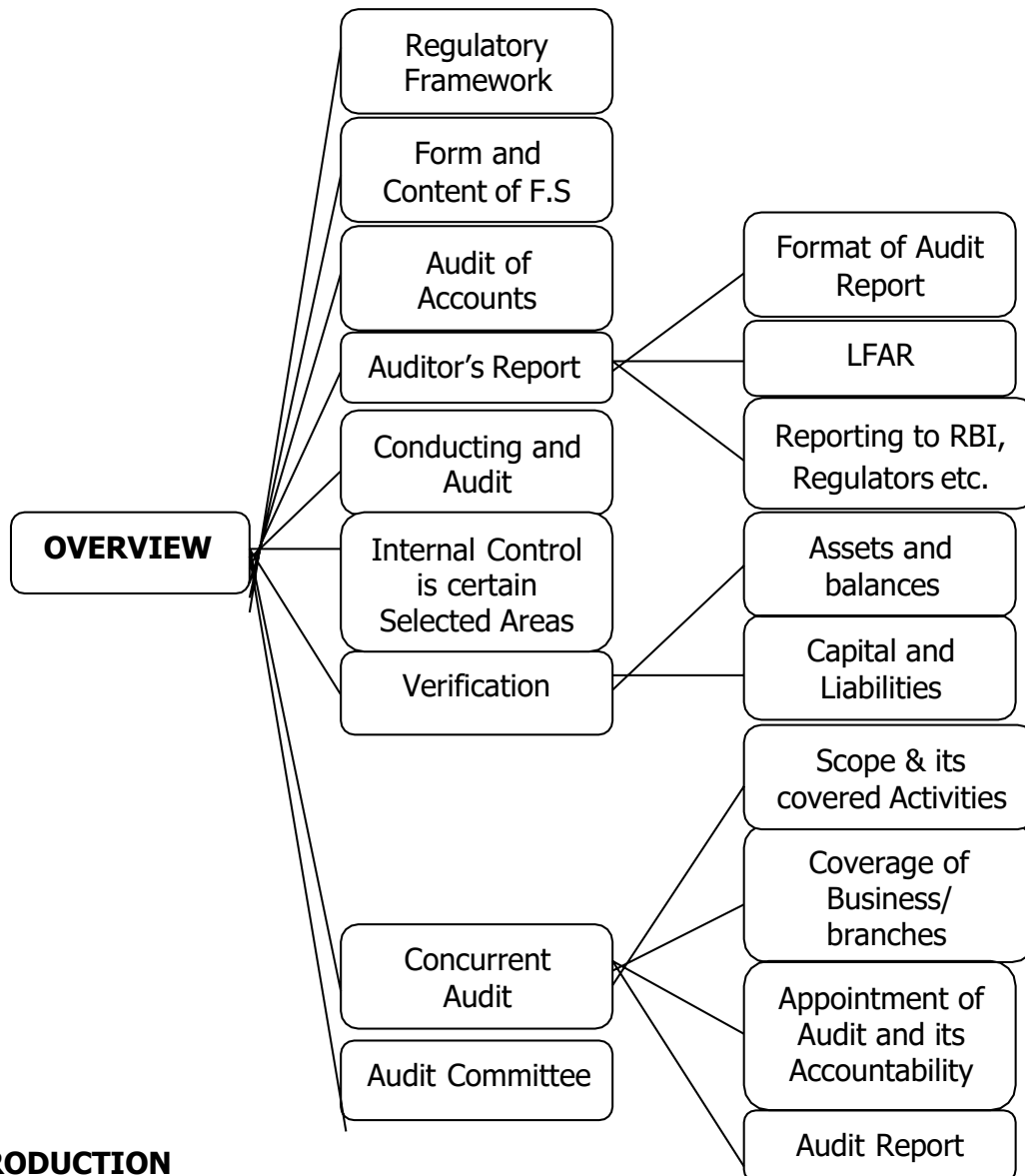
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CHAPTER-1 AUDIT OF BANKS

BANK AUDIT

CHAPTER OVERVIEW



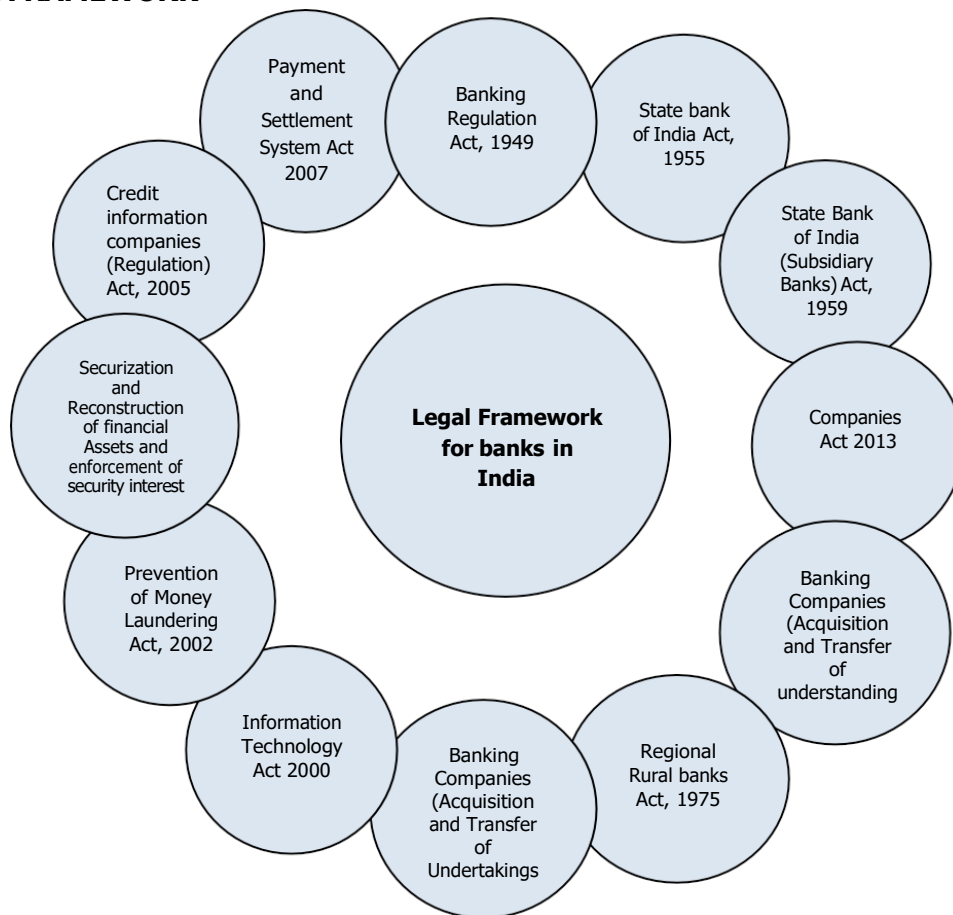
INTRODUCTION

Banks have certain characteristics distinguishing them from most other commercial enterprises.

- Custody of large volumes of monetary items
- Engagement in a large volume and variety of transactions and widespread use of Information Technology (IT).
- Operation through a wide network of geographically dispersed branches and departments
- Assumption of significant commitments without any transfer of Funds.
- Direct Initiation and completion of transactions by the customer without any intervention by the bank's employees.

- Integration and linkages of national and international settlement systems could pose a systemic risk to the countries in which they operate.
- Regulatory requirements by governmental authorities often influence accounting and auditing practices banking sector.

LEGAL FRAMEWORK



Special audit considerations arise in the audit of banks because of:

- the particular nature of risks associated with the transactions undertaken;
- the scale of banking operations and the resultant significant exposures which can arise within short period of time;
- the extensive dependence on IT to process transactions;
- the effect of the statutory and regulatory requirements;
- the continuing development of new products and services and banking practices which may not be matched by the concurrent development of accounting principles and auditing practices.

Evolution of technology and providing services through Net Banking and Mobiles has exposed banks to huge operational and financial risk

FORM AND CONTENT OF FINANCIAL STATEMENTS

Third Schedule to the Act **Form A** of the Third Schedule to the Banking Regulation Act, 1949, contains the for-4, Balance Sheet. **Form B** contains the form of Profit and Loss Account.

Every banking company needs to comply with the disclosure requirements under the various Accounting Standards, as specified under section 133 of the Companies Act, 2013, read with Rule 7 of the Companies (Accounts) Rules 2014, so far as they apply to banking companies or the Accounting Standards issued by the ICAI. ***It may be noted that implementation of Indian Accounting Standards (Ind AS) has been deferred by RBI for all scheduled commercial banks presently.***

It is pertinent to state that preparation of balance sheet of a bank usually involves preparation of standalone financial statements and consolidated financial statements. Preparation of Standalone financial statements involve consolidation of branch accounts and incorporation of various verticals/departments of bank in case of a nationalized bank/public sector bank. The detailed procedures in this regard may vary from bank to bank. In case of private banks, the processes of accounting are centralized and there is no concept of mandatory branch audit in accordance with RBI guidelines.

Public sector banks and private banks are listed on recognized stock exchange and are required to comply with SEBI regulations including LODR.

Audit of Accounts

Sub-section (1) of section 30 of the Act requires FS to be audited by a person duly qualified under any law for the time being in Force to be an auditor of companies.

Presently, the SCAs have to furnish the following reports/certificates in addition to their main report:

- Report on adequacy and operating effectiveness **of Internal Controls over Financial Reporting** in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013
 - **Long form audit report.**
 - Report on compliance with **SLR** requirements.
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- Report on whether the **treasury operations** of the bank have been conducted in accordance with the instructions issued by the RBI From time to time.
- Certificate on **reconciliation of securities** by the bank (both on its own investment account as well as PMS tanks' account).
- Certificate on **compliance by the** bank in key areas of prudential and other guidelines relating to such transactions issued by the RBI.
- Report on whether the **income recognition, asset classification** and **provisioning** have been made as per the guidelines issued by the RBI from time to time.
- Report on whether any **serious irregularity** was noticed in the working of the bank which requires immediate attention (in accordance with sec 143(12) of the Companies Act, 2013.)
- Authentication of **capital adequacy ratio**, including disclosure requirements and other ratios reported in the notes on accounts.
- Report on status of the compliance by the bank with regard to the implementation of recommendations of the **Ghosh Committee** relating to frauds and malpractices and of the recommendations of **Jilani Committee** on internal control and inspection/credit system.
- Report on instances of **adverse credit - deposit ratio** in the rural areas.
- Asset liability management.
- Certificate on **Corporate Governance** in case of banks listed on Stock Exchange. In some banks this certification may not be got done by the central auditors.
- Certification on **claim of various interest subsidies and interest subvention.**

Appointment of Auditor

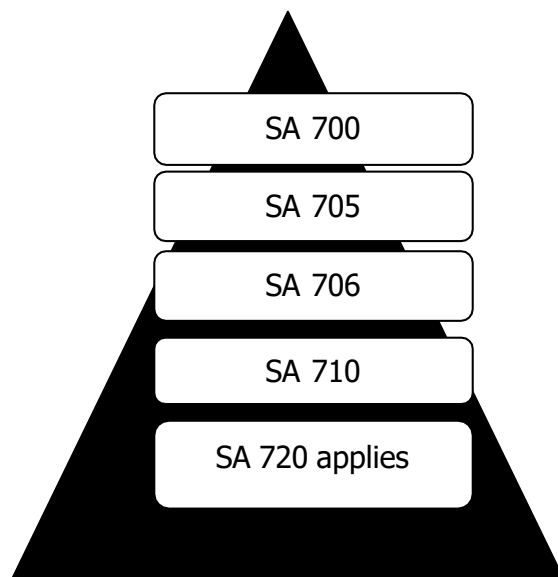
- The auditor of a banking company is to be appointed at the annual general meeting of the shareholders,
- Whereas the auditor of a nationalized bank is to be appointed by the concerned bank acting through its Board of Directors.
- In either case, approval of the Reserve Bank is required before the appointment is made.
- The auditors of the State Bank of India are to be appointed by the Comptroller and Auditor General of India in consultation with the Central Government.

AUDITOR'S REPORT

In the case of a nationalized bank, the auditor is required to make a report to the Central Government in which the auditor should state the following:

- Whether, in the auditor's opinion, the balance sheet is a full and fair balance sheet containing all the necessary particulars and is properly drawn up so as to exhibit a true and fair view of the affairs of the bank.
- In case the auditor had called for any explanation or information, whether it has been given and whether it is satisfactory.
- Whether or not the transactions of the bank, which have come to the auditor's notice, have been within the powers of that bank.
- Whether or not the returns received from the offices and branches of the bank have been Found adequate for the purpose of audit.
- Whether the profit and loss account shows a true balance of profit or loss for the period covered by such account.
- Any other matter which the auditor considers should be brought to the notice of the Central Government.

Format of Audit Report:



It may be noted that, in addition to the aforesaid, the auditor of a banking company is also required to state in the report in respect of matters covered by Section 143 of the Companies Act, 2013.

Long Form Audit Report:

Besides the audit report as per the statutory requirements discussed above, the terms of appointment of auditors of public sector banks, private sector banks and Foreign banks (as well as their branches), require the auditors to also furnish a Long Form audit report (LFAR).

The LFAR is to be submitted before 30th June every year.

Reporting to RBI - The said circular provides details regarding liability of accounting and auditing profession including the professional conduct, non - disclosure of client information and need to report fraud. Auditor should also consider the compliance with provisions of Standards on Auditing.

CONDUCTING AN AUDIT

Initiation Considerations	Understanding	Risk Assessment	Execution	Reporting
<ul style="list-style-type: none"> ➤ Acceptance & Continuan ce ➤ Declaratio n of Indebtedn ess ➤ Internal Assignm ent s in banks by 	<ul style="list-style-type: none"> ➤ Understa nding the Bank and its Environ ment includin g Internal Control ➤ Understa nding 	<ul style="list-style-type: none"> ➤ Identifying and Assessing the Risks of Material Misstateme nts ➤ Assess the Risk of Fraud including 	<ul style="list-style-type: none"> ➤ Engagem ent Team Discussions ➤ Prepare response to the Assessed Risks ➤ Establish the Overall Audit Strategy 	<ul style="list-style-type: none"> ➤ Independ ent Auditors' Report ➤ Long Form Audit Report ➤ Report any other matters to Bank,

Statutory Auditors ➤ Terms of Audit Engagements ➤ Communication with previous Auditor ➤ Establish Engagement Team	the Bank's Accounting Process ➤ Understanding the Risk management Process	Money Laundering ➤ Assess Specific Risks ➤ Risk Associated with Outstanding of Activities	➤ Audit Planning Memorandum ➤ Determine Audit Materiality ➤ Consider Going Concern	Regulator or Government
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Stage I: Initial Considerations

- **Acceptance & Continuance:** The assessment of engagement risk is critical decision of accepting the engagement and in planning decisions if the audit is accepted.
- **Declaration of Indebtedness:** A written confirmation that credit facilities, if any, availed from any other bank or financial institution by auditor/firm/partners/staff/family members have not become non-performing assets.
- **Internal Assignments in Banks by Statutory Auditors:** RBI decided that the audit firms should not undertake statutory audit assignment. SA 210,
- **Communication with Previous Auditor:** Clause (8)
- **Establish the Engagement Team:** The assignment of qualified and experienced professionals, size and composition of the engagement team would depend on the size, nature, and complexity of the bank's operations.

Stage II: Understanding

- to identify and assess risk;
- to develop an audit plan

Thus, understanding of the accounting process is necessary to identify and assess the risks of material misstatement whether due to fraud or not, and to design and perform further audit procedures.

SC of IG

- Oversight by those charged with governance
- Identification, measurement and monitoring of risks
- Control activities
- Monitoring activities
- Reliable information systems

Stage III: Risk Assessment

Identifying and Assessing the Risks of Material Misstatements: SA 315

Assess the Risk of Fraud including Money Laundering: As per SA 240

The RBI has framed specific guidelines that deal with prevention of money laundering and "Know Your Customer (KYC)" norms.

Assess Specific Risks: The auditors should identify and assess the risks of material misstatement at the financial statement level. Risk Associated with Outsourcing of Activities

Stage IV: Execution

- **Engagement Team Discussions:** SA 240
- **Response to the Assessed Risks:** SA 330
- **Establish the Overall Audit Strategy:** SA 300
 - establish the overall audit strategy, prior to the commencement of an audit; and
 - Involve key engagement team members and other appropriate specialists while establishing the overall audit strategy, which depends on the characteristics of the audit engagement.

Audit Planning Memorandum:

- Describe the expected scope and extent of the audit procedures to be performed by the auditor.
- Highlight all significant issues and risks identified during their planning and risk assessment activities, as well as the decisions concerning reliance on controls.
- Provide evidence that they have planned the audit engagement appropriately and have responded to engagement risk, pervasive risks, specific risks, and other matters affecting the audit engagement.
- **Determine Audit Materiality:** SA 320
- **Consider Going Concern:** SA 570

Stage V: Reporting

Special Considerations in IT Environment:

While the overall objective and scope of audit do not change the procedures followed by the auditor in study and evaluation of the accounting system and related internal controls and nature, timing and extent of other audit procedures are affected in a IT environment.

Key security control aspects

- Data is made available for processing.
- Ensure that in case of interruption due to power, system restarts without distorting
- System prevents unauthorised amendments to the programmes.
- Verify "access controls"
- Verify segregation of duties
- Verify changes made are authenticated.
- Verify all modules in the software are implemented.
- Verify that exceptional transaction reports are being authorised and verified on a daily basis.
- Account master and balance cannot be modified/amended/alterd except by the authorised personnel.
- Balance in general ledger tallies with the balance in subsidiary book.
- important passwords are kept in sealed cover
- back up is
 - bank takes daily and monthly backups.
 - backup register is maintained and updated.
- backup media is stored in fireproof cabinet

- anti-virus software of latest version is installed
- security patches are applied to systems
- access to the computer room is restricted

BASEL III framework:

The Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB) has undertaken an extensive review to issue the framework.

Demonetization
<p>On 8th November 2016, the Government announced Demonetisation Program by declaring withdrawal of legal tender status to currency notes denomination of Rs 1000 and Rs 500 (herein referred as Specified Bank Notes (SBN)) effective from November 09, 2016. Consequent to the announcement, there have been a series of announcements and notifications by the RBI regarding exchange facility, withdrawal limit, etc.</p> <p>The most important aspect of Demonetisation program is to reconcile the balance of SBN and its movement by banks to ensure no misuse by branch officials. Reporting of the said details by banks has also been prescribed.</p>

Risk-based Internal audit is conducted based upon the risk assessment of business and control risks of branches. The risk assessment process includes: -

- ***Identification of inherent business risks in various activities undertaken by branches (Business risk)***
- ***Assessment of effectiveness of control systems for monitoring inherent risks of business activities of branch (Control risk)***
- ***Making an assessment of level and direction of various risk areas and assess level and direction of overall business risk and control risk***

Drawing up of risk matrix taking into account factors viz. Risk of branch

INTERNAL CONTROL IN CERTAIN SELECTED AREAS

Area of Focus	Examples of Internal Control in a Bank
General	<ul style="list-style-type: none"> • Job Rotation w/o notice • Cross check • arithmetical accuracy of the books should be proved • All bank Forms (e.g. Cheque books, demand draft books, travelers' cheques etc.) should be kept in self possession of an officer, and another responsible officer should occasionally verify the stock.
	<ul style="list-style-type: none"> • The mail should be opened by a responsible officer.
	<ul style="list-style-type: none"> • The signature book and the telegraphic code book kept with responsible officers
	<ul style="list-style-type: none"> • Take insurance policies against loss and employees infidelity.
	<ul style="list-style-type: none"> • Powers of officers of different grades be defined.

	<ul style="list-style-type: none"> • Surprise inspection at periodic interval by the internal audit department.
Cash	<ul style="list-style-type: none"> • Joint custody
	<ul style="list-style-type: none"> • Test- checked daily and counted in full occasionally. Actual cash in hand should agree with Day Book every day.
	<ul style="list-style-type: none"> • The cashier should have no access to the customer's ledger accounts and the Day Book.
	<ul style="list-style-type: none"> • The counterfoil cash receipt vouchers should be signed by an officer in Cash Department, in addition to the receiving cashier.
	<ul style="list-style-type: none"> • Payments should be made only after the vouchers have been passed for payment.
	<ul style="list-style-type: none"> • Where the teller system is prevalent – <ul style="list-style-type: none"> ➤ A Limit should be placed on the powers of tellers to make payment.

	<ul style="list-style-type: none"> ➤ All vouchers which the tellers handle entered by them in the ledger cards first. ➤ Total payment made by a teller should be reconciled. ➤ Frequent rotation of tellers.
<p>Clearings</p>	<ul style="list-style-type: none"> • <i>Under the Cheque Truncation System (CTS) implemented by RBI, an electronic image of the cheque is transmitted to the paying branch through the clearing house, along with relevant information like data on the MICR band, date of presentation, presenting bank, etc. This effectively eliminates the associated cost of movement of the physical cheques, reduces the time required for their collection.</i> • <i>As per RBI guidelines, the branch is required to either call the customer or email him for any cheque received for the amount of ` 5 lakh and above in respect of inward clearings. The Auditor may verify the compliance on test check basis.</i> • <i>The Auditor is to check whether signature of the drawer of the cheque is being verified by the staff or not as else there will be liability of the paying bank under all circumstances.</i> • <i>The unpaid cheques received in outward clearing should be either sent to the customers at their recorded address or the customers be informed to collect the same from bank branch.</i>
<p>Constituents' Ledgers</p>	<ul style="list-style-type: none"> • Before making payment, cheques should be properly checked in respect of signature, date, balance in hand etc. • No withdrawals normally be allowed against clearing cheques deposited on the same day. • An officer should check entries made in the ledger with the original documents. • Interest debited or credited to constituents' accounts should be independently checked.
<p>Bills for collection</p>	<ul style="list-style-type: none"> • All the documents accompanying the bills should be received and entered in the Register by a responsible officer. • At time of dispatch, the officer should also see that all the documents are sent along with the bills. • The accounts be credited only after the bills have been collected. • It should be ensured that bills sent by one are not taken in the bills for collection twice in the amalgamated balance sheet of the bank. • For this purpose, the receiving branch should reverse the entries regarding such bills at the end of the year For closing purposes.

Bills Purchased	<ul style="list-style-type: none">➤ Verily documents of title are properly assigned to the bank.➤ Sufficient margin should be kept while purchasing or discounting a bill.➤ If the bank is unable to collect a bill on the due date, immediate steps should be taken.➤ All irregular outstanding accounts be reported to the Head Office.➤ Case of bills purchased outstanding at the close of the year the discount received be property apportioned between the two years.
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<p>Loans and Advances</p>	<ul style="list-style-type: none"> • Creditworthiness of the borrowers and after obtaining sanction. • All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed. • Sufficient margin should be kept. • All the securities should be received and returned by responsible officer kept in the Joint custody. • In the case of goods in the possession of the bank, contents be test checked. • Market value of goods should be checked. • All accounts should be kept within both the drawing power and the sanctioned limit additional temporary limit, for a maximum of 20% of existing limit and 90 days maximum tenure. • The operation (in each advance should be reviewed at least once every year.)
<p>Telegraphic Transfers and Demand Draft</p>	<ul style="list-style-type: none"> • The signatures on a demand draft • All the T.Ts and D.Ds. sold by a branch should be immediately confirmed by the advices to the branches concerned. • If the paying branch does not receive proper confirmation of any T.T or D.D. from the issuing branch take immediate steps to ascertain the reasons.
<p>Inter Branch Accounts</p>	<ul style="list-style-type: none"> • The accounts should be adjusted only on the basis of advices (and not on the strength of entries found in the statement of account) received from other branches, • Prompt action should be taken preferably by central authority, if any entries (particularly debit entries) are not responded to by any branch within a reasonable time.
<p>Credit Card Operations</p>	<ul style="list-style-type: none"> • There should be effective screening of applications with good credit assessments. • Strict control over storage and issue of cards. • System whereby a merchant confirms the status of unutilised limit of a credit-card holder from the bank before accepting the settlement. • System of prompt reporting by the merchants of all settlements accepted by them through credit cards. • Reimbursement after verification of the validity System to ensure that statements are sent regularly and promptly to the customer. • Items overdue beyond a reasonable period should be identified and attended to carefully. There should be a system of periodic review of credit card holders' accounts.

Compliance with CRR and SIR requirement

(CRR) specified minimum Fraction of the total deposits of customers, which commercial banks have to hold as reserves either (a) in cash or (b) as deposits with the central bank.

The RBI, From time to time, reviews the evolving liquidity situation and accordingly decides the rate of CRR required to be maintained by scheduled commercial banks.

Statutory Liquidity Ratio (SLR) Requirements - [% of DTL]

SLR is the requirement that the commercial banks in India require to maintain in the form of (a) gold (b) government approved securities. The Reserve Bank of India requires statutory central auditors of banks to verify the compliance with SLR requirements of 12 odd dates in different months of a fiscal year not being Fridays.

The report should cover two aspects:

- correctness of the compilation of DTL and
- maintenance of liquid assets.

Audit approach and procedure:

Area of Focus	Suggested Audit Procedures
<p>Compliance with CRR and SLR requirements</p>	<ul style="list-style-type: none"> ➤ Require the branch auditors to send their weekly trial balance as on Friday and these are consolidated at the head office. ➤ Based on this consolidation, the DTL position is determined for every reporting Friday. ➤ The statutory central auditor should request the branch auditors to verify the correctness of the trial balances relevant to the dates selected by him/her. ➤ The branch auditors should also be specifically requested to examine the cash balance at the branch on the selected dates. ➤ DTL examine the following items have been excluded From liabilities – <ul style="list-style-type: none"> ▪ recoveries From t he borrowers in respect of debts considered bad and doubtful of recovery. ▪ Amounts received against import bills held in sundry deposits pending receipts of final rates. ▪ Un-adjusted deposits/balances tying in link branches like dividend warrants, interest warrants, refund of application money, etc. ▪ Margins held and kept in sundry deposits ➤ Examine that the following items have been included in liabilities - <ul style="list-style-type: none"> ▪ Net credit balance in branch adjustment accounts ▪ Interest on deposit end of the firm half year reversed in the beginning of the next half - year. ➤ Examine whether the consolidations prepared by the bank include the relevant information in respect of all the branches. ➤ It may be noted that, even though interest accrues daily, it is recorded in the books only at periodic intervals. Thus, examine whether such interest accrued but not accounted for in books is included in the computation of DTL. ➤ While reporting on compliance with SLR requirements, the auditor should specify the number of unaudited branches and state that he/she has relied on the returns received From the unaudited branches in forming an opinion.

VERIFICATION OF ASSETS AND BALANCES

CASH, BANK BALANCES AND MONEY AT CALL AND SHORT NOTICE

- Cash
- Balances with Reserve Bank of India
- Balances with Other Banks
- Money at Call and Short Notice

Cash	<ul style="list-style-type: none"> ➤ Carry out the physical verification as close to the balance sheet date as possible. ➤ The cash balance be agreed with the balance shown in the cash book
Balance with Reserve bank of India	<ul style="list-style-type: none"> ➤ Verify the ledger balances in each account with reference to the bank confirmation certificates and reconciliation statements. ➤ Review the reconciliation statements. Pay special attention <ul style="list-style-type: none"> ▪ Cash transactions remaining unresponded; ▪ Revenue items requiring adjustments/write -offs; ▪ Old outstanding balances for over one year. ➤ Obtain a written explanation from the management as to the reasons for old outstanding transactions in remaining unexplained/ unadjusted for over one year. ➤ Other credit and debit entries originated in the statement provided by RBI remaining unresponded for more than 15 days.
Balance with Banks (Other than Reserve Bank of India)	<p>Apart from the procedures described above</p> <ul style="list-style-type: none"> ➤ Examine that no debit For charges or credit for interest is outstanding ➤ Examine that no cheque sent or received in clearing is outstanding. ➤ Examine all bills or cheques sent for collection and outstanding have been credited subsequently. ➤ Examine large transactions in inter-bank accounts to ensure that no transactions have been put through for window-dressing particularly towards the close of year.
Money at Call and Short Notice	<ul style="list-style-type: none"> ➤ Examine whether there is a proper authorisation, general or specific, for tending of the money at call or short notice. ➤ Call loans should be verified with the certificates of the borrowers the call loan receipts held by the bank. ➤ Examine whether the aggregate balances tally with the control accounts as per the general ledger. ➤ Examine subsequent repayments received from borrowing banks. It may be noted that call loans made by a bank cannot be netted-off against call loans received.

INVESTMENTS

- The auditor's primary objective in audit of investments is to satisfy himself as to their existence and valuation.
- Examination of compliance with statutory and regulatory requirements is also an important objective.
- The entire compliance need to be evaluated in terms of requirements of investment policy / master circular RBI.

Area of Focus	Suggested Audit Procedures
Internal Control Evaluation and Review of Investment Policy	To ascertain that the policy conforms, to the RBI's guidelines

Separation of Investment Functions	Check the segregation of duties within the bank staff in terms of executing trades, and monitoring of such trades, and accounting of the same.
Examination of Reconciliation	Physically verify the securities on hand confirmation of SGL balances with the PDO.
Examination of Documents	<ul style="list-style-type: none"> ➤ Ascertain whether the investments made by the bank are within its authority. ➤ Ensure that any other covenants or conditions which restrict right of ownership and/or disposal have been complied with by the bank. ➤ Verified with reference to the broker's contract note.
Physical Verification	<ul style="list-style-type: none"> ➤ Verify the investment scrips physically on the date of the balance sheet. ➤ In respect of scrip less dealings year - end confirmation certificates of the depository organisation. ➤ In respect of BRs issued by other banks examine confirmations of counterparty banks about such BRs. ➤ If certain securities are held in the names of nominees, examine whether there are proper transfer deeds and an undertaking from them that they hold the securities on behalf of the bank. <p>• Verify investments held with public debt office of RBI, custodians and depository with the statement of holdings as on date of balance sheet. Independent balance confirmation requests can be made in accordance with SA-505. In case independent confirmations are not received back, alternative audit procedures like getting bank personnel to download investment statement from E-Kuber for government securities (E-Kuber is CBS platform of RBI) in auditor's presence can be designed.</p>
Examination of Valuation	<ul style="list-style-type: none"> ➤ Examine that entire investment portfolio of bank is classified under three categories i.e. HTM, HFT and AFS and shifting of securities is as per regulatory norms and laid down policy. ➤ Examine whether the method of accounting followed by the bank in respect of investments, including their year -end valuation, is appropriate. ➤ Investments have been properly classified into the three categories at the time ➤ Examine compliance with the guidelines of the RBI ➤ Examine whether income from investments is properly accounted for Profit or loss on sale of investments has been computed properly. ➤ Proper system for recording maintenance of TDS certificates received by the bank.
Dealings in Securities on Behalf of Others	<ul style="list-style-type: none"> ➤ Examine whether prior approvals for carrying out such dealings have been obtained. ➤ Examine whether bank's income from such activities has been recorded.

<p>Special-purpose Certificates Relating to Investments</p>	<ul style="list-style-type: none"> ➤ Examine whether the bank is maintaining separate accounts for the investments) <ul style="list-style-type: none"> ▪ made by it on their own Investment Account, ▪ PMS clients' account ▪ behalf of other constituents (including brokers). ➤ As per the RBI guidelines, banks are required to get their investments under PMS separately audited by external auditors.
<p>Examination of classification and Shifting</p>	<p>Examine whether the shifting of the investments from 'available for sale' to 'held to maturity' is duly approved by the Board of Directors of the bank.</p>

ADVANCES

The Third Schedule to the Act requires classification of advances made by a bank from three different angles, viz., nature of advance, nature and extent of security, and place of making advance (i.e. whether in India or outside India). **Advances generally constitute the major part of the assets of the bank.**

Audit Procedures - In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the Following:

Area of Focus	Suggested Audit Procedures
<p>Evaluation of Internal Controls over Advances</p>	<ul style="list-style-type: none"> ➤ Examine area of credit appraisal and verify whether laid down procedures regarding credit appraisals including loan applications, preparation of proposals, obtaining satisfaction about credit worthiness of borrowers are being followed; ➤ Examine advances are sanctioned according to delegated authority; ➤ Examine all necessary loan documents have been executed after sanction but before disbursements are made to borrowers; ➤ Examine existence, enforceability and valuation of securities. In respect of securities requiring registration, examine this area also; ➤ Examine the validity of the recorded amounts; ➤ Review operations of the accounts and look for adverse features like unauthorised over drawings beyond limits; ➤ Examine whether system laid down in bank for review/renewals of advances is being followed; ➤ Review whether drawing power is being calculated properly on basis of stock/book debt statements received from borrowers as stipulated in respective sanction letters; ➤ Ensure compliance with Loan Policy of Bank as well as prudential norms of RBI including appropriate asset classification and provisioning.

<p>Substantive Audit Procedures</p>	<ul style="list-style-type: none"> ➤ <i>Verify correctness of master data of loan accounts updated in CBS. Check parameters like instalments, EMI, rate of interest, tenure of loans etc.</i> ➤ <i>Verify that each customer of bank is tagged under single customer id in respect of all its accounts including those in which credit facilities are granted.</i> ➤ <i>Examine all large advances while other advances may be examined on a sample basis</i> ➤ <i>Examine accounts identified to be problem accounts but which have not yet slipped into NPA category. This can be done by obtaining list of SMA1 and SMA2 borrowers from the bank and same can be considered for selection of problematic accounts</i> ➤ <i>Examine those accounts which have been adversely commented upon by concurrent auditors/bank's internal inspection/RBI inspection team.</i> ➤ <i>Examine list of restructured accounts to ensure that restructure is as per RBI guidelines. Remember restructured account portfolio requires additional provisioning</i> ➤ <i>Examine quick/early mortality accounts. Any advance slippage to NPA within 12 months of its sanction is called as quick/early mortality case.</i> ➤ <i>Verify completeness and accuracy of interest being charged.</i> ➤ <i>Carry out appropriate analytical procedures.</i>
<p>Recoverability of Advances</p>	<ul style="list-style-type: none"> ➤ <i>Review periodic statements submitted by the borrowers indicating the extent of compliance with terms and conditions.</i> ➤ <i>Review latest financial statements of borrowers.</i> ➤ <i>Review reports on inspection of security.</i>

	➤ Review Auditors' reports in the case of borrowers enjoying aggregate credit limits of Rupees 10 lakh or above for working capital from the banking system.
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Verification of Provision for Non -performing assets:

- Proper provision should be made in respect of advances where the recovery is doubtful.
- Auditors must take / download the latest Master Circular of RBI to familiarise himself fully with the norms prescribed by RBI in this regard.
- However, these norms should be construed as laying down the minimum provisioning requirements and wherever a higher provision is warranted in the context of the threats to recovery, such higher provision should be made.

Area of Focus	Suggested Audit Procedures
Classification and Provision	<ul style="list-style-type: none"> • <i>Verify whether bank has a system of ongoing identification and classification of advances through CBS without manual intervention and its accuracy in crystallising date of NPA.</i> • Examine whether the classification made by the branch is appropriate. Particularly, examine the classification of advances where there are threats to recovery. • Examine whether the secured and the unsecured portions of advances have been segregated correctly and provisions have been calculated properly. <p><i>Review and compare the date of NPA of loan accounts mentioned in current year statements with that of previous year. Reasons for any change should be ascertained.</i></p>
Drawing Power Calculation	<ul style="list-style-type: none"> ➤ Ensure that the drawing power is calculated as per the extant guidelines (i.e. the Credit Policy of the Bank) formulated by the Board of Directors of the respective bank. ➤ Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power ➤ The stock audit should be carried out by the bank for all accounts having funded exposure of more than stipulated limit. The report submitted by the stock auditors should be reviewed during the course of the audit.
Limits not reviewed	Accounts where regular/ad hoc limits are not reviewed within 180 days from the due date/date of ad hoc sanction, should be considered as NPA.

**Government
Guaranteed
Advances**

- IF government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realised.
- However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.
- This exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days.
- In case the bank has not invoked the Central Government Guarantee though the amount is overdue

	for tong, the reasoning for the same should be taken and duty reported in LFAR.
Agricultural Advances	Ensure that NPA norms have been applied in accordance with the crop season.
Provisioning Towards Standard Assets	<i>The auditor should check the latest RBI Circulars in this regard. It is be understood that provision for standard assets is also required to be made at variable rates in respect of different sectors for the funded outstanding in accordance with RBI norms as a matter of prudence. The provisions need to be checked in detail with the statement of advances. The bifurcation of standard advances under relevant category for proper calculation of provision should be checked and certified at branches level. The definition of respective items specified should be adhered as defined by RBI</i>
Restructuring of cases	RBI has given revised the guidelines for treatment of restructured accounts by its circular.
Up-gradation of Account	<i>Examine all the accounts upgraded from NPA to standard category during the year, to ensure that the upgrading of each account is strictly in terms of RBI guidelines. There can be a possibility of incorrect upgradation of account on the basis of partial recoveries made in the account and overdue portion might not have wiped out completely. There can also be a possibility of recoveries being made in the account after cut-off date and account being upgraded as on date of balance sheet.</i>

<p>Audit procedure for Accounts falling under CDR (Corporate Debt Restructuring Programme)</p>	<p>Following audit procedures are to be carried out to assess / gain an understanding about the borrower account –</p> <ul style="list-style-type: none"> ➤ Review the present classification of the account under IRAC norms adopted by the bank and corresponding provision made in the books of accounts, if any. If the account is already treated as NPA in the books of the bank, the same cannot be upgraded only because of the CDR package. ➤ Review the Debtor- Creditor Agreement (DCA) and Inter Creditor Agreement (ICA) (DCA may be entered at the time of original sanction of loan or at the time of reference to CDR). ➤ Auditor should ascertain the terms of rehabilitation along with the sacrifices ➤ Verify whether such sacrifices have been accounted in the books of accounts of the lender bank. ➤ Ascertain whether any additional financing / conversion of loan into equity have been envisaged in the rehabilitation / restructuring program. ➤ Auditor should also ascertain whether account has been referred to BIFR, as such cases are not eligible for restructuring under CDR system. ➤ Large value BIFR cases may be eligible For restructuring under CDR if specifically recommended by CDR core group.
<p>Treatment of accounts restricted under CDR program: Classification and provisioning:</p>	<p>The asset classification will be as per the lender bank's record of recovery and will be bank specific.</p> <p>The auditor should,</p> <ul style="list-style-type: none"> ➤ Ensure that the lender bank has applied the usual asset classification norms pending outcome of the account with the CDR Cell. ➤ The asset classification status should be restored to the position, which existed at the time of reference to the cell if the restructuring under the CDR system takes place. ➤ Ensure that in case a standard asset has been restructured second or more time, it has been downgraded to "sub -standard" asset.
<p>Restructured Advances</p>	<p><i>Restructuring is an act in which a lender, for economic or legal reasons relating to borrower's financial difficulty, grants concessions to the borrower. It may involve modification of terms of advances including alteration of amount of instalments/alteration of repayment period/rate of interest/sanction of additional credit facilities etc. to help in curing of default.</i></p> <p>RBI has given revised guidelines for treatment of restructured accounts by its circular. The auditor should verify compliance with the requirements of the circular issued in this regard.</p> <p><i>Banks may restructure the accounts classified under standard, substandard or doubtful categories. Banks cannot restructure accounts with retrospective effect.</i> Once the bank receives an application/proposal in respect of an account for restructuring, it implies that the account is intrinsically weak. Accordingly,</p>

	<p>during the time the account remains pending for restructuring, the auditors need to take a view whether provision needs to be made in respect of such accounts, pending approval for restructuring. <i>On restructuring, the account will be downgraded from Standard to substandard. NPAs will remain in the same category.</i></p>
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	<ul style="list-style-type: none"> ➤ Ensure that proper disclosure in the Notes to Accounts in respect of CDR of SME undertaken by the bank during the year, as prescribed in the RBI's circular, has been made.
<p>Sale / Purchase of NPAs</p>	<ul style="list-style-type: none"> ➤ the policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers including non performing financial assets that may be purchased/sold, norms or such purchase/sale, valuation procedure and accounting policy.only such NPA has been sold which has remained NPA in the books of the bank For at least 2 years. ➤ the assets have been sold/ purchased "without recourse' only. ➤ the assets have been sold/ purchased "without recourse' only.i.e the entire credit risk associated with the non-performing asset should be transferred to the purchasing bank. ➤ subsequent to the sale of the NPA, the bank does not assume any legal, operational or any other type of risk relating to the sold NPAs ➤ the NPA has been sold at cash basis only. Under no circumstances, NPA can be sold to another bank at a contingent price .The entire sale consideration has to be received on upfront basis ➤ the bank has not purchased an NPA which it had originally sold <p>In case of sale of an NPA, the auditor should also ensure that:</p> <ul style="list-style-type: none"> ➤ on the sale of the NPA, the same has been removed from the books of the account of selling bank on transfer; ➤ If the sale is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year. If the sale is for a value higher than the NBV, the excess provision shall not be reversed but will be utilised to meet the shortfall/ loss on account of sale of other non-performing financial assets
<p>Similarly, in case of purchase of NPAs, the auditor should verify that</p>	<ul style="list-style-type: none"> ➤ the NPA purchased has been subjected to the provisioning requirements appropriate to the classification status in the books of the purchasing bank. ➤ any recovery in respect of an NPA purchased from other banks is first adjusted against its acquisition cost and only the recovered amount in excess of the acquisition cost has been recognised as profit. ➤ for the purpose of capital adequacy, banks have assigned 100% risk weights to the NPAs purchased from other banks.

<p>Accounts with temporary deficiencies</p>	<p>➤ Banks should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of drawing power based on latest available stock statement, balance outstanding exceeding the limit temporarily and non-renewal of limits on the due date. However, stock statements relied upon by the banks for determining drawing power should not be older than 3 months. The outstanding in the account based on drawing power calculated from stock statements older than 3 months are considered as irregular. Ensure adherence to these guidelines.</p>
<p>Asset classification to be borrower wise and not facility wise`</p>	<p>➤ Ensure that asset classification is borrower wise and not facility wise. Therefore, it is to be ensured that all the facilities granted by a bank to borrower will have to be treated as NPA and not particular facility which has become irregular. Further, if debits arising out of devolvement of LC or invoked guarantees are kept in separate account, the outstanding balance should be treated as part of borrower’s principal account for purpose of application of prudential norms on asset classification, income recognition and provisioning.</p>

FIXED ASSETS

The Third Schedule to the Banking Regulation Act, 1949 requires fixed assets to be classified into two categories in the balance sheet, viz., **Premises and Other Fixed Assets.**

Section 9 of the Banking Regulation Act, 1949, prohibits a banking company from holding any immovable property, howsoever acquired(i.e., whether acquired by way of satisfaction of claims or otherwise), for a **period exceeding seven years** from the date of acquisition, except such as is required for its own use.

Audit Approach : *In most of the banks, fixed assets are generally purchased by the head office or regional/zonal offices. Statutory branch auditor has to ascertain the procedure followed and plan accordingly. In most of the banks, maintenance of records is centralized at head office level. In some of the banks, information relating to purchase, sale of fixed assets is accounted for with help of Fixed asset management software. The audit procedures have to be designed accordingly.*

Audit Procedures

In carrying out the audit of fixed assets, the auditor is concerned, primarily, with obtaining evidence about their **existence and valuation**. For this purpose, the auditor should review the following:

Area of Focus	Suggested Audit Procedures
Internal Controls	<ul style="list-style-type: none"> ➤ Control over expenditures incurred on fixed assets acquired or self - constructed; ➤ Information controls for ensuring availability of reliable information about fixed assets. ➤ Ascertain whether the accounts in respect of fixed assets are maintained at the branch or centrally. ➤ Ascertain the location of documents of title or other documents evidencing ownership of various items of fixed assets. ➤ Examine whether acquisitions, disposals, etc. effected at the branch during the year have been properly communicated to the head office.
Premises	<ul style="list-style-type: none"> ➤ Verify the opening balance of premises with reference to schedule of Fixed assets, Ledger or fixed assets register. ➤ Acquisition of new premises should be verified with reference to authorisation, title deeds, record of payment, etc. ➤ Self-constructed fixed assets should be verified with reference to authorisation and documents such as, contractors' bills, work order records and record of payments. ➤ Examine whether the balances as per the fixed assets register reconcile with those as per the ledger and the final statements. ➤ In the case of leasehold premises, capitalisation and amortisation of lease premium, if any, should be examined. ➤ In case the title deeds are held at the head office or some other Location, the branch auditor should obtain a written representation. ➤ Where premises are under construction, it should be seen that they are shown under a separate heading, e.g., 'premises under construction'. ➤ Where the premises (or any other Fixed assets) are re - valued, the auditor should examine the appropriateness of the basis of revaluation. ➤ Examine that no immovable properties other than those required for the own use of the bank have been included in fixed assets (own use would cover use by employees of the bank, e.g., residential premises provided to employees).
Other Fixed Assets	<ul style="list-style-type: none"> ➤ In respect of moveable fixed assets, the auditor should pay particular attention to the system of recording the movements as well as other controls over such fixed assets.

	<ul style="list-style-type: none"> ➤ The auditor should also examine whether discrepancies have been properly dealt with in the books of account and adequate provision in respect of any damaged assets has been made. ➤ In case of intangible assets, verify whether the relevant guidelines given by RBI by way of Circulars and the requirements of AS 26 have been followed. ➤ Examine whether fixed assets have been properly classified. Fixed assets of similar nature only should be grouped together. For example, items like safe deposit vaults should not be clubbed together with the office equipment's or the theft alarm system of the bank. ➤ Examine whether any expenditure incurred on a fixed asset after it has been brought to its working condition for its intended use, has been dealt with properly. The auditor at head office level should examine if the consolidated Fixed assets schedule matches in all respect and all the transfers ins/outs, are tallied. ➤ A broad check on the depreciation amount vis -a-vis the gross block of assets be reviewed with special emphasis on the computer hardware/software.
Impairment of Assets	Verify whether the guidelines given by RBI's circular on compliance with Accounting Standards, issued in April 2004 and the requirements of AS 28 have been followed.

OTHER ASSETS:

Area of Focus	Suggested Audit Procedures
Inter-Office Adjustment	<ul style="list-style-type: none"> ➤ Examine whether Inter-branch accounts are normally reconciled at the central level. ➤ The auditor should report on the year – end status of inter-branch accounts indicating the dates up to which all or any segments of the accounts have been reconciled. ➤ The auditor should also indicate the number and amount of outstanding entries in the inter branch accounts, giving the relevant information separately for debt and credit entries.
Interest Accrued	<ul style="list-style-type: none"> ➤ Examine whether Inter-branch accounts are normally reconciled at the central level. ➤ Special consideration should be given to the overdue bills purchased / discounted. ➤ Ensure that only such interest as can be realized in the ordinary course of business should be shown under this head.
Tax Paid in Advance/Tax Deducted at Source	Ensure that the certificates for such tax deducted at source is collected by the branch and the original copy is sent to the Head Office along with the transfer of such Tax Deducted at Source (TDS) amount to Head Office on periodic basis as defined.
Stationery and Stamps	<ul style="list-style-type: none"> • <i>Ensure that the item “Stationery and Stamps” includes only exceptional items of expenditure on stationery like bulk purchase of security paper which is to be written off over a</i>

	<p><i>period of time. Such items should be valued at cost. Normal expenditure on stationery is charged to profit & loss account. Therefore, this item may not appear at branch level as considerable part of stationery is supplied to branches by head office.</i></p>
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	<ul style="list-style-type: none"> ➤ Evaluate the existence, effectiveness and continuity of internal controls over these items in the normal course of audit. It may be noted that the branch auditor is required to specifically comment on the adequacy of the relevant internal controls in the LFAR. ➤ Physically verify the stationery and stamps on hand as at the year-end, especially stationery of security items. Any shortage should be inquired into as it could expose the bank to a potential loss from misuse. Examine whether the cost of stationery and stamps consumed during the year has been properly charged to the profit and loss account for the year in the context of the accounting policy/instructions from the head office regarding treatment of cost of stationery and stamps
<p>Non-Banking Assets Acquired in Satisfaction of Claims</p>	<ul style="list-style-type: none"> ➤ <i>Ensure that the heading includes those immovable properties/tangible assets which the bank has acquired in satisfaction of debts due or its other claims and these are being held with intention of being disposed off.</i> ➤ Verify such assets with reference to the relevant documentary evidence, e.g., terms of settlement with the party, order of the Court or the award of arbitration, etc. ➤ Check that the ownership of the property is legally vested with the bank. If there is any dispute or other claim about the property, the auditor should examine whether the recording of the asset is appropriate or not. In case the dispute arises subsequently, the auditor should examine whether a provision for liability or disclosure of a contingent liability is appropriate, keeping in view the requirements of AS 29 "Provisions, Contingent Liabilities and Contingent Assets". ➤ Ensure compliance with Section 9 of Banking Regulation Act, on holding period of such assets. ➤ <i>Ensure that as at date of acquisition, the assets should be recorded at lower of net book value of advance or net realisable value of asset acquired.</i>

OTHERS

This is the residual heading, which will include items not specifically covered under other sub-heads, e.g., claims which have not been received, debit items representing additions to assets or reductions in liabilities which have not been adjusted for technical reasons or want of particulars, etc., receivables on account of government business, prepaid expenses, Accrued income other than interest (e.g., dividend declared but not received) may also be included under this head. The audit procedures relating to some of the major items included under this head are discussed below:

Area of Focus	Suggested Audit Procedures
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<p>Non-Interest-Bearing Staff Advances</p>	<ul style="list-style-type: none"> ➤ Examine non-interest-bearing staff advances with reference to the relevant documentation and the policy in this regard which is framed by the bank. The availability, enforceability and valuation of security, if any, should also be examined. ➤ Ensure that the same relates to employees on the rolls of the bank on the date of the preparation of financial statements.
<p>Security Deposits</p>	<ul style="list-style-type: none"> ➤ Examine security deposits with various authorities (e.g., on account of telephone, electricity, etc.,) and with others (e.g., deposits in respect of premises taken on rent) with reference to documents containing relevant terms and conditions, and receipts obtained from the parties concerned.
<p>Suspense Account</p>	<p>Obtain from the management details of old outstanding entries along with reasons for delay in adjusting the entries.</p>
<p>Miscellaneous Debit Balances on Government Account</p>	<ul style="list-style-type: none"> ➤ Review the ageing statements pertaining to these items. ➤ Examine the recoverability of old outstanding items. ➤ Examine whether claims for reimbursement have been lodged by the branch in accordance with the relevant terms and conditions. ➤ For major variance as compared to the previous year figures, verify whether reasons for the same have been recorded and reviewed.

VERIFICATION OF CAPITAL & LIABILITIES**CAPITAL****Audit Procedures**

The auditor should verify the opening balance of capital with reference to the audited balance sheet of the previous year. An increase in subscribed and paid-up capital of a banking company, on the other hand, should be verified with reference to prospectus/other offer document, reports received from registrars to the issue, bank statement, etc.

Capital Adequacy:

- The basic approach of capital adequacy framework is that a bank should have sufficient capital to provide a stable resource to absorb any losses arising from the risks in its business.
- Capital is divided into tiers according to the characteristics/qualities of each qualifying instrument. For supervisory purposes capital is split into two categories: **Tier I** and **Tier II**, representing different instruments' quality as capital.
 - **Tier I** capital consists mainly of share capital and disclosed reserves and it is a bank's highest quality capital because it is fully available to cover losses.
 - **Tier II capital** consists of certain reserves and certain types of subordinated debt. The loss absorption capacity of Tier II capital is lower than that of Tier I capital.

Components of Capital: The Master Circular on Capital Adequacy discusses the Capital Funds in two categories - capital funds For Indian banks and capital funds of Foreign banks operating in India.

In case of foreign banks operating in India, RBI's Master Circular on Capital Adequacy also lays down certain additional provisions in respect of capital to be Followed by such banks.

Capital Risk Adequacy Ratio (CRAR): The CRAR is computed as follows:

$$\frac{\text{Capital Funds}}{\text{Risk weighted assets and off - balance sheet items}} \times 100$$

The RBI requires banks to maintain a minimum CRAR of 9 per cent on an ongoing basis.

RESERVES AND SURPLUS

The following are required to be disclosed in the balance sheet under the head 'Reserves and Surplus'.

- Statutory Reserves
- Capital Reserves
- Share Premium
- Revenue and Other Reserves including investment Fluctuation Reserve
- Balance in Profit and Loss Account

Audit Procedures

- The auditor should verify the opening balances of various reserves with reference to the audited balance sheet of the previous year.
- Additions to or deductions from reserves should also be verified in the usual manner, e.g., with reference to board resolution.
- In the case of statutory reserves and share premium, compliance with legal requirements should also be examined.

DEPOSITS

The Following areas should be considered when auditing Deposits

- Current Accounts & Savings Accounts (CASA)
- Term Deposits
- Deposits Designated in Foreign Currencies
- Interest Accrued But Not Due
- Know Your Customers Norms

Audit Procedures:

The auditor may verify various types of deposits in the following manner:

Area of Focus	Suggested Audit Procedures
Current and saving accounts	<ul style="list-style-type: none"> • <i>Verify on a sample basis current account and saving accounts opened during the year for adherence to KYC norms. Verify that saving accounts are opened in name of individuals, HUF, some approved institutions like trusts, educational institutes etc. Remember that saving accounts are not opened for business or professional concern. The business transactions are carried in current accounts which can be opened for all kind of customers like companies, individuals, partnership firms etc.</i> • <i>Verify the balances in individual accounts on a sample basis.</i> • <i>Check the calculations of interest on a test check basis. Remember that no interest is paid generally on current accounts by banks.</i> • <i>Examine whether the procedure for obtaining balance confirmation periodically has been followed consistently. Examine, on a sampling basis, the confirmations received.</i> • <i>Ensure that debit balances in current accounts are not netted out on the liabilities side but are appropriately included under the head 'advances'.</i> • <i>Inoperative accounts (both current and saving) are a high-risk area of frauds in banks. As per RBI guidelines, a savings/ current account should be treated as inoperative/dormant if there are no transactions in the account for over a period of two years. Verify on a sample basis some of inoperative accounts revived/closed during the year. Ensure that inoperative accounts are revived only with proper authority. In this regard, cases where there is significant reduction in balances of such accounts as compared to previous year, examine authorisation for withdrawals.</i>

Deposits designated in foreign currencies	<ul style="list-style-type: none">• Verify some of FCNR accounts opened during the year on sample basis and ensure these conform to RBI directions.• Verify on sample basis permissible credits and debits in FCNR accounts as per RBI directions.• In case of FCNR accounts, examine whether these have been converted into Indian Rupees at rate notified in this behalf by head office.• Examine whether any resultant increase or decrease has been taken to the profit and loss account.• Verify that interest on deposits has been paid on the basis of 360 days in a year.
Others	<ul style="list-style-type: none">• In case of NRE and NRO accounts, verify on a sample basis credits and debits as per RBI guidelines. Also check repatriability. NRE accounts are repatriable whereas NRO accounts are not repatriable except for all current income subject to certain conditions.

General	<ul style="list-style-type: none"> • <i>Verify that deposits of a bank are not inflated for purpose of balance sheet presentation. For example, some customers might be given overdrafts near date of balance sheet and the resultant overdrawn amounts may be placed as deposits with banks and further advances may be given on strength and security of these deposits. It would lead to inflated deposits as well as advances. The transactions may be reversed after close of the year. In such cases which indicate the possibility of window-dressing, the auditor should consider making a suitable qualification in main audit report besides other applicable reporting.</i> • Examine that interest accrued but not due on deposits is not included under the relevant deposits but is shown under the head 'other liabilities and provisions'. • Ensure that framework relating to 'Know Your Customer' and Anti-Money Laundering measures is formulated and put in place by the bank.
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BORROWINGS

Area of Focus	Suggested Audit Procedures
Borrowings	<ul style="list-style-type: none"> ➤ Obtain and verify confirmation certificates and other supporting documents such as, agreements, correspondence, etc. ➤ External confirmations ➤ Examine whether a clear distinction has been made between 'rediscount' and 'refinance' for disclosure of the amount under the above head since rediscount does not figure under this head. Examine whether borrowings of money at call and short notice are properly authorized. ➤ Borrowings have been made are in accordance with the authorization. ➤ Examine whether the amount shown in the branch accounts is properly classified based on security or otherwise.

OTHER LIABILITIES AND PROVISIONS

- Bills payable
- Inter-office adjustments (net)
- Interest accrued
- Others (including provisions)

Area of Focus	Suggested Audit Procedures
Bills Payable (DD, Traveller's Cheque etc.)	<p>Evaluate the existence, effectiveness and continuity of internal controls over bills payable.</p> <p>Such controls should usually include the following –</p> <ul style="list-style-type: none"> ➤ Drafts, mail transfers, traveller's cheques, etc. should be made out in standard printed forms. ➤ Unused forms relating to drafts, traveller's cheques, etc. should be kept under the custody of a responsible officer. ➤ The bank should have a reliable private code known only to the responsible officers and decoding of the telegrams should be done only by such officers. ➤ The signatures on a demand draft should be checked by an officer with the specimen signature book. ➤ All the telegraphic transfers and demand drafts issued by a branch should be immediately confirmed by advices to the branches concerned. <p>Correspondence with other branches after the year-end should be examined specially in so far as large value items outstanding on the balance sheet date are concerned.</p>
Inter-office Adjustments	The balance in inter-office adjustments account, if in credit, is to be shown under this head
Interest Accrued	Examine interest accrued with reference to terms of the various types of deposits and borrowings. It should be specifically examined that such interest has not been clubbed with the figures of deposits and borrowings shown under the head 'Deposits and Borrowings'.

CONTINGENT LIABILITIES

Contingent Liabilities

- Claims against the bank not acknowledged as debts
- Liability For partly paid investments
- Liability on account of outstanding forward exchange contracts.
- Guarantees given on behalf of constituents (within India; outside India)
- Acceptances, endorsements and other obligations
- Other items for which the bank is contingently liable

Audit Approach

In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. The auditor should obtain representation from management that:-

- (i) ***all off-balance sheet transactions have been accounted in the books of accounts as and when such transaction has taken place;***

- (ii) *all off balance sheet transactions have been entered into after following due procedure laid down;*
- (iii) *all off balance sheet transactions are supported by the underlying documents;*
- (iv) *all year end contingent liabilities have been disclosed;*
- (v) *the disclosed contingent liabilities do not include any crystallised liabilities which are of the nature of loss/ expense and which, therefore, require creation of a provision/adjustment in the financial statements;*
- (vi) *the estimated amounts of financial effect of the contingent liabilities are based on the best estimates in terms of Accounting Standard 29, including consideration of the possibility of any reimbursement;*
- (vii) *in case of guarantees issued on behalf of the bank’s directors, the bank has taken appropriate steps to ensure that adequate and effective arrangements have been made so that the commitments would be met out of the party’s own resources and that the bank will not be called upon to grant any loan or advances to meet the liability consequent upon the invocation of the said guarantee(s) and that no violation of section 20 of the Banking Regulation Act, 1949 has arisen on account of such guarantee; and*
- (viii) *such contingent liabilities which have not been disclosed on account of the fact that the possibility of their outcome is remote include the management’s justification for reaching such a decision in respect of those contingent liabilities*

Audit Procedures

Area of Focus	Suggested Audit Procedures
Contingent Liabilities	<ul style="list-style-type: none"> ➤ Ensure that there exists a system whereby the non -fund based facilities or additional/ad hoc credit Facilities to parties are extended only to their regular constituents, etc. ➤ Ascertain whether there are adequate internal controls

	<ul style="list-style-type: none"> ➤ Verify in case of LCs for import of goods, the payment to the overseas suppliers is made based on shipping documents. ➤ Ascertain whether the accounting system provides ➤ For maintenance of adequate records in respect of such obligations whether the internal controls ensure that contingent Liabilities are properly identified and recorded. ➤ Test the completeness of the recorded obligations. ➤ Review the reasonableness of the year -end amount of contingent liabilities in the light of previous experience and knowledge of the current year's activities. ➤ Review whether comfort Letters issued by the bank has been considered for disclosure of contingent liabilities. ➤ Examine whether the bank has given any guarantees in respect of any trade credit (buyer's credit or seller's credit). ➤ The period of guarantees is co-terminus with the period of credit reckoned from the date of shipment. ➤ Verify whether bank has extended any non - fund facility or additional/ad hoc credit facilities to other than its regular customers. In such cases, auditor should ensure concurrence of existing bankers of such borrowers and enquire regarding financial position of those customers.
<p>Claims Against the Bank Not Acknowledged as Debts</p>	<ul style="list-style-type: none"> ➤ Examine the relevant evidence, e.g., correspondence with lawyers / others, claimants, workers / officers, and workmen's / officers' unions. ➤ Review the minutes of meetings of board of directors/committees of board of directors, contracts, agreements and arrangements, list of pending legal cases, and correspondence relating to taxes, and duties, etc. to identify claims against the bank. ➤ Ascertain from the management the status of claims outstanding as at the end of the year. ➤ A review of subsequent events would also provide evidence about completeness and valuation of claims.
<p>Liability on Account of Outstanding Forward Exchange Contracts</p>	<p>Verify the outstanding forward exchange contracts with the statement of outstanding forward exchange contracts generated from the bank's computerised accounting system or manual register maintained by the branch. The auditor may physically verify the underlying documents including confirmations from merchants to test the existence of such outstanding contracts The auditor may verify outstanding derivative contracts like options, interest rate swaps etc with reports generated in this regard.</p>
<p>Guarantees Given on Behalf of Constituents</p>	<ul style="list-style-type: none"> ➤ Ascertain whether there are adequate internal controls over issuance of guarantees, e.g., proper sanctions, margins are taken from customers etc. ➤ Adequate controls over unused guarantee forms, ➤ Examine the guarantee register to seek marking off the expired guarantees. ➤ Check the relevant guarantee registers with the List of outstanding guarantees ➤ The auditor should also verify the securities held as margin.

**Acceptances,
Endorsements**

- Evaluate the adequacy of internal controls over issuance of Letters of credit and over custody of unused LC forms in the same manner as in the case of guarantees.

and Other Obligations	<ul style="list-style-type: none"> ➤ Verify the balance of letters of credit from the register maintained by the bank. The security obtained for issuing letters of credit should also be verified.
Other items for which the Bank is Contingently Liabile	<ul style="list-style-type: none"> ➤ Determine and verify any other items under this head as required. For example, outstanding underwriting contracts, bills rediscounting, disputed tax demands, interest rate swaps, etc.
Bills for Collection (of customers)	<ul style="list-style-type: none"> ➤ Ensure that the bills drawn on other branches of the bank are not included in bills for collection. ➤ Verify outward bills for collection with reference to the corresponding register maintained. ➤ Examine collections made subsequent to the date of the balance sheet to obtain further evidence about the existence and completeness of bills For collection. ➤ Examine the procedure for crediting has been collected. ➤ Examine that adequate internal controls exist that debits the customer's account with the amount of bank's commission as soon as a bill collected is credited to the customer's account.

CONCURRENT AUDIT

- Concurrent audit, as the name suggests, is an audit or verification of transactions or activities of an organisation concurrently as the transaction/activity takes place.
- It is not a pre-audit.
- The concept in this audit is to verify the authenticity of the transaction/activity within the shortest possible time after the same takes place.
- It is akin to internal audit which is a concept recognised under the Companies Act.

Appointment of Concurrent Auditors and Accountability

- *The option to consider whether concurrent audit should be done by bank's own staff or external auditors is left to the discretion of individual banks.*
- *In case the bank has engaged its own officials, they should be experienced, well trained and sufficiently senior. The staff engaged on concurrent audit must be independent of the branch where concurrent audit is to be conducted.*
- *ACB of the bank shall decide the maximum tenure of external concurrent auditors with the bank. Generally, tenure of external concurrent auditors with a bank shall not be more than five years on continuous basis. However, no concurrent auditor shall be allowed to continue with a branch/business unit for a period of more than three years.*
- *If external firms are appointed and any serious acts of omissions or commissions are noticed in their working their appointments may be cancelled and the fact may be reported to RBI & ICAI.*

Coverage of Business/Branches

The scope of work to be entrusted to concurrent auditors, coverage of business/branches, etc. is left to the discretion of the head of internal audit of banks with the due prior approval of the Audit Committee of the Board of Directors (ACB).

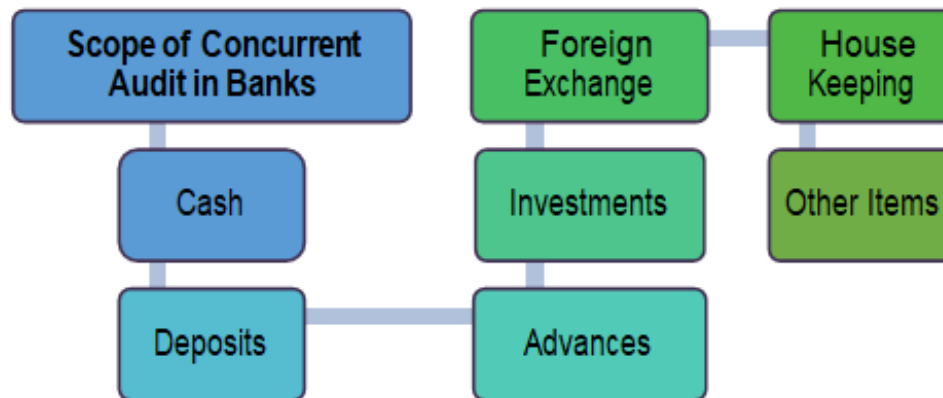
Banks may, however, ensure that risk sensitive areas identified by them as per their specific business models are covered under concurrent audit. The

detailed scope of the concurrent audit may be determined and approved by the ACB

Scope of Concurrent Audit

The detailed scope of the concurrent audit should be clearly and uniformly determined for the Bank as a whole by the Bank’s Central Inspection and Audit Department in consultation with the Bank’s Audit Committee of the Board of Directors (ACB). In determining the scope, importance should be given to checking high-risk transactions having large financial implications as opposed to transactions involving lesser amounts. The detailed scope of the concurrent audit may be determined and approved by the ACB. Further, the guidelines issued by the RBI cover all the key areas of activities of the branch which is under concurrent audit. Most banks have prepared an Audit Manual for this purpose

. Broadly stated, the following areas are covered by these guidelines:



Types of Activities to be Covered

Area of Focus	Suggested Audit Procedures
Cash	<ul style="list-style-type: none"> ➤ Daily cash transactions with particular reference to any abnormal receipts and payments. ➤ Proper accounting of inward and outward cash remittances. ➤ Proper accounting of currency chest transactions, its prompt reporting to the RBI. ➤ Expenses incurred by cash payment involving sizeable amount.
Investments	<ul style="list-style-type: none"> ➤ Ensure that in respect of purchase and sale of securities the branch has acted within its delegated power having regard to its Head Office instructions. ➤ Ensure that the securities held in the books of the branch are physically held by it. ➤ Ensure that the branch is complying with the RBI/head Office guidelines regarding BRs, SGL forms, delivery of scrips, documentation and accounting. ➤ Ensure that the sale or purchase transactions are done at rates beneficial to the bank.
Deposits	<ul style="list-style-type: none"> ➤ Check the transactions about deposits received and repaid. ➤ Percentage check of interest paid on deposits ➤ Check new accounts opened particularly current accounts
Advances	<ul style="list-style-type: none"> ➤ Ensure that loans and advances have been sanctioned properly ➤ Ensure that securities and documents have been received and properly charged/ registered. ➤ Ensure that post disbursement supervision and follow - up is proper, such as receipt of stock statements, instalments, renewal of limits, etc. ➤ Verify whether there is any misutilisation of the loans and whether there are instances indicative of diversion of funds. ➤ Check whether the letters of credit issued by the branch are within the delegated power and ensure that they are for genuine trade transactions. ➤ Check the bank guarantees issued, whether they have been properly worded and recorded in the register of the bank. Whether they have been promptly renewed on the due dates. ➤ Ensure proper Follow-up of overdue bills of exchange.

	<ul style="list-style-type: none"> ➤ Verify whether the classification of advances has been done as per RBI guidelines. ➤ Verify whether the submission of claims to DICGC and ECGC is in time. ➤ Verify that instances of exceeding delegated powers have been promptly reported to controlling/Head Office by the branch and have been confirmed or ratified at the required level.
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Area of Focus	Suggested Audit Procedures
Foreign Exchange	<ul style="list-style-type: none"> ➤ Check Foreign bills negotiated under letters of credit. ➤ Check FCNR and other non-resident accounts whether the debits and credits are permissible under rules. ➤ Check whether inward/outward remittance have been properly accounted for. ➤ Examine extension and cancellation of forward contracts for purchase and sale of Foreign currency. Ensure that they are duly authorised and necessary charges have been recovered. ➤ Ensure that balances in Nostro accounts in different Foreign currencies are within the limit as prescribed by the bank. ➤ Ensure that the overbought/oversold position maintained in different currencies is reasonable considering the Foreign exchange operations. ➤ Ensure adherence to the guidelines issued by RBI/ HO of the bank about dealing room operations. ➤ Verification/reconciliation of Nostro and Vostro account transactions/balances.
House Keeping	<ul style="list-style-type: none"> ➤ Ensure that the maintenance and balancing of accounts, ledgers and registers including clean cash is proper. ➤ Early reconciliation of entries outstanding in the inter - branch and inter-bank accounts, Suspense Account, Sundry Deposits Account, DDDR Account, Drafts Account, etc. ➤ Carry out a percentage check of calculations of interest, discount, commission and exchange. ➤ Check the transactions of staff accounts. ➤ Examine the day book to verify as to how the differences in clearing have been adjusted. ➤ Detection & prevention of revenue leakages through close ➤ Checking of inward and outward remittances (DDs, MTs & TTs).
Other items	<ul style="list-style-type: none"> ➤ In case the branch has been entrusted with government business, ensure that the transactions are done in accordance with the instructions issued by Government, RBI & HQ. Ensure that the branch gives proper compliance to the internal inspection/audit reports. ➤ Ensure that customers' complaints are dealt with promptly. ➤ Verification of statements, returns, statutory returns.

Appointment of Auditors and Accountability

- The option to consider whether concurrent audit should be done by bank's own staff or external auditors is left to the discretion of individual banks.
- Appointment of an external audit firm may be initially for one year and extended up to three years - after which an auditor could be shifted to another branch subject to satisfactory performance.

Remuneration of Concurrent Auditor

Remuneration may be fixed by banks at their discretion.

Reporting Systems

- Each bank should prepare a structured format.
- The major deficiencies/ aberrations noticed during audit should be highlighted in a special note and given immediately to the bank's branch/controlling offices.
- A quarterly review containing key features brought out during the concurrent audits should be placed before the ACB.
- There should be zone-wise reporting of the findings of the concurrent audit to ACB and an annual appraisal/report of the audit system should be placed before the ACB.
- Before submission of the report the auditor should discuss the important issues with the branch manager and concerned officers.
- Minor irregularities pointed out by the concurrent auditors are to be rectified in a timely manner. Serious irregularities should be reported to the controlling offices/ Head Offices for immediate action.
- Whenever fraudulent transactions are detected, they should immediately be reported to Inspection & Audit Department (Head Office) as also the Chief Vigilance Officer.
- Follow-up action on the concurrent audit reports should be given high priority.

AUDIT COMMITTEE

- In pursuance of RBI circular September 26, 1995, a bank is required to constitute an Audit Committee of its Board.
- The membership of the audit committee is restricted to the Executive Director, nominees of the Central Government and the RBI, Chartered Accountant director and one of the non-official directors.
- One of the functions of this committee is to provide direction and also oversee the operations of the total audit function in the bank.
 - The committee also has to review the internal inspection/audit function in the bank, with special emphasis on the system, its quality and effectiveness in terms of follow up.
 - The committee has to review the system of appointment and remuneration of concurrent auditors.

Format of Audit Report

The auditors, central as well as branch, should also ensure that the audit report issued by them complies with the requirements of SA 700, "Forming an Opinion and Reporting on Financial Statements", SA 705, "Modifications to the Opinion in the Independent Auditor's Report", SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", SA 710, "Comparative Information-Corresponding Figures and Comparative Financial Statements" and SA 720, The Auditor's Responsibility Relating to Other Information in Documents Containing Audited Financial Statements.

The auditor should ensure that not only the information relating to number of unaudited branches is given but quantification of advances, deposits, interest income and interest expense for such unaudited branches has also been disclosed in the audit report. Such disclosure in the audit report is not only in accordance with the best international trends but also provides useful information to users of financial statements

It may be noted that, in addition to the aforesaid, the auditor of a banking company is also required to state in the report the matters covered by Section 143 of the Companies Act, 2013. However, it is pertinent to mention that the reporting requirements relating to the Companies (Auditor's Report) Order, 2020 is not applicable to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949.

As per reporting requirements cast through Rule 11 of the Companies (Audit and Auditors) Rules, 2014 the auditor's report shall also include their views and comments on the following matters, namely:

- 1. whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;***
- 2. whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;***
- 3. whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.***
- 4. (i) Whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries;***
(ii) Whether the management has represented, that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been received by the company from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and
(iii) Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) and(ii) contain any material mis-statement.
- 5. Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013.***
- 6. [Whether the company, in respect of financial years commencing on or after the 1st April, 2022,] has used such accounting software for***

maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.]

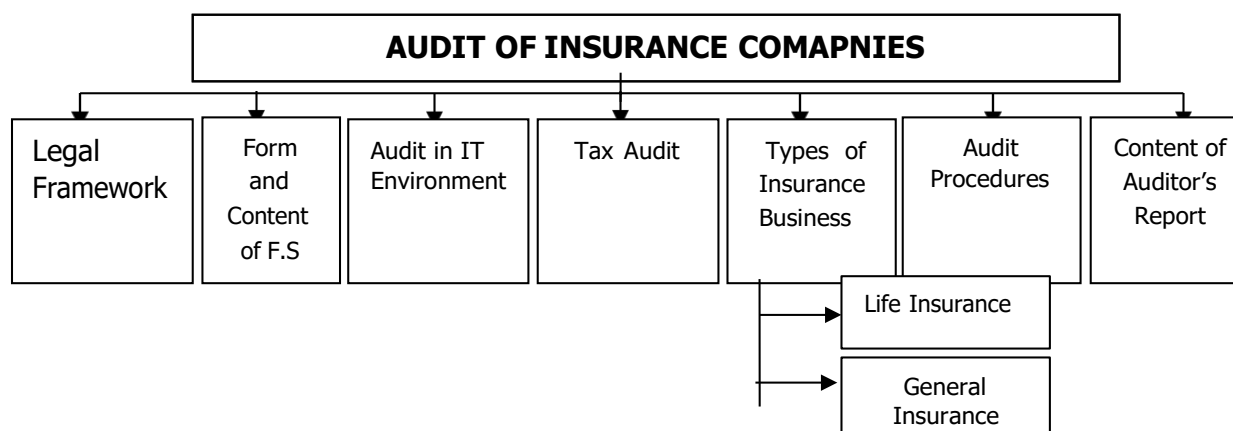
Long Form Audit Report

Besides the audit report as per the statutory requirements discussed above, the terms of appointment of auditors of public sector banks, private sector banks and foreign banks (as well as their branches), require the auditors to also furnish a long form audit report (LFAR). The long form audit report is to be given by statutory branch auditors as well as statutory central auditors. The LFAR for branch auditors is in form of questionnaire where observations/comments have to be provided on range of matters including cash, balance with banks, investments, advances, deposits etc. These are submitted by the statutory branch auditors to statutory central auditors. The consolidation is done at head office level and LFAR for bank is submitted by statutory central auditors to management. The LFAR, on the bank, after due examination, should be placed before the ACB of the bank indicating the action taken/proposed to be taken for rectification of the irregularities, if any, mentioned therein; and a copy of the LFAR and the relative agenda note, together with the Board's views or directions, is submitted to RBI within 60 days of submission of LFAR by statutory auditors.

CHAPTER-2 AUDIT OF INSURANCE COMPANIES

AUDIT OF GENERAL INSURANCE COMPANIES

CHAPTER OVERVIEW



INTRODUCTION	Insurance is a contract between two parties whereby one party agrees to undertake the risk of another in exchange for consideration known as premium and promises to pay a fixed sum of money to the other party on happening of an uncertain event (death) or after the expiry of a certain period (in case of life insurance) or to indemnify the other party on happening of an uncertain event (in case of general insurance). The party bearing the risk is known as the 'insurer' or 'assurer' and the party whose risk is covered is known as the 'insured' or 'assured'.								
	Important points of distinction between Life Insurance and General Insurance	<table border="1" style="width: 100%;"> <thead> <tr> <th style="text-align: center;">Life insurance</th> <th style="text-align: center;">General Insurance</th> </tr> </thead> <tbody> <tr> <td>Term may be Fixed or variable.</td> <td>Term is Fixed (usually 1 year).</td> </tr> <tr> <td>Pay-outs are certain either as claims or maturity benefits.</td> <td>Pay-outs are uncertain as claims may or may not arise.</td> </tr> <tr> <td>Multi-purpose (e.g. investment, tax benefits, insurance).</td> <td>solely For the insurance</td> </tr> </tbody> </table>	Life insurance	General Insurance	Term may be Fixed or variable.	Term is Fixed (usually 1 year).	Pay-outs are certain either as claims or maturity benefits.	Pay-outs are uncertain as claims may or may not arise.	Multi-purpose (e.g. investment, tax benefits, insurance).
Life insurance	General Insurance								
Term may be Fixed or variable.	Term is Fixed (usually 1 year).								
Pay-outs are certain either as claims or maturity benefits.	Pay-outs are uncertain as claims may or may not arise.								
Multi-purpose (e.g. investment, tax benefits, insurance).	solely For the insurance								
LEGAL FRAMEWORK	The primary legislations which deal with the insurance business in India are the Insurance Act, 1938 and the IRDA Act, 1999. ➤ The Insurance Act, 1938 as amended by the Insurance Laws (Amendment) Act, 2015 (including Insurance Rules, 1939);								

	<ul style="list-style-type: none"> ➤ The Insurance Regulatory and Development Authority Act, 1999 as amended by the Insurance Laws (Amendment) Act, 2015; ➤ The Insurance Regulatory and Development Authority Regulations framed under the IRDA, Act, 1999; ➤ The Companies Act, 2013; and ➤ IRDA Investment Regulations, 2013 (as amended From time to time).
DEFINITION	<p>Insurer - Section 2(9) of the Insurance Act, 1938 defines the term 'Insurer' as:</p> <ul style="list-style-type: none"> ➤ an Indian Insurance Company, or ➤ a statutory body established by an Act of Parliament to carry on insurance business, or ➤ an insurance co-operative society, or ➤ a Foreign company engaged in re -insurance business through a branch established in India. <p>Prohibition of Insurance Business by Certain Persons -Third proviso to section 2C (1) of the Insurance Act, 1938 (inserted by the IRDA Act, 1999) prohibits persons other than an Indian insurance company to begin to transact the insurance business after the commencement of the IRDA Act, 1999.</p>
	<p>Registration of Indian Insurance Companies</p> <p>Section 3 of the Insurance Act, 1938 requires every insurer to obtain a certificate of registration before commencement of insurance business in India.</p> <p>The registration of Indian insurance companies is done in accordance with the IRDA (Registration of Indian Insurance Companies) Regulations, 2000</p>
	<p>Requirements as to the Minimum Paid-up Capital</p> <p>The minimum paid-up equity share capital of an Indian insurance company carrying on insurance business should be Rs.100 crores excluding preliminary expenses incurred in the formation and registration of company.</p>
FORM AND CONTENTS OF FINANCIAL	<p>Every insurer, in respect of insurance business transacted and in respect of shareholder's funds, is required to prepare a Balance Sheet, a Profit and Loss Account, a separate Account of Receipts and Payments, a Revenue Account for each year in accordance with the Regulations as may be specified.</p>
STATEMENTS	<p>The Authority has issued regulations for the preparation of the Financial statements and auditor's report of companies containing three schedules.</p> <ul style="list-style-type: none"> ➤ Schedule A is applicable to companies carrying on Life Insurance business. ➤ Schedule B is applicable to Companies carrying on General Insurance business. ➤ Schedule C to the Regulations lays down the matters to be dealt with by the auditor's report of an insurance company. Schedule C is applicable to insurers carrying on general insurance business as well as life insurance business.

<p>AUDIT OF ACCOUNTS</p>	<ul style="list-style-type: none"> ➤ Under section 12 of the Insurance Act, 1938, the financial statements to be audited annually by an auditor. ➤ Section 2(4) defines the term 'auditor' as a person qualified under the Chartered Accountants Act, 1949 to act as an auditor company. ➤ The auditor, has rights and under the Companies Act, 2013. ➤ There is also a requirement by IRDA that half year accounts ended September 2016 need to be reviewed by the statutory auditor <p>The provisions of section 12 of the Insurance Act, 1938 apply only in a case where the financial statements of the insurer are not subject to audit under the Companies Act, 2013.</p>
	<p>Did you Know?</p> <p>Is Receipts & Payment A/c required to be reported upon by the auditor? The financial statements under section 12 include Balance Sheet, Profit and Loss Account, Revenue Account. Section 12 of the Insurance Act, 1938 does not cover the requirement for audit of the Receipts and Payments Account of an insurer. However, sub-section (1) of section 11 of the Insurance Act, 1938 requires that every insurer, should prepare, at the end of each financial year, a Balance Sheet, a Profit and Loss Account, a separate Account of Receipts and Payments and a Revenue Account in accordance with the regulations as may be specified. Since Receipts and Payments Account has been made a part of financial statements of an insurer, it is implied that the Receipts and Payment Account is also required to be audited.</p> <p>IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002. Require the auditor of an insurance company to report whether the Receipts and Payments Account of the insurer is in agreement with the books of account and returns and to express an opinion as to whether the Receipts and Payments Account has been prepared in accordance with the provisions of the relevant statutes and whether the Receipts and Payments Account gives a true and fair view of the receipts and payments of the insurer For the period under audit.</p>
	<p>Appointment of Auditors</p> <ul style="list-style-type: none"> ➤ General Insurance Corporation of India, and its subsidiaries and the divisions by the Comptroller and Auditor General of India, as in the case of other public sector undertakings. ➤ Others auditor is appointed at the AGM an auditor can conduct audit only for three insurance companies and not more than 2 life or 2 general.

		<ul style="list-style-type: none"> ➤ The Guidelines also mandate a mandatory joint audit for all insurance companies.
	Remuneration of Auditors	<p>Fixed in accordance with the provisions of section 142 of the Companies Act, 2013</p> <ul style="list-style-type: none"> ➤ The divisions of the companies carrying on general insurance business are treated for the purposes of the Companies Act, 2013 as their branches. ➤ It follows that the branch auditors appointed to conduct the audit of the divisions have the same rights and obligations under the statute as those of the, statutory auditors to whom they are expected to submit their report. ➤ In case of private companies, the accounting and operational systems of the company are centralized and hence, the principle of divisional offices preparing accounts and they being consolidated is not applicable to such companies. The accounts of all the divisions, trial balances and their balance sheets are prepared at the Head office only.
	Investment Risk Management Systems and Process Audit	<p>The IRDA advised that the Chartered Accountants firm, which is not the Statutory or Internal or Concurrent Auditor of the concerned Insurer shall certify that the Investment Risk Management Systems and Processes are in place. For this purpose, the ICAI has also issued "Technical Guide on Review and Certification of Investment Risk Management Systems and Processes of Insurance Companies" in consultation with the IRDA.</p>
	Direction of C&AG	<p>The Comptroller and Auditor General of India has the power to direct the manner in which the accounts shall be audited and give such instructions in regard to any matter relating to performance of functions by the auditor and to conduct the supplementary or test audit of the accounts of such companies by such person or persons as may be authorised in this behalf. Section 143(5) and 143(6) of the Companies Act, 2013. The statutory auditors are required to submit a copy of their report to the C&AG who has the right to comment upon or supplement the audit report.</p>
	Applicability of CARO, 2016	<p>The additional reporting requirement under Companies (Auditor's Report) Order, 2016 is exempted for an insurance company as defined under the Insurance Act, 1938</p>
REQUIREMENTS OF THE INSURANCE ACT, 1938 VIS A VIS THE		<ul style="list-style-type: none"> ➤ According to section 1 of the Companies Act, 2013, the provisions of the Companies Act, 2013 shall apply to insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999.

<p>COMPANIES ACT, 2013</p>	<ul style="list-style-type: none"> ➤ Section 117 of Insurance Act, 1938, provides that nothing in the Insurance Act, 1938 shall affect the liability of an insurer, being a company, to comply with the provisions of the Companies Act, 2013 in matters not otherwise specifically provided for by Insurance Act, 1938. ➤ Therefore, the provisions of the Companies Act, 2013 would be applicable wherever the Insurance Act, 1938 does not cover the relevant aspects and the insurer is a company within the meaning of the Companies Act, 2013. ➤ The provisions of the Companies Act, 2013 should be applied in a harmonised manner with the provisions of the Insurance Act, 1938, and the rules and regulations framed thereunder.
<p>AUDITING IN AN INFORMATION TECHNOLOGY ENVIRONMENT</p>	<ul style="list-style-type: none"> ➤ Auditor has to familiarise himself with the IT environment in insurance companies. ➤ The auditor may select a few transactions of each type and trace them through the system, i.e., identify the audit trail. ➤ This would help him in not only understanding flow of transactions and manner of processing but it will also provide him evidence as to whether the results of processing are correct. ➤ Where the auditor is satisfied about the design and operation of the IT system, he may limit the extent of his checking of transactions in so far as those aspects are concerned, where the IT system has in-built control. ➤ The auditor should seek a written representation from the management about any changes in the IT systems.
<p>TAX AUDIT</p>	<ul style="list-style-type: none"> ➤ It is necessary for general insurance companies to get their accounts audited under Section 44 AB of the said Act. ➤ For this purpose, the tax auditor(s) may be appointed by the company itself by means of a resolution of the Board of Directors or by the Chairman/ Managing Directors if so authorised in this behalf. ➤ The company is expected to fix separate remuneration for the auditor(s) appointed for this purpose.
<p>SPECIFIC CONTROL PROCEDURES RELATED TO AUDIT OF LIFE INSURANCE COMPANIES</p>	<p>Types of Life Insurance Products</p> <ul style="list-style-type: none"> ➤ Term / Protection: Term insurance covers the policy holder for specific period and pays the death benefits only if the policy holder dies during the policy period. ➤ Endowment/ Pure Endowment: Endowment policies cover the risk for a specified period and at the end of the policy the sum assured is paid back to the policyholder along with all bonus accumulated during the policy term. ➤ Money Back Plan: Money Back policies are type of Endowment policies which provides periodic payments of partial benefits during the term of policy so long as the policy holder is alive. Peculiar nature of these policies is that, in event of death at any time during policy term, the death claim would comprise of full sum assured without deduction of any survival benefit amounts. ➤ Whole Life Insurance Product: It provides cover through the life time of the person do not carry any maturity value and

		<p>sum assured is paid to the Family in case of unfortunate death of the policyholder.</p> <ul style="list-style-type: none"> ➤ Unit Linked Insurance Plan (ULIP): Value of the policy changes as per the underlying investment Assets. The Premium paid is used for the purchase of units in Investment assets. ➤ Pension or Retirement Plans: A pension plan is retirement solution where policyholder decides the age retirement age and agrees to pay premium till the time of the retirement and thereafter he has option to commute the a part of his fund value and take an annuity for the balance. Pension plan provides Income protection as well as the Life Cover. ➤ Annuities: Annuity is a contract where insurer in return For the payment at regular intervals till fixed date make series of agreed payments at regular intervals from fixed date. ➤ Group Insurance: Group Insurance is an insurance that covers a group of people, who are the members of the societies, employees of an organisation or professionals in common group. ➤ Others
<p>PART I: ACCOUNTING PRINCIPLES FOR PREPARATION OF FINANCIAL STATEMENTS</p>	<p>Applicability of Accounting Standards</p>	<p>Every balance sheet, Revenue Account (Policy holders account), Receipts and Payments account (Cash flow statement) and Profit and Loss account (Shareholder's account) of an insurer shall be in conformity with the Accounting standards (AS) issued by the ICAI, to the extent insurers carrying on life insurance business, except that:</p> <ul style="list-style-type: none"> ➤ Accounting standard 3 (AS 3) - Cash flow statements - Cash Flow statements shall be prepared only under the direct method. ➤ Accounting standard 17 (AS 17) - Segment Reporting - shall apply to all insurers irrespective of the requirements regarding the listing and turnover mentioned therein.
	<p>Premium</p>	<p>Premium shall be recognized as income when due. For linked business the due date For payment may be taken as the date when the associated units are created.</p>
	<p>Acquisition Costs</p>	<p>Acquisition costs if any shall be expensed in the period in which they are incurred.</p>
	<p>Claims</p>	<p>The ultimate cost of claims shall comprise the policy benefit amount and specific claims settlement costs, wherever applicable.</p>
	<p>Actuarial valuation- Liability for Life Policies</p>	<p>The estimation of liability against life policies shall be determined by the appointed actuary of the insurer pursuant to his annual investigation of the life insurance-business. Actuarial assumptions are to be disclosed by way of notes to the account</p>
	<p>Procedure to</p>	<p>a. Real estate investment property –</p> <ul style="list-style-type: none"> ➤ at historical cost

	<p>determine 'Value of investments'</p>	<ul style="list-style-type: none"> ➤ subject to revaluation at least once in every 3 years change ➤ Shall be taken to revaluation reserve. ➤ Assess at each balance sheet date whether any impairment of the property has occurred. ➤ 'Revaluation Reserve' recycled to the relevant revenue account or profit and loss account on sale of that property. ➤ Except For the amount that is released to policyholders as per the authority's direction, no other amount shall be distributed to shareholders out of revaluation reserve account. ➤ An impairment loss of shall be recognized as an expense in the revenue / Profit and loss account immediately, unless the asset is carried at revalued amount. <p>b. Debt Securities — Including government securities and redeemable preference shares, shall be considered as 'held to maturity' measured at historical cost subject to amortization.</p> <p>c. Equity Securities and Derivative Instruments that are traded in markets Listed</p> <ul style="list-style-type: none"> ➤ measured at fair value on the balance sheet date. ➤ The insurer shall assess on each balance sheet date whether an', impairment has occurred. ➤ Unrealised gains/losses shall be taken to 'Fair value change account'. ➤ 'Fair value changes account' being recycled to the relevant Revenue account or Profit and loss account on actual sale of that security. ➤ The Authority may issue directions specifying the amount to be released from the Fair Value Change Account for declaring bonus to the policyholders. Other amount shall be distributed to shareholders out of Fair Value Change Account. <p>d. Unlisted and other than actively traded (Thinly Traded) Equity Securities and Derivative Instruments –</p> <ul style="list-style-type: none"> ➤ shall be measured at historical cost ➤ Provision shall be made for diminution value of such investments.
	<p>Loans</p>	<p>Insurer grants Loan on the security of policy document to the person who is entitled for the</p>

		same, policy holder. Loans shall be measured at historical cost subject to impairment provisions.
	Linked (ULIP) Business	The accounting principles used for valuation of Investments are to be consistent with principles as enumerated above. A separate set of financial statements, For each segregated fund of the [inked business should be annexed. Segregated funds represents Funds maintained in accounts to meet specific investment objectives of policy holders who bear the Investment risk.
	Funds for Future appropriation	The funds for Future appropriation represent all funds, the allocation of which, either to policyholders or to the shareholders, has not been determined by the end of the financial year.
PART II: DISCLOSURES FORMING PART OF FINANCIAL STATEMENTS	<ul style="list-style-type: none"> ➤ Contingent Liabilities: <ul style="list-style-type: none"> a. Partly-paid up investments b. Underwriting commitments outstanding c. Claims, other than those under policies, not acknowledged as debts d. Guarantees given by or on behalf of the company e. Statutory demands/liabilities in dispute, not provided For f. Reinsurance Obligations to the extent not provided for in accounts g. Others (to be specified). ➤ Actuarial assumptions for valuation of liabilities for life policies in force. ➤ Encumbrances to the assets of the Company in and outside India. ➤ Commitments made and outstanding For Loans, Investments and Fixed Assets. ➤ Basis of amortisation of debt securities ➤ Claims settled and remaining unpaid for a period of more than six months as on closing date. ➤ Value of Contracts in relation to Investment for (a) Purchases where deliveries are pending; (b) Sales where payments are overdue. ➤ Operating expenses relating to insurance business, basis of allocation of expenditure to various segments of business. ➤ Computation of managerial remuneration. ➤ Historical costs of those Investments valued on fair value basis. ➤ Basis of revaluation of Investment property. 	
	Accounting Policies	All significant accounting policies in terms of the accounting standards issued by the ICAI. The following information shall also be disclosed: <ul style="list-style-type: none"> ➤ Investments made in accordance with any statutory requirement should be disclosed separately together with its amount, nature,

	<p>security and any special rights in and outside India;</p> <ul style="list-style-type: none"> ➤ Segregation into performing/non-performing investments For purpose of Income recognition as per the directions, if any, issued by the Authority; ➤ Assets to the extent required to be deposited under local laws or otherwise encumbered in or outside In ➤ Percentage of business sector-wise; ➤ A summary of financial statements for the last five years, in the manner as may be prescribed by the Authority. ➤ Bases of allocation of investments and income thereon between Policy-holders' Account and Shareholder Account; ➤ Accounting Ratios as may be prescribed by the Authority.
<p>PART III: GENERAL. INSTRUCTION S FOR PREPARATION OF FINANCIAL STATEMENTS:</p>	<ul style="list-style-type: none"> ➤ Corresponding amounts for the immediately preceding Financial year ➤ Rounded off to the nearest thousands. ➤ Interest, dividends and rentals receivable should be stated at gross amount For the purposes of financial statements, unless the context otherwise requires – <ol style="list-style-type: none"> a. the expression 'provision' shall, mean any amount written of F or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by way of providing For any known liability or loss b. the expression 'reserve' shall not, amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability or loss; c. the expression 'capital reserve' shall not include any amount regarded as Free For distribution through the profit and loss account; and the expression 'revenue reserve' shall mean any reserve other than a capital reserve; d. the expression liability" shall include all liabilities in respect of expenditure contracted for and all disputed or contingent liabilities. ➤ Extent of risk retained and re-insured shall be separately disclosed. ➤ Any debit balance of the Profit and Loss Account shall be shown as deduction from uncommitted reserves and the balance, if any, shall be shown separately.
<p>PART IV: CONTENTS OF MANAGEMENT REPORT</p>	<p>There shall be attached to the financial statements, a management report containing, inter alia, the following duly authenticated by the management:</p> <ul style="list-style-type: none"> ➤ Confirmation regarding the continued validity of the registration granted by the Authority;

	<ul style="list-style-type: none"> ➤ Certification that all the dues payable to the statutory authorities have been duly paid; ➤ Confirmation to the effect that the shareholding pattern and any transfer of shares during the year are in accordance with the statutory or regulatory requirements; ➤ Declaration that the management has not directly or indirectly invested outside in India the funds of the holders of policies issued in India. ➤ Confirmation that the required solvency margins have been maintained. ➤ Certification to the effect that the values of all the assets have been reviewed on the date of the Balance Sheet and that in his (Insurer) belief the assets set forth in the Balance Sheets are shown in the aggregate at amounts not exceeding their realisable or market value under respective headings of the Assets. ➤ Certification to the effect that no part of the life insurance fund has been directly or indirectly applied in contravention of the provisions of the Insurance Act, 1938 (4 of 1938) relating to the application and investment of the Life Insurance funds. ➤ Disclosure with regards to the overall risk exposure and strategy adopted to mitigate the same. ➤ Operations in other countries, if any, with a separate statement giving the Management's estimate of country risk and exposure risk and the hedging strategy adopted. ➤ Ageing of claims indicating the trends in average claim settlement time during the preceding Five years; ➤ Certification to the effect as to how valuation of Investments has been carried out. ➤ Review of asset quality and performance of investment in terms of portfolios, i.e., separately in terms of real estate, loans, investments, etc. ➤ A responsibility statement indicating therein that: (Like 5-134 of Companies Act, 2013) <ol style="list-style-type: none"> a. in the preparation of financial statements, the applicable accounting standards, principles and policies have been Followed along with proper explanations relating to material departures, if any; b. the management has adopted accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and Fair view of the state of affairs of the Company a t the end of the Financial year and of the Operating profit or loss of the Company For the year. c. the management has taken proper and sufficient care for the maintenance of adequate accounting records with the applicable provisions of the Insurance Act , 1938 (4 of 1938)/ Companies Act, 2013, For safeguarding the assets of the Company and for preventing and detecting Fraud and other irregularities;
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


	<ul style="list-style-type: none"> d. the management has prepared the financial statements on a going concern basis.; e. the management has ensured that an internal audit system commensurate with the size and nature of the business exists and is operating effectively; <p>➤ A schedule of payments, made to individuals, firms, companies and organizations in which Directors of the insurer are interested.</p>				
	<p>Areas which are peculiar to Life Insurance business are enumerated below:</p> <table border="1"> <tr> <td>Actuarial Process</td> <td>The job of actuary or actuarial department in any Life Insurance Company involves, detailed analysis of data to quantify risk.</td> </tr> <tr> <td>Role of Auditor</td> <td>Role of Auditor: to certify, whether the actuarial valuation of liabilities is duly certified by the appointed actuary, including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms. Hence, Auditors generally rely on the Certificate issued by the Appointed Actuary. However, Auditor may discuss with the Actuaries with respect to process followed and assumptions made by him before certifying the Policy liabilities.</td> </tr> </table>	Actuarial Process	The job of actuary or actuarial department in any Life Insurance Company involves, detailed analysis of data to quantify risk.	Role of Auditor	Role of Auditor: to certify, whether the actuarial valuation of liabilities is duly certified by the appointed actuary , including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms. Hence, Auditors generally rely on the Certificate issued by the Appointed Actuary. However, Auditor may discuss with the Actuaries with respect to process followed and assumptions made by him before certifying the Policy liabilities.
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Underwriting	<p>A proposal is an application for an insurance cover. The process of verifying the level of risk in each new entrant is called 'selection' or 'underwriting'. The function of the underwriter is to acquire-or to "write"-business that will bring money to the insurance company, and to protect the company's business From risks that they feel will make a loss.</p> <table border="1"> <tr> <td>Role of Auditor</td> <td>Objective of the Audit should be to review the process of acceptance of risk through the underwriting process, and evaluate and test the effectiveness of internal controls in place to ensure timely and accurate Insurance policy, adherence to the IRDA Act and Rules and regulations made there under.</td> </tr> </table>	Role of Auditor	Objective of the Audit should be to review the process of acceptance of risk through the underwriting process, and evaluate and test the effectiveness of internal controls in place to ensure timely and accurate Insurance policy, adherence to the IRDA Act and Rules and regulations made there under.		
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Reinsurance	<p>Reinsurance is a risk mitigating tool adopted by Insurer whereby the risk underwritten by one insurer is transferred partially to another Insurer.</p> <p>Role of Auditor: The primary objective of the audit should be to check and confirm that reinsurance premium calculation and payment is in accordance with the agreement with the reinsurer.</p>				
	<table border="1"> <tr> <td>Free Look Cancellation (FLC)</td> <td>Policy holder can cancel policy within a period of 15 days From the date of receipt of the policy document after review of the terms and conditions of the policy. He shall be entitled to a refund of the premium paid, subject only to a deduction of a</td> </tr> </table>	Free Look Cancellation (FLC)	Policy holder can cancel policy within a period of 15 days From the date of receipt of the policy document after review of the terms and conditions of the policy. He shall be entitled to a refund of the premium paid, subject only to a deduction of a		
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		<p>proportionate risk premium for the period on cover and the expenses incurred by the insurer on medical examination of the proposer and stamp duty charges".</p> <table border="1"> <tr> <td>FLC refund is calculated as follows:</td> <td></td> <td></td> </tr> <tr> <td>FLC premium paid</td> <td>XXX</td> <td></td> </tr> <tr> <td>(Less: - Proportionate risk premium</td> <td>XXX</td> <td></td> </tr> <tr> <td>(Less) – Medial charges, if any, by the insurer</td> <td></td> <td>X</td> </tr> </table>	FLC refund is calculated as follows:			FLC premium paid	XXX		(Less: - Proportionate risk premium	XXX		(Less) – Medial charges, if any, by the insurer		X
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FLC premium paid	XXX													
(Less: - Proportionate risk premium	XXX													
(Less) – Medial charges, if any, by the insurer		X												
		<p>Role of Auditor The primary objective of the audit is to check and confirm that FLC Auditor requests are received within 15 days from receipt of policy document by the policy holder, verification of signatures of the policy holder and processing of FLC request.</p>												
	Policy Lapse and Revival	<ul style="list-style-type: none"> ➤ "Lapse" is the discontinuance of the policy owing to non -payment of premium dues. ➤ If payment is missed, the insurer allows a period of 15/30 days from the premium due date for making the payment. This period is termed as "grace period". ➤ If the policy holder does not make the payment within the grace period, the policy gets "lapsed". 												
		<p>Lapsation affects all the stake - holders The policy holder, agents and the insurer. A lapsed policy ceases to affects all provide insurance protection to the insured. It forfeits the benefits the stake-under the policy and cost of new policy is higher. Agents do not get holders renewal premium commission if the policy is lapsed.</p>												
		<p>Renewal The terms and conditions of the policy stipulate, that where the premium is not paid within the grace period, the policy lapses but may be revived during the life time of the life assured. Some insurers do not allow revival, if the policy has remained in lapsed condition for more than five years. This is because of the possibility that the arrears of premiums on such a policy would be too heavy.</p>												
		<p>Role of Auditor The primary objective of the audit is to check and confirm that due dates are recorded and monitored properly and polices are marked as "lapsed" on non - receipt of renewal premium within due dates/grace period. In case of revival request, whether adequate checks are in place For receipt of outstanding amounts and adequate documents are obtained before reviving the policy.</p>												

	<p>Policy Surrender:</p>	<ul style="list-style-type: none"> ➤ Voluntary termination of the insurance contract before the expiry of the term of the contract. ➤ The process of surrender is initiated by the policy holder. ➤ A policy becomes eligible for surrender on completion of 3 years From the commencement of the policy provided that 3 years premium have been paid within the due dates. The policy holder has to submit surrender request Form duly signed off. ➤ The policy can be surrendered only when the insured person is alive.
		<p>Role of Auditor</p> <p>The primary objective of the audit is to check and confirm that Auditor surrender requests are received from the policy holder only, and that adequate controls are in place to ensure proper verification process For checking of request, whether premiums are paid on regular basis. Check whether surrender amount is paid only to the policy holder and is paid only as per terms and conditions mentioned in the policy document and appropriate accounting entries are passed.</p>
	<p>Premium Collection, Accounting and reconciliation</p>	<ul style="list-style-type: none"> ➤ Premium accounting refers to recognizing the premium earned by the insurer as income in the accounting system. ➤ Income is recognized as: <ol style="list-style-type: none"> 1. New business premium - premium received for the First policy year and 2. Renewal premium - premium received for subsequent policy years. ➤ Premium received but not identifiable against any policy would be treated as 'unallocated premium/suspense amount'. <p>Further following points should be noted while recognizing the premium:</p> <ol style="list-style-type: none"> 1. When the new policy is issued by the Insurer, new business premium is recognised on the realisation of premium. In certain cases, policies are issued awaiting realisation of premiums. 2. Renewal income is recognized (1) on realization of the premium amount or (2) when premium is due but not received up to the end of grace period. 3. Auditors should also evaluate various sub-processes, employed by the Insurance Companies in accounting of premiums like collection of premium from the policy holders, booking of premium, banking, accounting and reconciliation of the same.

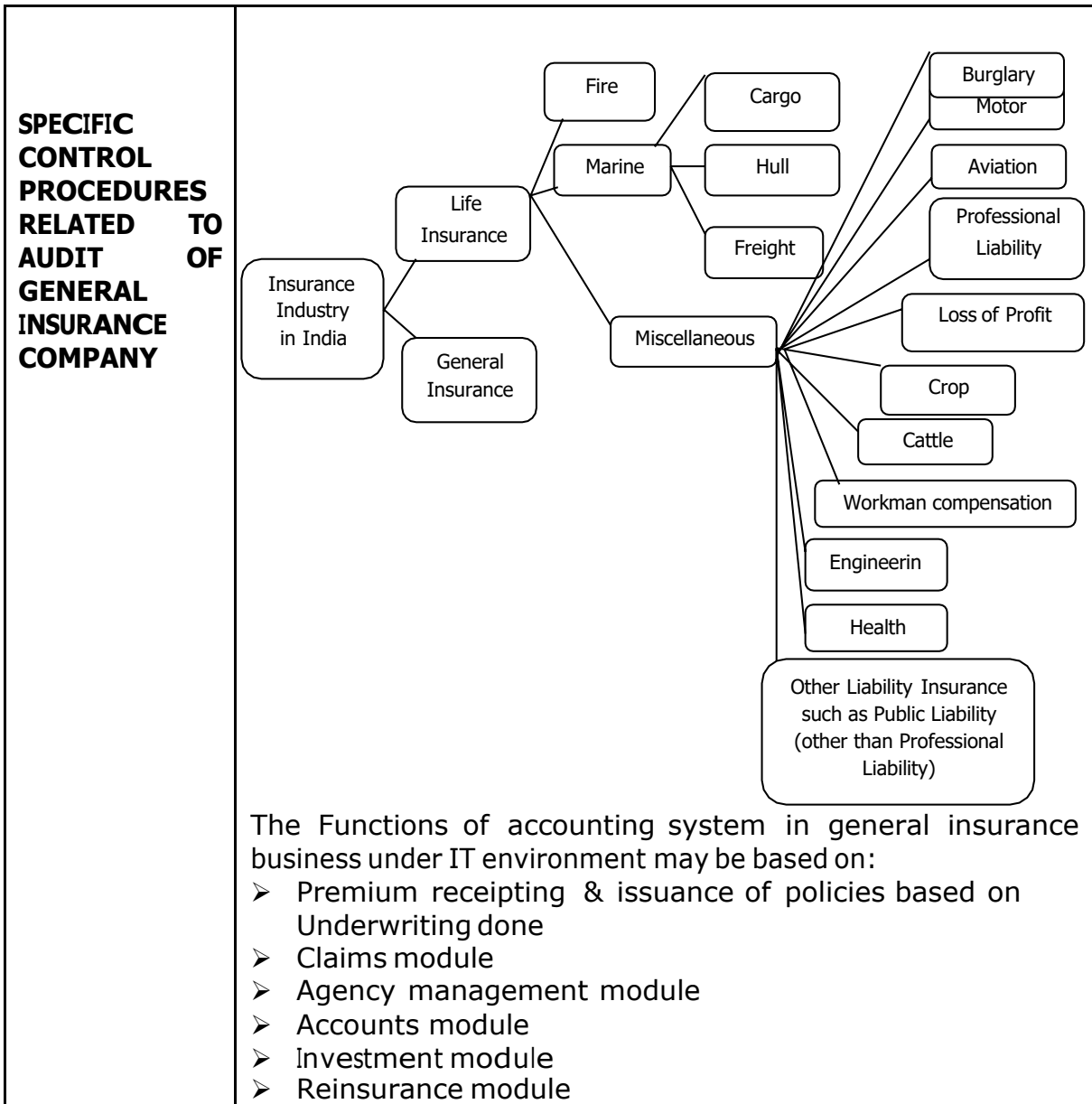
		<p>Following are the certain illustrative points, Auditors are required to follow during the Audit of Accounting of Premiums:</p> <ol style="list-style-type: none"> 1. Collection of Premium: <ul style="list-style-type: none"> • Check whether there is daily reconciliation process to reconcile the amounts collected, entered into the system and deposited into the bank. • Check that there is appropriate mechanism to ensure all the collections are deposited into the Bank on timely basis. 2. Calculation of Premium: <ul style="list-style-type: none"> • Check that Accounting system, employed by the Company, calculates premium amounts and its respective due dates correctly. • Check that system employed as such is equipped to calculate all types of premium modes correctly. 3. Recognition of Income: <ul style="list-style-type: none"> • Check that premium is recognised only on the basis of 'Issued Policies' and not on underwriting dates. • Check that there is inbuilt mechanism the system all the premium collected are correctly allocated all various components of the Policies. • Check that there is appropriate mechanism in place to conduct reconciliation on daily basis and reconciling items, if any, are rectified / followed up. 4. Accounting of 'advance Premium': <ul style="list-style-type: none"> • Check, whether system has capability to identify regular and advance premium. • Check whether there is a process of applying advance premium to a contract when premium is due. 5. Reporting of Premium figures to IRDA/ Management: <ul style="list-style-type: none"> • Check the methodology for generation of MIS From the system and there is no manual intervention. • Check the procedure For Maker/ Checker before finalizing the MIS. • Check whether there is a reconciliation process between premium Income as per financials and as reported. 6. Other Areas: <ul style="list-style-type: none"> • Check whether there are appropriate SOPs developed by the Companies and are strictly
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		<p>followed by all the departments/ branches of the Company.</p> <ul style="list-style-type: none"> • Ensure duly approved Delegation of Authority parameters matrix already in place for authorisation limits. • Premium recognition and refund of premium are independent processes with adequate segregation of duties amongst the personnel. • Check that the Company conducts premium reconciliation on daily basis. • Check the robustness of interface between administration and accounting system. Auditors may also refer to IRDA (Preparation of Financial Statements & Auditors Report of Insurance Companies) Regulations, 2000 for premium accounting. 														
	<p>Claims:</p>	<p>Checking of accuracy of processing and accounting of claims lodged with the Insurer, is the primary objective of Audit of Life Insurance Companies.</p> <table border="1" data-bbox="646 897 1419 1157"> <tr> <th colspan="7">Claims payouts would include a wide variety of customer benefits including:</th> </tr> <tr> <th>Death Claims</th> <th>Maturity Claims</th> <th>Annuities</th> <th>Health Claims</th> <th>Rider Claims</th> <th>Policy surrenders</th> <th>Other Survival benefits.</th> </tr> </table> <p>Claims review primarily ensure focus on the Following areas:</p> <ul style="list-style-type: none"> • Claims lodgment and processing • Authority matrix For approval of claims • Review of payouts and disbursements • Review of compliance to applicable IRDA Regulations, relevant sections of Insurance Act 1938 and the prevention of Money Laundering Act, 2002. • Review of Reinsurance recovery process • Review of reporting of claims (life & health) and benefits paid. <p>Following are the certain illustrative points, Auditors are required to follow during the Audit of Claims:</p> <ol style="list-style-type: none"> 1. Auditor should review the standard policy document template to ensure that the policy document prescribes the minimum documentary evidence needed to support a claim. 2. Ensure that the Insurer maintains a register or record of claims, in which every claims are entered along with the date of the claim and date on which the claim was discharged. 3. In case the claims are rejected, the reasons For the rejections should be closely reviewed. 	Claims payouts would include a wide variety of customer benefits including:							Death Claims	Maturity Claims	Annuities	Health Claims	Rider Claims	Policy surrenders	Other Survival benefits.
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Death Claims	Maturity Claims	Annuities	Health Claims	Rider Claims	Policy surrenders	Other Survival benefits.										

		<ol style="list-style-type: none"> 4. Check whether all claims received are registered and enter into the system. 5. It should be ensured that there is a system of collecting appropriate KYC documents, as required, and discrepancies, if any, are intimated to the policyholders within 15 days of intimation. 6. It should be ensured that all the processed claims are accounted in to the system properly. 7. It should be ensured that appropriate provisioning has been carried out, in the cases of all the claims intimated but not paid. 8. It should be ensured that Claims cost includes the Claims settlement Cost. 9. In case of living/ survival/ maturity / annuity benefits it should be ensured that liability is automatically triggered.
	<p>Investments</p>	<ul style="list-style-type: none"> ➤ The Investment portfolio of Life Insurance companies comprise of Shareholders' Funds and Policyholders' Funds. ➤ Policyholders' funds can Further be segregated as linked and non - linked. ➤ Investment regulations are however prescribed separately for the following investment categories: <div style="display: flex; justify-content: space-around; align-items: center;"> <div style="border: 1px solid black; border-radius: 15px; padding: 10px; text-align: center;">  i. Linked Funds </div> <div style="border: 1px solid black; border-radius: 15px; padding: 10px; text-align: center;">  ii. Pension and Annuity Funds </div> <div style="border: 1px solid black; border-radius: 15px; padding: 10px; text-align: center;">  iii. Controlled Funds </div> </div> <p>IRDA (investment) regulations, 2000 gives details of the pattern in which Funds of the Life Insurance business, should be kept invested at any given point of time.</p>
		<p>Role of Auditor:</p> <ul style="list-style-type: none"> ➤ Review the Investment management structure to ensure adequate segregation of duties between Investment Front office, Mid Office and Back office ➤ Review of insurer's Standard Operating Procedures which are prescribed by the IRDA Regulations and are required to cover the entire gamut of investment related processes and policies ➤ Review of insurer's Investment policy ➤ Review of functioning and scope and minutes of Investment Committee ➤ Compliance of all investment regulations; various other circulars

			<p>specified by IRDA and other regulations specified in the Insurance Act, 1938</p> <ul style="list-style-type: none"> ➤ Review of insurer's Disaster Recovery, Backup and Contingency Plan ➤ Review of access Controls, authorization process for Orders and Deal execution, etc ➤ Review of insurer's Cash Management System to track funds available for Investment considering the settlement obligations and subscription and redemption of units, etc. The system should be validated not to accept any commitment beyond availability of funds and restrict Short Sales at the time of placing the order. Further insurer's system should be able to determine the amount of Investible surplus ➤ Ensure that the system is be able to automatically monitor various Regulatory limits on Exposure and Rating of debt instruments ➤ Review of fund wise reconciliation with Investment Accounts Bank, and Custodian records ➤ Ensure that there is split between Shareholders' and Policyholders' funds, and earmarking of securities between various funds namely Life (Participating & Non - Participating Pension & Group (Participating & Non-Participating) and Unit Linked Fund ➤ Review the arrangements and reconciliations of holdings wit-the insurer's custodian ➤ Review and check insurer's investment Accounting and valuation policy and the controls around this process ➤ insurer's risk management policies and processes to manage investment risk such as Market risk, Liquidity risk, Settlement risks etc ➤ Determine the extent of activities outsourced and the controls over such activities ➤ Controls over NAV computation and declaration
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			➤ Flow of data from PMS to the Investment Accounting system
	Operating Expenses related to Insurance Business (Expenses of Management)		<ul style="list-style-type: none"> ➤ All the administrative expenses in an insurance company are broadly classified under 14 heads as mentioned in Schedule 3 forming part of Financial Statements given under Schedule A to the Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002. ➤ Any other expenses are required to be disclosed under the head 'Others'. Any major expenses (Rs 5 Lacs or in excess of 1% of net premium, whichever is higher) are required to be shown separately.
		Role of Auditor	<ul style="list-style-type: none"> ➤ The auditor should ensure that these expenses are first: Auditor aggregated and then apportioned to the Revenue Account of each class of business on a reasonable and equitable basis. ➤ The accounting policy should clearly indicate the basis apportionment of these expenses to the respective Revenue Accounts (i.e., Participating and Non - participating policies and in between Linked and Non- Linked business) along with the certificate that all expenses of management, wherever incurred directly or indirectly, read with the accounting policy, have been fully debited to the respective Revenue Account as expenses.



Requirements of Schedule B to the IRDA (Preparation of Financial Statements and Auditors' Report of Insurance Companies) Regulations, 2002

<p>PART I: ACCOUNTING PRINCIPLES FOR PREPARATION OF FINANCIAL STATEMENTS</p>	<p>Applicability of Accounting Standards</p>	<p>Shall be in conformity with the Accounting Standards (AS) issued by the ICAI, except that:</p> <ul style="list-style-type: none"> ➤ Accounting Standard 3 (AS 3) - Cash Flow Statements - Cash Flow Statement shall be prepared only under the Direct Method. ➤ Accounting Standard 13 (AS 13) - Accounting for Investments, shall not be applicable. ➤ Accounting Standard 17 (AS 17) - Segment Reporting - shall apply irrespective of whether the securities of the insurer are traded publicly or not.
	<p>Premium</p>	<ul style="list-style-type: none"> ➤ Premium shall be recognised as income over the contract period or the period of risk, whichever is appropriate. ➤ Unearned premium as well as premium received in advance, both of which represent premium

		<p>income not relating to the current accounting period, shall be disclosed separately in the Financial statements.</p> <ul style="list-style-type: none"> ➤ A Reserve For Unearned Premium, may be created as the amount representing that part of the premium written which is attributable and to be allocated to the succeeding accounting periods. ➤ Premium Received in Advance, which represents premium received prior to the commencement of the risk, shall be shown separately under the head 'Current Liabilities' in the financial statements. ➤ Unearned premium shall be shown separately under the head 'Current Liabilities' and appropriate disclosures regarding management's basis of assessment shall be made in the financial statements. ➤ Premium revenue recognition is based on the pattern of risk to which the insurer is exposed.
	Premium Deficiency	<p>Premium deficiency shall be recognised if the sum of expected claim costs, related expenses and maintenance costs exceeds related unearned premiums. For contracts exceeding Four years, once a premium deficiency has occurred, future changes to the liability shall be based on actuarial/technical evaluation.</p>
	Acquisition Costs	<p>Acquisition costs, if any, shall be expensed in the period in which they are incurred.</p>
	Claims	<p>Claims under policies comprise the claims made for losses incurred, and those estimated or anticipated under the policies.</p> <p>A liability For outstanding claims shall be brought to account in respect of both direct business and inward reinsurance business. The liability shall include:-</p> <ol style="list-style-type: none"> a. Future payments in relation to unpaid reported claims; b. Claims Incurred But Not Reported (IBNR) including inadequate reserves (sometimes referred to as Claims Incurred But Not Enough Reported (IBNER)). <p>Actuarial Valuation of claim liability - Estimate of claims made in respect of contracts exceeding four years shall be recognised on an actuarial basis.</p>
	Procedure to determine the value of	<p>An insurer shall determine the values of investments in the Following manner:-</p> <ol style="list-style-type: none"> a. Real Estate - Investment Property - <ul style="list-style-type: none"> ➤ Investment Property shall be measured at historical cost less accumulated depreciation

	<p>investments</p>	<p>and impairment loss, residual value being considered zero and no revaluation being permissible.</p> <ul style="list-style-type: none"> ➤ The Insurer shall assess at each balance sheet date whether any impairment of the investment property has occurred. ➤ An impairment loss shall be recognised as an expense in the Revenue/Profit and Loss Account immediately. ➤ Fair value as at the balance sheet date and the basis of its determination shall be disclosed in the financial statements as additional information. <p>b. Debt Securities - Debt securities including government securities and redeemable preference shares shall be considered as "held to maturity" securities and shall be measured at historical cost subject to amortisation.</p> <p>c. Equity Securities and Derivative Instruments that are traded in active markets –</p> <ul style="list-style-type: none"> ➤ measured at fair value as at the balance sheet date. ➤ For the purpose of calculation of Fair value, the Lowest of the last quoted closing price of the stock exchanges where the securities are listed shall be taken. ➤ Unrealised gains/losses arising due to changes in the fair value of listed equity shares and derivative instruments shall be taken to equity under the head 'Fair Value Change Account' and on realisation reported in Profit and Loss Account. ➤ For the removal of doubt, it is clarified that balance or any part thereof shall not be available for distribution as dividends. Also, any debit balance in the said Fair Value Change Account shall be reduced from the profits/free reserves while declaring dividends. ➤ An impairment loss shall be recognised as an expense in Revenue/Profit and Loss Account to the extent of the difference between the remeasured fair value of the security/investment and its acquisition cost as reduced by any previous impairment loss recognised as expense in Revenue / Profit and Loss Account. Any reversal of impairment loss, earlier recognised in Revenue / Profit and Loss Account shall be recognised in Revenue / Profit and Loss Account.
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		<p>d. Unlisted and other than actively traded Equity Securities and Derivative Instruments - measured at historical costs. Provision shall be made for diminution in value of such investments.</p> <p>For the purposes of this regulation, a security shall be considered as being not actively traded, if its trading volume does not exceed ten thousand units in any trading session during the last twelve months.</p>
	Loans	<p>Loans shall be measured at historical cost subject to impairment provisions The impairment provision shall not be less than the aggregate amount of loans which are subject to defaults of the nature mentioned below:-</p> <ol style="list-style-type: none"> i. interest remaining unpaid for over a period of six months; and ii. instalment (s) of loan falling due and remaining unpaid during the last six months.
	Catastrophe Reserve	<p>Catastrophe Reserve Catastrophe reserve shall be created in accordance with norms, if any, prescribed by the Authority.</p>
PART II: DISCLOSURES FORMING PART OF FINANCIAL STATEMENTS	The following shall be disclosed by way of notes to the Balance Sheet	<ol style="list-style-type: none"> 1. Contingent Liabilities: <ol style="list-style-type: none"> a. Partly-paid up investments b. Underwriting commitments outstanding c. Claims, other than those under policies, not acknowledged as debts d. Guarantees given by or on behalf of the company e. Statutory demands/liabilities in dispute, not provided for f. Reinsurance obligations g. Others (to be specified) 2. Encumbrances to assets of the company in and outside India. 3. Commitments made and outstanding for Loans, Investments and Fixed Assets. 4. Claims, less reinsurance, paid to claimants in/outside India. 5. Actuarial assumptions for claim liabilities in the case of policies exceeding four years. 6. Ageing of claims — distinguishing between claims outstanding for more than six months and other claims. 7. Premiums, less reinsurance, written from business in/outside India. 8. Extent of premium income recognised, based on varying risk pattern, category wise, with basis and justification therefore, including whether reliance has been placed on external evidence. 9. Value of contracts in relation to investments, For:

		<div style="display: flex; justify-content: space-around; align-items: center;"> <div style="border: 1px solid black; border-radius: 15px; padding: 5px; text-align: center;"> Purchases where deliveries are pending </div> <div style="border: 1px solid black; border-radius: 15px; padding: 5px; text-align: center;"> Sales where payments are </div> </div> <ol style="list-style-type: none"> 10. Operating expenses relating to insurance business: basis of allocation of expenditure to various classes of business. 11. Historical costs of those investments valued on Fair value basis. 12. Computation of managerial remuneration. 13. Basis of amortisation of debt securities. 14. <ol style="list-style-type: none"> a. Unrealised gain/losses arising due to changes in the Fair value of listed equity shares and derivative instruments are to be taken to equity under the head 'Fair Value Change Account' and on realisation reported in profit and loss Account. b. Pending realisation, the credit balance in the 'Fair Value Change Account' is not available for distribution. 15. Fair value of investment property and the basis therefore. 16. Claims settled and remaining outstanding for a period of more than six months on the balance sheet date. 		
	<p>The following accounting policies shall form an integral part of the financial statements:</p>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%; padding: 5px;"> All significant accounting policies in terms of the accounting standards issued by the ICAI, and significant principles and policies given in Part I of Accounting Principles. Any other accounting policies followed by the insurer shall be stated in the manner required under Accounting Standard AS issued by ICAI. </td> <td style="width: 50%; padding: 5px;"> Any departure from the accounting policies as aforesaid shall be separately disclosed with reasons for such departure. </td> </tr> </table>	All significant accounting policies in terms of the accounting standards issued by the ICAI, and significant principles and policies given in Part I of Accounting Principles. Any other accounting policies followed by the insurer shall be stated in the manner required under Accounting Standard AS issued by ICAI.	Any departure from the accounting policies as aforesaid shall be separately disclosed with reasons for such departure.
All significant accounting policies in terms of the accounting standards issued by the ICAI, and significant principles and policies given in Part I of Accounting Principles. Any other accounting policies followed by the insurer shall be stated in the manner required under Accounting Standard AS issued by ICAI.	Any departure from the accounting policies as aforesaid shall be separately disclosed with reasons for such departure.			
	<p>The following information shall</p>	<ol style="list-style-type: none"> 1. Investments in and outside India. 2. Segregation into performing/ non performing investments 3. Percentage of business sector-wise. 		

	also be disclosed:	<p>4. A summary of financial statements for the last five years</p> <p>5. Accounting Ratios as may be prescribed</p> <p>6. Basis of allocation of Interest, Dividends and Rent</p>
PART III: GENERAL INSTRUCTIONS FOR PREPARATION OF FINANCIAL STATEMENTS	Same as LIC	
PART IV: CONTENTS OF MANAGEMENT REPORT	<p>There shall be attached to the Financial statements, a management report containing, inter alia, the Following duly authenticated by the management:</p> <ul style="list-style-type: none"> ➤ Confirmation regarding the continued validity of the registration granted by the Authority; ➤ Certification that all the dues payable to the statutory authorities have been duly paid; ➤ Confirmation to the effect that the shareholding pattern and any transfer of shares during the year are in accordance with the statutory or regulatory requirements; ➤ Declaration that the management has not directly or indirectly invested outside India the Funds of the holders of policies issued in India; ➤ Confirmation that the required solvency margins have been maintained; ➤ Certification to the effect that the values of all the assets have been reviewed on the date of the Balance Sheet and that in his (insurer's) belief the assets set forth in the Balance-sheets are shown in the aggregate at amounts not exceeding their realisable or market value. ➤ Certification to the effect that the that no part of the life insurance Fund has been directly or indirectly applied in contravention of the provisions of the Insurance Act, 1938. ➤ Disclosure with regard to the overall risk exposure and strategy adopted to mitigate the same; ➤ Operations in other countries, if any, with a separate statement giving the management's estimate of country risk and exposure risk and the hedging strategy adopted; ➤ Ageing of claims indicating the trends in average claim settlement time during the preceding five years; <p>A responsibility statement indicating therein (Like LIC)</p>	
PART V: PREPARATION OF FINANCIAL STATEMENTS	<ul style="list-style-type: none"> ➤ An insurer shall prepare the Revenue Account, Profit and Loss Account [Shareholders' Account] and the Balance Sheet in Form B-RA, Form B-PL, and Form B-BS, or as near thereto as the circumstances permit. It may be noted that an insurer shall prepare Revenue Account separately For fire, marine, and miscellaneous insurance business. ➤ An insurer shall prepare separate Receipts and Payments Account in accordance with the Direct Method prescribed in AS 3 - "Cash Flow Statement" issued by the ICAI. 	

	<p>Audit of Accounts of general Insurance Business</p>	<p>Audit Procedures: Premium: The objectives of internal controls over premium is to ensure that correct premium is calculated and collected before acceptance of any risk, that premium is accounted for in an appropriate manner and that the premium is collected only in respect of such risks which are assumed by the company. No Risk Assumption without Premium Section 64VB of the Insurance Act, 1938</p>	
		<p>Verification of Premiums</p>	<ul style="list-style-type: none"> i. Before commencing verification of premium income, the auditor should look into the internal controls and compliance thereof as laid down for collection and recording of the premiums. ii. The auditor should broadly review the systems used by the company to collect money, underwrite and issue the policy. iii. The auditor should ascertain that all the cover notes relating to the risks assumed have been serially numbered for each class of business. The auditor should also verify that there is an adequate internal check on the issue of stationery comprising of cover notes, policy documents, stamps, etc. The auditor may apply sampling techniques For verification of larger volume of transactions. iv. The auditor should ensure that premium in respect of risks incepting during the relevant accounting year has been accounted as premium income of that year on the basis of premium revenue recognition. The auditor should verify that policy documents have not been issued, in case: <ul style="list-style-type: none"> a. premium had not been collected at all;

			<ul style="list-style-type: none"> b. premium had been collected but the relevant cheques have been dishonored; c. premium had not been collected due to risk cover being increased d. Instalments of premium have not been collected in time in respect of certain categories of policies, e.g., marine-cum-erection policies v. The auditor should examine whether the reinsurance company is not under a risk in respect of amount lying at credit and outstanding as at the year - end in the following accounts: <ul style="list-style-type: none"> a. Premium Deposit Account; b. Premium Received in Advance Account; c. Inspectors' Deposits Account; and d. Agent's Premium Accounts vi. The auditor should verify the collections lodged by agents after the balance sheet date to see whether any collection pertains to risk commencing for the year under audit. vii. In case of co-insurance business, auditor should see that the company's share of the premium has been accounted for on the basis of the available information on nature of risk and the provisional premium charged by the leading insurer. viii. The auditor should check whether Premium Registers have been maintained chronologically, ix. The auditor should verify whether instalments falling due on or before the balance sheet date, whether received or not, have been accounted for as premium income as for the year under audit.
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			<p>x. The auditor should also check that in case of cancellation of policies/cover notes issued, no risk has been assumed between the date of issue and subsequent cancellation thereof.</p> <p>xi. Where premium originally received has been refunded, the auditor should verify whether the agency commission paid on such premium has been recovered.</p> <p>xii. The auditor should verify whether GST has been charged from the insured, at the rates in force.</p>
			<p>xiii. The auditor should also check that money collected by the agents from the policyholders have been received by the company as quickly as possible.</p>
	<p>Claims:</p>	<p>A demand For payment of policy benefit because of the occurrence of an insured event is known as 'claim'. Internal controls are established over claims to ensure that only bonafide claims are paid and that claims paid do not exceed the value of loss incurred and/r do not exceed the sum insured. Cost of claims are properly recorded and disclosed in the Financial statements.</p> <p>A liability for outstanding claims should be brought to account on the following:</p> <div style="display: flex; justify-content: space-around; align-items: center; margin: 10px 0;"> <div style="border: 1px solid black; padding: 5px; text-align: center;">  i. Direct Business; </div> <div style="border: 1px solid black; padding: 5px; text-align: center;">  ii. Inward Reinsurance business; and </div> <div style="border: 1px solid black; padding: 5px; text-align: center;">  iii. Co-Insurance Business </div> </div> <p style="text-align: center; margin: 0 100px;">←—————→</p> <p>Registers and Records - The following register and records are generally prepared in respect of claims:</p> <ol style="list-style-type: none"> i. Claims Intimation Register; ii. Claims Paid Register; iii. Claims Disbursement Bank Book; iv. Claims Dockets, normally containing the following records: Claim intimation, claim form, particulars of policy, survey report, Photograph showing damage, repairer's bills, letter of subrogation, police report, fire 	

		<p>service report, claim settlement note, claim satisfaction note, salvage report, salvage disposal note, claims discharge voucher, etc.;</p> <p>v. Report of quality assurance team; and</p> <p>vi. Salvage register.</p>
		<p>Verification of Claims</p> <p>Claims Provisions - The auditor should obtain From the divisions/branches, the information for each class of business, categorizing the claims value-wise before commencing verification of the claims provisions, appropriate statistical sampling techniques may be applied, ensure that representative volume of claims is verified for each class of business.</p> <p>The auditor should satisfy himself that the estimated liability provided for by the management is adequate keeping in view the following:</p> <ul style="list-style-type: none"> i. that provision has been made for all unsettled claims. The date of loss is important ii. that provision has been made for only such claims for which the company is legally liable, considering (a) that the risk was covered (b) that claim did not arise during the period the company was not supposed to cover the risk, iii. that the provision made is normally not in excess of the amount insured iv. that in determining the amount of provision, events after the balance sheet date have been considered v. that in determining the amount of provision, the 'average clause' has been applied in case of under-insurance by parties. vi. that in case of co-insurance arrangements, the company has made provisions only in respect of its own share of anticipated liability. vii. that wherever an unduly long time has elapsed after the filing

			<p>of the claim and there has been no further communication and no litigation or arbitration dispute is involved, the reasons for carrying the provision have been ascertained.</p> <p>viii. that wherever legal advice has been sought or the claim is under litigation, the provision is made according to the legal advisor's view and differences, if any, are explained.</p> <p>ix. that the claims are provided For net of estimated salvage, wherever applicable.</p> <p>x. that intimation of loss is received within a reasonable time and reasons for undue delay in intimation are looked into.</p>
		<p>Claims Paid</p>	<p>The auditor may determine the extent of checking of claims paid on the same line as suggested for outstanding claims.</p> <p>Other aspects in respect of claims paid to be examined by the auditors are as follows:</p> <p>i. that in case of co-insurance arrangements, claims paid have been booked only in respect of company's share.</p> <p>ii. that in case of claims paid on the basis of advices from other insurance companies (where the company is not the leader in co-insurance arrangements), whether share of premium was also received by the company.</p> <p>iii. that the claims payments have been duly sanctioned by the authority concerned.</p> <p>iv. that the salvage recovered has been duly accounted.</p> <p>v. that the amounts of the nature of pure advances/deposits with Courts, etc., in matters under litigation / arbitration have not been treated as claims paid but are held as assets</p>

			<ul style="list-style-type: none"> vi. that payment made against claims partially settled have been duly vouched. vii. that in case of final settlement of claims, the claimant has given an unqualified discharge note, not. viii. that payments have been made within 30 days of the receipt of the last document received. In case, there are delays, interest on such delays have to be paid as per IRDAI regulations.
	<p>Commission / Brokerage</p>	<p>The term 'commission' is used for the payment of consideration to get Direct business.</p> <p>Commission received on amount of premium paid to a re-insurer is termed `Commission on re insurance accepted' and is reduced from the amount of commission expenditure.</p> <p>The auditor should, inter alia, do the following for verification of commission:</p>	<ul style="list-style-type: none"> ➤ Ensure that commission/brokerage is not paid in excess of the limits specified by IRDAI ➤ Ensure that commission/brokerage is paid as per rates with the agent and rates filed with IRDAI ➤ Ensure that commission/brokerage is paid to the agent/broker who has solicited the business ➤ Ensure that the agent/broker is not blacklisted by IRDAI and is not terminated for fraud etc. ➤ Vouch disbursement entries with reference to the disbursement vouchers with copies of commission bills and commission statements. ➤ Check whether the vouchers are authorised by the officers –in-charge as per rules. ➤ Test check correctness of amounts of commission allowed. ➤ Check whether commission outgo For the period under audit been duly accounted.
	<p>Operating expenses related to Insurance Business (Expenses to</p>	<ul style="list-style-type: none"> ➤ All the administrative expenses in an insurance company are broadly classified under 13 heads as mentioned in Schedule 4 Forming part of Financial Statements given under Schedule B to the Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002. ➤ Any other expenses are required to be disclosed under the head 'Others'. Any major expenses (5 	

	management)	<p>lacs or in excess of 1% of net premium, whichever is higher) are required to be shown separately.</p> <ul style="list-style-type: none"> ➤ Expenses relating to investment department, brokerage, bank charges, transfer Fees, etc. do not have a direct relationship to the day -to-day working of the insurance business and as such would not be included in the revenue account. ➤ These expenses are First aggregated and then apportioned to the Revenue Account of each class of business on a reasonable and equitable basis. ➤ The accounting policy should clearly indicate the basis of apportionment of these expenses to the respective Revenue Accounts (i.e., fire, marine and miscellaneous)
	Legal and professional Charges	<p>Survey Fees, legal and other expenses should form part of claim cost, and therefore, are not to be included under the head Legal and Professional Charges. Hence, the auditor should ensure that all other expenses which are not covered under the claims cost are required to be included under this head.</p>
	Interest Dividend and Rent	<ul style="list-style-type: none"> ➤ Funds received from the policy holders are invested in securities as per the investment pattern specified by IRDAI. ➤ Interest income From such investments Forms a major part of the income of a general insurance company. ➤ The interest or dividend earned as against the policyholders' Funds is required to be apportioned to the Revenue Account. ➤ The interest earned on, say, deposits with banks of the shareholders, Funds, rent received on let out properties owned by the company, by way of investments shareholders, funds, etc. are required to be shown under the profit and Loss Account.
	Underwriting	<ul style="list-style-type: none"> ➤ The underwriting function, which comprises of examination and evaluation of applications for insurance, the rating of risks and the establishment of premiums, is Fundamental to the operations of a general insurance company. ➤ The prime objectives of an internal control system for underwriting is adherence to guidelines For acceptances of insurance, proper recording of insurance risk and its evaluation.
	Investment	<p>The regulations issued by the authority From time to time affect the quantum of investments, the nature of assets in which investments are to be made.</p>

		Objective	The auditor's primary objective in audit of investments is to satisfy himself as to their existence and valuation . Examination of compliance with statutory and regulatory requirements is also an important objective in audit of investments
		Verification	The auditor should verify the investment scrips from the custodian statement , demat account or other equivalent electronic accounts.
		Genuine investment	He should take particular care to see that only genuine investments are produced before him, and that securities held by the insurance company on behalf of others (e.g., those held as security against loans) are not shown to him
		Investment at Branches	Investments are normally dealt with at the Head Office and not at the branches. However, sometimes, for realisation of interest, etc. and other similar purposes, investments of an insurance company may be held at Branch Offices also. The branch auditors should report whether adequate records are maintained by the branch for the securities held by it on behalf of the Head Office.
		Investment held outside	Investments should not normally be held by any other person. When investments are held by any other person on behalf of the insurance company, the auditor should obtain a certificate from him.
		Matured Investment	The auditor should examine whether the portfolio of the insurance company consists of any securities whose maturity dates have already expired. In case the amount of such investments or the income accrued thereon is material, the auditor should seek an explanation from the management on this aspect. He should also consider whether any provision For loss on this account is required. Similarly, where income on any security is long overdue, the auditor should consider whether provision is required in respect of such income accrued earlier.

		<p>Valuation</p> <p>The auditor should examine whether the method of accounting followed by the insurance company in respect of investments, including their year-end valuation, is appropriate.</p> <p>The auditor should examine the manner of accounting For investments in the context of the guidelines of the Insurance Regulatory and Development Authority and the accounting policy followed by the insurance company in respect of investments.</p> <p>A change in the method of valuation of investments constitutes a change in accounting policy and adequate disclosure regarding the fact of the change along with its financial effect should be made in the balance sheet.</p> <p>The auditor should examine whether income from investments is properly accounted For.</p>
	<p>Cash and Bank Balances</p>	<p>The auditor should apply the Following audit procedures For verification claims.</p> <ul style="list-style-type: none"> ➤ The auditor should physically verify cash balance cheques in hand ➤ check the dates of the cheques in hand ➤ apply test check on the bank transactions. ➤ check Bank Reconciliation statement ➤ obtain confirmation of Bank Balances ➤ verify Term Deposit Receipts issued by bankers. ➤ subsequent realisations for all items appearing in the reconciliation. ➤ In case of funds, in-transit, he should verify that the same are properly reflected as part of bank balance.
	<p>Outstanding Premium and Agents' Balances:</p>	<p>The following are the audit procedures to be followed for verification of outstanding premium and agents' balances:</p> <ul style="list-style-type: none"> ➤ Scrutinise and review control account debit balances and their nature should be enquired into. ➤ Examine inoperative balances and treatment given for old balances with reference to company rules. ➤ Enquire into the reasons for retaining the old balances. ➤ Verify old debit balances which may require provision or adjustment. Notes of explanation may be obtained from the management in this regard.

		<ul style="list-style-type: none"> ➤ Check age-wise, sector-wise analysis of outstanding premium. ➤ Verify whether outstanding premiums have since been collected. ➤ Check the availability of adequate bank guarantee or premium deposit for outstanding premium.
	Provision for Taxation	The auditor should check whether the provision For taxation has been made after taking into account the specific provisions applicable to insurance companies carrying on general insurance business. The auditor should assess compliance with the provisions of Chapter III, Chapter VI A of the Income Tax Act, 1961, income computation relating to foreign branches grossing up of TDS relating to the income system of GST collection etc.
	Unexpired Risks Reserve (URR)	<p>Since the insurers close their accounts on a particular date, not all risks under policies expire on that date.</p> <p>In other words, at the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the year end.</p> <p>There are two methods of creating this reserve.</p> <ol style="list-style-type: none"> a. One is based on the proportionate number of days of risk remaining to risk expired, which is called 1/365 method. b. The other method is by taking a URR directly on 50% of the premium amount. <p>According to IT Rule, the insurance companies are allowed a deduction of 50 per cent of net premium income in respect of Fire and Miscellaneous Business and 100 per cent of the net premium income relating to Marine Insurance business.</p>
	Reinsurance:	<p>A reinsurance transaction may be defined as an agreement between a 'ceding company' and a 'reinsurer' whereby the former agrees to 'cede' and the latter agrees to accept a certain specified share of risk or liability upon terms as set out in the agreement.</p> <p>A 'ceding company' is the original insurance company which has accepted the risk and has agreed to 'cede' or pass on that risk to another insurance company or the reinsurance company. It may, however, be emphasised that the insured does not acquire any right under an insurance contract.</p> <p>Type of Reinsurance Contracts</p> <p>There are broadly two types of reinsurance contracts, viz., facultative reinsurance and treaty reinsurance. A diagrammatic presentation is as below:</p>

		<pre> graph TD A[Types of Reinsurance Contracts] --> B[Facultative Reinsurance] A --> C[Treaty Reinsurance] C --> D[Proportional Treaty] C --> E[Non-Proportional] D --> F[Quote Share Treaty] D --> G[Surplus Treaty] D --> H[Auto-fac Treaty] E --> I[Pools] E --> J[Excess of Loss (XL) Treaty] E --> K[Stop Loss Treaty] </pre> <p>Facultative Reinsurance - It is that type of reinsurance whereby the contract relates to one particular risk and is expressed in the reinsurance policy. Each transaction under facultative reinsurance has to be negotiated individually.</p> <p>Treaty Reinsurance - Under this type of reinsurance, a treaty agreement is entered into between the ceding company and the reinsurer(s) where reinsurances are within the limits of the treaty. These limits can be monetary, geographical, section of business, etc. Under this contract, it is obligatory for the reinsurer to accept all risks within the scope this treaty and it is obligatory for the ceding company to cede risks in accordance with the terms of the treaty.</p> <p>It may be noted here that the treaty reinsurance contracts generally provide that in the event of any large claim being lodged with the insurer, the reinsurer shall make the payment even before the claim is finally settled or the statement of treaty reinsurance is received by the reinsurer. The reinsurer, in such cases, treats the amount paid to the insurer as 'advance against claim'. Treaties can also be divided into two categories, viz., proportional treaties and non-proportional treaties.</p> <p>Proportional Treaties - Such treaties are based on pro-rata apportionment of the sum insured, premium and losses, according to a pre-determined percentage/ratio</p> <p>Non-Proportional Treaties - Such treaties are characterized by a distribution of liability between the ceding company and the reinsurer on the basis of losses rather than the sum insured, as is the case</p>
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		<p>in proportional reinsurance. The Following are the other characteristics of non-proportional treaties:</p> <ol style="list-style-type: none"> i. Premium is not calculated on each cession, but on the whole portfolio of the ceding company. ii. The premium rate is predetermined. iii. Cost of reinsurance can vary substantially each year, depending on the premium income, loss ration and reinsurance marked situations. iv. Normally no commission is paid. <p>A. Verification of Re-insurance Inward (Premium accepted, claims paid)</p> <ul style="list-style-type: none"> ➤ Re-insurance Inward underwriting should be as per the norms and guidelines prescribed by the Insurance Act, 1938 and IRDA Regulations. ➤ The auditor should also verify whether the policy adopted For booking the accounts is on "receipt" basis or "due" basis. ➤ examine whether proper system exists to have control over the quantum of agreements existing at any point of time. ➤ The auditor should verify whether proper closing returns have been received for premiums and claims for Facultative acceptances. ➤ The auditor should evaluate the system and practice adopted in recognising the foreign currency transaction and also whether it is in accordance with the Accounting Standard - 11 "The Effects of Changes in Foreign Exchange Rates". ➤ The auditor should verify whether profit commission has been calculated as per the agreement and terms and conditions and all the statements rendered are properly taken into account. ➤ The auditor should examine whether the outstanding claim figures have been properly obtained well in time, under proper systematic arrangements and sufficient provisioning has been made for all the outstanding claims. ➤ As per IRDA (General Insurance Re-insurance) Regulations, 2013, every re -insurer is required to make provision for outstanding claims for ever y reinsurance arrangement accepted on the basis of loss information advices received from brokers / cedants and where such advices have not been received, on an actuarial estimation basis. ➤ losing balances of the re-insurer's accounts should be reconciled and the confirmation of
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		<p>balances should be obtained from all the companies.</p> <ul style="list-style-type: none"> ➤ The auditor must ensure that foreign inward accounts balances have been re -stated at the prevailing value at the year end ➤ The auditor should verify the requirement of provision / writing off of reinsurance inward balances based on the doubtful nature of recovery, if any. <p>B. Verification of Re-insurance Outward (Premium ceded, claimed recovered)</p> <p>The following steps may be taken by the auditor in the verification of re -insurance outward:</p> <ul style="list-style-type: none"> ➤ The auditor should verify that re-insurance underwriting returns received from the operating units regarding premium, claims paid, outstanding claims tally with the audited figures of premium, claims paid and outstanding claims. ➤ The auditor should check whether the pattern of re -insurance underwriting for outward cessions Fits within the parameters and guidelines applicable to the relevant year. ➤ The auditor should also check whether the cessions have been made as per the stipulation applicable to various categories of risk. ➤ The auditor should verify whether the cessions have been made as per the agreements entered into with various companies. ➤ It should also be seen whether the outward remittances to foreign re -insurers have been done as per the Foreign exchange regulations. It should also be seen whether the commission on cession has been calculated as per the terms of the agreement with the re-insurers. ➤ He should see whether provisioning for outstanding losses recoverable on cessions have been confirmed by the re-insurers and in the case of major claims, documentary support should be insisted and verified. ➤ Accounting aspects of the re-insurance cession premium, commission receivable, paid claims recovered, and outstanding losses recoverable on cessions have to be checked. ➤ The auditor should check percentage pattern of gross to net premium, claims paid and outstanding claims to ensure comparative justification. The auditor should review the individual accounts to find out whether any balance requires provisioning / write off or write back.
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		<ul style="list-style-type: none"> ➤ He should verify whether the balances with re - insurers are supported by necessary confirmation obtained from them. ➤ Any major event after the Balance Sheet date which might have wider impact with reference to subsequent changes regarding the claim recovery both paid and outstanding and also re - insurance balances will need to be brought out suitably. Where the insured chooses to have more than one insurer for the same transaction of risk, it would amount to coinsurance. Leader of the business receives the premium and issues policy with a co-insurance clause in the policy and the referred leader also settle the claims to the insured in case of the occurrence of claims. Balances pertaining to other companies relating to premiums and claims are accounted under co-insurance as "Amounts due to / due from" other insurance companies. <p>Balances are settled in periodical meetings and exchange of statements as agreed between the companies.</p> <p>The Insurance Council may recommend the following norms while entering into coinsurance agreement:</p> <ul style="list-style-type: none"> ➤ Settlement of commission Collection and Remittance of service tax ➤ Standard practices for settlement of dues ➤ Settlement of claims ➤ Reinsurance arrangement for the risk booked ➤ Exceptional booking and the powers thereof deviating from the Council's understanding. <p>The auditor should go through the understanding of the Council and ensure that the risks are covered as per the terms and conditions with adequate consideration and proper settlement.</p>
	<p>Solvency Margin</p>	<p>Section 64VA of the Insurance Act, 1938 as amended by insurance Laws (Amendment) Act, 2015 requires every insurer and re-insurer to maintain an excess of the value of assets over the amount of liabilities at all times which shall not be less than 50% of the amount of minimum capital as stated under section 6 (requirement as to capital) of the Act and arrived at in the manner specified by the regulations. Sub -section (2) of section 64VA states that if an insurer or re-insurer fails to comply with the prescribed requirement of maintaining excess of value of assets over amount of liabilities, it shall deemed to be insolvent and may be wound up by the Court on an application made by the authority.</p>

		<p>The Insurance Act requires every insurer to furnish a statement of his assets and liabilities as assessed in the manner laid down by the section 64V Every Insurer is required to prepare a statement of value of assets in "Form IRDA -Assets-AA."</p> <p>A statement of the amount of liabilities in case of general insurance business is to be prepared in "Form HG"</p> <p>A statement of Solvency. Margin in "Form KG" as specified in the Insurance Regulatory and Development Authority (Assets, Liabilities and Solvency Margin of Insurers) Regulations, 2000.</p> <p>The statement of assets, liabilities and solvency margin are to be certified by an auditor and filed by the insurance company with the Authority along with the audited accounts and statements</p>
	<p>Trade credit insurance</p>	<p>"Trade credit insurance" means insurance of suppliers against the risk of non -payment of goods or services by their buyers who may be situated in the same country as the supplier (domestic risk) or a buyer situated in another country (export risk) against:</p> <ol style="list-style-type: none"> a. non -payment as a result of insolvency of the buyer or non-payment after an agreed number of months after due - date (protracted default) or non-payment Following an event outside the control of the buyer or the seller (political risk cover) b. Political risk cover is available only in case of buyers outside India and in countries agreed upon at the proposal stage. <p>"Trade Credit Insurance transaction" means a transaction between two persons for supply of goods or services on open and agreed terms.</p> <p>Basic Requirements of a Trade Credit Insurance Product: An insurer shall offer trade credit insurance product only if all requirements mentioned below are met –</p> <ul style="list-style-type: none"> • Policyholder's loss is non-receipt of trade receivable arising out of a trade of goods or services. • Policyholder is a supplier of goods or services in consideration For a Fai market value. • Policyholder's trade receivable does not arise out of factoring • Policyholder has a customer (i.e. Buyer) who is liable to pay a trade receivable • Policyholder undertakes to pay premium for the entire Policy Period.

	<ul style="list-style-type: none"> Any other requirement that may be specified by the Authority from time to time.
<p>CONTENTS OF AUDITORS REPORT</p>	<p>Apart From normal contents of Auditor's report, as prescribed For 'Limited Companies' IRDA has prescribed the certain matters to be dealt with by the Auditors' in their Report vide Regulation under Schedule C of IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002.</p> <p>The Schedule C is reproduced below —</p> <p>"The report of the auditors on the financial statements of every insurer shall deal with the specified herein -</p> <ol style="list-style-type: none"> 1. <ol style="list-style-type: none"> a. That they have obtained all the information and explanations which, to the best of their-knowledge and belief, were necessary for the purposes of their audit and whether they have found them satisfactory; b. Whether proper books of account have been maintained by the insurer so Far as appears from an examination of those books; c. Whether proper returns, audited or unaudited, from branches and other offices have been received and whether they were adequate For the purpose of their audit; d. Whether the Balance Sheet, Revenue Account s and Profit and Loss Account dealt with-by the report and the Receipts and Payments Account are in agreement with the books of account and returns; e. Whether the actuarial valuation of liabilities is duly certified by the appointed actuary including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the authority and/or the Actuarial Society of India 17 concurrence with the Authority. 2. The auditors shall express their opinion on: <ol style="list-style-type: none"> a. <ol style="list-style-type: none"> i. Whether the Balance Sheet gives a true and fair view of the insurer's affairs as at r end of the Financial year/period; ii. Whether the Revenue Account gives a true and fair view of the surplus or the deficit for the financial year/period; iii. Whether the Profit and Loss Account gives a true and fair view of the profit or loss For the Financial year/period; iv. Whether the Receipts and Payments Account gives a true and fair view of the receipts and payments For the Financial year/period; b. The financial statements stated at (a) above are prepared in accordance with the requirements of the Insurance Act, 1938 the Insurance Regulatory and Development Authority Act, 1999 and the Companies

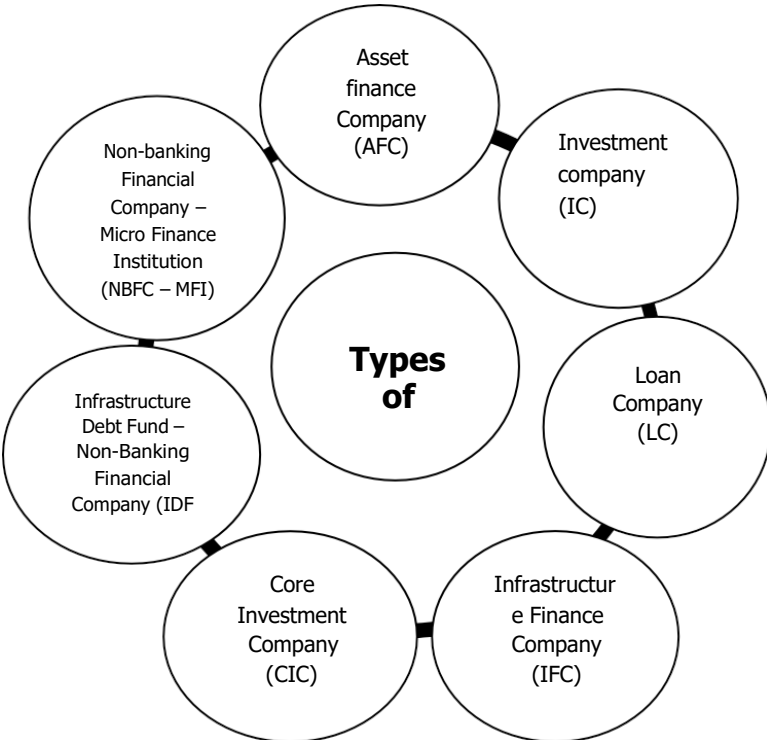
	<p>Act, 2013, to the extent applicable and in the manner so required.</p> <p>c. Investments have been valued in accordance with the provisions of the Act and the Regulations.</p> <p>d. The accounting policies selected by the insurer are appropriate and are in compliance with the applicable Accounting Standards and with the accounting principles, as prescribed in these Regulations or any order or direction issued by the Authority in this behalf.</p> <p>3. The auditors shall further certify that:</p> <p>a. they have reviewed the management report and that there is no apparent mistake or material inconsistencies with the financial statements; and</p> <p>b. the insurer has complied with the terms and conditions of the registration stipulated by the Authority.</p> <p>4. A certificate signed by the auditors (which is in addition to any other certificate or report which is required by law to be given with respect to the balance sheet) certifying that:</p> <p>a. they have verified the cash balances and the securities relating to the insurer's loans, reversions and life interests (in the case of life insurers) and investments;</p> <p>b. the extent, if any, to which they have verified the investments and transactions relating to any trusts undertaken by the insurer as trustee; and</p> <p>c. no part of the assets of the policyholders' funds has been directly or indirectly applied in contravention of the provisions of the Insurance Act, 1938 relating to the application and investments of the policyholders' funds."</p> <p>A. Signed: by the chairman, and two directors and the principal officer of the company.</p> <p>B. Statement: names, descriptions and occupations of, and the directorships held by, the persons in charge of the management</p>
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CHAPTER-3 AUDIT OF NBFC

AUDIT OF NON-BANKING FINANCIAL COMPANIES

TOPICS
DEFINITION OF NBFC
REGISTRATION AND REGULATION OF NBFC
AUDIT
PROCEDURE
CLASSIFICATION OF FRAUDS BY NBFC
AUDIT CHECK-LIST
<ul style="list-style-type: none"> • Hire Purchase Finance Company (HPFC) • Investment Company • Loan Company
AUDITOR'S REPORT
COMPLIANCE WITH CARO 2016

DEFINITION OF NBFC	<p>Section 45 1(f) of Reserve Bank of India (Amendment) Act, 1997 defines a non-banking financial company as:</p> <ul style="list-style-type: none"> • A financial institution which is a company; • A non banking institution which is a company with principal business of receiving of deposits, under any scheme of arrangement or in any other manner, or lending in any manner; • Such other non-banking institution or class of such institutions, as the Reserve Bank with the previous approval of the Central Government may specify by notification in the Official Gazette. For purposes of RBI Directions relating to Acceptance of Public Deposits, non -banking financial company means only the non-banking institution which is a -- Loan company, Investment company, Hire purchase finance company, Equipment leasing company and Mutual benefit financial company". 	
	Important	Further, Financial activity as principal business also happens when a company's Financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by RBI.
	Registration and Regulation of NBFC	Under Section 45—IA of the Reserve Bank of India (Amendment) Act, 1997, no non -banking financial company is allowed to commence or carry on the business of a non -banking financial institution

		<p>without obtaining a certificate of registration issued by the Reserve Bank of India.</p> <p>To obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock Broking Companies registered with SEBI, Insurance Company holding a valid Certificate of Registration issued by IRDA, Nidhi Companies as notified under Section 406 of the Companies Act, 2013, Chit Companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982 or Housing Finance Companies regulated by National Housing Bank.</p> <p>The Reserve Bank of India has issued directions to non-banking financial companies on acceptance of public deposits, prudential norms like capital adequacy, income recognition, asset classification, provision for bad and doubtful debts, risk exposure norms and other measures to monitor the financial solvency and reporting by NBFCs. Directions were also issued to auditors to report non-compliance with the RBI Act and regulations to the Reserve Bank, Board of Directors and shareholders.</p>
	<p>Types of NBFCs - Compliance and Regulatory Perspective</p>	<p>Currently, NBFCs registered with RBI are being classified as:</p>  <p>All NBFCs are either deposit taking or non-deposit taking. If they are non-deposit taking, ND is suffixed to their name (NBFC-ND). The NBFCs which have asset size of Rs 500 Crore or more are known as</p>

		Systematically important NBFC. They have been classified so because they can have bearing on Financial stability of the country. The Non-deposit taking NBFCs are denoted as NBFC NDSI.
		Asset Finance Company (AFC) The principal business of these companies is to finance the assets such as machines, automobiles, generators, material equipments, industrial machines etc. Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising there From is not less than 60% of its total assets and total income respectively.
		Investment Company (IC) The main business of these companies is to deal in securities.
		Loan Companies (LC) The main business of such companies is to make loans and advances (not for assets but for other purposes such as working capital Finance etc.)
		Infrastructure Finance Company (IFC) A company which has net owned funds of at least Rs 300 Crore and has deployed 75% of its total assets in Infrastructure loans is called IFC provided it has credit rating of A or above and has a CRAR of 15%.
		Systemically Important Core Investment Company (CIC – ND – SI) A systematically important NBFC (assets Rs 500 crores and above) which has deployed at least 90% of its assets in the form of investment in shares or debt instruments or loans in group companies is called CIC -ND-SI. Out of the 90%, 60% should be invested in equity shares or those instruments which can be compulsorily converted into equity shares. Such companies do not accept public Funds.
		Infrastructure Debt Fund (IDF-NBFC) IDF-NBFC is a company registered as NBFC to Facilitate the flow of long term debt into infrastructure projects. IDF - NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 years maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.
		Non-Banking Financial Company - NBFC-MF1 is a non- deposit taking NBFC which has at least 85% of its assets in the Form of microfinance. Such microfinance should be in the form of loan given to those who have annual income of Rs 1,00,000 in rural areas and Rs 160,000 in

		Micro Finance Institution (NBFC-MFI):	urban or semi urban areas. Such loans should not exceed Rs 1,00,000 and its tenure should not be less than 24 months. Further, the loan has to be given without collateral. Loan repayment is done on weekly, fortnightly or monthly installments at the choice of the borrower.
		Mortgage Guarantee Companies (MGC):	MGC are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned Fund is Rs 100 crores.
		NBFC – Non - Operative Financial Holding Company (NOFHC):	NOFHC is financial institution through which promoter / promoter groups will be permitted to set up a new bank. It's a wholly -owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.
DIFFERENCES BETWEEN BANKS AND NBFCs	<p>NBFCs lend and make investments and hence, their activities are akin to that of banks, however, there are a few differences as given below:</p> <ul style="list-style-type: none"> • NBFC cannot accept demand deposits; • NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself; • deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation (DICGC) is not available to depositors of NBFCs, unlike in case of banks. 		
PRUDENTIAL NORMS	Capital Requirements	<p>Every applicable NBFC shall maintain a minimum capital ratio consisting of Tier 1 and Tier II capital which shall not be less than 15 percent of its aggregate risk weighted assets on -balance sheet and of risk adjusted value of off-balance sheet items. The Tier I capital in respect of applicable NBFCs (other than NBFC -MFI and IDF-NBFC), at any point of time, shall not be less than 8.5% by March 31, 2016 and 10% by March 31, 2017.</p> <p>Applicable NBFCs primarily engaged in lending against gold jewellery (such loans comprising 50 percent or more of their financial assets) shall maintain a minimum Tier I capital of 12 percent.</p> <p>Explanations: The risk weighted asset shall be calculated as the weighted aggregate of funded items as detailed hereunder:</p>	

S. No	Weighted risk assets -On - Balance Sheet items	Percentage weight
i.	Cash and bank balances including fixed deposits and certificates of deposits with banks	0
ii.	Investments: a. Approved securities [Except at (c) below] b. Bonds of public sector banks c. Fixed deposits / certificates of deposit / bonds of public financial institutions d. Shares of all companies and debentures / bonds / commercial papers of all companies and unit of all mutual funds	0 20 100 100
iii.	Current assets: a. Stock on hire (net book value) b. Inter corporate loans/ deposits c. Loans and advances fully secured against deposits held d. Loans to staff e. Other secured loans and advances considered good [Except at (vi) below] f. Bills purchased / discounted g. Others (To be specified)	100 100 0 0 100
iv.	Fixed Assets (net of depreciation): a. Assets leased out (net book value) b. Premises c. Furniture & Fixture	100 100 100
v.	Other assets:- a. Income tax deducted at source (net of provision) b. Advance tax paid (net of provision)	0 0 0

			c. Interest due on Government securities d. Others (to be specified)	100
	<p>Income Recognition</p>	<p>The income recognition shall be based on recognised accounting principles. Income including interest/ discount/ hire charges/ lease rentals or any other charges on NPA shall be recognised only when it is actually realised. Any such income recognised before the asset became non -performing and remaining unrealised shall be reversed.</p> <p>Asset classification: The asset classification norms as given below shall apply to every applicable NBFC (except NBFC-MFIs):</p> <ul style="list-style-type: none"> i. Standard asset shall mean the asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem or carry more than normal risk attached to the business; ii. "Sub-Standard Asset" shall mean: <ul style="list-style-type: none"> a. an asset which has been classified as non-performing asset For a period not exceeding 18 months; Provided that the period 'not exceeding 18 months' stipulated in this sub-clause shall be 'not exceeding 16 months' For the financial year ending March 31, 2016 , 'not exceeding 14 months' For the Financial year ending March 31, 2017, and 'not exceeding 12 months' for the financial year ending March 31, 2018 and thereafter. b. An asset where the terms of the agreement regarding interest and/or principal have been renegotiated or rescheduled or restructured after commencement of operations. iii. Doubtful Asset shall mean: <ul style="list-style-type: none"> a. a term loan, or b. a lease asset, or c. a hire purchase asset, or d. any other asset, <p>which remains a sub-standard asset For a period 'exceeding 18 months' For the financial year ended March 31, 2015; 'exceeding 16 months' for the financial year ended March 31, 2016; 'exceeding 14 months' For the Financial year ending March 31, 2017 and 'exceeding 12 months' For the Financial year ending March 31, 2018 and thereafter.</p> 		

		<p>iv. Loss Asset shall mean:</p> <p>a. an asset which has been identified as toss asset by the applicable NBFC or its internal or external auditor or by the Bank during the inspection of the applicable NBFC, to the extent it is not written off by the applicable NBFC; and</p> <p>b. an asset which is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of security or due to any fraudulent act or omission on the part of the borrower</p> <p>v. Non-Performing Asset</p> <p>a. an asset, in respect of which, interest has remained overdue for a period of six months or more;</p> <p>b. a term loan inclusive of unpaid interest, when the installment is overdue for a period of six months or more or on which interest amount remained overdue for a period of six months or more;</p> <p>c. a bill which remains overdue for a period of six months or more</p> <p>d. any dues on account of sale of assets or services rendered reimbursement of expenses incurred, which remained overdue for a period of six months or more; [Provided that the period of 'six months or more' stipulated in sub - clauses (a) to (1) shall be 'five months or more' for the Financial year ending March 31, 2016; 'four months or more' for the financial year ending March 31, 2017 and 'three months or more', For the financial year ending March 31, 2018 and thereafter].</p> <p>the lease rental and hire purchase installment, which has become overdue for a period of twelve months or more; [Provided that the period of 'twelve months or more' stipulated in this sub - clause shall be 'nine months or more' for the Financial year ending March 31, 2016; 'six months or more' for the financial year ending March 31, 2017; and 'three months or more' for the financial year ending March 31, 2018 and thereafter].</p>
	<p>Provisioning Requirements</p>	<p>The provisioning requirements as given below shall apply to every applicable NBFC (except NBFC-MFIs):</p> <p>i. Loss Assets: The entire asset shall be written off. IF the assets are permitted to remain in t</p>

		<p>he books for any reason, 100% of the outstanding shall be provided For;</p> <p>ii. Doubtful Assets:</p> <p>a. 100% provision to the extent to which the advance is not covered by the realisable value of the security.</p> <p>b. In addition to item (a) above, depending upon the period for which the asset has remained doubtful, provision to the extent of 20% to 50% of the secured portion (i.e. Estimated realisable value of the outstanding) shall be made on the following basis:</p> <table border="0"> <tr> <td>Period for which the asset has been considered as doubtful</td> <td>Percent of provision</td> </tr> <tr> <td>Up to one year</td> <td>20</td> </tr> <tr> <td>One to three years</td> <td>30</td> </tr> <tr> <td>More than three years</td> <td>50</td> </tr> </table> <p>iii. Sub-standard assets: A general provision of 10 percent of total outstanding shall be made.</p> <p>iv. Standard asset provisioning: Every applicable NBFC shall make provisions for standard assets at 0.30 per cent by the end of March 2016; 0.35 per cent by the end of March 2017 and 0.40 per cent by the end of March 2018 and thereafter.</p> <p>The provision towards standard assets need not be netted from gross advances but shall be shown separately as 'Contingent Provisions against Standard Assets' in the balance sheet.</p>	Period for which the asset has been considered as doubtful	Percent of provision	Up to one year	20	One to three years	30	More than three years	50
Period for which the asset has been considered as doubtful	Percent of provision									
Up to one year	20									
One to three years	30									
More than three years	50									
AUDIT PROCEDURES	The following are the necessary steps involved -									
	Ascertaining the Business Of the company	<ul style="list-style-type: none"> • Scan through the Memorandum and Articles of Association of the company • Scan through the minutes of the Board/Committee Meetings and hold discussions with the top level management to ascertain the corporate business plan/strategy. • Based on the classification of a company into a loan Company/Investment company etc., it will be accordingly required to comply with the provisions relating to limits on acceptance of public deposits as contained in the NBFC Public Deposit Directions. 								
	Evaluation of Internal Control System	An auditor should gain an understanding of the accounting system and related internal controls adopted by the NBFC to determine the nature, timing and extent of his audit procedures.								

		He should ascertain whether the NBFC has an effective system of periodical review of advances in place.
	Registration with the RBI	Section 45-IA RBI Act, has made it incumbent on the part of all NBFCs to comply with registration requirements and have minimum net owned funds (NOF) of Rs 2 Crore. An auditor should obtain a copy of the certificate of registration granted by the RBI or in case the certificate of registration has not been granted, a copy of the application form filed with the RBI for registration.
	Investments in liquid assets	Every NBFC holding public deposits is required to invest a specified percentage in liquid assets and report on a quarterly basis. This quarterly return (duly signed by an officer of the NBFC) is required to be submitted within 30 days From the end of the relevant quarter and with reference to investments held in approved securities during the relevant quarter. The auditor should ascertain compliance.
	NBFC Public Deposit Directions -	The auditors must ascertain whether the company is a loan company or an investment company or a hire purchase finance company or an equipment leasing company as per the classification, if any, assigned to the NBFC by the RBI. Thereafter, it must be ascertained whether the company has complied with the following aspects in relation to the activity of mobilisation of public deposits: <ol style="list-style-type: none"> i. The ceiling on quantum of public deposits has been linked to its credit rating as given by an approved credit rating agency. In the event of a downgrading of credit rating, the auditor should bear in mind that the NBFC will have to reduce its public deposits in accordance with the revised credit rating assigned to it within a specified time frame. ii. Test checks the interest calculations in respect of public deposits mobilised by a NBFC to ascertain that the NBFC has not paid interest in excess as per specification. Likewise, test check the brokerage calculations with the bills and vouchers for reimbursement of out of pocket expenses. iii. Ascertain whether the NBFC has accepted or renewed any public deposit only after a written application form the depositor in the form to be supplied by the company. iv. Verify the deposit register maintained by a NBFC and test check the particulars that have been entered therein in respect of each

		<p>depositor with supporting receipts issued to the depositors.</p> <ul style="list-style-type: none"> v. Also check whether the NBFC is regularly paying its deposits on due dates and in the case of a delay/default, the reasons For the delay/default and the actual date of payment. vi. Check whether the investments made in approved liquid assets by a NBFC holding public deposits have been lodged in safe custody with a designated scheduled commercial bank. vii. In the case of NBFCs accepting/holding public deposits ascertain whether audited statement of accounts together with a copy of the auditor's report and director's report thereon have been submitted within prescribed time limit from the date of holding the Annual general meeting. viii. Check whether the NBFC has filed its annual return as specified in the First Schedule before the 30th June with reference to its position as on the 31st March of each year. ix. In the case of NBFCs not accepting/holding public deposits, check whether a board resolution has been passed by the NBFC to the effect that it has neither accepted any public deposits nor would it accept any public deposits during the year. x. In the case of Group Holding Investment Companies, check whether the NBFC has passed a board resolution to the effect that the company has invested or would invest/hold its investments in share and securities of group companies specifying the names of the companies. In addition to the above, group holding investment companies are required to give a Further undertaking that it would not trade in such shares/securities and that it has neither accepted nor would it accept any public deposits during the year.
	<p>NBFC Prudential Norms Directions</p>	<ul style="list-style-type: none"> i. Check compliance with prudential norms encompassing income recognition, income from investments, accounting standards, accounting for investments, asset classification, provisioning for bad and doubtful debts, capital adequacy norms, prohibition on granting of loans by a NBFC against its own shares, prohibition on loans and investments for failure to repay public

		<p>deposits and norms for concentration of credit/investments.</p> <ul style="list-style-type: none"> ii. An auditor should ensure that the Board of Directors of every NBFC granting/intending to grant demand/call loans shall frame a policy For the company and shall implement too. iii. An auditor should assess on the basis of examinations conducted by him whether the NBFC has complied with the prudential norms. In particular, he should verify that advances and other credit Facilities have been properly I classified as standard/sub standard/doubtful/loss and that proper provision has been made in accordance with the Directions. iv. In respect of Non Performing Assets, an auditor should check whether the unrealised income in respect of such assets has not been taken to the Profit & Loss Account on an accrual basis. Income from NPAs should be accounted for on realisation basis only. v. Check whether all accounts which have been classified as NPAs in the previous year also continue to be shown as such in the current year also. If the same is not treated as a NPA in the current year, the auditor should specifically examine such accounts to ascertain whether the account has become regular and the same can be treated as performing as per the Directions.
<p>CLASSIFICATION OF FRAUDS BY NBFC</p>	<p>In order to have uniformity in reporting, Frauds have been classified as under based mainly on the provisions of the Indian Penal Code:</p> <ul style="list-style-type: none"> a) Misappropriation and criminal breach of trust. b) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property. c) Unauthorised credit facilities extended for reward or for illegal gratification. d) Negligence and cash shortages. e) Cheating and Forgery. f) irregularities in foreign exchange transactions. g) Any other type of fraud not coming under the specific heads as above. <p>Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (d) and (1) above are to be reported as Fraud if the intention to cheat/ defraud is suspected/ proved. However, the following cases where fraudulent intention is not suspected/ proved, at the time of detection, will be treated as fraud and reported accordingly:</p> <ul style="list-style-type: none"> a) cases of cash shortages more than 10,000/- and 	

	<p>b) cases of cash shortages more than 5000/- if detected by management/ auditor/ inspecting officer and not reported on the occurrence by the persons handling cash. NBFCs having overseas branches/offices should report all frauds perpetrated at such branches/offices also to the Reserve Bank as per the prescribed format and procedures.</p>	
AUDIT CHECK-LIST	<p>Some special points that may be covered in the audit of NBFCs are given below:</p>	
	<p>Hire Purchase Finance Company (HPFC).</p>	<ul style="list-style-type: none"> • Internal Controls: Examine the adequacy operation and the effectiveness of the internal controls, for extending Hire Purchase Finance. • Asset Verification: See whether the NBFC has a system for verifying the Hire Purchase Assets periodically to ensure that the Hirers have not sold the assets or otherwise encumbered them. • Asset Acquisition: Ensure that the Original Invoice has been made out in the name of the NBFC, and the payment for acquiring assets is made directly to the Supplier / Dealer. • Valuation / Installation Reports: Ascertain whether the valuation reports a:-installation reports are obtained, in respect of high value Hire Purchase items relating to machinery / equipment. • Physical Verification: For high value items, physically verify the asset possession of the hirers, especially in case of any doubt as to the genuineness of the transaction. • Endorsement in RC: For HP Finance against Vehicles, ensure that the Registration Certificate contains an endorsement in favour of the Hire Purchase Company. • HP Installments: Verify that the Hire Installments are being received regularly as and when they Fall due. • Overdue Installments: Check whether adequate provision has been made from overdue HP installments as required under RBI Directions. • Accounting: <ul style="list-style-type: none"> ➤ Finance Charges: Verify the method of accounting followed by the NBFC For apportionment of finance charges over the period of the Hire Purchase contract. ➤ Change in Method: Ascertain that there is no change in the method of accounting as compared to the immediately preceding previous year. • Insurance: Verify that the assets given on Hire Purchase have been adequate: insured against, and the insurance policy is in Force.

		<ul style="list-style-type: none"> • Repossession: Where goods are repossessed by the HPFC on account of non-repayment of installments, ensure that they are valued on a realistic and consistent basis.
	<p>Investment Company</p>	<ul style="list-style-type: none"> ➤ Physical Verification: Verify all the securities in hand and reconcile the same with the Register maintained in this regard. Verify the certificate From Bank. Depository or any other institution where securities are lodged with them. ➤ Ceiling on Loan / Investment: Examine compliance with the NBFC Prudential, Norms, which prescribes the following maximum limits in relation to making loans / investing in shares – <ul style="list-style-type: none"> a) For a single borrower / Company – 15% of Net Owned Funds, b) For a group of borrowers / Companies – 40% of Net Owned Funds. c) Composite credit to and investment in a single Company – 25% of Net Owned Funds. d) Composite credit and investment in a group of Companies – 40 % of Net Owned Funds. ➤ Advance against Own Shares: Ensure that the NBFC has not advanced any loans against the security of its own Shares. ➤ Income Recognition: <ul style="list-style-type: none"> • Cash Basis: Ensure that Dividend Income, Income from Mutual Funds and Income from NPAs have been accounted for on cash basis. However, Dividend declared by a Body Corporate in its AGM, can be accounted for by the NBFC, on accrual basis, if the right to receive the payment has been established. • Bond / Debenture Income: Verify that the income from Bonds / Debentures of Corporate Bodies, is accounted on accrual basis, only if the interest rate on these instruments is pre-determined and interest is serviced regularly and not in arrears. ➤ Contract Notes: Test check Bills / Contract Notes received From Brokers with reference to the prices vis-a-vis the Stock Market Quotations on the respective dates. ➤ Investment Classification: Examine the minutes of the Board Meeting for purchase and sale of investments to ascertain the classification of investments acquired. ➤ Valuation: Verify whether valuation of investments has been done in compliance with RBI Directions and adequate provision for fall in the market value of securities have been made there against.

		<ul style="list-style-type: none"> ➤ Subsidiary / Group Companies: In respect of investment made in a Subsidiary / Group Company during the year, ascertain the basis For arriving at the price paid For the acquisition of such shares. ➤ Unquoted Bonds: Ensure that investments in Unquoted Debentures / Bonds are treated as Term Loans / Credit Facilities, For the purposes of Income Recognition and Asset Classification. ➤ AS – 13: Ensure that the requirements of AS-13 (to the extent they are not inconsistent with the RBI Directions) have been duly complied with by the NBFC. ➤ Securities Lending Scheme: <ul style="list-style-type: none"> • Tenure / Fees / Collateral Security: IF securities are tent / borrowed under the Securities Lending Scheme of SEBI, examine the agreement with the approved intermediary regarding the period of depositing lending securities, fees for depositing / tending, collateral securities and provision for the return including pre-mature return of the securities deposited / tent. • Receiving Back: Ensure that the securities of the same type / class are received back by the Lender / paid by the Borrower at the end of the specified period together with all benefits thereof like — dividends, rights, bonus, interest or any other rights or benefit accruing thereon. • Confirmations: Verify the confirmation received from the approved intermediary regarding securities deposited with / borrowed from it as at the Balance Sheet date.
	<p>Loan Company</p>	<ul style="list-style-type: none"> ➤ Controls: Verify whether the NBFC has an adequatesystem of proper appraisal and Follow-up of Loans and Advances. Ensure that each Loan or Advance is sanctioned as per the applicable control procedures. ➤ Terms of Sanction: Verify the conditions attached to the sanction of each loan or advance like limit on borrowings, nature of security, interest, terms of repayment, etc. ➤ Security: Examine the security obtained and the agreements entered into, if any, with the Borrowers, in respect of the advances given. ➤ Readability: Ascertain the nature and value of security and the Net Worth of the Borrower / Guarantor, to determine the extent to which an advance is considered realizable.

		<ul style="list-style-type: none"> ➤ Confirmation of Balance: Examine the confirmation of balances as certified by Borrowers, and review the reconciliation statements, if any, ➤ Bill Discounting:- Ensure that the proper records / documents have be maintained for every bill discounted / re- discounted by the NBFC. Test the transactions with reference to the documents maintained, to ascertain that the discounting charges, wherever due, have been duly accounted. ➤ Ceiling on Loans / Investments: Ensure that the NBFC has not lent / investment in excess of the specified limits to any single borrower or group of borrower as per RBI Directions. ➤ Loan against Own Shares: Ensure that the NBFC has not advanced any Loans against the security of its own Shares. ➤ NBFCs providing funds in ICD Market: <ul style="list-style-type: none"> • Examine whether the NBFC has a regular system to ascertain the credit worthiness of its Clients and whether there is any risk of non-recovery. • See whether interest on ICDs is received regularly. • Check into the rollover of ICDs and non-realisation of interest / principal amounts to determine whether the ICD should be treated as a NPA. ➤ Level of NPA: Study the trend of NPA recovery performance to ensure the NBFC does not have an unduly high level of NPAs. ➤ Prudential Norms: Ensure compliance with RBI Directions in classification of Loans and Advances. ➤ Income Recognition and NPA Provisioning: Verify that the Provision for bad and Doubtful Debts is disclosed separately in the Balance Sheet and are not netted off against the income or against the value of assets.
<p>AUDITORS REPORT</p>	<p>The following are the important duties of an auditor as per directions known as "Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2008.</p> <p>Auditors to submit additional Report to the Board of Directors: In addition to the Report made by the auditor under Section 143 of the Companies Act, 2013 the auditor shall also make a separate report to the Board of Directors of the Company on the matters specified below:</p> <p>Matters to be included in the auditor's report: The auditor's report on the accounts of a non-banking financial company shall include a statement on the following matters, namely:</p>	

A. In the case of all non-banking Financial companies

- i. Whether the company is engaged in the business of non-banking financial institution and whether it has obtained a Certificate of Registration (CoR) from the Bank.
- ii. In the case of a company holding CoR issued by the Bank, whether that company is entitled to continue to hold such CoR in terms of its asset/income pattern as on March 31 of the applicable year.

B. In the case of a non-banking financial company accepting/holding public deposits:

Apart from the matters enumerated in (A) above, the auditor shall include a statement on the Following matters, namely:-

- i. Whether the public deposits accepted by the company together with other borrowings are within the limits;
- ii. If excess whether are regularised in the manner provided in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998
- iii. Whether an
 - Asset Finance Company having Capital to Risk Assets Ratio (CRAR) less than 15% or
 - Investment / Loan Company is accepting "public deposit" without minimum investment grade credit rating from an approved credit rating agency;
- iv. In respect of NBFCs referred to in clause (iii) above,
 - a) whether the credit rating is in force; and
 - b) whether the aggregate amount of deposits outstanding as at any point during the year has exceeded the limit specified by the such Credit Rating Agency;
- v. In case of NBFCs having Net Owned Funds of Rs 25 lakh and above but less than Rs 200 lakhs, whether the public deposit held by the companies is Frozen or has brought down its level of deposits to the level of revised ceiling of deposits
- vi. Whether the company has defaulted in paying to its depositors the interest and /or principal amount of the deposits after such interest and/or principal became due;
- vii. Whether the company has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts, and concentration of credit/investments
- viii. Whether the capital adequacy ratio as disclosed in the return submitted to the Bank in has been correctly determined and whether such ratio is in compliance with the minimum CRAR prescribed therein;
- ix. Whether the company has complied with the liquid assets requirement as prescribed by the Bank in exercise of powers under section 45-1B of the RBI Act and whether the details of the designated bank in which the

	<p>approved securities are held is communicated to the office concerned of the Bank;</p> <ul style="list-style-type: none"> x. Whether the company has furnished to the Bank within the stipulated period the return on deposits as specified in the NBS 1 to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998; xi. Whether the company has furnished to the Bank within the stipulated period the half-yearly return on prudential norms as specified in the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007; xii. Whether, in the case of opening of new branches or offices to collect deposits or in the case of closure of existing branches/offices or in the case of appointment of agent, the company has complied with the requirements contained in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998. <p>C. In the case of a non-banking financial company not accepting public deposits: Apart from the aspects enumerated in (A) above, the auditor shall include a statement on the following matter, namely:-</p> <ul style="list-style-type: none"> i. Whether the Board of Directors has passed a resolution for non-acceptance of any public deposits; ii. Whether the company has accepted any public deposits during the relevant period / year; iii. Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts. iv. In respect of Systemically Important Non-deposit taking NBFCs: <ul style="list-style-type: none"> a) Whether the capital adequacy ratio as disclosed in the return submitted to the Bank has been correctly arrived at and whether such ratio is in compliance with the minimum CRAR prescribed by the Bank; b) Whether the company has furnished to the Bank the annual statement of capital funds, assets / exposures and risk asset ratio within the stipulated period. <p>D. In the case of a company engaged in the business of non-banking financial institution not required to hold CoR subject to certain conditions: Apart from the matters above, the auditor shall include a statement on the following matters, namely: Where a Company has obtained a specific advice from the Bank that it is not required to hold CoR from the Bank whether the company is complying with the conditions stipulated as advised by the Bank.</p>
<p>Obligation of auditor to submit an</p>	<p>I. Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 above, is</p>

	<p>exception report to the Bank</p>	<p>unfavourable or qualified, or in the opinion of the auditor the company has not complied with:</p> <ul style="list-style-type: none"> a) the provisions of Chapter III B of Reserve Bank of India Act, 1934 (Act 2 of 1934); or b) the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998; or c) Non-Banking Financial (Deposit Accepting or Holding) Prudential Norms (Reserve Bank) Directions, 2007; or d) Non-Banking Financial (Non- Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007; <p>II. The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions.</p>
<p>COMPLIANCE WITH CARO 2016</p>	<p>As per CARO 2016 the auditor is required to report that "Whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained. [Paragraph 3(xvi)]"</p>	
	<p>Relevant Provisions</p>	<ul style="list-style-type: none"> a) The auditor is required to examine whether the company is engaged in the business which attract the requirements of the registration. The registration is required where the financing activity is a principal business of the company. b) The Reserve Bank of India restrict companies from carrying on the business of a non-banking Financial institution without obtaining the certificate of registration. The relevant Text of the Section 45-IA is reproduced in Appendix XI to this Guidance Note. c) A Non-banking Financial Company (NBFC) is a company registered under the Act, engaged in the business of loans and advances, acquisition of shares/ stocks/ bonds/ debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. <p>A non-banking institution which is a company and has principal business of receiving deposits under</p>

		<p>any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking Financial company (Residuary non-banking company).</p> <p>As per response to an FAQ as given by Reserve Bank of India, "Financial activity as principal business is when a company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria will be registered as NBFC by RBI. The term 'principal business' is not defined by the Reserve Bank of India Act. The Reserve Bank has defined it so as to ensure that only companies predominantly engaged in financial activity get registered with it and are regulated and supervised by it. Hence if there are companies engaged in agricultural operations, industrial activity, purchase and sale of goods, providing services or purchase, sale or construction of immovable property as their principal business and are doing some financial business in a small way, they will not be regulated by the Reserve Bank. Interestingly, this test is popularly known as 50-50 test and is applied to determine whether or not a company is into financial business."</p> <p>d) NBFCs are doing functions similar to banks, however there exist difference between banks & NBFCs. NBFCs tend and make investments and hence their activities are akin to that of banks; however there are a few differences as given below:</p> <ol style="list-style-type: none"> i. NBFC cannot accept demand deposits; ii. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself; iii. deposit insurance Facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks. <p>As per Reserve Bank of India Act, 1934 Section 451 Clause (c) any company carries on as its business or part of its business any activity considered as carrying on the business of Financial Institution.</p> <p>The Reserve Bank of India defined "net owned fund" as (a) the aggregate of the paid-up equity capital and free reserves as disclosed in</p>
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		<p>the latest balance-sheet of the company after deducting there From</p> <ul style="list-style-type: none"> i. accumulated balance of loss; ii. deferred revenue expenditure; and iii. other intangible assets; and (b) further reduced by the amounts representing – <ul style="list-style-type: none"> 1) investments of such company in shares of – <ul style="list-style-type: none"> i. its subsidiaries; ii. companies in the same group; iii. all other non- banking financial companies; and 2) the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with,— <ul style="list-style-type: none"> i. subsidiaries of such company; and ii. companies in the same group, to the extent such amount exceeds ten per cent of (a) above. ("Subsidiaries" any "companies in the same group" shall have the same meanings assigned to them in the Companies Act, 1956.)
	<p>Audit Procedures and Reporting</p>	<ul style="list-style-type: none"> a) The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the No Banking Financial Companies. b) The financial statements should be examined to ascertain whether company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income. c) Whether the company has net owned funds as required for the registration NBFC. d) Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented. e) The auditor should report incorporating the following:- <ul style="list-style-type: none"> i. Whether the registration is required under section 45 - IA of the RBI Act 1934. ii. If so, whether it has obtained the registration. iii. If the registration not obtained, reasons thereof.

CHAPTER-11

PEER REVIEW & QUALITY REVIEW

PEER REVIEW

OBJECTIVES	<p>The purpose of the Peer Review statement is to provide a framework for, planning, performing, reporting and administration of the Peer Review process.</p> <p>Peer Review process is intended to Review the quality control framework of the Practice Unit as well as proper and consistent application of such control frameworks across engagement samples selected For Review</p>
DEFINITIONS	<p>MEMBER - means a member as stated in section 2 (2) of the Chartered Accountants Act, 1949,</p> <p>Peer Review period — means 3 years preceding the year in which the Practice Unit is selected or such other period or any period as may be prescribed by the Peer Review Board For conducting a Peer Review.</p> <p>Practice Unit - means a Firm of Chartered Accountants or a member in Practice, practicing whether in an individual name or a trade name or such other entity as recognized by the Institute of Chartered Accountants of India from time to time.</p> <p>Peer Review - means an examination and Review of the systems and procedures to determine whether the same have been put in place by the Practice Unit for ensuring the quality of assurance services as envisaged by the Technical, Professional and Ethical Standards and whether the same were consistently applied in the period under review.</p> <p>Reviewer - means a member duly approved and empanelled by the Board on fulfilling the qualifications prescribed For a Reviewer as per Para 10.0 of this Statement.</p> <p>Qualified Assistant - The reviewer may take the help of a qualified assistant while carrying out peer review. In this context, the Board decided to clarify that a reviewer is permitted to take the assistance of only one assistant who shall be a chartered accountant and a person who does not attract any of the dis-qualifications prescribed under Section 8 or Section 21 of the Chartered Accountants Act, 1949.</p> <p>The name of the qualified assistant which the reviewer would like to assist him shall be identified and intimated to the Board as well as the practice unit before the commencement of the peer review.</p> <p>Such a qualified assistant shall also have to sign the declaration of confidentiality as annexed to the Statement.</p>

<p>ELIGIBILITY TO BE A REVIEWER</p>	<p>A Peer Reviewer shall</p>	<ul style="list-style-type: none"> ➤ <i>Shall be a member in practice with at least 7 years of audit experience.</i> <i>In case a member has moved from industry to practice and is currently in practice he should have at least 10 years of audit experience in industry and at least 3 years audit experience in practice</i> ➤ Should have undergone the requisite training and cleared the requisite test for Peer Review as prescribed by the Board. ➤ <i>A member on being appointed as a Reviewer shall be required to furnish- a declaration as prescribed by the Board, at the time of Empanelment as a Peer Reviewer. a Declaration of Confidentiality as per Annexure A to this Statement while giving consent for appointment as a Peer Reviewer.</i> <i>A member shall not be eligible for being appointed as a Reviewer of a PracticeUnit, if –</i> <ol style="list-style-type: none"> 1. any disciplinary action / proceeding is pending against him; 2. he has been found guilty of professional or other misconduct by the Council or the Board of Discipline or the Disciplinary Committee at any time 3. he has been convicted by a competent court whether within or outside India, of an offence involving moral turpitude and punishable with imprisonment, 4. he or his partners have any obligation or conflict of interest in the Practice Unit. 5. <i>He has undergone training/articleship under any of the partner of PracticeUnit.</i> <ul style="list-style-type: none"> • A Reviewer shall not accept any professional assignment from the Practice Unit for a period of next two years from the date of appointment. Further, he should not have accepted any professional assignment from the Practice Unit for a period of two years before the date of appointment as reviewer of that Practice Unit.
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PRACTICE UNITS SUBJECT TO REVIEW	Every Practice Unit, based on their category as determined below will be subject to Peer Review in accordance with this statement.	
	Level I	<p><i>A Practice Unit which has undertaken any of the under-mentioned assurance services in the period under review shall be treated a Level I entity:</i></p> <ul style="list-style-type: none"> i. <i>Statutory Central Audit of any Bank or Insurance Company</i> ii. <i>Statutory Audit of Central or State Public Sector Undertakings and Central Cooperative Societies having turnover exceeding Rs.250 crores or net worth exceeding Rs.5 crores.</i> iii. <i>Statutory Audit of asset management companies or mutual funds.</i> iv. <i>Statutory Audit of enterprises whose equity or debt securities are listed in India or abroad as defined under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. Statutory audit of any body corporate including trusts which are covered under public interest entities.</i> v. <i>Statutory Audit of entities which have raised funds from public or banks or financial institutions or by way of donations/contributions over Rs.50 Crore rupees. Statutory Audit of entities having net worth of more than Rs.100 crore or having turnover of Rs.250 crore or above.</i> vi. <i>Statutory Audit of entities which have been funded by Central and / or State Government(s) schemes of over Rs.50 Crore.</i> vii. <i>Statutory Audit of Non – Banking Financial Companies (NBFCs) having deposits of Rs.100 crore, or above.</i> viii. <i>Statutory Audit of Entities preparing the financial statements as per Ind AS.</i>
	Level II	<p><i>A Practice Unit which has undertaken any of the under-mentioned assurance services in the period under review shall be treated as Level II entity:</i></p> <p><i>Statutory / Internal / Concurrent / Systems / Tax audit and / or Departmental Review of Branches / Offices of -</i></p> <ul style="list-style-type: none"> a) <i>Public Sector undertaking</i> b) <i>Any bank</i>

		<ul style="list-style-type: none"> ii. <i>Any Insurance Company</i> iii. <i>Statutory Audit of Non – Banking Financial Companies (NBFCs) notcovered in L-1 above,</i> iv. <i>UDIN's generated by the Practice Units more than the specified number determined by the Board from time to time.</i> v. <i>Any other Practice Unit providing assurance or other services notcovered under (i) (ii), and (iii) hereinabove.</i>
	Others	<ul style="list-style-type: none"> 6. <i>Special case review : The Board, based on specific information received from Secretary, ICAI or Disciplinary directorate or any other Regulator , which in the opinion of the Board requires a special review of the Practice Unit, may conduct a special review of the Practice Unit for a period to be determined in each case.</i> 7. Any Practice Unit not selected for Peer Review, may <i>suo moto</i> apply to the Board for the conduct of its Peer Review. The Board shall act upon the same within 30 days from the date of receipt of such request. 8. An auditee (Client) may request the Board for the conduct of Peer Review of its auditor (Practice Unit). The Board shall act upon the same within 30 days from the date of receipt of such request. 9. The Board may, with the approval of the Council, modify any of the above criteria.
OBLIGATIONS OF THE PRACTICE UNIT / PEER REVIEWER	Obligations of the Practice Unit	Any Practice Unit, in addition to the prescribed information to be furnished including the questionnaire, statements and such other particulars as the Board may deem Fit, shall Produce to the Reviewer or allow access to, any record, document or prescribed register maintained by the Practice Unit or any other record or document which is of a class or description so specified, and which is in the possession or under the control of the Practice Unit; Provide to the Reviewer such explanation or Further particulars in respect of anything produced in compliance with a requirement under sub clause (i) above, as the Reviewer shall specify; and

	<p>Provide to the Reviewer all assistance in connection with Peer Review;</p>	<p>Where any information or matter relevant to a Practice Unit is recorded otherwise than in a 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 of it in a legible form, with a translation in English or Hindi if the matter is in any other language, and if such translation is requested For by the Reviewer.</p>
<p>OBLIGATIONS OF THE PEER REVIEWER</p>	<p>The Reviewer shall not take any extracts of the Practice Units 'Clients' file or records examined by him while conducting Peer</p>	

	Review, as a part of his working papers. The Reviewer shall complete the Review within the prescribed time frame.
PERIODICITY OF PEER REVIEW	The Periodicity of Peer Review will be a) Level - I Practice Units Once in 3 years. b) Level - II Practice Units Once in 4 years c) Level - III Practice Units — Once in 5 Years However, if the Board so decides or otherwise at the request of the Practice Unit, the Peer Review for a Practice Unit can be conducted at shorter intervals.
COST OF PEER REVIEW	The cost of Peer Review including the limit of out of pocket expenses payable to the Reviewer shall be decided by the Board from time to time and shall be paid by the Practice Unit. In case Reviewer has to conduct "Follow-On" Review, the same rate would apply to the follow-on Review also. The amount shall be paid by the Practice Unit within 30 days of receipt of the bills from the Reviewer.
REVIEW FRAMEWORK	The Peer Review process will include ➤ Selection of Practice Unit and appointment of Reviewer, ➤ Planning ➤ Execution and ➤ Reporting.
	<p>Selection of Practice Unit & appointment of Reviewer:</p> <ul style="list-style-type: none"> ➤ Notification to the Practice Unit: A Practice Unit which has been selected for a PeerReview shall be notified by the Board. ➤ <i>A detailed declaration cum questionnaire in the form approved by the Board shall be submitted by the Practice Unit within seven days from the date the Practice Unit (PU) has been notified by the Board so that Reviewer to be allotted from the Panel of three reviewers can be identified by the Board as per declaration cum questionnaire submitted by Practice Unit.</i> ➤ Name of three Reviewers shall be recommended by the Board to the Practice Unit so selected. The Practice Unit shall select one out of the three Reviewers & intimate to the Board within seven days of receipt of the names. The Board shall intimate the Reviewer so selected and seek his consent within seven days.

	<p>Planning</p>	<ul style="list-style-type: none"> ➤ <i>Information to be furnished by Practice Unit: On intimation by the Board, of the Reviewer’s consent, the Practice Unit shall within 2 days provide the copy of completely filled up questionnaire earlier submitted with Board to the Reviewer alongwith: Details of any proceedings against the Practice Unit or any of its partners or qualified assistants taken by any regulatory, monitoring or enforcement bodies relating to investigation or allegation of deficiency in the conduct of attest function by them during the period of three financial years preceding the period of review or at any time thereafter i.e. till the date of submission of the duly filled-in Questionnaire</i> ➤ <i>Information to be furnished by Peer Review Board: The Peer Review Board shall call for relevant information from the UDIN Directorate and may share the concerned details with Peer Reviewer which shall form part of Peer Review.</i>
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		<p>➤ Selection of Sample by the Reviewer:</p> <ul style="list-style-type: none"> ○ <i>The Reviewer shall within 7 days of receiving the information from the Practice Unit select a sample of the assurance services that he would like to Review and intimate the same to the Practice Unit and the Peer Review Board.</i> ○ The Reviewer may also seek further / additional clarification from the Practice Unit on the information furnished / not furnished. ○ <i>The Reviewer shall plan for an on-site Review visit or initial meeting in consultation with the Practice Unit. The Reviewer shall give the Practice Unit at least five days' time to keep ready the necessary records of the selected assurance services.</i> <i>The Reviewer and Practice Unit shall mutually cooperate and ensure that the entire Review process is completed within 60 days from the date of notifying the Practice Unit about its selection for Review.</i>
	<p>Execution</p>	<ul style="list-style-type: none"> i. Peer Review Visits: Peer Review visits will be conducted at the Practice Unit's head office or /and branch(es) or any other locations. <i>This on-site Review should not extend beyond seven working days based on the size of the Practice Unit.</i> ii. Compliance Review-General Controls: The Reviewer is required to carry out a compliance Review of the following General Controls for evaluating the degree of reliance to be placed upon them for effective Review <ul style="list-style-type: none"> ○ Independence ○ Maintenance of Professional Skills and Standards

		<ul style="list-style-type: none"> ○ Outside Consultation ○ Staff recruitment, Supervision and Development ○ Office Administration <p>iii. Selection of Assurance Service Engagements for Review</p> <p>a) The number of assurance service engagements to be Reviewed shall depend upon:</p> <ul style="list-style-type: none"> ○ Standard of quality controls generally prevailing; ○ The size and nature of assurance service engagements undertaken by the Practice Unit. ○ The methodology generally adopted by the Practice Unit in providing assurance services. The number of partners / members involved in assurance service engagements in the Practice Unit; ○ The number of locations / branch offices of the practice Unit; ○ The Fees charged / received / service tax paid by the Practice unit. <p>b) From the initial sample selected at the planning stage, the Reviewer, in consultation with the Practice Unit, may reduce or enlarge the initial sample size of assurance service engagements for Review.</p> <p>iv. Review of Records</p> <p>The Reviewer is required to adopt a combination of compliance approach and substantive approach in the Review process.</p> <p>A. Compliance Approach - Assurance Service Engagements</p> <p>The compliance approach is to assess whether proper control procedures have been established / followed by the Practice Unit to ensure that assurance services are being performed in accordance with Technical, Professional and Ethical Standards. The Following areas shall be considered:</p> <ul style="list-style-type: none"> ○ Assurance services records For Administration
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		<ul style="list-style-type: none"> ○ Review and Evaluation of System of Internal controls ○ Substantive Tests ○ Financial Statements Presentation and ○ Assurance Services Conclusions Assurance Services Reporting <p>B. Substantive Approach - Assurance Service Engagements This approach requires a Review of the assurance working papers in order to establish the extent of compliance, whether the assurance work has been carried out as per the Technical, Ethical and Professional Standards.</p>
	<p>Reporting</p>	<p>i. Discussion/Communication of Findings</p> <p>a) <i>After completing the on-site review, the Reviewer, before making his Report to the Board, shall communicate his findings to the Practice Unit if in his opinion, the systems and procedures are deficient or non-compliant with reference to any matter that has been noticed by him or if there are other matters where he wants to seek clarification.</i></p> <p>b) <i>The Practice Unit shall, within 5 days of the date of receipt of the findings, make its submissions or representations, in writing to the Reviewer.</i></p> <p>ii. Peer Review Report of Reviewer</p>

		<p>a) At the end of an on-site Review if the Reviewer is satisfied with the reply received From the Practice Unit, he shall submit a Peer Review Report to the Board along with his initial findings, response by the Practice Unit and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.</p> <p>b) In case the Reviewer is of the opinion that the response by the Practice Unit is not satisfactory, the Reviewer shall accordingly submit a modified Report to the Board incorporating his reasons for the same. The Reviewer shall also submit initial findings response by the Practice Unit and the manner in which t-responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.</p> <p>c) In case of a modified report, The Board shalt order For a "Follow On" Review after a period of one year from the date of issue of report as mentioned in (b) above. IF the Board so decides, the period of one year may be reduced but shalt not be less than six months from the date of issue of the report.</p>
	Working papers	The Reviewer shall document all his working papers and submit a copy of his working papers to the Board, if called For by the Board within 12 months of completion of Review / submission of Review Report.
	Peer Review Certificate	On receipt of the Peer Review Report, the Board shall within three months, <p>a) Issue a Peer Review Certificate to the Practice Unit mentioning the next due date for Review.</p> <p>b) Inform the Practice Unit that a Peer Review certificate cannot be issued along with the reasons therefore as well inform the Practice Unit about the due date for conducting a Follow on review.</p>

As per the Statement, **Technical, Professional and Ethical Standards** – means

10. Accounting Standards issued by ICAI that are applicable for entities other than companies under the Companies Act, 2013;

11. Accounting Standards prescribed under section 133 of the Companies Act; 2013 by the Central Government based on the recommendation of ICAI and in consultation with and after examination of the recommendations made by the National Financial Reporting Authority (NFRA);

12. Indian Accounting Standards prescribed under section 133 of the Companies Act 2013 by the Central Government based on the recommendation of ICAI and in consultation with NFRA and notified as Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time;

13. Standards

Standards issued by the Institute of Chartered Accountants of India including-	
(a) Engagement and Quality Control Standards	(d) Standards on Internal Audit.
(b) Statements	(e) Guidelines/ Notifications / Directions / Announcements / Pronouncements / Professional Standards issued from time to time by the Council or any of its Committees.
(c) Guidance notes	

14. Framework for the preparation and presentation of financial statements, Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services and Framework for Assurance engagements;

15. Provisions of the relevant statutes and / or rules or regulations which are applicable in the context of the specific engagements being reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements.

Confidentiality

Strict confidentiality shall be maintained by all those involved in the Peer Review process, namely, Reviewers, members of the Board, any Qualified Assistants or Practice Unit.

All persons governed by the secrecy provisions:

- (a)** shall at all times preserve and aid in preserving secrecy with regard to any matter arising in the performance or in assisting in the performance of any function, directly or indirectly related to the process and conduct of Peer Reviews;
- (b)** Reviewer shall not make use of or disclose the contents of Review report or any confidential information about the process of Review unless as required by the Board or the Council

Non-compliance with the secrecy provisions in the above clause shall amount to professional misconduct as defined under Section 22 of the Chartered Accountants Act, 1949.

A Declaration of Confidentiality shall be signed by the persons who are responsible for the conduct of Peer Review i.e., Reviewers and his Qualified Assistants and be filed with the Board. All members of the Board shall also sign a declaration of Confidentiality in a manner as may be prescribed by the Board.

APPROACH OF THE REVIEWER

Briefly, the stepwise approach which may be adopted by the reviewer is discussed in the following paragraphs:

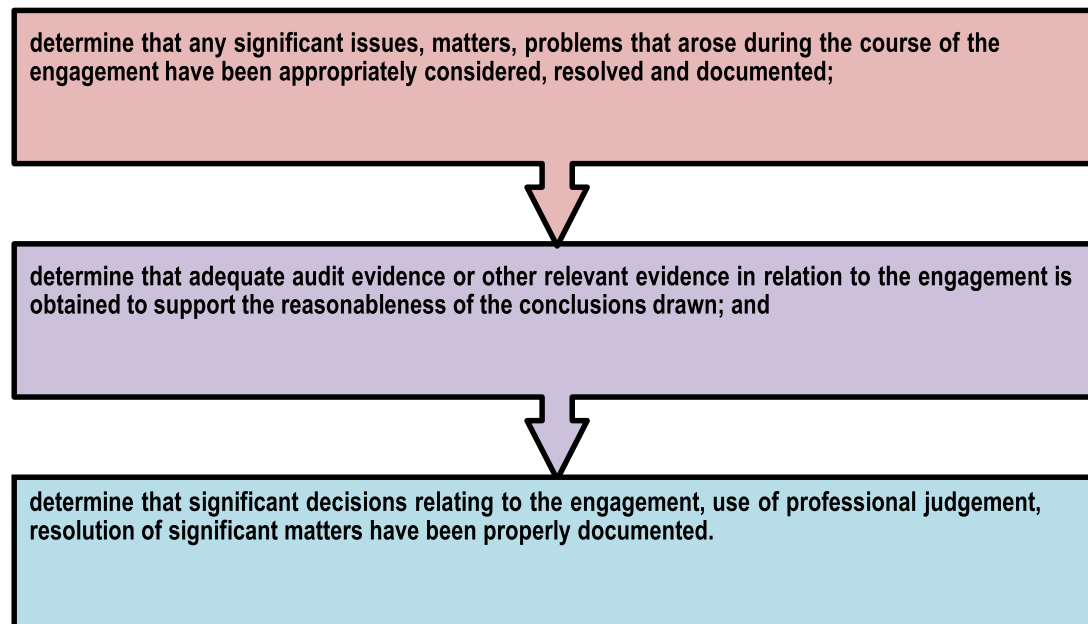
- 1.** The reviewer should gain an understanding of the engagement letter since an assurance engagement or for that matter any other kind of engagement should begin with an engagement letter. Engagement letter is an important document as it defines the nature and scope of the assurance engagement, practice unit's responsibilities with regard to the engagement. This understanding would help him in planning the review of documentation. The reviewer should focus the review primarily on the key engagement matters. The reviewer should also consider the materiality of the matter while planning the review.
- 2.** The number of assurance engagements to be selected requires the exercise of judgement by the reviewer based on the evaluation of replies given in the questionnaire and the size of the practice unit. The objective is to obtain a reasonable cross-section of the practice unit's clients although greater weight may be given to large clients.
- 3.** The practice unit may have policies and procedures for accepting a particular engagement. These policies and procedures may not exist in the form of records in each practice unit. In

such a case the reviewer should consider enquiring from the concerned persons about such policies and procedures. The reviewer should, wherever possible, examine that the policies and procedures for acceptance of audit have been complied with and necessary documentation with regard to the same exists.

4. The reviewer may follow a combination of compliance procedures and substantive procedures throughout the peer review process. The mix of compliance and substantive procedures depends upon the professional judgement of the reviewer. The reviewer may consider the following:

In carrying out the compliance tests, the reviewer may evaluate whether the policies and procedures of the practice unit are sufficient to ensure compliance of technical standards and whether these policies and procedures are adequately communicated to all staff who are involved in carrying out the assurance work.	In performing substantive tests, the reviewer should evaluate whether the practice unit's working papers relating to the client adequately document the findings and conclusions and whether the report of practice unit is in consonance with the findings and conclusions drawn.
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5. Finally, the reviewer while evaluating records may consider the following:



Obligations of the Peer Reviewer

1. *The Reviewer shall not take any extracts of the Practice Units clients' file or records examined by him while conducting Peer Review, as a part of his working papers.*
2. *The Reviewer shall complete the Review within the prescribed time frame and submit the report to the Board.*
3. *The Reviewer shall document all his working papers and submit a copy of his working papers to the Board, if called for by the Board within 18 months of submission of Review Report.*

Peer Review Certificate

On receipt of the Peer Review Report, the Board shall within three months:

- (a) *Issue a Peer Review Certificate to the Practice Unit mentioning the validity period.*
- (b) *Inform the Practice Unit that a Peer Review certificate cannot be issued along with the reasons therefor as well inform the Practice Unit about the due date for conducting a follow on review.*

DIFFERENCE BETWEEN PEER REVIEW AND QUALITY REVIEW

Peer review is a review of the systems and procedures of an audit firm. Although sample audit files are inspected by the peer reviewer, it is done for the purpose of testing the effectiveness of the systems and procedures. The intention is not to find faults but to help the firm develop effective systems. It is a kind of mentoring process. Peer review is a part of the activities of ICAI aimed at improving the quality of service.

In contrast, a quality review is supposed to act as a deterrent. Quality Review Board (QRB) is constituted by the Central Government and is independent of ICAI. As per Section 28A of the Chartered Accountant's Act, the Central Government has the authority to constitute a Quality Review Board. QRB carries out supervisory and disciplinary functions. A quality review normally pertains to one particular audit conducted by an audit firm. The main objective quality review is to find errors or inadequacies, if any, committed by the auditor while conducting the audit. Serious errors detected in quality review lead to disciplinary action against the member.

QUALITY REVIEW

<p>INTRODUCTION</p>	<p>Quality means doing it right when no one is looking.</p> <p>Every audit firm is required to establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements and that reports issued by the firm or engagement partner(s) are appropriate in the circumstances.</p> <p>Standard on Quality Control (SQC) 1 requires that every Firm's system of quality control should include policies and procedures addressing each of the following elements:</p> <ul style="list-style-type: none"> a) Leadership responsibilities for quality within the firm b) Ethical requirements c) Acceptance and continuance of client relationships and specific engagements d) Human resources e) Engagement performance
<p>OBJECTIVES OF QUALITY REVIEW</p>	<p>Quality review is directed towards evaluation of audit quality and adherence to various statutory and other regulatory requirements.</p> <p>It is not the purpose of a review, however, to review all of a firm's audits or to identify every aspect in which a reviewed audit is deficient. Accordingly, a review should not be understood to provide any assurance that the Firm's audits, or its clients' financial statements or reporting thereon, are Free of any deficiencies</p>
<p>SCOPE OF QUALITY REVIEW</p>	<p>The scope of the quality review includes:</p> <ul style="list-style-type: none"> a) Examining whether the Engagement Partner has ensured compliance with the applicable technical standards in India and other applicable professional and ethical standards and requirements. b) Examining whether the Engagement Partner has ensured compliance with the relevant laws and regulations. c) Examining whether the Audit firm has implemented a system of quality control as envisaged in line with the Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements. <p>As per the QRB, the term "Technical Standards" includes:</p> <ul style="list-style-type: none"> ➤ The Accounting Standards notified under section 133 of the Companies Act, 2013; ➤ The Accounting Standards issued by the Institute of Chartered Accountants of India;

	<ul style="list-style-type: none"> ➤ The Framework for the Preparation and Presentation of Financial Statements issued the institute of Chartered Accountants of India; ➤ The applicable Quality Control and Engagement Standards issued by the Institute of Chartered Accountants of India; ➤ The Statements on Auditing issued by the Institute of Chartered Accountants of India; ➤ The Guidance Notes on accounting and auditing matters issued by the Institute of Chartered Accountants of India; ➤ The Notifications/Directions/Guidelines issued by the Institute of Chartered Accountants of India including those of a self-regulatory nature. ➤ The Code of Ethics issued by the Institute of Chartered Accountants of India. <p>Presently, the review undertaken by QRB covers statutory audit services only and does re: extend to internal audit services provided by the members of the Institute.</p>
<p>THE QUALITY REVIEW BOARD (QRB)</p>	<p>Constitution and composition of Quality Review Board</p> <p>In terms of section 28A of the Chartered Accountants Act, 1949, the Board comprises of a Chairperson and ten other members.</p> <p>Chairperson and members of the Board are experienced in the Field of law, the economics, business, finance or accountancy.</p> <p>Five members of the Board shall be nominated by the Central Government and other five members shall be nominated by the Council.</p>
	<p>Functions of Quality Review Board</p> <ul style="list-style-type: none"> ➤ Review quality of services provided by the members ➤ Make recommendations to the Council For quality of services provided by the members ➤ Guide the members to improve the quality of services and adherence to the various statutory and other regulatory requirements ➤ However, the Ministry of Corporate Affairs, vide letter F.No.7/1/2019 -CL-1 dated 30th January, 2019, has clarified to the Quality Review Board that in view of Sec.132 (2) of the Companies Act, 2013 r/w Rule 9(4) of NFRA Rules, 2018, the issue of QRB reviewing audits of the companies/bodies corporate specified under Rule 3 of the NFRA Rules, 2018 will only arise in case a reference is so made to QRB by NFRA, and not otherwise. ➤ Rule 3 (1) of National Financial Reporting Authority Rules, 2018, as notified by Central Government on 13 November, 2018, inter alia, provides that the Authority (read NFRA) shall

		<p>have power to monitor and enforce compliance with accounting standards and auditing standards, oversee the quality of service under sub-section (2) of section 132 or undertake investigation under sub-section (4) of such section of the auditors of the following class of companies and bodies corporate, namely:-</p> <ol style="list-style-type: none"> 1. companies whose securities are listed on any stock exchange in India or outside India; 2. unlisted public companies having paid-up capital of not less than rupees five hundred crores or having annual turnover of not less than rupees one thousand crores or having, in aggregate, outstanding loans, debentures and deposits of not less than rupees five hundred crores as on the 31st March of immediately preceding financial year; 3. insurance companies, banking companies, companies engaged in the generation or supply of electricity, companies governed by any special Act for the time being in force or bodies corporate incorporated by an Act in accordance with clauses (b), (c), (d), (e) and(f) of sub-section (4) of section 1 of the Act; 4. any body corporate or company or person, or any class of bodies corporate or companies or persons, on a reference made to the Authority by the Central Government in public interest; and 5. a body corporate incorporated or registered outside India, which is a subsidiary or associate company of any company or body corporate incorporated or registered in India as referred to in clauses (a) to (d), if the income or net-worth of such subsidiary or associate company exceeds twenty percent of the consolidated income or consolidated net-worth of such company or the body corporate, as the case may be, referred to in clauses (a) to (d).
	<p>Powers of Quality Review Board</p>	<p>'Chartered Accountants Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board Rules, 2006'.</p> <p>Rule 6 of rules provides:</p> <ol style="list-style-type: none"> a) Evaluate and review the quality of work and service provided by member of the Institute. b) Lay down the procedure of evaluation criteria to evaluate various service being provided by the members. c) Call of information from the institute, of Council or its Committee Members, Clients of members or other persons or organizations.

		<p>d) Invite experts to provide expert/technical advice or opinion or analysis any matter or issue which the Board may fell relevant for the purpose assessing the quality of work and services offered by the members.</p> <p>e) Make recommendations to the Council.</p> <p>The Rules also provide that where the Board does not receive the information called for by it from any member of the Institute, the Board may request the Institute to obtain the information from the member and furnish the same to the Board.</p> <p>Similarly, if the Board does not receive the information called for by it from any company registered under the Companies Act, 1956 / Companies Act, 2013,</p>
<p>SELECTION OF AUDIT FIRMS</p>	<p>Selection of Audit Firm based on the Financial Statements of the Enterprise/s Audited by the latter:</p>	<p>Under this category, in the initial stage, the audited accounts of companies having wider public interest, such as listed companies, insurance companies, NBFCs, unlisted public sector undertakings, asset management companies may be selected by QRB on the basis of one or more of the following:</p> <ul style="list-style-type: none"> ➤ suo moto or random selection from particular class of enterprises/audit Firms ➤ on account of being a part of a sector otherwise identified as being susceptible to risk on the basis of market intelligence reports ➤ regulatory concerns pointing towards stakeholder risks ➤ reported Fraud or likelihood of Fraud ➤ serious accounting irregularities reported in media or other reports ➤ major non-compliances with provisions relating to disclosures under relevant statutes ➤ reference made to it by any regulatory body such as Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, Ministry of Corporate Affairs, etc. <p>1. The Board may also review the quality of the statutory audit services of AFUR with a view to assessing the quality of statutory audit and reporting by the statutory auditors and their quality control framework on a reference made to it by any regulatory body like Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, Ministry of Corporate Affairs, National Financial Reporting Authority (NFRA) under Rule 9(4) of NFRA Rules, 2018 etc.</p>

		<ol style="list-style-type: none"> 2. The Board shall not consider cases of complaints received from individuals, firms, companies, other entities and their partners, directors and other officers etc. which shall be continued to be dealt with in accordance with the mechanism available under the Chartered Accountants Act, 1949. Cases of complaints from only regulatory bodies and other media reports involving serious accounting irregularities shall be considered by the Board for the purpose of initiating the review. 3. The selection for suo moto quality reviews may, however, be done using methods such as random sampling, selection of particular class or classes of entities/audit firms, in the manner as specified at (i) above. 4. The QRB secretariat should place the details of the entities and audit firms, which may be selected for quality review before the Board for its consideration. The Board, at this stage, may consider whether the case warrants a quality review by a TR and may refer the cases selected for quality review to the relevant TRs. The Board will obtain the Annual Report of the entity concerned in terms of the 'Chartered Accountants Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board Rules, 2006'.
	<p>Criteria based on Audit Firms Auditing the Accounts.</p>	<p>Selection of audit firms should also be made for quality review of their statutory audit work on random basis, the volume of work handled by them represented by the number and nature of clients, sectors that may be identified as facing high risk, or on account of fraud or likelihood of fraud.</p>
<p>Quality Review Cycle:</p>		<p>The following quality review cycle of Audit firms may be followed generally or as may be decided by the Board:</p> <ol style="list-style-type: none"> 1. Once in 3 years for Audit firms having 20 or more Partners 2. Once in 4 years for Audit firms having 10 or more but less than 20 Partners 3. Once in 5 years for Audit firms having less than 10 Partners. 4. Upto 3 audit engagements of an AFUR may be selected by the Board, as may be considered appropriate, during a particular quality review cycle covering entities of varied industries, size, geographical spread and regulatory concerns. However, in the absence of any adverse finding in a past review, not more than one audit engagement of the same engagement partner/ proprietor of an AFUR may be selected for quality review by the Board during a particular quality

		<p>review cycle</p> <p>5. However, in case of any adverse findings in past review/s or in any other situation, QRB may conduct quality review of any particular audit firm or of a particular engagement partner at more frequent interval and/or select more than 3 audit engagements.</p>
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<p>THE QUALITY REVIEW PROCESS</p>	<p>Technical Reviewer appointed for the review and the review In so far as the technical reviewer is concerned, the quality of a quality review is directly affected by factors such as:</p> <ul style="list-style-type: none"> ➤ Knowledge and experience of the technical reviewer ➤ Time devoted by the technical reviewer ➤ Composition of the quality review team ➤ Understanding of the objective and scope of work ➤ Monitoring, direction and supervision of the quality review team by the technical reviewer 	
	<p>Various Stages involved in the Conduct of the Quality Review Assignments</p>	<ul style="list-style-type: none"> ➤ Selection of Audit Firm and Technical Reviewer to conduct Quality Review and sending Offer Letter of Engagement to the Technical Reviewer. ➤ Technical Reviewer to convey his acceptance of Letter of Engagement by sending necessary declarations For meeting eligibility conditions and furnishing statement of confidentiality by the Technical Reviewer and his assistant/s, if any. ➤ Intimation to the Audit Firm about the proposed Quality Review and acceptance of the assignment by the Technical Reviewer. Also marking a copy of the intimation to the Technical Reviewer. ➤ Technical Reviewer to send the specified Quality Review Program General Questionnaire to the ➤ Audit firm for Filling-up and call for additional information From the Audit Firm, if required. ➤ Technical Reviewer to carry out the Quality Review by visiting the office of the Audit Firm by fixing the date as per mutual consent. ➤ Technical Reviewer to send the preliminary report to Audit firm. ➤ Audit firm to submit representation on the preliminary report to the Technical Reviewer. ➤ Technical Reviewer to submit final report along with a copy of Annual report of the company/entity for the year, to the Board in the specificd format, on their (individual) letterhead, duly signed and dated within 45 days from the date of acceptance of the assignment. <p>Technical Reviewer should also send a copy of their final report to the Statutory Auditor/Audit firm, requesting the firm to send their submissions thereon to the Board within 7 days of receipt of the final report with a copy to Technical Reviewer. Upon receipt of their final submission, Technical Reviewer shall submit within next 7 days a summary of</p>

		<p>their findings, reply of the audit firm thereon along with their final comments in the specified format.</p> <ul style="list-style-type: none"> ➤ Quality Review Group to consider the report of the Technical Reviewer and responses of the Audit firm and make recommendations to Quality Review Board. ➤ Quality Review Board to consider the report of the Quality Review and decide the final course of action.
	<p>Objective of Technical Review</p>	<p>As per the Reporting Guidelines issued by the Board, the technical reviewer required to examine the procedures and implementation thereof in the Audit firm under review (AFUR) for ensuring:</p> <ul style="list-style-type: none"> a) compliance with the applicable technical standards in India, other applicable professional and ethical standards and relevant laws and regulations; b) implementation of a system of quality control with reference to the applicable quality control standards; c) consideration of SA 240, "The Auditors' Responsibilities relating Fraud in an Audit of Financial Statements" issued by The Institute : Chartered Accountants of India (ICAI); and d) whether there is no material misstatement of assets and liabilities as at the reporting date in respect of the Company/entity audited by the AFUR. <p>A quality review of the audit services of the Firm in terms of the Procedure for Quality Review of Audit Services of Audit Firms issued by the QRE ("the Procedures") involves interviewing, making enquiries and performing such other procedures.</p>
	<p>Independence and Qualifications of Technical Reviewers</p>	<p>For being a technical reviewer:</p> <ul style="list-style-type: none"> ➤ A member should not have disciplinary proceeding under the Chartered Accountants Act, 1949 pending against him/her or any disciplinary action under the Chartered Accountants Act, 1949 / penal action under any other law taken/pending against you during last three financial years and/or thereafter. ➤ A member or his/her firm or any of the network firms or any of the partners of the Firm or that of the network firms should not have been the statutory auditor of the company, as specified, or have rendered any other services to the said company/entity during last three financial years and / or thereafter.

		<ul style="list-style-type: none"> ➤ A member or his/her firm or any of the network firms or any of the partners of the firm or that of the network firms should not have had any association with the specified statutory audit firm, during the last: three financial years and /or thereafter. ➤ A member to comply with all the eligibility conditions laid down for appointment as an auditor of a company u/s 141(3) of the Companies Act, 2013 which apply mutatis mutandis in respect of the review of the quality of statutory audit of the company/entity, as specified, so Far as applicable.
	<p>Empanelment of Technical Reviews</p>	<p>Reviewer should have minimum fifteen years of post qualification experience as a chartered accountant and be currently active in the practice of accounting and auditing.</p> <ul style="list-style-type: none"> ➤ Reviewer should have handled as a signing partner/proprietor at least three statutory audit assignments as a Central Statutory Auditor of Banks/Public Limited Companies/Government Companies/Private Limited Companies having annual turnover of rupees fifty crores and above during the last ten financial years; Provided that out of the aforesaid three statutory audit assignments, at least one must be in respect of entities other than Private Limited Companies. ➤ Reviewer should not have any disciplinary proceeding under the Chartered Accountants Act, 1949 pending against him or any disciplinary action under the Chartered Accountants Act, 1949 / penal action under any other law taken/pending against you during last three financial years and/or thereafter. ➤ Reviewer should not currently be a Member of the QRB or ICAI's Central Council/Regional Council/Branch level Management Committee.

	<p>On-site-visit and Qualified Assistant</p>	<p>The technical reviewers for carrying out the quality review assignment, could undertake a maximum of one on -site visit to the Statutory Audit Firm which shall not extend beyond seven days or, in exceptional circumstances, such other extended period, for specific reasons to be recorded in writing, with the prior approval of the Chairperson, Quality Review Board, which shall not, in any case, extend beyond fourteen days.</p> <p>For this purpose, they could also take the assistance of not more than 3 assistants who:</p> <ul style="list-style-type: none"> a) shall be chartered accountant; b) do not attract any of the disqualifications prescribed under the Chartered Accountants Act, 1949; c) shall also have to sign the statement of confidentiality in a prescribed format;
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		<p>d) shall have no direct interface either with the audit firm under review or the Board;</p> <p>e) should have been working with them for at least one year as a member/a partner in the CA firm with them;</p> <p>f) should not have been associated with the Statutory auditor/audit Firm under review and the company/ entity selected during last three financial years and/or thereafter.</p>
	<p>Confidentiality</p>	<p>Technical Reviewers should ensure that all information, papers, materials, documents etc. relating to the company/audit Firm, as selected and assigned to them, that they will gain during the course of assignment are kept in strict confidence.</p>
	<p>Stage-wise Approach of Quality Review Process</p>	<p>i. The Board may constitute one or more Quality Review Groups (hereinafter referred to as Review Groups) to conduct preliminary reviews of the general purpose financial statements, with a view to assessing the quality of audit and reporting by the auditors, in consultation with the Board. There could be two categories of the Review Groups:</p> <p>a) Industry Specific (For reviewing general purpose financial statements of enterprises associated with a particular industry, for example, banking, insurance, electricity, mutual funds, merchant bankers, etc.</p> <p>b) Generic.</p> <p>ii. Each of the Review Group would be assisted by Technical Reviewer(s) who may be an outsourced service provider. The job of the Technical Reviewer(s) would be to prepare a report on the review of general purpose Financial statements, with a view to assessing the quality of audit and reporting by the auditors, and the review of quality control Framework adopted by the auditors/audit Firms in conducting audit.</p> <p>iii. The report, so prepared by the Technical Reviewer, may be considered at the meetings of the Review Group. The Review Group may also consult the Board on any issue, on which the Group feels that the guidance of the Board is necessary.</p> <p>The Review Group may complete the review of cases referred to it and submit its</p>

		<p>report on the same to the Board within the specified period of time. The Board may, however, extend this time limit for submission of reports by the Review Group.</p> <p>iv. The report of the Review Group shall expressly state the Following: Particulars of the Enterprise;</p> <ul style="list-style-type: none"> ➤ A detailed description of the non-compliance with the matters stated in the Terms of Reference, if any; ➤ A detailed description of the evidences that support the non-compliance; and ➤ Review Group's recommendations about the actions that are required to be taken in a particular case. <p>v. The Technical Reviewer, after completion of his review, is required to submit a preliminary report to the audit firm on the review of the quality of audit and reporting by the auditors in the general purpose financial statements within the specified period of time before submitting the final report to the Board. The Board may, however, extend the time limit for submission of preliminary review report.</p>
	<p>Evaluation of Findings</p>	<p>The Technical reviewer or Quality review team may note a non-compliance with one or more standards on auditing or accounting standards or disclosure requirements as may be applicable to the engagement.</p> <p>Quality reviewer's team are required to evaluate the Finding in the light of the following considerations:</p> <ul style="list-style-type: none"> a) The responses given by the engagement team; b) Materiality of the items of the financial statements involved; c) Accounting and auditing practices under the legal and regulatory framework applicable to the industry to which the audit client belongs; and d) If the findings are related to non-compliance with the procedures required to be performed in accordance with the Standards on Auditing, whether the engagement team carried out alternative procedures to obtain sufficient appropriate audit evidence in relation to the financial statement assertion under question.

<p>REPORTING AND OTHER PROCEDURES</p>	<p>The reviewer, after completion of his review, is required to submit a preliminary report to the audit firm on the review of the quality of audit and reporting by the auditors in the general purpose financial statements within the specified period of time before submitting the final report to the Board. The reviewer, based upon his satisfaction From the representation by the audit Firm, may decide to issue either an interim report or a final report to the Board.</p> <p>Reviewers, based on the conclusions drawn From the review, shall issue a preliminary report and subsequently the Final report.</p> <p>A clean report indicates that the reviewer is of the opinion that the affairs are being conducted in a manner that ensures the quality of services rendered.</p> <p>However, a reviewer may qualify the report due to one or more of the following:</p> <ul style="list-style-type: none"> ➤ non-compliance with technical standards; ➤ non-compliance with relevant laws and regulations; ➤ quality control system design deficiency; ➤ non-compliance with quality control policies and procedures; or ➤ nonexistence of adequate training programmes for staff. 	
	<p>Basic Elements of the Reviewer's Report:</p>	<p>The report should contain:</p> <p>a) Elements relating to audit quality of companies:</p> <ol style="list-style-type: none"> i. A reference to the description of the scope of the review and the period of review of audit firm conducted along with existence of limitation(s), if any, on the review conducted with reference to the scope as envisaged. ii. A statement indicating the instances of lack of compliance with technical standards and other professional and ethical standards. iii. A statement indicating the instances of lack of compliance with relevant laws and regulations. <p>b) Elements relating to quality control framework adopted by the audit firm in conducting audit:</p> <ol style="list-style-type: none"> i. An indication of whether the firm has implemented a system of quality control with reference to the quality control standards. ii. A statement indicating that the system of quality control is the responsibility of the reviewed firm. iii. An opinion on whether the reviewed firm's system of quality control has been designed to meet the requirements of the quality control standards For attestation services and whether it was

		<p>complied with during the period reviewed to provide the reviewer with reasonable assurance of complying with technical standards in all material respects.</p> <p>iv. Where the reviewer concludes that a modification in the report is necessary, a description of the reasons for modification. The report of the reviewer should also contain the suggestions.</p> <p>v. A reference to the preliminary report.</p> <p>vi. An attachment which describes the quality review conducted including an overview and information on planning and performing the review.</p>
ACTIONS THAT MAY BE RECOMMENDED BY THE QUALITY REVIEW BOARD	<p>The actions that may be recommended by the Board include one or more of the following:</p> <ul style="list-style-type: none"> ➤ Referring the case to the Director (Discipline) of the Institute for necessary action under the Chartered Accountants Act, 1949; ➤ Informing the details of the non-compliance to the regulatory bod(y)/ies relevant to the enterprise; ➤ Intimating the concerned auditor as to the findings of the Report as well as action initiated under (a) and/or (b) above; ➤ Consider the matter complete and inform the audit firm/auditor accordingly. 	
QUALITY REVIEW CHECKLIST	<p>In addition to compliance with the statutory provisions and technical standards, the following checklist should be used for quality reviews:</p>	

Various Stages involved in the Conduct of the Quality Review Assignments

The following table describes the various stages generally involved in the conduct of the quality review assignments:

QRB selects Audit Firm and the audit file for review and identifies TR to conduct Quality Review.
QRB sends Offer Letter of Engagement to TR.
TR conveys his acceptance of Letter of Engagement to QRB by sending necessary declarations for meeting eligibility conditions and furnishing statement of confidentiality by himself and his assistant/s, if any.
QRB intimates AFUR about the proposed Quality Review. QRB also sends a copy of this intimation letter to TR and provides them contact details of each other for further communication.
TR sends the specified Quality Review Questionnaire to the AFUR for filling-up. He also calls for additional information from the AFUR, if required.
TR & his team carry out the Quality Review by starting their off-site review by making

proper planning for the review and then on-site visiting the office of the AFUR by fixing the date as per mutual consent ensuring that review exercise gets completed within specified time frame.

On completion of on-site review, TR to send the preliminary report to AFUR. TR shall send a copy of preliminary report to QRB as well.

AFUR to submit representation on the preliminary report to the TR and TR to immediately send the reply of the AFUR to QRB.

TR to submit final report along with a copy of Annual report of the entity for the year under review, to the QRB in the specified format, on his (individual) letterhead, duly signed and dated within specified time frame or as extended by the QRB. In addition, he shall also send a copy of the final report to the AFUR, requesting them to send their final reply thereon to the QRB within 7 days of receipt of the final report. AFUR shall also send a copy of their final reply to TR.

AFUR to submit to QRB their reply on the final report and feedback, in prescribed format, regarding their experience of the quality review.

Upon receipt of the final reply from the AFUR, TR shall submit to QRB within next 7 days a summary of his findings, in the specified format, containing his findings, technical requirements, final reply of the AFUR and his final comments thereon.

QRB to consider the report of the TR and responses of AFUR and make recommendations to QRB. QRB may also call for additional details/information/explanations, if required, from TR/AFUR or issue such directions to TR, as it may deem appropriate, enabling it to assess the quality of audit and reporting by the AFUR.

QRB to consider report and recommendations of QRB and decide further course of action.

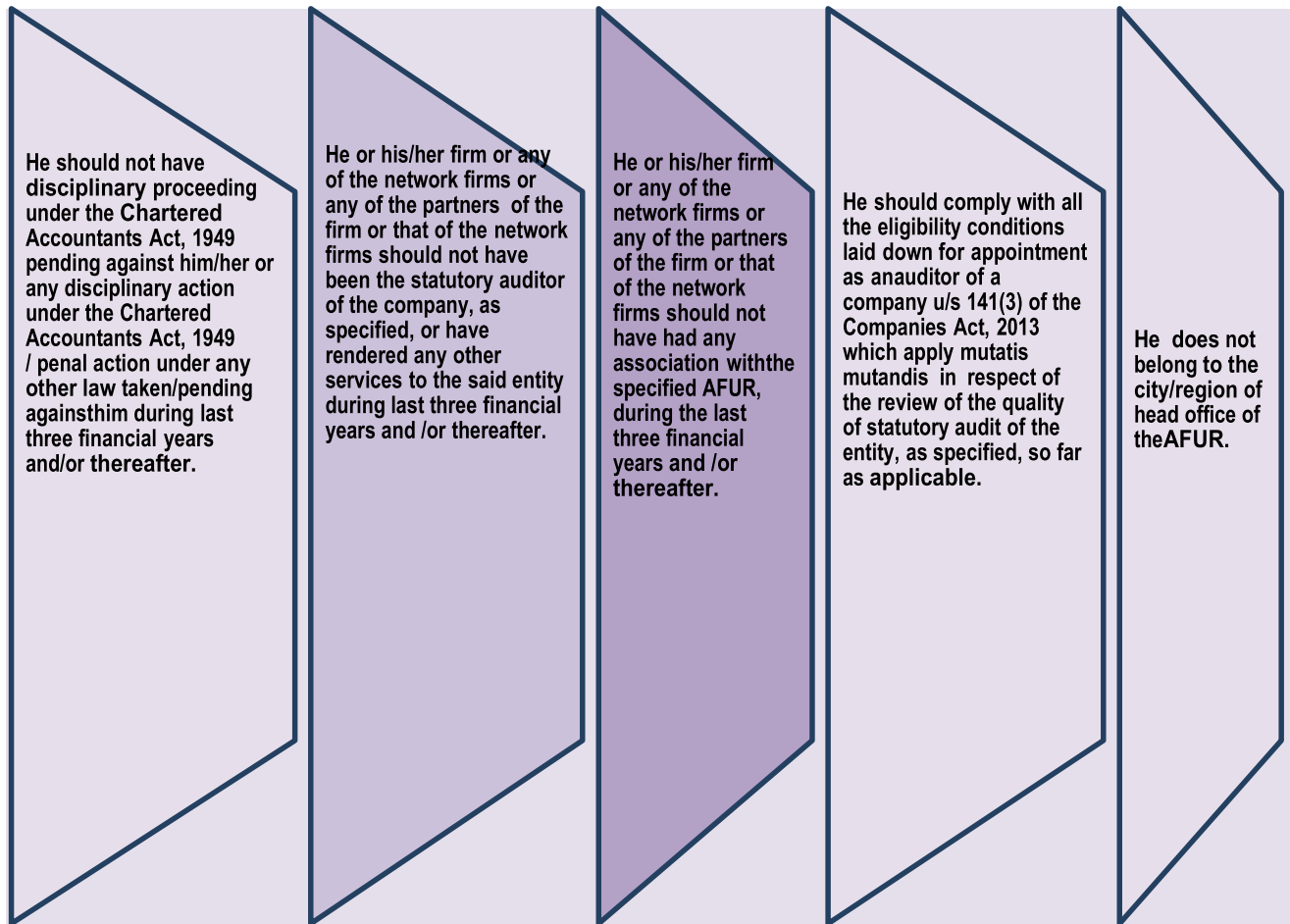
Composition of the Review Team

The composition of the review team would depend on the size of the AFUR/entity/(ies) under review. The composition of the team, mandatorily headed by a TR empaneled with the Quality Review Board, may also include up to 5 Assistants engaged by the TR, as may be fixed by the Board in each case on need basis. However, no firm of Chartered Accountants may be included as a member of the review team.

Independence and Qualifications of Technical Reviewers

While assigning the quality review work to the respective Technical Reviewers, in order to ensure independence and avoid conflict of interest, the following eligibility conditions were specified for carrying out the specified quality review assignment to the Technical Reviewers who were required to submit a declaration of eligibility before starting the assignment.

For being a technical reviewer(TR):



Independence of Assistant (Qualified Assistance)

The QRB, from time to time, shall specify the requirements for engaging Assistants by the TR for ensuring their independence and avoiding conflict of interest including

- (a) He shall be chartered accountant;
- (b) He does not attract any of the disqualifications prescribed under the Chartered Accountants Act, 1949;
- (c) He shall also have to sign the statement of confidentiality in a prescribed format;
- (d) He shall have no direct interface either with the audit firm under review (AFUR) or the Board;
- (e) He should have been working with them for at least one year as a member/a partner in the CA firm with them;
- (f) He should not have been associated with the AFUR and the concerned entity, whose audit is being reviewed, during last three financial years and/or thereafter.
- (g) He should not have any disciplinary proceeding under the Chartered Accountants Act, 1949 pending against him or any disciplinary action under the Chartered Accountants Act, 1949 / penal action under any other law taken/pending against him during last three financial years and/or thereafter;
- (h) He should not be a member of current QRB/ICAI's Central Council/Regional Council/Branch

level Management Committee; and

- (i) He should not himself be empanelled as a TR with the Quality Review Board.

Confidentiality

Confidentiality of information pertaining to the quality review assignments is of paramount importance. Technical Reviewers should ensure that all information, papers, materials, documents etc. relating to the company/audit firm, as selected and assigned to them, that they will gain during the course of assignment are kept in strict confidence. They are required to send duly signed statement of confidentiality including by each one of their assistants in a prescribed format. There should be no conflict of interest of all those connected with the entire review process. All persons involved with the entire review process including members of Board/Group, Technical Reviewers, his/her assistants and QRB secretariat shall maintain confidentiality of information obtained during reviews and also appropriately disclose to the Board, from time to time, their interests or that of the partners of their firm or their relatives, if any, in relation to statutory audit firm being reviewed by Board or entity concerned whose audit was selected for review.

Guidelines for the Technical Reviewers (TR)

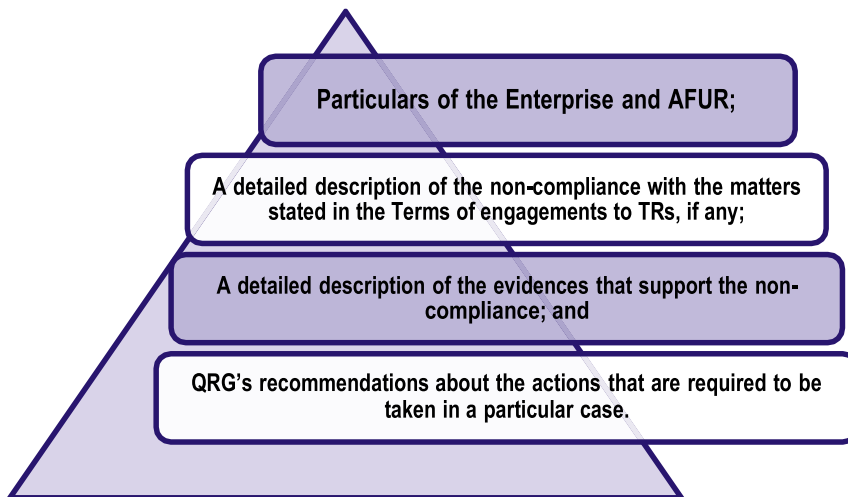
TR should adhere to the principle requirements mentioned while preparing his report. It may be noted that the requirements mentioned apply to the interim as well as the final reports of the TR. TR should also adhere to the various guidelines given to him by the Board, from time to time, including:-

- (a) TR shall himself make on-site visit, alongwith his Assistant/s, if any, to the AFUR for conducting the review of audit working papers as defined under the relevant standards;
- (b) TR shall follow Technical Guide on conducting Quality Review as brought out by the QRB while conducting the review;
- (c) TR, including his Assistant/s, will have access to or take abstracts of the records and documents maintained by the AFUR in relation to the review; However, in order to maintain confidentiality, the TR, including his Assistant/s, shall not make any copies/extracts of the AFUR's Clients' file or records examined by them while conducting review, as part of their working papers;
- (d) TR shall provide detailed comments giving proper justification and explanation in respect of the various matters required to be commented upon by TRs in the final report including its Appendices;
- (e) TR shall also refer other guidance provided by the Quality Review Board from time to time such as Audit Quality Review Reports of the QRB appearing at the website of the QRB, other reports of international bodies or any other guidance as may be provided by the QRB from time to time as well as industry specific Technical Guide/s, if any, brought out by the ICAI while conducting the review;
- (f) TR shall be required to segregate his observations into those material and non-material;
- (g) TR should build in a review process to be able to review audit documentation maintained by the AFUR in electronic form in line with the requirements of SA 230; and
- (h) TR shall specifically include a suitable paragraph in the review report on the adequacy of fraud reporting by the Statutory Auditors in their Independent Auditor's Report.

Stage-wise Approach of Quality Review Process

- (i) The Board may constitute one or more Quality Review Groups as discussed above.
- (ii) Technical Reviewer(s) will be assisting each of the Review Group.
- (iii) The TR, after completion of his on-site review, is required to submit a preliminary report to the AFUR on the review of the quality of audit and reporting by the AFUR on the financial statements and the AFUR's quality control framework. After obtaining comments of AFUR on his preliminary report, TR would submit his final report to the Board in a specified format and within specified period of time. The Board may, however, extend the time limit for submission of final report. Report should be issued on the TRs (individual) letterhead and duly signed by the TR. The report should be addressed to the Chairperson of the Board and should be dated as of the date of the conclusion of the review. The TR, based upon his satisfaction from the representation by the AFUR, may decide to issue either an interim report or a final report to the Board. TR shall also forward a copy of his final report to the AFUR requesting them to submit to the Board their final comments on the observations made by him in the Final Report.
- (iv)
 - (a) The report, so prepared by the TR, and the AFUR's final comments on the observations made by TR in the Final Report shall be considered by the QRG. QRG may issue such directions to the TRs as may be considered necessary enabling QRG to make recommendations to the Board on the review. The QRG may also consult the Board on any issue, on which QRG feels that the guidance of the Board is necessary
 - (b) QRG may also call for additional details/ information from the concerned TR and/or Audit Firm, if needed.
 - (c) Where interaction with the TR is necessarily warranted to seek clarifications/further details on certain issues in the report enabling the QRG to make necessary recommendations to the QRB.
 - (d) Where there are complete differences between the observations of the TR and the views of the AFUR to the extent that an interaction with the TR and/or AFUR is considered necessary.
 - (e) Where the QRG is dissatisfied with the quality of the review report of the TR enabling the TR to have a better understanding of the expectations from him.
 - (f) QRG may also interact with the AFUR, if needed, in certain special circumstances and request the AFUR to explain/present their views enabling the QRG to make necessary recommendations to the QRB.
- (V)
 - (a) Generally, review reports in respect of all the joint auditors of an entity should be considered together by the QRG, as far as practicable.
 - (b) In view of SA 299 'Responsibility of Joint Auditors', if TR finds that response of other joint auditor is required on any particular observation(s) as the concerned area was allocated to them, he may, through the office of QRB, communicate with the concerned audit firm. TR shall submit his final report after giving reasonable opportunity to the requisite audit firm for obtaining their response.
- (vi) QRG shall consider the reports of TRs in respect of the quality reviews referred to it and submit its recommendations on the same to the Board within a reasonable period of time. The

recommendations of the QRG may expressly state the following:



- (i) QRG may consider the following broad parameters for determining the action to be recommended to the Board upon consideration of the observations of the TRs:-
- (a) In situations where the financial statements are not materially prepared in accordance with the requirements of the applicable financial reporting framework considering qualitative aspects of the entity's accounting practices as would affect the truth and fairness of the financial statements; auditor has not obtained reasonable assurance about whether the financial statements as a whole are free from material misstatements, whether due to fraud or error; auditor does not express a qualified opinion when, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually, or in aggregate, are material; and in other cases of material non-compliances of technical standards, other relevant guidance, ethical standards and other relevant laws and regulations as would affect the truth and fairness of the financial statements; the matter may be recommended to the Council of the ICAI u/s 28B(a) of the Chartered Accountants Act, 1949 for referring to the Disciplinary Directorate of the Institute for consideration and appropriate action.
 - (b) In other cases of non-compliances to various requirements of technical standards, other relevant laws and regulations and other relevant guidance which are not so material in nature as would affect the truth and fairness of the financial statements, individually or in aggregate, an advisory/guidance to the AFUR may be issued by the QRB in terms of the requirements of Sec. 28B(c) of the Chartered Accountants Act, 1949.
 - (c) In respect of other observations of trivial nature, and where the AFUR has also agreed to take effective corrective steps in future or has already taken corrective steps, the report may be taken on record and the matter may be closed.
 - (d) The members of the QRB/QRG may be entitled for sitting fees and reimbursement of travelling expenditure incurred in connection with the meetings of the QRB/QRG in terms of Chartered Accountants (Procedures of Meetings of Quality Review Board, and Terms and Conditions of Service and Allowances of the Chairperson and Members of the Board) Rules, 2006.
 - (e) TRs who incurred travelling expenditure in connection with the meetings of the QRB/QRG would be eligible for reimbursement at such rates as may be fixed by the Board from time to time in this regard. However, members of the QRB/QRG,

nominated by the Council of the ICAI, will not be entitled for any sitting fees for attending meetings.

REPORTING AND OTHER PROCEDURES

The reviewer, based on the conclusions drawn from the review, shall issue a preliminary report and subsequently the final report. **The final report shall be issued in the format as may be specified by the Board from time to time.** A clean report indicates that the TR is of the opinion that the statutory audit is being conducted in a manner that ensures the quality of audit services rendered. However, a reviewer may qualify the report due to one or more of the following:

- ◆ non-compliance with technical standards and other relevant guidance;
- ◆ non-compliance with relevant laws and regulations as required under applicable auditing standard;
- ◆ quality control system design deficiency; or
- ◆ non-compliance with quality control policies and procedures

CONSIDERATION OF THE REPORTS OF THE QUALITY REVIEW GROUPS:

The Quality Review Group's Report on the quality of audit by the auditor of a Public Sector Undertaking (PSU) should be furnished to the Office of Comptroller and Auditor General of India (C&AG), on case to case basis, and the C&AG's views, if any, shall be put-up before the Board along with the recommendations of the QRG. In all other cases, the QRG's recommendations along with the decision of the Board on the quality of audit by the auditor of a PSU shall be furnished to the Office of the C&AG for information

The **recommendations** of the QRG on the quality of statutory audits by the auditors of entities (other than those covered above) shall be placed before the Board for its consideration directly.

The Board may, after due consideration of the recommendations and comments of Office of the C&AG, wherever applicable, decide whether the recommendation made by the QRG should be accepted or otherwise. The Board may, suo moto, take such further action, as it may deem appropriate. If the Board decides against the recommendations made by the QRG in its report, the Board shall record the reasons for doing so.

ACTIONS THAT MAY BE RECOMMENDED BY THE QUALITY REVIEW BOARD

The actions that the Board may take, based upon consideration of recommendations of the QRG, include one or more of the following:-

- (a) ***Make recommendations to the Council of ICAI u/s 28B(a) of Chartered Accountants Act, 1949 for referring the case to the Director (Discipline) of the Institute for consideration and necessary action under the Chartered Accountants Act, 1949***
- (b) ***Issue advisory and guidance to the AFUR u/s 28B(c) of Chartered Accountants Act, 1949 for improvement in the quality of services and adherence to various statutory and other regulatory requirements. A copy of such advisory may also be sent to the ICAI for information***
- (c) ***Inform the details of the non-compliance to the regulatory bod(y)/ies relevant to the entity as may be decided by the Board***
- (d) ***Intimate the AFUR as to the findings of the Report as well as action initiated as above***
- (e) ***In case of review arising out of a reference received from a regulatory body, inform the results of review and the details of action taken to the concerned regulatory body***
- (f) ***Consider the matter complete and inform the AFUR accordingly***

MECHANISM FOR FOLLOW-UP OF REVIEW FINDINGS

Quality Review Board shall require AFUR to submit a compliance report to the Board within specified period for adopting necessary measures to avoid recurrence/corrective steps in respect of advisories and guidance issued to AFUR by the QRB u/s 28B(c) of Chartered Accountants Act, 1949 for improvement in the quality of services and adherence to various statutory and other regulatory requirements.

Quality Review Board may follow-up and review effectiveness of corrective actions taken by AFURs. The results of reviews shall be used for off-site monitoring as well as for next on-site review.

In case of lack of effective corrective actions by AFURs, next on-site review might be organised earlier.

Cases of continued non-compliance may be recommended to the Council of the ICAI for taking necessary action. Horizontal and in-depth analysis of results of individual off-site monitoring and on-site review will be conducted to identify industry-wide issues across audit firms.

Quality Review Board may also share results of such analysis with relevant stakeholders, as may be decided by the Board.

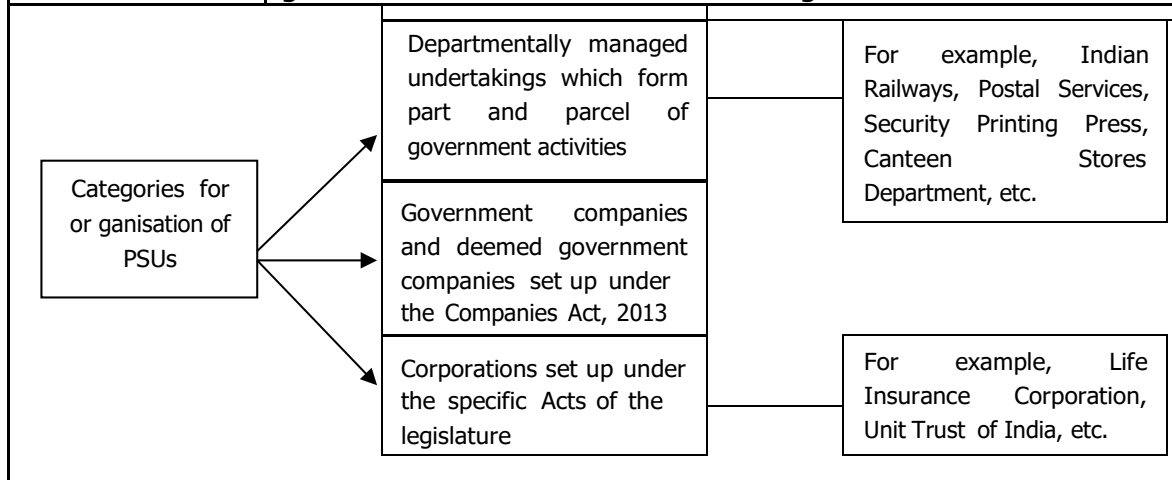
CHANGES TO THE REPORTING FORMATS/QUESTIONNAIRE

The Board had specified the format for the Final Report, and the Quality Review Program General Questionnaire containing questions concerning various aspects of an audit firm such as Quality control, ethical requirements & audit independence; leadership and responsibilities; assurance practices; client relationships & engagements; human resources, consultation; differences of opinion; engagement quality control review; engagement documentation; audit planning & risk assessment; materiality; audit sampling & other selective testing procedures; audit documentation; audit evidence; written representations; and Auditor's report. However, whenever the Quality Review Board is of such a view, in the light of international practices, changes in domestic laws & regulations and through experience gained, it may, amend, or modify the Quality Review Questionnaire/ reporting formats, from time to time, as it may deem appropriate

CHAPTER-12

AUDIT OF PUBLIC SECTOR UNDERTAKING (PSUs)

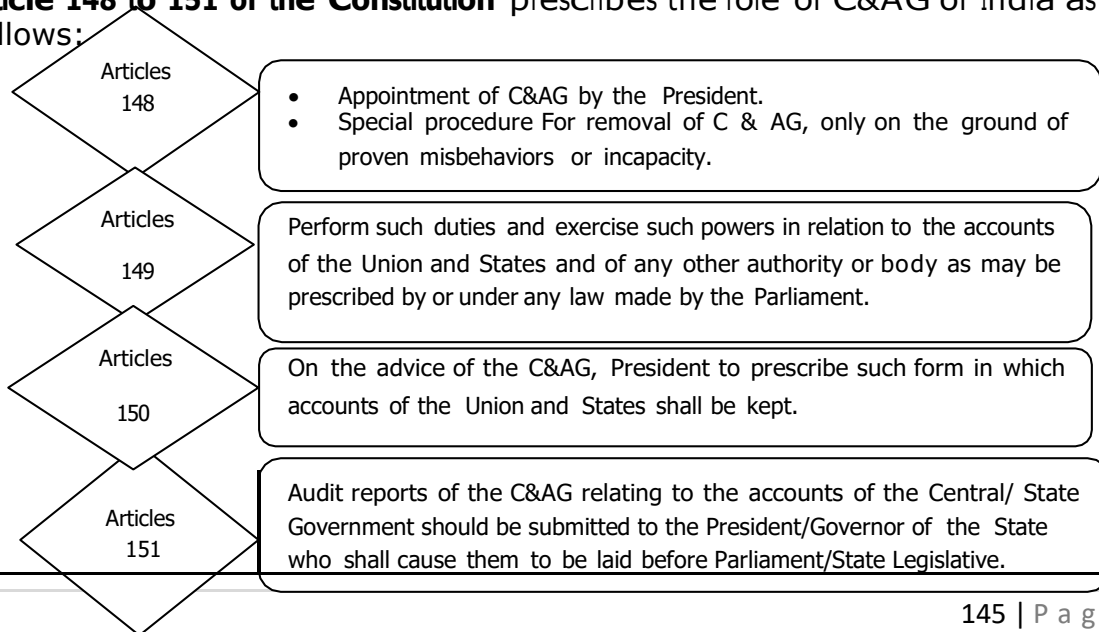
INTRODUCTION	Public sector undertakings in India are fundamentally owned or controlled by central government, or any state government or governments, or partly by the central government and one or more state governments.
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FRAMEWORK FOR GOVERNMENT AUDIT	As defined under section 2(45) of the Companies Act, 2013, a "Government company" is a company in which not less than 51% of the paid -up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.
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C & AG	Comptroller and Audit General (C&AG) of India, Indian Audit and Accounts Department.
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Article 148 to 151 of the Constitution prescribes the role of C&AG of India as Follows:



The Comptroller and Audit Generals (Duties, Power and Conditions of Services) Act, 1971, prescribes that the C&AG shall hold office For a term of six years or up to the age of 65 years, whichever is earlier.

The number of organisations subject to the audit of the Comptroller and Auditor General of India is very large. This includes:

All the Union and State Government departments and offices including the Indian Railways and Posts and Telecommunications.	Public commercial enterprises controlled by the Union and State governments, i.e. government companies and corporations.
Non-commercial autonomous bodies and authorities owned or controlled by the Union or the States.	Authorities and bodies substantially financed from Union or State revenues.

AUDIT OF GOVERNMENT COMPANIES (COMMERCIAL AUDIT)	The auditors of these companies are Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditors directions on the manner in which the audit should - conducted by them.
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AUDIT BOARD SETUP IN COMMERCIAL AUDIT - (FOR COMPREHENSIVE AUDITS)	<ol style="list-style-type: none"> 1. works under the supervision and control of the Comptroller and Auditor General. 2. associate with them experts 3. results are incorporated in his reports.
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ACTION ON AUDIT REPORTS	<p>Parliament and the State Legislatures have, for this purpose, constituted specialized Committees like the Public Accounts Committee (PAC) and the Committee on Public Undertakings (COPU), to which these audit Reports and Annual Accounts automatically stand referred.</p> <p>Public Accounts Committee (PAC) — [Financial/Expenditure Control — Govt. Dept.]</p> <ol style="list-style-type: none"> i. That the moneys were disbursed legally on the service or purpose to which they w applied. ii. That the expenditure was authorised.
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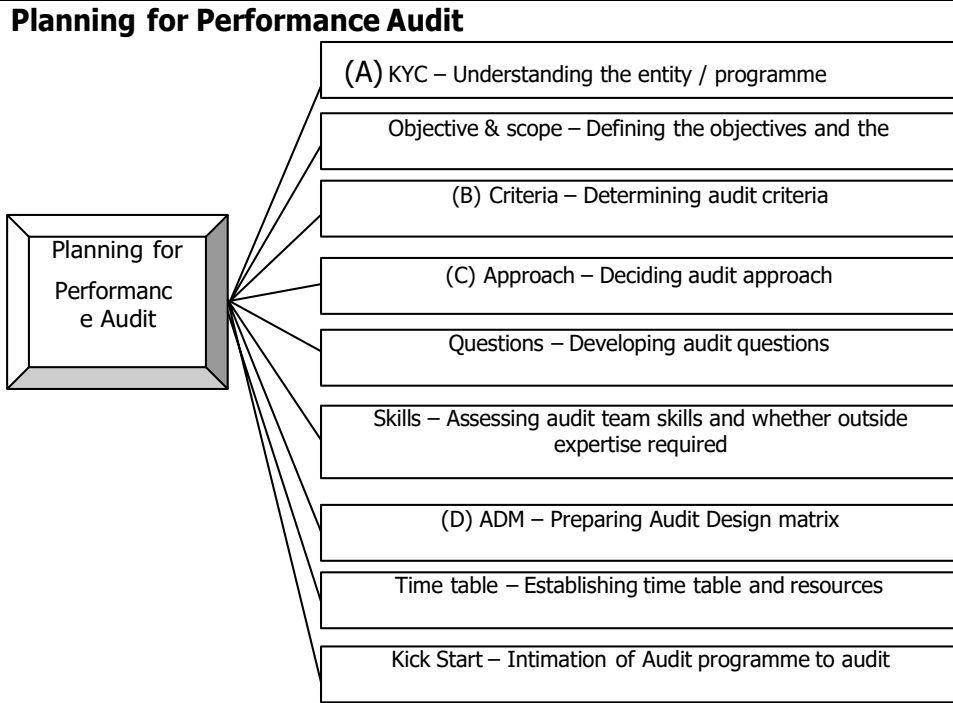
	<p>iii. That re-appropriation has been made in accordance with the provisions made distribution of Funds).</p> <p>Estimates Committee — The Committee examines the estimates with a view to:</p> <ol style="list-style-type: none"> i. Report that economies, improvements in organization, efficiency, consistent with policy underlying the estimates may be effected; ii. Suggest alternative policies; iii. Examine whether the money is well laid out within the limit; and iv. Suggest the Form in which the estimates shall be presented to Parliament. <p>The Committee does not comment upon a policy approved by Parliament, but where the evidence that a particular policy is not leading to the desired results, or is leading to waste, it is the duty of the Committee to bring it to the notice of the House.</p> <p>Committee on Public Undertakings [Financial control PSUs] — Committee on Public Undertakings exercises the same financial control on the public se undertakings as Accounts Committee exercises over the functioning of the Govern Departments.</p> <ol style="list-style-type: none"> i. Examine reports and accounts ii. Examine reports Comptroller & Auditor General. iii. efficiency of public undertakings. iv. other functions.
<p>OBJECTIVE AND SCOPE OF PUBLIC ENTERPRIS ES AUDIT</p>	<ol style="list-style-type: none"> 1. Audit of PSUs not constrained to Financial and Compliance Audit 2. Propriety Audit 3. Comprehensive Audit: whether the undertakings have fulfilled the objectives whether value for-money spent whether the targets have been achieved 4. Organization’s Decision to be taken by Competent Authority 5. Helping Government 6. Highlighting issues of Efficient and Economic Operations. 7. Fiscal and managerial Accountability:
<p>ELEMENTS OF PSU AUDITS</p>	<p>Public sector auditing augments the confidence of the intended users by providing relevant information and independent and objective assessments concerning deviations from accepted standards or principles of good governance.</p> <p>Audit of all public-sector undertakings has the following basic elements:</p> <p style="text-align: center;">Basic Elements of PSU Audits</p> <pre> graph TD A[Basic Elements of PSU Audits] --> B[Three parties] A --> C[Subject matter, criteria and subject matter information] A --> D[Types of engagement] B --> E[Auditor] B --> F[Responsible party] B --> G[Intended users] D --> H[Attestation Engagements] D --> I[Direct Reporting Engagement] </pre>

<p>The Three parties Auditors, Responsible Party and Intended Users.</p>	<p>Auditor: The role of auditor is fulfilled by Supreme Audit Institution (SAI), India and by its personnel delegated with the duty of conducting audits.</p> <p>Responsible Party: The relevant responsibilities are determined by constitutional or legislative arrangement. Generally, auditable entities and those charged with governance of the auditable entities would be the responsible parties. The responsible parties may be responsible for the subject matter information, for managing the subject matter or for addressing recommendations.</p> <p>Intended Users: Intended users are the individuals, organizations or classes thereof for whom the auditor prepares the audit report.</p>		
<p>Subject matter, criteria and subject matter information.</p>	<p>Subject matter</p>	<p>This refers to the information, condition or activity that is measured or evaluated against certain criteria.</p>	
	<p>Criteria</p>	<p>These are the benchmarks used to evaluate the subject matter.</p>	
	<p>Subject matter information</p>	<p>This refers to the outcome of evaluating or measuring the subject matter against the criteria.</p>	
<p>Types of engagement - Attestation Engagements and Direct</p>	<p>Attestation Engagements</p>	<p>In attestation engagements, the responsible party measures the subject matter against the criteria and presents the subject matter information, on which the auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for expressing a conclusion.</p>	
	<p>Reporting Engagement</p>	<p>Direct Reporting Engagement</p>	<p>In direct reporting engagements, it is the auditor who measures or evaluates the subject matter against the criteria.</p> <p>Financial audits are always attestation engagements, as they are based on financial information presented by the responsible party.</p> <p>Performance audits and compliance audits are generally direct reporting engagements.</p>
<p>PRINCIPLES OF PSU AUDITS</p>	<p>The principles of PSU Audits constitute the general standards that apply to SAI India's personnel a auditors and are Fundamental to the conduct of all types of PSU Audits. The principles are categorized into two distinct groups as below:</p> <ol style="list-style-type: none"> I. General Principles II. Principles related to the Audit Process 		

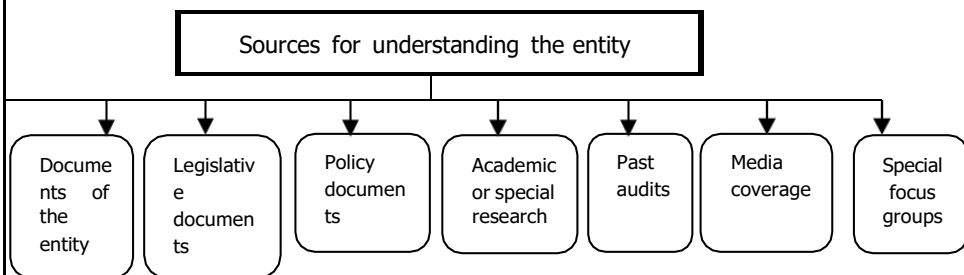
	<div style="text-align: center; border: 1px solid black; padding: 5px; margin-bottom: 10px;">GENERAL PRINCIPLES</div> <div style="display: flex; justify-content: space-around; text-align: center;"> <div style="border: 1px solid black; padding: 5px; width: 15%;">Ethics & Independence</div> <div style="border: 1px solid black; padding: 5px; width: 15%;">Professional Judgment due care and skepticism</div> <div style="border: 1px solid black; padding: 5px; width: 15%;">Quality Control</div> <div style="border: 1px solid black; padding: 5px; width: 15%;">Audit team Management & Skill</div> <div style="border: 1px solid black; padding: 5px; width: 15%;">Audit Risk</div> <div style="border: 1px solid black; padding: 5px; width: 15%;">Materiality</div> <div style="border: 1px solid black; padding: 5px; width: 15%;">Documentation</div> <div style="border: 1px solid black; padding: 5px; width: 15%;">Communication</div> </div> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="3" style="text-align: center;">Principles related to the Audit Process</th> </tr> <tr> <th style="width: 33%;">Planning the Audit</th> <th style="width: 33%;">Conducting the Audit</th> <th style="width: 33%;">Reporting & Follow-up</th> </tr> </thead> <tbody> <tr> <td style="vertical-align: top;"> <ul style="list-style-type: none"> Establish the terms of the audit. Obtain understanding of the entity. Conduct Risk assessment of problem analysis. Identify risks of fraud. Develop an audit plan. </td> <td style="vertical-align: top;"> <ul style="list-style-type: none"> Perform the planned audit proceduresto obtain audit evidence. Evaluate audit evidence and draw conclusions. </td> <td style="vertical-align: top;"> <ul style="list-style-type: none"> Prepare a report based on the conclusions reached. Follow-up on reporter matters as relevant. </td> </tr> </tbody> </table>	Principles related to the Audit Process			Planning the Audit	Conducting the Audit	Reporting & Follow-up	<ul style="list-style-type: none"> Establish the terms of the audit. Obtain understanding of the entity. Conduct Risk assessment of problem analysis. Identify risks of fraud. Develop an audit plan. 	<ul style="list-style-type: none"> Perform the planned audit proceduresto obtain audit evidence. Evaluate audit evidence and draw conclusions. 	<ul style="list-style-type: none"> Prepare a report based on the conclusions reached. Follow-up on reporter matters as relevant.
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<p>AUDIT OF GOVERNMENT COMPANIES</p>	<p>Audit of Government Companies (Discussed in Company Audit) The following steps are involved in the audit of government companies:</p> <ol style="list-style-type: none"> a) Appointment of Auditors under Section 139(5) and 139(7) read with section 143(5) of the Companies Act, 2013 b) Supplementary audit under section 143(6)(a) of the Companies Act, 2013. c) Comment upon or supplement such Audit Report under section 143(6)(b) of the Companies Act, 2013. d) Test audit under section 143(7) of the Companies Act, 2013. 									
<p>AUDIT BY C & AG</p>	<div style="text-align: center; border: 1px solid black; padding: 5px; margin-bottom: 10px;">Audit conducted by C & AG</div> <div style="display: flex; justify-content: space-around; text-align: center;"> <div style="border: 1px solid black; padding: 5px; width: 15%;">Financial</div> <div style="border: 1px solid black; padding: 5px; width: 15%;">Compliance</div> <div style="border: 1px solid black; padding: 5px; width: 15%;">Performance</div> <div style="border: 1px solid black; padding: 5px; width: 15%;">Comprehensive</div> <div style="border: 1px solid black; padding: 5px; width: 15%;">Propriety</div> </div>									
<p>FINANCIAL AUDIT</p>	<p>Financial audit is primarily conducted to express an audit opinion on a set of Financial statements. It includes:</p> <ol style="list-style-type: none"> i. examination and evaluation of financial records opinion on Financial Statements; ii. financial systems and compliance with applicable statutes and regulations iii. internal control and internal audit functions 									

COMPLIANCE AUDIT	Compliance audit is an independent verification process of evaluating audit evidence to determine whether specified compliance requirements are met.	
	Examination of Transaction	It examines the transactions relating to expenditure, receipts, assets and liabilities of Government for compliance with: <ol style="list-style-type: none"> i. provisions of the Constitution of India and the applicable laws; and ii. rules, regulations, orders and instructions issued by the competent authority.
	Examination of Rules, Regulations, Instruction & Orders	Compliance audit also includes an examination of the rules, regulations, orders and instructions for their legality, adequacy, transparency, propriety, prudence and effectiveness, that is, whether these are: <ol style="list-style-type: none"> i. Intra vires of the provisions of the Constitution of India ii. Sufficiently comprehensive and ensure effective control iii. Clear and free from ambiguity iv. achieve the intended objectives
PERFORMANCE AUDIT	<ol style="list-style-type: none"> i. Resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price. ii. Efficiency - It is valuation of the input-output ratio. <ol style="list-style-type: none"> a) Procurement; - sound Practices b) Resources — Well protected, maintained & efficiently and optimumly used c) Public Sector programmes — Efficiently managed regulated, organized and executed and cost effective. d) Operating procedures are efficient iii. Effectiveness - extent to which objectives are achieved in auditing effectiveness, performance audit may, for instance while reviewing a public sector programme <ol style="list-style-type: none"> a) assess whether the objectives of and the means provided public sector programme are proper, b) determine the extent to which desired level of program results achieved c) assess and establish direct or indirect social and economic impacts of a policy are due to the policy or to other causes; d) identify Factors inhibiting satisfactory performance e) assess whether the programme complements, duplicates, overlaps or counteracts other related programmes; f) assess the effectiveness of the program g) determine whether management has considered alternatives that might yield desired results more effectively or at a lower cost; 	

h) assess the adequacy of the management control system For measuring, monitoring an reporting a programme's effectiveness;
 i) assess compliance with laws and regulations applicable to the program; and
 j) Identify ways of making programmes work more effectively.
 The supplementary or test audit under companies Act, 2013 conducted by the Comptroller an Auditor General is in the nature of efficiency-cum-performance appraisal.

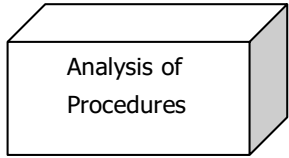
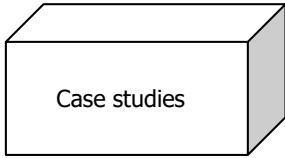
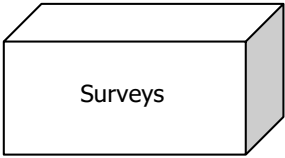
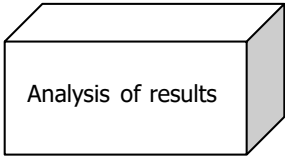
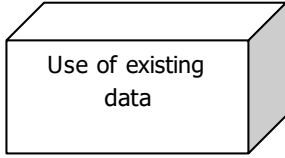
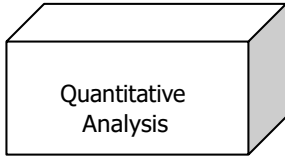


A. Sources for understanding the entity



(B) Determining audit criteria

- standards used sources:
- i. Procedure manuals
 - ii. directives and guidelines.
 - iii. used by the same entity or other entities
 - iv. expert opinion
 - v. established scientific knowledge
 - vi. literature and research papers.

(C) Deciding audit approach -	
Some of the methods which could be used in conducting performance audits include:	
	
	
	
(D) Preparing Audit Design Matrix (ADM)	
It highlights the data collection and analysis method as well as the type and sources of evidence required to support audit opinion/findings.	
An ADM is prepared on the basis of information and knowledge obtained during the planning stage. A well-designed ADM leads to effective audits thus providing highest assurances to the auditing entities.	
Comprehensive Audit	<p>Efficiency-cum-performance audit other locates the area of weakness and extravagance for managements' information.</p> <p>Investment decisions, project formulation, organisational effectiveness, utilisation, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, capacity, costs prices, materials management, sales and credit control, budgetary and internal control systems, etc.</p> <p>Issues examined in comprehensive audit are:</p> <ol style="list-style-type: none"> a) Overall capital cost of the project; b) Accepted production; c) Planned rate of return been achieved; d) systems of project formulation; e) Cost control measures adequate; f) Purchase Policies adequate; g) Repairs and maintenance; h) Effective and economical; i) Poor or insufficient or project planning.
Property Audit	<p>E.L. Kohler has defined the term propriety as "that which meets the tests of public interest, commonly accepted customs, and standards of conduct, and particularly as applied to professional performance, requirements of law, Government regulations and professional codes".</p> <ol style="list-style-type: none"> a) Propriety audit is concerned with scrutiny of executive actions decisions bearing on financial and profit and loss situation of the

		<p>come with special regard to public interest and commonly accepted customs standards of conduct.</p> <p>b) Every officer has exercised the same vigilance in respect of expending incurred From public money, as a person of ordinary prudence would exe-in respect of expenditure of his own money under similar circumstances.</p> <p>In 'propriety audit', the auditors try to bring out cases of improper, avoidable in fructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Must be checked in expense highly wasteful.</p> <p>Propriety requires the transactions, and more particularly expenditure, to conform to certain general principles. These principles are:</p> <ul style="list-style-type: none"> i. that the expenditure is not prima fade more than the occasion demands and that every official exercises the same degree of vigilance in respect of expenditure as a person of ordinary prudence would exercise in respect of his own money; ii. that the authority exercises its power of sanctioning expenditure to pass an order which will not directly or indirectly accrue to its own advantage; iii. that funds are not utilised for the benefit of a particular person or group of persons and iv. that, apart from the agreed remuneration or reward, no other avenue iskept open to indirectly benefit the management personnel, employees and others.
<p>RELEVANT PROVISIONS IN THE COMPANIES ACT, 2013:</p>	<ol style="list-style-type: none"> 1. Section 148 relating to Cost Records and Audit. 2. Section 143(1) requiring enquiry into certain specified matters. 3. Section 143(6) and 143(7) requiring a supplementary audit and test audit respectively in respect of the Government companies on matters specified. 4. Additional information in Part II of Schedule III. <p>The implications of the Companies (Auditor's Report) Order, 2016 and the provisions of the section 143(6) and the directions issued by the Comptroller and Auditor General also contain significant elements of propriety.</p>	
<p>PROPRIETY ELEMENTS UNDER</p>		<p>a) whether the company has granted loans, secured or unsecured, to companies, firms or other parties covered in the register maintained under section 189 of the Companies Act...</p>

<p>CARO, 2016:</p>	<p>b) whether the company regular in depositing undisputed statutory dues ...</p> <p>c) whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders...</p> <p>d) Whether money raised by way of initial public offer or Further public offer and term loans were applied for the purpose for which the loans were obtained...</p> <p>e) whether any fraud by the company or any frauds on the company by its officers or employees...</p> <p>Propriety Audit-Problems —</p> <ul style="list-style-type: none"> ➤ formulation of verifiable auditing propositions ➤ subjectivity ➤ moral element
<p>AUDIT REPORT OF THE COMPTROLLER AND AUDITOR GENERAL</p>	<p>Several Parts</p> <p>a) Introduction Government companies, deemed Government companies and corporations.</p> <p>b) comprehensive appraisals Audit Board.</p> <p>c) company auditors reports comments on the accounts of the Government companies.</p> <p>d) Significant results undertakings not taken up for appraisal by the Audit Board.</p> <p>For certain specified states, the Comptroller and Auditor General submit a separate audit report (commercial) to the legislature, while For other States/Union Territories with legislature, there is a commercial chapter in the main audit report.</p> <p>The State audit reports, contains both the results of audit appraisal of performance of selected companies/corporations as well as important individual instances of financial irregularities, wasteful expenditure, system deficiencies noticed by the statutory auditors, comments noticed in Government audit in the audit functions of certification of accounts and a general review of the working results of Government companies and corporations.</p>

CHAPTER-13

INVESTIGATIONS, DUE DELIGENCE & FORENSIC AUDIT

AUDIT VERSUS INVESTIGATION	<p>Audit aims at collection of sufficient appropriate audit evidence to enable the auditor to form a judgement and express an opinion on the Financial statements or other data under examination.</p> <p>An investigation, on the other hand, requires special in -depth examination of the particular records or transaction with the objective of establishing a part or happening or assessing a particular situation.</p> <p>The difference is tabulated below:</p>		
	Basis of Difference	Investigation	Audit
	Objective	An investigation aims at establishing a Fact or a happening or at assessing a particular situation.	The main objective of an audit is to verify whether the financial statements display a true and fair view of the state of affairs and the working results of an entity.
	Scope	The scope of investigation may be governed by statute or it may be non-statutory.	The scope of audit is wide and in case of statutory audit the scope of work is determined by the provisions of relevant law.
	Periodicity	The work is not limited by rigid time frame. It may cover several years, as the outcome of the same is not certain.	The audit is carried on either quarterly, half-yearly or yearly.
	Nature	Requires a detailed study and examination of Facts and figures.	Involves tests checking or sample technique to draw evidences for forming a judgement and expression of opinion.
	Inherent Limitations	No inherent limitation owing to its nature of engagement.	Audit suffers from inherent limitation.
	Evidence	It seeks conclusive evidence.	Audit is mainly concerned with prima-fade evidence.

	Observance of Accounting Principles	It is analytical in nature and requires a thorough mind, capable of observing, collecting and evaluating facts.	Is governed by compliance with generally accepted accounting principles, audit procedures and disclosure requirements.
	Reporting	The outcome is reported to the person(s) on whose behalf investigation is carried out.	The outcome is reported to the owners of the business entity.

STEPS IN INVESTIGATION	<ol style="list-style-type: none"> 1. Determination of objectives and establishment of scope of investigation. 2. Formulation of the investigation programme 3. Examination and study of various records by reference to appropriate evidence. 4. Analysis, processing and interpretation of findings. 5. Preparation of report and drawing up of conclusions.
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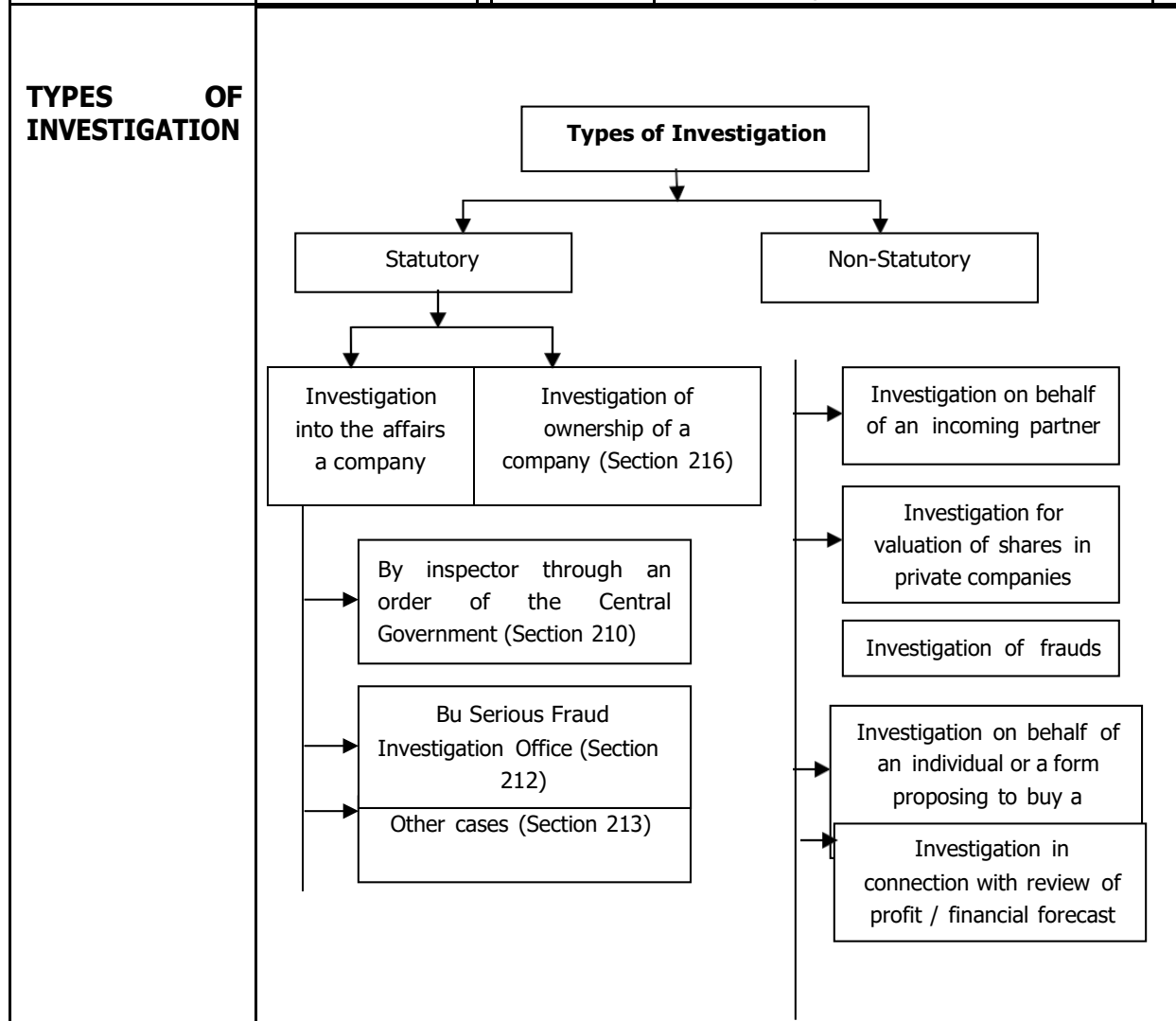
SPECIAL ISSUES IN INVESTIGATIONS	<p>a) Whether an investigator is required to undertake a cent per cent verification approach or whether he can adopt selective verification - The answer to this question depends on the exact circumstances of the case under investigation. It is always safer to go by statistically recognised sampling methods than to depend on the so - called "test checks where circumstances permit selective verification.</p> <p>b) Whether the investigator can put reliance on the already audited statement of account - It is, therefore, desirable for the investigator to ascertain from the client, advance, in writing, whether the audited statements of account produced to him should taken as correct.</p> <p>c) Whether an investigator necessarily requires assistance of expert - It would be therefore, proper for the investigator to get the written general consent of his client, refer special matters for views of different experts.</p> <p>d) Investigation out of disputes and conflicting claims - The investigator should keep him scrupulously professional and should keep the interest of all the involved parties in view.</p> <p>e) Basis of opinion of an investor - The investigator should refrain from issuing speculative, opinion. He should confine his opinion to the established facts and nothing more.</p> <p>f) Whether an investigator can make futuristic statements - The investigator should refuse to be futuristic.</p> <p>g) Whether to retain working papers or not - Another important precaution is that the investigating accountant should retain,</p>
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	on his files full notes of the work carried out, copies of schedules and all working papers, record of conversations and the like.	
SPECIAL ASPECTS IN ANY BUSINESS INVESTIGATION	A. Studying the Overall Picture	<ul style="list-style-type: none"> ➤ SA 315 – Tax structure, Freight, Middlemen / supply chain, management etc. ➤ Management, Goodwill, Other factors ➤ Profitability and Economic position in reference to Adequacy of Working Capital, ROCE and Sales Trends ➤ Lines of activity ➤ Company and its Group Companies ➤ Labour / Capital Intensive ➤ Study of its external environment
	B. Statement of Profit and Loss	Study of profit and loss statement should cover profit statements over a period of 5 to 7 years in order to cover all possible phases of business cycle. This will also enable the accountant to establish a trend between various related elements of profit statement. Study of profit and loss account may be broken down into study of its elements.
	Turnover	Turnover may be studied as Follows: <ul style="list-style-type: none"> • Turnover of the company should be broken between various products, types of customers, territory etc. • Order books should be examined to identify and eliminate Fictitious entries. • Income and expenses should be split proportionately between manufacturing and trading operations. • Activity based costing and profit analysis • Verification of customer base
	Wage Structure	<ul style="list-style-type: none"> • The method of computing wages and rate of wages should be examined, • Any unusually high wage payment should be adjusted. • In case the business has suffered labour disturbance in the past then it should be examined whether a long lasting settlement has been reached.
	Depreciation	<ul style="list-style-type: none"> • It should be verified whether depreciation has been provided on a consistent basis and that it is adequate. Check and compare annual depreciation charges and repairs and maintenance expense • In case certain assets have been revalued, depreciation should be

			<p>provided on revalued amount and over their estimated useful life.</p> <ul style="list-style-type: none"> • In case of leasehold property, it should be ascertained whether an adequate provision has been made for the deterioration charge that may be payable at the end of lease period.
		Man ageri al remu nerati on:	<ul style="list-style-type: none"> • It should be verified that remuneration payable is not excessive and in-accordance with provisions of Companies Act • Even if no or nominal remuneration has been paid, it should be adjusted to arrive at true profitability.
		Exce ption al and non- recur ring items	<p>These items disturb the trends of the profits. Therefore, the effect of these items along with their tax implications should be adjusted.</p>
		Repa irs and Maint enan ce:	<ul style="list-style-type: none"> • Major repairs and over hauling jobs are generally undertaken at any interval of 3 to 4 years. It should be ensured that these expenses have been systematically appropriated over a period of time. • Repairs expenses should be correctly identified into capital and revenue expenses.
		Unus ual Year	<p>In order to determine Future maintainable profits of the business from the study of past years performance, it is imperative upon the investigating accountant to eliminate results of one or more years which vitiated the trend due to exceptional Factors.</p>
	C. BALANCE SHEET		<p>The elements of Balance sheet may be studied as under -</p> <ul style="list-style-type: none"> ➤ Fixed Assets - Fixed assets may be studied as regards with <ul style="list-style-type: none"> • Age of fixed assets in order to determine replacements that may be required in the Future. • In case proper repair and maintenance has not been ensured, a provision for heavy expenditure on repairs that may be required should be made in the value of the assets.

		<ul style="list-style-type: none"> • In case of revaluation of fixed assets, depreciation should be provided on the revalued amount. ➤ Investments – <ul style="list-style-type: none"> • Current investments should be valued at market price. • Long term investments should be valued at cost. However, a permanent decline in value should be provided. • Pre-acquisition profits should be reduced from cost of investment. ➤ Trade Receivables – <ul style="list-style-type: none"> • The bad debts should be adjusted in the year of sale unless the write off is on account of slump or Fall in international prices. • A study of credit period allowed by a business which shows rise in credit period over the period of investigation is indicative of diminishing sales. • Age - wise classification of debts helps in understanding the nature of customers and amount of working capital requirement of business. ➤ Inventories – <ul style="list-style-type: none"> • Valued consistently as per generally accepted accounting policies • Due allowance for damaged, obsolete and show moving items should made ➤ Other Liquid Assets — E.g. Money with Bank in liquidation taken to account only to the extent it is guaranteed by Deposit Insurance Scheme ➤ Idle Assets – <ul style="list-style-type: none"> • E.g. Cash, Plant & Machinery, etc • To be excluded from net worth and only Form part of value of business ➤ Liabilities – <ul style="list-style-type: none"> • Overdues, Off Balance Sheet liabilities • Not Understated, Property Classified ➤ Taxation – <ul style="list-style-type: none"> • It should be verified that adequate provision for tax has been made • Study of Tax Benefits and period till which they will be available
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		<ul style="list-style-type: none"> ➤ Capital – <ul style="list-style-type: none"> • Debt Equity Ratio • Capital Gearing Ratio — Higher ratio to reduce the return on equity 								
	D. INTERPRETATION OF FIGURES	<table border="1"> <tr> <td>Fixed Assets</td> <td>Amount required for replacement of assets Amount required to replace obsolete machinery</td> </tr> <tr> <td>Turnover</td> <td>Trends New markets Political & Economic Considerations — Fed Rates, WPI, Disposable Income, etc Competition — Price, Market Share, Demand</td> </tr> <tr> <td>Working Capital</td> <td>STR, CTR / Avg payout period, DTR / Credit Policy</td> </tr> <tr> <td>FMPs</td> <td>Trend Analysis</td> </tr> </table>	Fixed Assets	Amount required for replacement of assets Amount required to replace obsolete machinery	Turnover	Trends New markets Political & Economic Considerations — Fed Rates, WPI, Disposable Income, etc Competition — Price, Market Share, Demand	Working Capital	STR, CTR / Avg payout period, DTR / Credit Policy	FMPs	Trend Analysis
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FMPs	Trend Analysis									



<p>INVESTIGATION UNDER THE COMPANIES ACT, 2013:</p>	<p>A. Investigation into the affairs of a company B. Investigation of ownership of a company (Section 216)</p>	
	<p>Investigation into the affairs of a company:</p>	<p>This may further be divided into three parts:</p> <p>1) Investigation into the affairs of a company as envisaged under Sect: 210: Where the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company –</p> <ul style="list-style-type: none"> a) on the receipt of a report of the Registrar or inspector; b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or c) in public interest <p>It may order an investigation into the affairs of the company.</p> <p>Further, where an order is passed by a court; or the Tribunal requiring investigation, the Central Government shall order an investigation into affairs of that company.</p> <p>For the above purposes, the Central Government would appoint one or more persons as inspectors to investigate into the affairs of the company and to report thereon in such manner as the Central Government may direct.</p> <p>2) Investigation into the affairs of a company by Serious Fraud Investigation Office under Section 212: The Central Government may, by an order, assign the investigation, into the affairs of the company, to the Serious Fraud Investigation Office, when it considers necessary to investigate into the affairs of the company, on receipt of a report of the Registrar or inspector; or on intimation of a special resolution passed by a company; or in public interest; on request from the Department of the Central Government, or a State Government.</p> <p>Where the Central Government assign any case to the Serious Fraud Investigation Office for investigation under this Act, no other investigating agency of Central Government or any State Government shall proceed investigation in such case. The Serious Fraud Investigation Office shall follow the manner and procedure as provided and submit its report to the Government. The Central Government may also direct to submit an interim report.</p>

		<p>3) Investigation into the affairs of a company in other cases as provided under Section 213: The Tribunal may order investigation into affairs of the company, on an application received by specified number of members and supported by such evidence; or on an application made to it by any other person or otherwise, if it is satisfied that there are circumstances Like. business of the company is being conducted with intent to defraud its creditors, or that the company was formed for any fraudulent or unlawful purpose, or the members of the company have not been given all the information with respect to its affairs, etc. The investigation may be ordered after giving a reasonable opportunity of being heard to the parties concerned.</p> <p>It may be noted that if after investigation it is proved that -</p> <ol style="list-style-type: none"> i. the business of the company is being conducted with intent to defraud its creditors, members or any other persons or otherwise For a fraudulent or unlawful purpose, or that the company was Formed for any fraudulent or unlawful purpose; or ii. any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct, then, every officer of the company who is in default and the person or persons concerned in the Formation of the company or the management of its affairs shall be punishable for fraud. <p>a) Who can be appointed as an Inspector [SF10] - A firm, body corporate or other association cannot be appointed as an inspector. Thus, a firm of professional accountant cannot be appointed as inspector but an individual accountant can be so appointed.</p> <p>b) PROCEDURE, POWERS ETC. OF INSPECTORS Section 217 of the Companies Act, 2013 states the procedures, powers of the Inspectors as follows:</p> <ul style="list-style-type: none"> o Duty of officers and employees of the company towards inspector: It shall be the duty of all officers and other employees and agents including the former officers, to preserve all books and papers relating to the company or. o Inspector may ask information From any body corporate o Not to keep Books and Papers in custody for more than 180 days o Examine on oath
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		<ul style="list-style-type: none"> ○ Inspector to possess all the Powers of Civil Court ○ Assistance of Officers of Government to Inspector ○ Evidence from place outside India: court may issue a letter of request to a court or an authority in such country or place for seeking such evidence. <p>c) INSPECTOR'S REPORT – Under Section 223 of the Companies Act, 2013, an inspector shall, if so directed by the Central Government, submit interim reports to that Government, and on the conclusion of the investigation, shall submit a final report to the Central Government. Section 224 of the Companies Act, 2013, deal with follow-up of the inspector's report and gives power to the central government to launch prosecution; apply For winding up of the company etc.</p> <p>GENERAL APPROACH FOR INVESTIGATION –The general approach for investigation under Sections 210, 212 and 213 of the Companies Act, 2013 is conditioned by the legal requirements in these regards. From the foregoing requirements of law, it is apparent that investigations under these requirements may encompass a wide field. The affairs of the company may include everything such as goodwill, profit El loss, contracts, investments, assets, shareholding in subsidiaries, decision making etc. Also the specific circumstances mentioned in these sections Like Fraud mismanagement, oppression of any shareholder etc. come within the term "affairs of the company."</p> <p>Investigation under Sections 210 and 213 do not call for any special approach. Approach/Steps for pursuing the investigation are:</p> <ul style="list-style-type: none"> i. Clarity of Terms of Reference: The approach to any investigation is determined on a consideration of the nature of the investigation and the terms of reference. However, the inspector should ensure that the terms of reference are clear, unambiguous and in writing. If he has any doubt about any item in the terms, he should obtain clarification in writing. It should also be, seen that the terms of reference are not too general, because that may frustrate the whole objective of the investigation; the scope of the investigation will become unwieldy and ill defined. An investigation order to investigate into
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		<p>the affairs of the company would be an instance at point. Therefore, the inspector should ask for reframing of the order Specifying the exact matters to be investigated. He should also take into consideration the possible effect of limitations, if any, put in the terms of reference and should keep the Central Government informed in writing about their effect on the investigation.</p> <p>ii. Scope of Investigation: The next point for consideration of the inspector would be the determination of the scope of the investigation on the basis of the terms of reference. At this stage, it may be useful for the inspector to go into the history of the company and its affiliates or associates. He should evaluate the terms of reference in sketching the scope investigation; this will enable him to locate the limitation, if any, in the terms of reference, not clearly mentioned. For a purposeful investigation, he may need to stretch his inquiry into the books and records of allies associated persons and concerns and may require to arm himself with the powers given under the Companies Act.</p> <p>iii. Period for investigation: He should also have regard to the period over which the investigation should stretch. The evaluation of terms of reference and the consequential determination of the scope of investigation are the twin props on which the entire investigation would rest and, therefore, the inspector appointed under Sections 210 and 213 should devote careful attention to these.</p> <p>iv. Framing of Programme: The next step is the investigator/inspector should frame his programme for investigation in a systematic manner. He should keep adequate working notes and papers with references and cross references in a proper and methodical way to aid him in the preparation of the report. The actual process of investigation would be essentially an evidence gathering procedure and, at every step, he should have regard to the procedures laid down in these sections regarding production of documents and evidence, examination on oath and seizure of documents. He should also keep his mind open to the revelations he comes across in the process of evidence collection and should assess whether</p>
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		<p>the programme of investigation needs amendment or modification.</p> <p>v. Using the work of Experts: He should also consider whether assistance of other experts like engineers, lawyers, etc., is necessary in the interest of a comprehensive and Full proof examination of the documents and information.</p> <p>vi. Legal requirements and investigation Report: Only after he has completed the steps in the investigation programme and has marshaled all the information that he needed should he prepare his report. He, however, can also make interim report as provided under Section 223 of the Companies Act. The findings should be completed and exhaustive. Before he makes his final report he should obtain and keep on record the evidences relied upon by him. By the nature of things, such evidence should be as conclusive as possible depending on circumstances of the case. He should make his report in accordance with the provisions of the section 223 of the Companies Act, 2013.</p> <p>The general approach For investigations under Sections 210 and 213 should, therefore, be Formulated having regard to the terms of reference, scope, the period, the programme and procedure of the investigation and the attending legal requirements specified above.</p>
	<p>Investigation of ownership of A company:</p>	<ul style="list-style-type: none"> ➤ According to Section 216 of the Companies Act, 2013, where it appears to the Central Government that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons, who are or have been Financially interested in the success or Failure, whether real or apparent, of the company; or who are or have been able to control or to materially influence the policy of the company. ➤ Investigating accountant should determine the areas of accounts which require investigation and the extent to which the enquiry is to be made as well as his general approach to the enquiry. ➤ The enquiry therefore should show the motive, if any, of the contravention. ➤ It the loss suffered by the company has given rise to a gain by a director and other managerial personnel or its associates, the manner in which the benefit has accrued and the amount thereof shall have to be investigated.

		<ul style="list-style-type: none"> ➤ It may be necessary for an investigator to interrogate directors, officers, agents, and others concerned with matters under his enquiry.
<p>NON STATUTORY INVESTIGATION</p>	<p>– Investigation on behalf of an incoming partner</p>	<p>Broadly, the steps involved are the following:</p> <ul style="list-style-type: none"> ➤ Ascertainment of the history of the inception and growth of the firm. ➤ Study of the provisions of the deed of partnership, particularly For composition of partners, their capital contribution, drawing rights, retirement benefits, job allocation, financial management, goodwill, etc. ➤ Scrutiny of the record of profitability of the Firm's business over a suitable number of years., with usual adjustments that are necessary in ascertaining the true record of business profits. Particular attention should, however, be paid to the nature of partners' remuneration. ➤ Examination of the asset and liability position to determine the tangible asset backing For the partner's investment, appraisal of the value of intangibles like goodwill, know how, patents, etc. impending liabilities including contingent liabilities and-those for pending tax assessment. ➤ Position of orders at hand and the range and quality of clientele should be thoroughly examined, which the Firm is presently operating. ➤ Position and terms of loan Finance would call for careful scrutiny to assess its usefulness and implication For the overall Financial position; reason For its absence should be studied. ➤ It would be interesting to study the composition and quality of key personnel employed by the firm and any likelihood of their leaving the organisation in the near future. ➤ Various important contractual and legal obligations should be ascertained and their nature studied. ➤ Reasons for the offer of admission to a new partner should be ascertained. ➤ Appraisal of the record of capital employed andthe rate of return. It is necessary to have a comparison with alternative business avenues for investments and evaluation of possible results on a changed capital and organisation structure, if any, envisaged along with the admission of the partner. ➤ It would be useful to have a firsthand knowledge about the specialisation, if any, attained by the Firm in any of its activities. ➤ Manner of computation of goodwill on admission as also on retirement, if any, should be ascertained. ➤ Whether any special clause exists in the deed of partnership to allow admission in future of a new

		<p>partner, who may be specified, on concessional terms.</p> <ul style="list-style-type: none"> ➤ Whether the incomplete contracts which will be transferred to the reconstituted Firm will be a liability or a Loss.
	<p>Investigation for valuation of shares in private companies</p>	<p>In respect of equity shares, there are two main methods of valuation</p> <ul style="list-style-type: none"> ➤ Network Basis: <i>→ Network Basis</i> The amount of net worth is divided by the number of shares comprising the equity capital to arrive at the value for one share. Goodwill of the business, based on the estimated Future maintainable profit, is included among the assets to arrive at the amount of net worth ➤ Yield Basis: <i>Yield</i> average profit earned by the business during the preceding 5 to 7 years is computed. Value of business is calculated by capitalizing it at a reasonable rate of interest. (Refer FR - Valuation of shares)
	<p>Investigation on behalf of a bank proposing to advance loan to a company:</p>	<p>The investigating accountant, in the course of his enquiry, should attempt to collect information on the under-mentioned points:</p> <ul style="list-style-type: none"> ➤ The purpose for which the loan is required ➤ The schedule of repayment of loan submitted by the borrower, ➤ The financial standing and reputation for business integrity enjoyed by directors and officers of the company. ➤ Whether the company is authorised by the Memorandum or the Articles of Association to borrow money For the purpose For which the loan will be used. ➤ The history of growth and development of the company and its performance during the past 5 years. ➤ How the economic position of the company would be affected by economic, political and social changes that are likely to take place during the period. <i>(CBE)</i> <p>To investigate the profitability of the business investigating accountant should take the under - mentioned steps:</p> <ul style="list-style-type: none"> ➤ Prepare a condensed income statement From the Statement of Profit and Loss for the previous Five years ➤ Compute the under-mentioned ratios: <ul style="list-style-type: none"> ○ Sales to Average Inventories held. <i>S. AV</i> ○ Sales to Fixed Assets. ○ Equity to Fixed Assets. ○ Current Assets to Current Liabilities. <i>CR</i> ○ Quick Assets (the current assets that are readily realisable) to Quick Liabilities. <i>Quick Assets</i>

		<ul style="list-style-type: none"> ○ Equity to Long Term Loans. ✓ ○ Sales to Book Debts. ✓ ○ Return on Capital Employed. ✓ ➤ Enter in a separate part of the statement the break - up of annual sales product-wise to show their trend. <p>The investigating accountant should prepare schedules of assets and liabilities of the borrower and include in the particulars stated below:</p> <ul style="list-style-type: none"> ➤ Fixed assets - A Full description of each item, its gross value, the rate at which depreciation has been charged and the total depreciation written off. ➤ Inventory - The value of different types of inventories held (raw materials, work-in- progress and Finished goods) and the basis on which these have been valued. ➤ Trade Receivables, including bills receivable - Their composition should be disclosed. <p>Further, the total amount outstanding at the close of the period should be segregated as follows:</p> <ul style="list-style-type: none"> ○ Debts due in respect of which the period of credit has not expired: } Debts class. ○ Debts due within six months: and ○ Debts due but not recovered For over six months. ➤ Investments - It should disclose the - date of purchase, cost and the nominal and market value of each investment. ➤ Secured Loans - Debentures and other loans should be included together in a separate schedule. ➤ Provision of Taxation - The previous years up to which taxes have been assessed should be ascertained. ➤ Other Liabilities - It should be stated whether all the liabilities, actual and contingent, are correctly disclosed. ➤ Insurance - A schedule of insurance policies giving details of risks covered. ➤ Contingent Liabilities - Finally, the investigating accountant should ascertain whether any application For loan to another bank or any other party has been made. If so, the result thereof should be examined.
	<p>Investi gation of Frauds</p>	<p>In the Companies Act, 2013 meaning of fraud has been considered in two specific sections viz. Section 143(10), where the SAs specified by the ICAI are deemed to be the auditing standards for purposes of the Act, which, inter alia, define fraud, and in Section 447, where punishment For fraud has been prescribed.</p> <p>Fraud has been defined in paragraph 11(a) of SA 240 , "The Auditor's responsibilities Relating to Fraud in an</p>

	<p><u>Fraud</u></p>	<p>Audit of Financial Statements" as 'an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage'.</p> <p>In the context of stating the provisions for punishment for fraud, Section 447 of the Act has explained the term 'fraud' as "Fraud in relation to affairs of a company or any body corporate, includes any act, omission, concealment of fact or abuse position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person whether or not there is any wrongful gain or wrongful loss."</p> <p>This Section further explains the terms 'wrongful gain' and 'wrongful loss' to mean the gain by unlawful means of property to which the person gaining is not legally entitled; and the loss by unlawful means of property to which the person losing is legally entitled, respectively.</p> <p>Frauds may be classified as defalcations involving misappropriation, either of money or that of goods, and manipulation of accounts not involving a defalcation. The detections of manipulations of accounts being one of the objects of an audit For the detection of Frauds perpetrated for misappropriating either money or goods, knowledge of the various circumstances under which these may be committed and that of different forms they take is essential. On this account, a brief description thereof at different level is given below.</p>
		<p>Types of Frauds</p> <ul style="list-style-type: none"> ➤ <u>Fraudulent Entries</u> (Journals) ➤ <u>Sales Frauds</u> ➤ <u>Collection Frauds</u> ➤ <u>Expenses Frauds</u> ➤ <u>Payroll Frauds</u> ➤ <u>Data Frauds</u> ➤ <u>Technology related Frauds</u> ➤ <u>Banking related Frauds</u> ➤ <u>Others</u>
		<p>Fraud for Personal gain</p> <p>i. Bribery: Money, gift or other favours offered to procure (often illegal or dishonest) action or decision in favour of the giver. These are also relatable to contract fraud or procurement fraud and are generally, out of books transactions. The auditor normally conducts a propriety audit over the</p>

			<p>veracity of the transaction and review of any undue Favours to vendors.</p> <p>ii. Corporate Frauds/ irregularities</p> <ul style="list-style-type: none"> ➤ Advance Billing: Advance billing is a situation where the company officials indulge in booking Fictitious sales in anticipation of actual sales. This results in misrepresentation of revenue in the books thereby misleading financiers and stakeholders. When the management treats borrowings from money lenders as customer advances in the books against sale orders or For adjusting bills receivables, the Fraudulent act gets unnoticed For an extended period. This situation results in a death knell For the corporation as the company is dragged into an irredeemable debt trap. Use of Shell Company, False vendors, purchases of personal nature booked as official expenses enable falsification of accounts and diversion of funds for purposes other than an intended purpose. These could also be mechanism For employees or cartel of employees engaging in personal gain at the cost of the company. In the Former incident this could be termed as management Fraud. ➤ Shell/ Dummy Company Schemes: Generally, represents a fictitious company or a paper company' to transfer profit is or funds from the main company. This could also involve Fictitious bills (mostly For services rendered or consultancy charges that cannot be corroborated) which are used in the name of dummy companies diverting the funds taken From banks and Financial institutions. The books could be falsified by wrong classification of expenses, inflating the expense claims, fictitious expenses or multiple reimbursements. A review of controls, normally, leads to the uncovering of expense booking that are prima facie not incurred. ➤ Money Laundering Activities: As per the Prevention of Money Laundering
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			<p>Act, 2002 whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money laundering."</p> <p>The person indulging in money laundering looks for avenues with weak banking controls For converting illegal money into the banking system. Any excess credit in the bank accounts that does not belong to the customer or is parked for a temporary period should raise suspicion of such activities. This person indulging in money laundering activity looks for avenues to enter into 'benami' (could be called Rs proxy' name lending) transactions. Companies with extensive cash handling and inadequate identification process of source of money or about the remitter are susceptible to money laundering activities.</p> <p>iii. Fraud at Operational Level Employees</p> <ul style="list-style-type: none"> ➤ Tampering of Cheques / Drafts / On-line payments / receipts: Tampering of cheques, payee name being altered, or preparation of cheques without issue of the cheques to payee, etc., are methods that may also lead to Falsification of accounts. <p>On-line payments generally are considered a transparent mechanism to prevent the above frauds. The ATM is a popular technological advancement that has inherent control gaps. For example, credit cards once swiped the transaction is put through in the system without the need For a signature of the payer. Similarly, unauthorised credits in bank accounts through ATMs are an immense source of threat to recipients including bribery allegations, unless they lodge a complaint with the bankers or the regulatory authorities in a prompt manner of such</p>
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			<p>unauthorised credits to their accounts / or company bank accounts.</p> <p>Care should be taken that the name of the payee in the payment transactions in books and cheque issued therein for payment is not fabricated to wrongly codify and book against an improper account head.</p> <p>➤ Off Book Frauds: In off book Frauds, the Fraud perpetrator misappropriates the cash before these are recorded in the books or before the sale is recorded in the books. These frauds are difficult to unearth as the cash or collection is taken off before the accounting entries are made in the books. This situation arises especially in unorganized markets and in rural economies where banking habits are relatively under developed. These are difficult to establish due to absence of audit trails and are more prevalent in businesses that have extensive cash dealings. These are difficult to uncover as the means adopted could include printing of receipts/ bills outside the system.</p> <p>The above Fraudulent schemes can be established based on circumstantial evidence or validation through external sources such as, customer balance confirmations where feasible) and customer copy of the receipts or other documents that are retained by them. These are also further supplemented by external evidence in the form of background checks and surveillance mechanism.</p> <p>➤ Cash Misappropriation: Cash is misappropriated after the accounting entries are already passed in the books. These are identified through surprise checks and through shortages in cash balances. These occur when there are delays in accounting of cash collections and there are no laid cash flow controls. Unaccounted money in</p>
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			<p>any form entity is a serious red Flag in uncovering of irregularities. Improper daily fund monitoring mechanism is another factor that results in creating unauthorised float by employees in their personal account or in fictitious surrogate (proxy entities by Fraudsters.</p> <ul style="list-style-type: none"> ➤ Teeming and Lading: This is also achieved through cash deposits or cheques collected from customers being overlapped with the collections from subsequent customers and the amount collected is diverted to personal account. The ageing of receivables is not a constant, and, therefore, this makes the task of identifying the leakage of collections unless all the customer accounts are reconciled at a single point of time. ➤ Fraudulent Disbursements: Fraudulent disbursements or reimbursements take place either by issuing or submission of False bills, or personal expense bills being converted into official expenses bills. The other method that is resorted to by the perpetrator of fraud is to inflate the refunds due to a customer and skim the excess refunds. claiming reimbursement. In some cases, employees may get reimbursed by third parties (such as distributors) as well as by claiming these expenses From the company. Multiple expense claims based on duplicate bills or photostat copies. ➤ Payroll Fraud: The payroll Fraud could include payment to non-existent employees or in a contractual arrangement inflating of the manpower resources than those actually deployed while billing the client. It may also include showing higher pay than actual disbursement to employees / workers, etc. The process would require a detailed review of statutory declarations / Filings under various labour law statutes including disclosures in Financial statements of retirement
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			<p>benefits such as <u>P.F</u>, <u>Gratuity</u> and <u>Superannuation</u> benefits From an evidence gathering perspective.</p> <ul style="list-style-type: none"> ➤ Commission Schemes: The salesman exaggerates the sales through <u>Fictitious billings</u> to <u>earn higher commission</u> or alter the <u>sates prices of the products sold from those stipulated by the company</u> or share the <u>sales volumes achieved with other employees</u> to share higher <u>commission</u>. <u>Commission schemes in mega deals backed by legal documents are often tools used to camouflage kickbacks.</u> These are <u>often difficult to uncover and would need to be supplemented by the monetary traits across entities and geographies.</u>
		<p>Cash embezzlement frauds</p> <p><i>175000 = scrap</i></p>	<p>a) Cash receipts - In cases like <u>holding back cash sales, collections by travelling salesmen, V.P.P receipts, or casual receipts, e.g., sales of scrap, recoveries out of debts written off earlier, etc.,</u> the amount or amounts of receipts embezzled may be subsequently covered up by the perpetrator adopting one or other of the under - mentioned devices:</p> <ul style="list-style-type: none"> ➤ Issuing a receipt to the payee for the <u>full amount collected and entering only a part of the amount on the counterfoil.</u> ➤ Showing a <u>larger cash discount than actually allowed.</u> ➤ Adjusting a <u>fictitious credit in the account of a customer for the value of goods returned by him.</u> ➤ Adjusting a <u>cash sale as a credit sale, and raising a debit in the account of the customer.</u> ➤ Writing off a <u>good debt as bad and irrecoverable to cover up the amount collected which has been misappropriated.</u> ➤ Short-debiting the <u>customer's account in the ledger with an intention to withdraw the difference when the full amount payable by him is collected.</u>

			<ul style="list-style-type: none"> ➤ Under-casting the receipts side of the Cash Book or over - casting the payment side; carrying over a shorter total of the receipts From one page of the Cash Book to the next or over - carrying the total of the payment from one page of the Cash Book to the next with a view to covering up misappropriation; either short banking of cash collection or apart of the amount withdrawal From the bank. <p>Verification of Cash Receipts</p> <ul style="list-style-type: none"> ➤ evidence as regards income received From different sources should be scrutinised, e.g., inventory, sales summaries, rental registers, correspondence with customers, advices travelling salesmen and counterfoils or receipts. ➤ Carbon copies of receipts marked 'duplicate', should be scrutinised. ➤ Recalling paying -in-slips From the bank the details of deposited on each day should be compared with those shown in the Cash Book. ➤ The record of sales of scrap of waste paper, that of collection of rents from labourers temporarily accommodated in the company's quarters, that of refunds of amounts deposited with the electric supply co., and other Government authorities should be examined for Finding out if any of amounts have been misappropriated. ➤ Cash sales should be vouched in detail. ➤ Recoveries from customers and sundry parties should at checked with (501) ➤ Deductions made on account of cash discounts should be reviewed. All withdrawals from the bank should be checked by reference to corresponding entries in the bank pass book. <p>b) Inflating cash payment -</p> <ul style="list-style-type: none"> ➤ Making double payment of an invoice or paying a false invoice ➤ Paying personal expenses out of the business by falsifying details. e.g., showing betting losses as advertise charges.
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			<ul style="list-style-type: none"> ➤ Withdrawing <u>unclaimed credit balances of customer or amounts falsely credited in the accounts of parties.</u> ➤ <u>Falsely adjusting a refund in the account of a customer or withdrawing the credit balance.</u> ➤ <u>Wrong totaling of the wage sheets and misappropriating the excess amount withdrawn from the bank for payment of wages.</u> <p>Verification of Cash Payments</p> <ul style="list-style-type: none"> ➤ Evidence as regards cash payments made, should be <u>carefully scrutinised.</u> ➤ Case where a figure appears to have been <u>erased or altered actual amount paid to him should be confirmed.</u> ➤ All payments by <u>bearer cheques should be examined.</u> ➤ System of recording of <u>wages should be reviewed, specially as regards possible over - totalling of wage sheets, and entries in them of dummy workmen.</u> ➤ The system of ordering and receiving goods should be reviewed so as to confirm that <u>no payment has been made in respect of supplies which have not been received.</u> ➤ Confirmations should be <u>obtained From partners or Directors in respect of amounts shown to have been paid to them. The Petty Cash Book should be vouched and totaled. Special attention should be paid to payments made on account of salaries and wages;</u> ➤ All the withdrawals from the bank should be checked by reference to <u>entries in the bank's pass book.</u> ➤ All the bills receivable or payable <u>should be checked by reference to the Bills Books.</u> <p>c) Frauds through suppliers' ledger</p> <ul style="list-style-type: none"> ➤ Adjusting <u>Fictitious or duplicate invoices as purchases in the accounts of suppliers and subsequently misappropriating the amounts when payments are made to the suppliers in respect of these invoices.</u> ➤ Suppressing the <u>Credit Notes issued by suppliers and withdrawing the</u>
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			<p>corresponding amounts <u>not claimed</u> by them.</p> <ul style="list-style-type: none"> ➤ <u>Withdrawing amounts unclaimed by suppliers, for one reason or another by showing that the same have been paid to them.</u> ➤ <u>Accepting purchase invoices at prices considerably higher than their market prices and collecting the excess amount, paid in cash, from the suppliers.</u> <p>Verification of balances in suppliers' ledger</p> <ul style="list-style-type: none"> ➤ The Bought Journal should be vouched by reference to entries in the Goods Inward Book and the suppliers' invoices to confirm that amounts credited to the accounts of supplier were in respect of <u>goods, which were duly received</u> and the <u>suppliers' accounts had been credited correctly.</u> ➤ All the suppliers should be requested to Furnish statements of their accounts. <ul style="list-style-type: none"> ○ By the 'teeming and lading' method, i.e., misappropriating the amount collected from a customer and crediting his account by the amount paid by him only when <u>an amount is subsequently collected from another customer</u>; repeating this practice with several items collected and depositing <u>back the amount or amounts so misappropriated before the close of the year.</u> ○ Misappropriating the amount collected from a customer and subsequently <u>adjusting his account by crediting the amount on account of allowance or a rebate for excess price charged.</u> ○ Crediting the amount received From a customer to the account of <u>another customer</u> and <u>subsequently withdrawing the amount wrongly credited.</u> <p>Verification of balances in customers' ledger</p> <ul style="list-style-type: none"> ➤ Special attention should be paid to allowances adjusted on account of <u>goods returned or difference in price or on any, other account as well as to amounts written off as bad debts</u>
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		<ul style="list-style-type: none"> ○ Totals of the Inventory Book should be checked. ○ Shortages observed on physical verification of inventory should be reconciled with the discrepancies observed on checking the books in the manner mentioned above. ○ Defalcations of inventory, sometimes, also are committed by the management, by diverting a part of production for detecting such shortages, the investigating accountant should take assistance of an engineer. Guidance can also be taken from past records showing the extent of wastage in production in the past.
<p>Investigation on behalf of an individual or firm proposing to buy a business</p>	<p>a) In case of proprietary concerns or partnerships –</p> <ul style="list-style-type: none"> ➤ <u>Reasons</u> for the sale of the business and the effect on turnover and an individual, profits that there would be on retirement of the present proprietor (or or firm partners). ➤ The length of <u>lease</u> under which the premises are held; the <u>prospects of its renewal or extension</u>. ➤ The <u>unexpired period of any patents owned by the vendors</u>. ➤ The <u>age of the present managerial staff and the prospects of continuing in service under the new proprietorship and the possible liability, not already provided for that would arise as regards payment of pensions or gratuities in case of old and aged employees and those retrenched</u>. ➤ If the bulk of sales are made to customers whose number is small, the <u>profitability of the business would be greatly shaken on withdrawing their support</u>. This would be an <u>element of weakness which should be investigated as it might affect future profitability</u>. ➤ The valuation that could be placed on goodwill to <u>determine whether that appearing in the book is less or more; if none is included to determine the amount that should be included, if at all</u>. <p>b) If the business belongs to a limited company - The vendors' interest in this case will be purchased by the acquisition of shares. On that account, the following <u>additional matters would also require consideration</u>:</p> <ul style="list-style-type: none"> ➤ The <u>authorised and issued capital of the company</u>. ➤ Whether there is any <u>uncalled liability on the shares</u>. 	<p><i>Reasons</i></p> <p><i>10-15</i></p> <p><i>Length of lease</i></p> <p><i>Patents</i></p> <p><i>Age of Emp</i></p> <p><i>Too much dependence</i></p> <p><i>CR/SL</i></p>

		<ul style="list-style-type: none"> ➤ If the capital is divided into <u>different classes of shares</u> - the <u>rights that are attached to each class</u>. ➤ <u>Particulars of dividends paid in the past and the amounts thereof which are in arrear (on cumulative preference shares)</u>. ➤ If there are any <u>mortgages created on the assets appearing in the company's books</u>, a search should be made in the <u>Register of Charges</u> in the office of the Registrar of Companies. ➤ The price at which <u>the shares are being offered</u>. If the company is a public company, the price will usually be in <u>excess of market price</u> quoted on the Stock Exchange, but in the case of <u>unquoted shares particularly where the company whose shares are being acquired is a private company</u>, a <u>valuation will have to be placed on the shares for the purpose of purchase</u>. <p style="text-align: right; margin-right: 50px;"> → NLO ↔ gm. </p>
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DUE DILIGENCE


OVER VIEW	<ul style="list-style-type: none"> • Due Diligence is used to <u>investigate</u> and evaluate a business opportunity. • It implies a <u>general duty to exercise care</u> in any transaction. • Due diligence is a process of <u>investigation</u> performed by investors, into the details of a <u>potential investment</u> such as an <u>examination of operations and management</u> and the <u>verification of material facts</u>. • It entails conducting <u>inquiries</u> For the purpose of <u>timely, sufficient and accurate disclosure of all material statements/information or documents</u>, which may influence the <u>outcome of the transaction</u>. • Due diligence involves an <u>analysis carried out before</u> acquiring a controlling interest in a company • Also <u>due diligence can apply to recommendation for an investment or advancing a loan/credit</u>. • Due Diligence may also required to be performed in cases of <u>corporate restructuring, venture capital</u>
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	<p>financing, lending, leveraged buyouts, public offerings, disinvestment, corporatization, etc.</p>														
DIFFERENCE BETWEEN DUE DILIGENCE AND AUDIT	<p>Audit is an independent examination and evaluation of the financial statements on an organization with a view to express an opinion thereon.</p> <p>Due diligence refers to an examination of a potential investment to confirm all material facts of the prospective business opportunity. It involves review of financial and non-financial records as deemed relevant and material. Simply put, due diligence aims to take the care that a reasonable person should take before entering into an agreement or a transaction with another party.</p>														
IMPORTANCE OF DUE DILIGENCE	<ul style="list-style-type: none"> • There are many reasons for carrying out due diligence including: • To confirm that the business is what it appears to be; • To identify potential "deal killer" defects in the target and avoid a bad business transaction; • To gain information that will be useful for valuing assets, defining representations and warranties, and/or negotiating price concessions; and • To verify that the transaction complies with investment or acquisition criteria. 														
CLASSIFICATION OF DUE-DILIGENCE	<p>Due Diligence can be sub-classified into discipline-wise exercises in following manner:</p>														
	<table border="1"> <tr> <td>Commercial / Operational</td> <td>It is generally performed by the concerned acquire enterprise involving an evaluation from commercial, strategic and operational perspectives. For example,</td> </tr> <tr> <td>Due Diligence</td> <td>whether proposed merger would create operational synergies.</td> </tr> <tr> <td>Financial Due Diligence</td> <td>It involves analysis of the books of accounts and other information pertaining to financial matters of the entity. It should be performed after completion of commercial due diligence.</td> </tr> <tr> <td>Tax Due Diligence</td> <td>It is generally included in the financial due diligence. The accountant has to look at the tax effect of the merger or acquisition.</td> </tr> <tr> <td>Information Systems Due Diligence</td> <td>It pertains to all computer systems and related matter of the entity.</td> </tr> <tr> <td>Legal Due Diligence</td> <td>This may be required where Legal aspects of functioning of the entity are reviewed.</td> </tr> <tr> <td>Environmental Due Diligence</td> <td>It is carried out in order to study the entity's environment, its flexibility and adaptiveness to the acquirer entity.</td> </tr> </table>	Commercial / Operational	It is generally performed by the concerned acquire enterprise involving an evaluation from commercial, strategic and operational perspectives. For example,	Due Diligence	whether proposed merger would create operational synergies.	Financial Due Diligence	It involves analysis of the books of accounts and other information pertaining to financial matters of the entity. It should be performed after completion of commercial due diligence.	Tax Due Diligence	It is generally included in the financial due diligence. The accountant has to look at the tax effect of the merger or acquisition.	Information Systems Due Diligence	It pertains to all computer systems and related matter of the entity.	Legal Due Diligence	This may be required where Legal aspects of functioning of the entity are reviewed.	Environmental Due Diligence	It is carried out in order to study the entity's environment, its flexibility and adaptiveness to the acquirer entity.
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	Personnel Due Diligence	It is carried out to ascertain that the entity's personnel policies are in line or can be changed to suit the requirements of the restructuring.
	Financial Due Diligence	It should not be confused with overall due diligence review. Role of financial due diligence commences after a price has been agreed For the business. The principal objective of <u>Financial due diligence</u> , therefore, is usually to look behind the <u>veil of initial information</u> provided by the company and to assess the benefits and costs of the proposed acquisition/merger by <u>inquiring into all relevant aspects of the past, present and future of the business to be acquired/merged with.</u>
	Due diligence process can include any of the following objectives	<ul style="list-style-type: none"> ➤ <u>Brief description of the history of business</u> ➤ <u>The background of promoters</u> ➤ <u>Accounting policies and practices</u> ➤ <u>Management information systems</u> ➤ <u>Details of management structure</u> ➤ <u>Trading results both <u>past</u> and the recent <u>past</u></u> ➤ <u>Assets and liabilities as per latest <u>balance sheet</u></u> ➤ <u>Current status of <u>Income tax assessments</u> including <u>appeals pending against tax liabilities assessed by tax authority.</u></u> ➤ <u>Cash flow patterns</u> ➤ <u>The projection of future profitability</u>
	<p>If a full fledged financial due diligence is conducted, it would include the inter alia, in its scope:</p> <ul style="list-style-type: none"> ➤ <u>Brief history of the <u>target</u> and <u>background</u> of its promoter;</u> ➤ <u>Accounting policies;</u> ➤ <u>Review of financial statements;</u> ➤ <u>Taxation;</u> ➤ <u>Cash Flow;</u> ➤ <u>Financial projection;</u> ➤ <u>Management and employees;</u> ➤ <u>Statutory Compliance.</u> 	
	Brief history of the target and background of its promoters -	<p>The details of how the company <u>was set up and who were original promoters</u> has to be <u>gone into,</u></p> <p>An eye into the history of the target may reveal its turning points survival strategies adopted by the target From time to time, the <u>market share enjoyed by the target</u></p>

			<p>and changes therein, <u>product life cycle and adequacy of resources.</u></p> <p>Broadly, the accountant should make relevant enquiries about the history of target's <u>business products, markets, suppliers, expenses, operations.</u></p> <p>This could, inter alia, include the following:</p> <ul style="list-style-type: none"> ➤ <u>Nature of business(es)</u> ➤ <u>Location of production Facilities, warehouses, offices.</u> ➤ Employment By <u>location, supply, wage levels, union contracts, pension commitments, government regulation.</u> ➤ Products or services and markets <p>Major customers and contracts, terms of payment, profit margins, market share, competitors, exports, pricing policies, reputation of products, warranties, order book, trends marketing strategy and objectives, manufacturing processes.</p> ➤ History of the business with important suppliers of goods and services Long-term contracts, <u>stability of supply, terms of payment, imports, methods of delivery such as "just-in-time".</u> ➤ Inventories <p>Locations, Quantities.</p> <ul style="list-style-type: none"> ➤ <u>Franchises, licenses, patents.</u> ➤ <u>Important expense categories.</u> ➤ <u>Research and development.</u> ➤ <u>Foreign currency assets, liabilities and transactions.</u>
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			<ul style="list-style-type: none"> ➤ Legislation and regulation that significantly affect the <u>entity</u>. ➤ <u>Information systems</u>.
		<p>Accounting policies</p> 	<p>Whether any accounting policy is inappropriate.</p> <p>The accountant should also see the effects <u>of the recent changes the accounting policies</u>.</p> <p>The accountant's report should include</p> <ol style="list-style-type: none"> a) a <u>summary of significant accounting policies used by the target</u>. b) that changes that have been <u>made to the accounting policies in the recent past</u>, c) the <u>areas in which accounting policies followed by the target are different from those adopted by the acquiring enterprise, the effect of such differences</u>.
		<p>Review of Financial Statements</p>	<p><u>Financial statements of the target have been prepared in accordance with the Statute governing the target, and the relevant Accounting Standards.</u></p> <p>It is important to make an evaluation of the <u>profit reported by the target. The reason being that the price of the target would be largely based upon its operating results.</u></p> <p>The accountant should consider the <u>presence of an extraordinary item of income or expense that might have affected the operating results of the target.</u></p> <p>It is advisable to compare the actual figures with the budgeted figures For the <u>period under review and those of the previous accounting period.</u></p> <p>It is important that the <u>trading results for the past four to five years</u></p>

			<p>are compared and the trend of normal operating profit arrived at.</p> <p>The normal operating profits should further be benchmarked against other similar companies.</p> <p>The net worth of the business has to be arrived at by taking into account the impact of over/under valuation of assets and liabilities.</p>
			<p>HIDDEN LIABILITIES:</p> <ul style="list-style-type: none"> ➤ The company may not show any show cause notices which have not matured into demands, as contingent liabilities. ➤ The company may have given "Letters of Comfort" to banks and Financial Institutions. ➤ The Company may have sold some subsidiaries / businesses and may have agreed to take over and indemnify all liabilities and contingent Liabilities of the same. ➤ Product and other Liability claims; warranty liabilities; product returns/discounts; liquidated damages For late deliveries etc. and all litigation. ➤ Tax liabilities under direct and indirect taxes. ➤ Agreement to buy back shares sold at a stated price. ➤ Future lease liabilities. ➤ Environmental problems/claims/third party claims. ➤ Unfunded gratuity / superannuation / leave salary incorrect gratuity valuations. ➤ Huge labour claims under negotiation when the labour wage agreement has already expired
			<p>OVER-VALUED ASSETS:</p> <ul style="list-style-type: none"> ➤ Uncollected/uncollectable receivables.

			<ul style="list-style-type: none"> ➤ Obsolete, slow non-moving inventories or <u>inventories value: above NRV;</u> ➤ Underused or obsolete Plant and Machinery and their spares; ➤ Assets carried at much more than current market value due to capitalization of expenditure / foreign exchange Fluctuation, or <u>capitalization of expenditure mainly in the nature of revenue.</u> ➤ Litigated assets and property. ➤ Investments carried at cost though <u>realizable value is much lower.</u> ➤ In fructuous project expenditure / deferred revenue expenditure etc. ➤ Group Company balances under reconciliation etc. ➤ Intangibles of no value.
		<p>Taxation.</p>	<p>It is important to check if the company is regular in paying various taxes to the Government. The accountant has to also look at the tax effects of the merger or acquisition.</p>
		<p>Cash Flow</p>	<p>A review of historical cash flows and their pattern would reflect the <u>cash generating abilities of the target company and should highlight the major trends.</u></p> <p>It is important to know if the company is able to meet its cash requirements through <u>internal accruals or does it have to seek external help from time to time.</u></p> <p>It is necessary to check that:</p> <ol style="list-style-type: none"> a) Is the company able to honour its commitments to its <u>trade payables, to the banks, to government and other stakeholders</u> b) <u>How well is the company able to turn its trade receivables and inventories</u> c) <u>How well does it deploy its funds</u>

Further

			<p>d) Are there any funds tying idle or is the company able to reap <u>maximum benefits out of the available funds?</u></p>
		Financial Projections	<p>The accountant should obtain from the <u>target company the projections For the next five years</u> with detailed assumptions and workings.</p> <p>He should ask the target to give projections on <u>optimistic pessimistic and most likely bases.</u></p> <p>The accountant evaluates the <u>appropriateness of assumption</u></p> <p>If, the accountant is of the opinion that as assumption used by the <u>target is unrealistic, the accountant should consider its impact on the overall valuation of the company.</u></p> <p>He should thoroughly check the <u>arithmetic of the calculations made for financial projections.</u></p>
		Management and Employees	<p>In <u>most of the companies which are available for take over the problem of excess work force is often witnessed.</u></p> <p>It is important to work out <u>how much of the Labour Force has to be retained.</u></p> <p>Complex set of Labour Laws applicable to them</p> <p>It is important to see if all employee benefits like Provident Fund (RE.), Employees State Insurance (E.S.I.), Gratuity, leave and Superannuation have been properly paid/ provided For / funded.</p> <p>The assumptions regarding increase in salaries, interest rate,</p>

(R&R)

			<p>retirement etc. have to be gone into to see if they are reasonable.</p> <p>It is very important to consider the pay packages of the key employees as this can be a crucial factor in future costs.</p> <p>It is also important to identify the key employees who will not continue after the acquisition either because they are not willing to continue or because they are to be transferred to another company within the 'group' of the target company.</p>
		<p>Statutory Compliance</p>	<p>Make a list of laws that are applicable to the entity as well as to make a checklist of compliance required from the company under those laws. If the company has not been regular in its legal compliance it could lead to punitive charges under the law. These may have to be quantified and factored into the financial results of the company.</p>

WORK APPROACH TO DUE DILIGENCE

- Reviewing and reporting on the financials submitted by the target company.
- Assessing the business first hand by a site visit (if applicable).
- Working through the due diligence process with the acquisition company or investor by defining the key areas.
- Helping prepare an offer based on completion of due diligence.

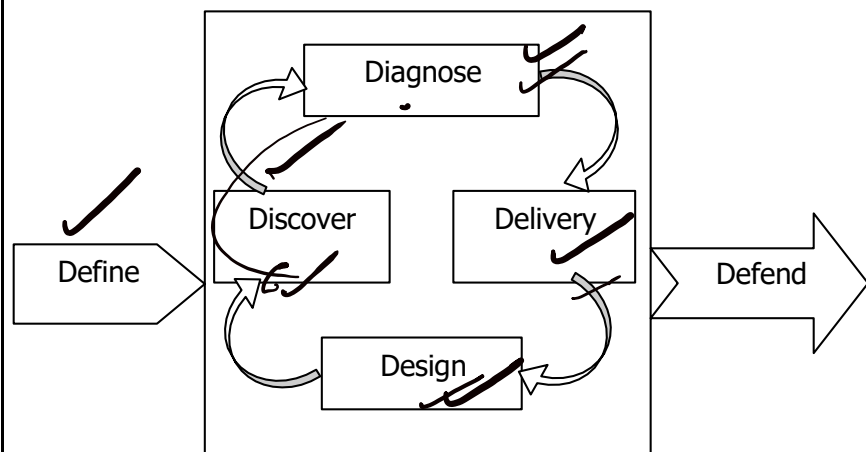


Figure: Six Dimensional Process Framework

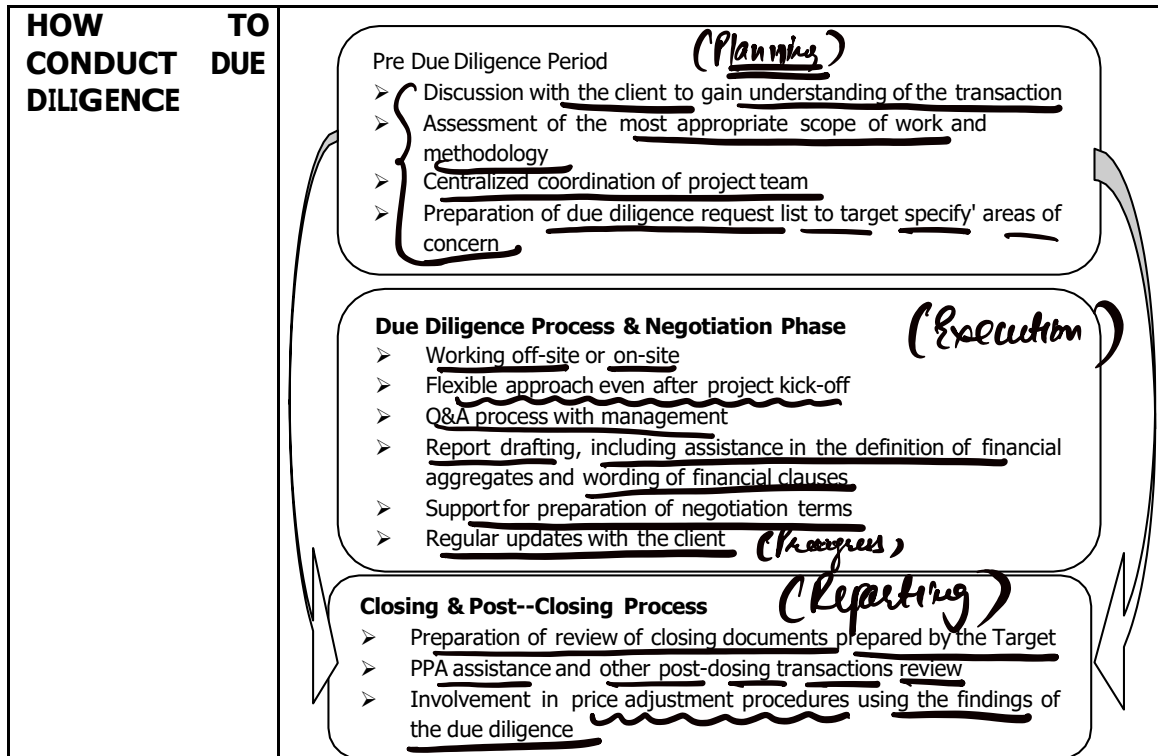


Image : Due Diligence Process

- **Start with an open mind. Do not assume that anything wrong** will be Found and look for it. What needs to be done is to identify trouble spots and ask For explanations.
- **Get the best team of people.** IF you do not have a group of people inside your Firm that can do the task (e.g. lack of staff, lack of people who know the new business because you are acquiring a business in an unrelated areas, etc.), there are due diligence experts that you can hire. When hiring such professionals, look For their experience record in the industry.
- Get help in all areas Like finance, tax accounting, legal, marketing, technology, and any, others relevant to the assignment so that you get a 360 degree view of the acquisition candidate.
- **Talk to customers, suppliers, business partners, and employees** are great resource s.
- Take a risk **management approach**. So, while you want to do your research, you also want make sure that you do not antagonise the team of people of the target company by bogging them down with loads of questions.
- Prepare a comprehensive report detailing the compliances and substantive risks / issues.

CONTENTS OF A DUE DILIGENCE REPORT	The contents of a due diligence report will always vary with individual circumstances. Following headings are illustrative: Example of Headings of a Due Diligence Report
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	<ul style="list-style-type: none"> • Executive Summary • Introduction • Background of Target • Objective of due diligence • Terms of reference and scope of verification • Brief history of the company • Share holding pattern • Observations on the review • Assessment of management structure • Assessment of financial liabilities • Assessment of valuation of assets • Comments on properties, terms of Leases, lien and encumbrances. • Assessment of operating results • Assessment of taxation and statutory liabilities • Assessment of possible liabilities on account of litigation and legal proceedings against the company • Assessment of net worth • Interlocking investments and financial obligations with group / associates companies, amounts receivables subject to litigation, any other likely liability which is not provided For in the books of account • SWOT Analysis • Comments on future projections • Status of charges, liens, mortgages, assets and properties of the company • Suggestion on ways and means including affidavits, indemnities, to be executed to cover unforeseen and undetected contingent liabilities • Suggestions on various aspects to be taken care of before and after the proposed merger/acquisition.
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FORENSIC AUDIT

OVER VIEW	<p>The number of Fraudulent activities and ambiguous financial activities have been accelerating all over the world. Consequently, businesses are exposed to risks of Fraudulent activities. With all of the recent corporate accounting scandals at Parmatat, Xerox Corporation, and Satyam Computer Services, and all the high profile corporate Frauds at Enron, WorldCom, and HealthSouth followed by Bernie Madoff's colossal ponzi scheme, the media has made Forensic Accounting and Fore-Auditing into a growth industry.</p> <p>Forensic Auditing has established itself as <u>dynamic and strategic tool in combating corruption financial crimes and frauds through investigations and resolving allegations of Fraud and embezzlement.</u></p>
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	<p>"Forensic" means "suitable for use in the court of law". → AIC Fraud.</p> <p>Bologna said that it is the application of <u>Financial skills and investigative mentality</u> to unresolved issues, conducted within the <u>context of the rules of evidence</u>.</p> <p>As an emerging discipline, it encompasses <u>Financial expertise, Fraud knowledge and a sound knowledge and understanding of business reality</u> and the <u>working of legal system</u>.</p> <p>Forensic Auditing includes the use of <u>accounting, auditing and investigative skills</u> to assist in legal matters.</p>		
	<p>Forensic Accounting It is the <u>application of accounting methods to the tracking and collection of forensic evidence</u>, usually for <u>investigation and prosecution of criminal acts embezzlement or fraud</u>.</p> <p>Forensic Accounting can sometimes be referred to as <u>Forensic Auditing</u>.</p>		
	<p>Forensic Investigation Also known as <u>forensic audit</u> is the <u>examination of documents and the interviewing of people to extract evidence</u>.</p>		
	<p>Fraud Auditing It is a <u>meticulous review of financial documents conducted when fraud is suspected</u>. Some <u>entities do them as a precaution to prevent Fraud from happening and to it before the loss magnifies</u>.</p> <p>A <u>Fraud Audit however is not an Investigation</u>. <u>Fraud auditing is used to ice-Fraudulent transactions, not to figure out how they were created</u>.</p> <p>Fraud auditors often go outside the books of accounts to Find Fraudulent transactions.</p>		
	<p>Red Flag Red flags are sign or warning of <u>any impending danger or inappropriate behavior</u>. Red Flag <u>do not necessarily indicate the existence of fraud however are indicators that caution needs to be exercised while investigating the situations</u>. Red Flags are <u>classified in categories such as Financial performance red flag, accounting system red Flags, operational red Flags and behavioral red Flags</u>.</p>		
<p>AUDIT V/S. FORENSIC ACCOUNTING</p>	<p>In comparison, forensic accounting and audit differ in specific ways, as shown below:</p> <table border="1" style="width: 100%;"> <tr> <td data-bbox="443 1965 667 2080">Forensic Accounting</td> <td data-bbox="667 1965 1396 2080"> <ul style="list-style-type: none"> ➤ <u>In response to an event</u> ➤ <u>Financial investigation</u> </td> </tr> </table>	Forensic Accounting	<ul style="list-style-type: none"> ➤ <u>In response to an event</u> ➤ <u>Financial investigation</u>
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FORENSIC AUDIT		<ul style="list-style-type: none"> ➤ <u>Finding used as evidence in court or to resolve disputes</u>
	Audit	<ul style="list-style-type: none"> ➤ <u>Mandatory</u> ➤ <u>Measures compliance with reporting standards</u> ➤ <u>Obtain reasonable assurance that Financial statements are free of material misstatement</u> In practice, there are <u>difference in mind set</u> between <u>Forensic accounting</u> and <u>audit</u>: ➤ <u>"Investigative mentality"</u> vs. <u>"professional scepticism"</u>. A Forensic accountant will often require more extensive corroboration. ➤ <u>A forensic accountant may Focus more on seemingly immaterial transactions.</u>

A forensic accountant will often look for indications of fraud that are not subject to the scope of Financial statement audit.

Sr. No	Particulars	Other Audits	Forensic Audit
1.	Objectives	<u>Express an opinion as to 'True & Fair presentation</u>	<u>Whether fraud has taken place in books</u>
2.	Techniques	<u>Substantive & Compliance. Sample based</u> →	<u>Investigative, substantive or in depth checking</u> ✓
3.	Period	<u>Normally For a particulars accounting period.</u>	<u>No such limitations</u> <i>Conclude Ex. 9</i>
4.	Verification of stock, Estimation realisable value of assets, provisions, liability etc	<u>Relies on the management certificate/ Management Representation</u> <i>(Presumptive Evidence)</i>	<u>Independent /verification of suspected /selected items where misappropriation in suspected</u>
5.	Off balance sheet items (like contracts etc.)	<u>Used to vouch the arithmetic accuracy & compliance with procedures.</u>	<u>Regulatory & propriety of these transactions/ contracts are examined.</u>
6.	Adverse findings if any	<u>Negative opinion or qualified opinion expressed with/without quantification</u>	<u>Legal determination of fraud impact and identification of perpetrators depending on scope.</u> <i>Out of law</i>

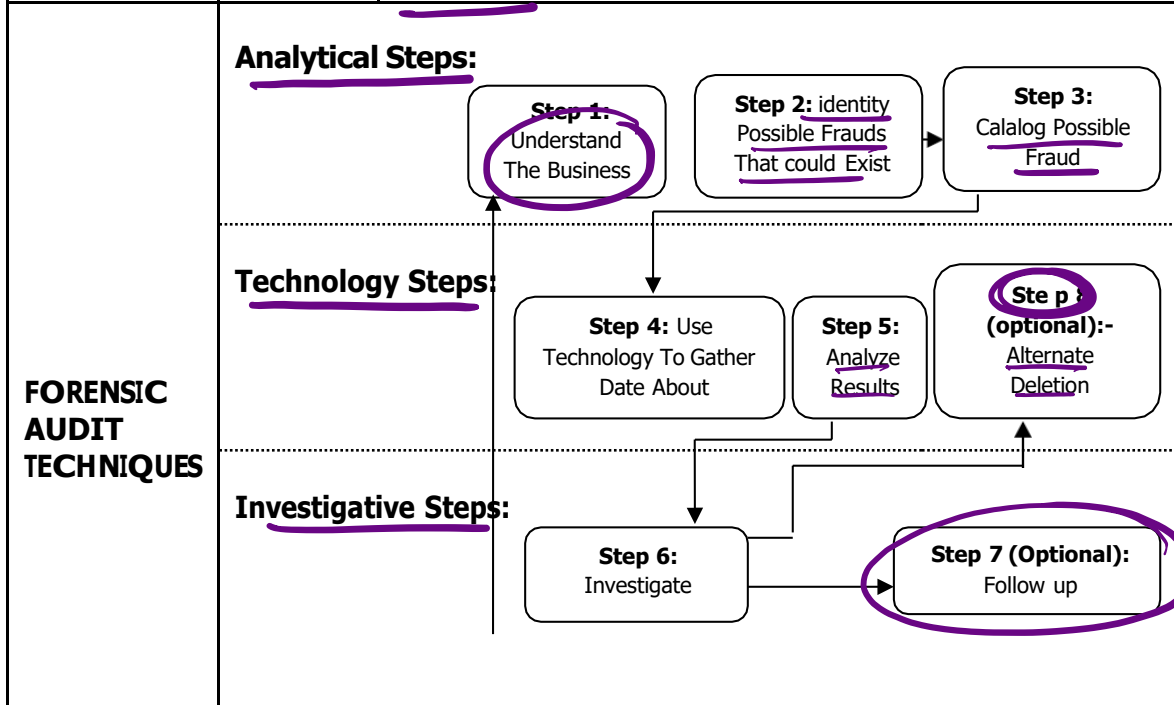
<p>FORENSIC AUDITOR</p>	<p>Forensic Accountants are trained to look beyond the numbers and deal with the business reality of the situation. Forensic audits are highly specialized, and the work requires detailed knowledge of fraud investigation techniques and the legal framework.</p>					
<p>A Forensic Auditor is often involved in the following:</p>	<p>Fraud Detection:</p> <ul style="list-style-type: none"> Investigating and analyzing financial evidence, detecting financial frauds and tracing misappropriated funds 	<p>Computer Forensics:</p> <ul style="list-style-type: none"> Developing computerized applications to assist in the recovery, analysis and presentation of financial evidence; <p><i>RAID</i></p>	<p>Fraud Prevention:</p> <ul style="list-style-type: none"> Either reviewing internal controls to verify their adequacy or providing consultation in the development and implementation of an internal control framework aligned to an organization's risk profile 	<p>Providing Expert Testimony:</p> <ul style="list-style-type: none"> Assisting in legal proceedings, including testifying in court as an expert witness and preparing visual aids to support trial evidence <p><i>Peer Review</i></p>		
<p>Forensic Auditors are retained by:</p>						
<p>Importance of Forensic Auditors</p>	<p>They can resolve the matters by combining accounting knowledge & experience respect to:</p> <ul style="list-style-type: none"> Fraud Prevention Fraud Detection Risk Management 					
<p>Demand</p>	<p>The services rendered by the forensic accountants are in great demand in Following areas:</p> <ul style="list-style-type: none"> Criminal Investigation Professional Negligence Cases Arbitration service Fraud Investigation and Risk/Control reviews Settlement of insurance claims Dispute settlement <table border="1" data-bbox="589 1809 1396 2070"> <tr> <td data-bbox="589 1809 922 2070"> <p>Characteristics- Forensic Auditor</p> <ul style="list-style-type: none"> Out of the Box Thinking Strong Visualization </td> <td data-bbox="922 1809 1396 2070"> <p>Skills forensic Auditor should possess</p> <ul style="list-style-type: none"> Auditing standards, procedures and related methodologies Accounting & Business reporting systems <p><i>PET</i> <i>B MIS</i></p> </td> </tr> </table>				<p>Characteristics- Forensic Auditor</p> <ul style="list-style-type: none"> Out of the Box Thinking Strong Visualization 	<p>Skills forensic Auditor should possess</p> <ul style="list-style-type: none"> Auditing standards, procedures and related methodologies Accounting & Business reporting systems <p><i>PET</i> <i>B MIS</i></p>
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		<p>and Imagination</p> <ul style="list-style-type: none"> • <u>Curiosity</u> • <u>Persistence</u> • <u>Detail-oriented</u> • <u>Inquisitiveness</u> • <u>Creativity</u> • <u>Discretion</u> • <u>Skepticism</u> • <u>Confidence</u> <p>and</p> <ul style="list-style-type: none"> • <u>Sound professional judgement.</u> 	<ul style="list-style-type: none"> • <u>Information Technology Analytics Criminology</u> • <u>Legal Framework</u> • <u>Litigation processes & procedures</u> • <u>Investigative Techniques</u> • <u>Evidence gathering</u> • <u>Network of professional contacts in related fields' viz. enforcement, regulatory bodies, law, industry, peers etc.</u>
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PROCSS OF FORENSIC ACCOUNTING	<p>Each Forensic Accounting assignment is unique. Accordingly, the actual approach adopted and the procedures performed will be specific to it. However, in general, many Forensic Accounting assignments will include the steps det</p> <pre> graph TD A[Initialization *step 1] --> B[Develop the Plan *Step 2] B --> C[Obtain Relevant Evidence *Step 3] C --> D[Perform Analysis * Step 4] D --> E[Reporting * Step 5] E --> F[Court W. Proceedings * Step 6] </pre>
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Step 1. Initialization	<p>It is vital to clarify and remove all doubts as to the real motive, purpose and utility of the assignment.</p>
Step 2. Develop Plan	<p>This plan will take into account the knowledge gained by meeting with the client and carrying out the initial investigation and will set out the objectives to be achieved and the methodology to be utilized to accomplish them.</p>
Step 3. Obtain Relevant Evidence	<p>The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss suffered.</p> <p style="text-align: center;"><i>Ident</i></p>
Step 4. Perform the analysis	<p>The actual analysis performed will be dependent upon the nature of the assignment and may involve:</p> <ul style="list-style-type: none"> ➤ <u>calculating economic damages;</u> ➤ <u>summarizing a large number of transactions;</u> ➤ <u>performing a tracing of assets;</u> ➤ <u>performing present value calculations utilizing appropriate discount rates;</u> ➤ <u>performing a regression or sensitivity analysis;</u> ➤ <u>utilizing a computerized application such as a spread sheet, data base or computer model; and</u> <p style="text-align: left;"><i>Final Sentence</i></p>

		<p>utilizing charts and graphics to explain the analysis.</p>
Step 5. Reporting		<p>The client will expect a report containing the findings of the investigation, including a summary of evidence and a conclusion as to the amount of loss suffered as a result of the fraud. The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions.</p>
Step 6. Court proceedings		<p>The evidence gathered during the investigation will need to be presented at court, and team members may be called to court to describe the evidence they have gathered and to explain how the suspect was identified.</p>



Some of the techniques that a forensic auditor may use are listed below:

- i. **General Audit Techniques:**
 - Testing defenses
- ii. **Statistical & Mathematical Techniques:**
 - Trend Analysis
 - Ratio Analysis

(SAP)
- iii. **Technology based / Digital Forensics Techniques**
 Close scrutiny of relevant emails, accounting records, phone logs and target hard drives is a requisite facet of any modern forensic audit.
 - Live Analysis
 - Deleted Files
 - Steganography
 - Tracking Log Files
 - PC System Log

Data Analytics

- iv. **Computer Assisted Auditing Techniques (CAATs)**
are computer programs that the auditors use as part of the audit procedures to process data of audit significance
- v. **Generalised Audit Software (GAS):** *(Character)*
Currently, the latest versions of GAS include the Audit Command Language (ACL), Interactive Data Extraction and Analysis (IDEA) and Panaudit.
- vi. **Common Software Tool (CST):**
Spreadsheets (like MS Excel, Lotus, etc.), RDBMS (like MS Access, etc.) and Report writers (like Crystal reports, etc.) are few examples of CSTs.
- vii. **Data Mining Techniques:**
Data mining techniques are categorized in three ways: Discovery, Predictive modeling and Deviation and Link analysis.
- viii. **Laboratory Analysis of Physical and Electronic Evidences:**

Computer Forensics	Protection/Validation of Evidence
<ul style="list-style-type: none"> ➤ hard disk imaging ➤ E-mail analysis ➤ search for erased files ➤ analyze use & possible misuse ➤ computer software to analyze data 	<ul style="list-style-type: none"> ➤ Altered & Fictitious Documents ➤ physical examination ➤ fingerprint analysis ➤ forgeries ➤ ink sampling ➤ document dating

FORENSIC AUDIT REPORT

The Forensic Audit Report is nothing but statements of observation gathered & considered proving conclusive while evidence.

It is a medium through which an auditor expresses his opinion under audit.

Sample Table of Contents of a Forensic Audit Report may include the following:

1. EXECUTIVE SUMMARY

- Background ✓
- Origin of the Audit ✓
- Audit Objective ✓
- Proposed Audit Outputs ✓
- Audit Implementation Approach ✓

2. RISK ANALYSIS *MICRO*

Internal Environment Risk	External Environment Forces
Financial Management ✓	Influence of Economics and relevant Market
Customers, Products and Competitors ✓	Political and Legal Scenario
Information technology	Technology in the Sector
Business Process	
Human Resource Management	

3. AUDIT PROCESS

- Preliminary understanding of scope and incident coverage
 - Identification of all related data elements
 - Preparation of a List of "persons of interest" for interview
 - Obtain management approval for scope
- Collect Evidence
- Conduct Interviews
- Analyze Findings
- Validate Inferences and conclusions

4. EVIDENCE OF RISK EVENTS

- Conflicts of interest
- Bribery
- Extortion
- Theft
- Fraudulent transactions
- Inventory Frauds
- Misuse of assets
- Financial Statement frauds

5. AUDIT RECOMMENDATIONS

- Logical Framework Approach
- Preconditions and Risks

6. GOVERNANCE ON RECOMMENDATION IMPLEMENTATION

- Stakeholders
- Budget Considerations

LIST OF ANNEXURES**Annex 1:** Members of the Interviews**Annex 2:** Organization Chart of Auditee organization**Annex 3:** Financial Performance (YYYY to YYYY)**Annex 4:** Audit Recommendation Logical Framework**Annex 5:** Analysis of Key Risk Events

CHAPTER-14
INTERNAL AUDIT,
OPERATIONAL AUDIT &
MANAGEMENT AUDIT

INTERNAL AUDIT	The internal auditing need not be confined to financial transactions and its scope may be extended to the task of reviewing whether the resource utilisation of the enterprise is efficient and economical. This would necessitate a review of all operations of the enterprise as also an evaluation of the effectiveness of management.	
	Applicability of Provisions of internal Audit	As per section 138 of the Companies Act, 2013, following class of companies (prescribed in rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors - Refer Company Audit
	To achieve	<p>a) The goals and objectives of the concern, b) quantify them to the extent possible, c) develop major policies and plans, d) implement them and exercise control over such implementation.</p> <p>Each of the managerial functions should constantly be viewed by the internal auditor. Internal auditors work should include a review of –</p> <ul style="list-style-type: none"> i. internal control system and procedures. ii. system regarding the custodianship and safeguarding of assets - monetary and non- monetary of enterprise. iii. compliance by the various segments with the policies, plans and procedures of the enterprise as well as with the relevant regulations and laws. iv. system of collecting data both monetary and non -monetary - to ensure that the information given to management and to external agencies is relevant and reliable. v. organisational structure of the enterprise and its congruence with its objectives. vi. efficient and economical use of available resources tangible as well as intangible. vii. various operations.

<p>INTEGRITY, OBJECTIVITY AND INDEPENDENCE OF INTERNAL AUDITOR</p>	<p>As per Standard on Internal Audit (SIA) 2, Basic Principles Governing Internal Audit, issued by the Council of the Institute of Chartered Accountants of India, The internal auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude. He should not only be independent in fact but also appear to be independent. The internal auditor should immediately bring any actual or apparent conflict of interest to the attention of the appropriate level of management so that necessary corrective action may be taken.</p>	
<p>INTERNAL AUDIT REPORT</p>	<p>Basic Elements of the Internal Audit Report</p>	<p>Basic elements of the internal audit report as per Standard on Internal Audit (SIA), on Reporting issued by the Council of the Institute of Chartered Accountants of India, The internal auditor's report includes the Following basic elements, ordinarily, in the Following layout:</p> <ul style="list-style-type: none"> ➤ Title; ➤ Addressee; ➤ Report Distribution List; ➤ Period of coverage of the Report; ➤ Opening or introductory paragraph; <ul style="list-style-type: none"> • identification of the processes/Functions and items of financial statements audited; and • a statement of the responsibility of the entity's management and the responsibility of the internal auditor; ➤ Objectives paragraph - statement of the objectives and scope of the internal audit engagement; ➤ Scope paragraph (describing the nature of an internal audit): <ul style="list-style-type: none"> • a reference to the generally accepted audit procedures in India, as applicable; • a description of the engagement background and the methodology of the internal audit together with procedures performed by the internal auditor; and • a description of the population and the sampling technique used. ➤ Executive Summary, highlighting the key material issues, observations, control weaknesses and exceptions; ➤ Observations, findings and recommendations made by the internal auditor; ➤ Comments from the local management; ➤ Action Taken Report – Action taken/ not taken pursuant to the observations made in the previous internal audit reports;

		<ul style="list-style-type: none"> ➤ Date of the report; ➤ Place of signature; and ➤ Internal auditor's signature with Membership Number.
	Essential features of a good internal audit report	<ul style="list-style-type: none"> ➤ Objectivity ➤ Clarity ➤ Accuracy ➤ Conciseness ➤ Constructiveness ➤ Readability ➤ Timeliness ➤ Findings and conclusions ➤ Recommendations ➤ Auditee's views ➤ Summary ➤ Supporting information ➤ Draft Report ➤ Writing and issuing the Final Report <p>Follow-up: The internal auditor should review whether follow -up action is to be taken by the management on the basis of his report. If no action is taken within a reasonable time he should draw the management's attention to it.</p>
RELATIONSHIP BETWEEN INTERNAL AND EXTERNAL AUDITORS	SA 610 "Using the work of an Internal Auditor" deals with the relationship between internal and external auditors — (Refer SA)	

MANAGEMENT AUDIT

MANAGEMENT AUDIT	<ul style="list-style-type: none"> ➤ Management audit is an "audit of the management" also. ➤ T.G. Rose, "The management audit would therefore concern itself with the whole field of activities of the concern, from top to bottom, starting, as always where management control is concerned, From the top. ➤ It should definitely cover everything that we know as operational audit and, in addition it should also include review of the adequacy and competence of the objectives, plans, policies and decisions of the top management. ➤ John C. Burton, in the article "Management Auditing" (The Journal of Accountancy, May 1968) commented as follows: "In a management audit, the auditor will look to see whether management is getting information relevant to the decisions and actions which it must take. This will require a much more intensive analysis of information needs and the efficiency of the existing system in meeting
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	<p>them. The auditor will not have to decide whether management is making the right strategic and operative decisions but rather whether management has available to it and is using the relevant information and techniques necessary to evaluate rationally the various alternatives that exist".</p> <ul style="list-style-type: none"> ➤ From the authorities quoted above, it seems that the preponderant view about management audit is that it is wider in scope compared to operational audit. ➤ Management audit is concerned with the quality of managing, whereas operational audit centres on the quality of operations. ➤ The basic difference between the two audits, then, is not in method, but in the level of appraisal. ➤ The two audits are complementary and supplementary to one another. ➤ In management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. ➤ In addition to what would normally be covered in an operational audit, management audit would also encompass the relevance and effectiveness of the aims, duties and decisions of management at various levels. ➤ The effectiveness of management under the control of managing director and the various members of the Board including those in charge of finance, production, sales etc., should be subject to review of the management auditor.
	<p>Management auditor, should have knowledge about the following</p> <ul style="list-style-type: none"> ➤ Purpose for which the organisation has been created ➤ Management structure including ➤ Reports required For a proper management and the reports actually received. ➤ Internal controls. ➤ Production planning. ➤ Nature of production Factory layout, design and installed capacity. ➤ Personnel policy and personnel management ➤ Materials management including ➤ Sales management and sales planning including advertisement policy. ➤ Decision making process. ➤ Books and records including cost accounting records ➤ Financial management of the organization.
<p>DESIRABILITY OF</p>	<ul style="list-style-type: none"> ➤ The principal reason for undertaking a management audit is the need For detecting and overcoming current

<p>MANAGEMENT AUDIT</p>	<p>managerial deficiencies (and resulting operational problems) in ongoing operations.</p> <ul style="list-style-type: none"> ➤ A management audit represents a more positive: <ul style="list-style-type: none"> a) Forward-looking approach that evaluates how well management accomplishes its stated organisational objectives; b) How effective management is in planning, organising, directing, and controlling the organisation's activities; c) And how appropriate management's decisions are for reaching stated organisation objectives. ➤ Benefit of the management audit is that managerial problems and related operational difficulties can be spotted before the Fact rather than after the fact as with a Financial audit. This forward-looking approach is analogous to the preventive maintenance concept. ➤ Important benefit of management auditing is that it represents another management tool to assist the organisation in accomplishing desired objectives. ➤ Management auditing would be clearly helpful in the case of ailing industries, to isolate the problems and account for their ailments. ➤ It is especially important if such industries are either to be taken over by the government or to be heavily Financed by financial institutions with a view to bring back vigor in them.
	<p>Organizing the Management Audit</p>
<p>CONDUCTING A MANAGEMENT AUDIT</p>	<ul style="list-style-type: none"> ➤ Devising the statement of policy ➤ Location of audit Function within the organisation ➤ Allocation of personnel ➤ Staff training programme ➤ Time and other aspects ➤ Frequency
<p>CONCLUDING A MANAGEMENT AUDIT</p>	<p>I. Measuring performance through the Management Audit Questionnaire</p> <p>Management audit questionnaire for this part of the audit not only serves as a management tool to analyse the current situation; more importantly, it enables the management auditors to synthesis those elements that are causing organisational difficulties and deficiencies.</p> <p>Concluding a management Audit</p> <ol style="list-style-type: none"> 1. The preparation of the management audit report that covers the details of the management auditor's findings and recommendations. 2. Meet with management and other concerned personnel For the purpose of discussing Freely any aspect or Finding of the audit.

	<p>3. Type of report required varies with the level of investigation.</p> <p>4. Oral recommendations for improvement.</p> <p>II. Getting the facts through interviews</p> <p>a) The exchange between auditor and manager should be friendly and conducted in an open atmosphere so as to encourage a free exchange of ideas.</p> <p>b) Verify the accuracy of information by requesting the person interviewed to.</p> <p>c) The auditors should begin by stating the purpose of the audit.</p>		
	<p>Reports may be divided into four main categories:</p>	<ul style="list-style-type: none"> ➤ Management audit staff after their visits to a unit. ➤ Periodical reports prepared by senior members of management audit into four department which summarise the main audit Findings and recommendations ➤ Reports on the results of special investigations and inquiries. ➤ An annual audit report. 	
		<p>Types of Reports</p>	<ul style="list-style-type: none"> ➤ Oral reports ➤ Interim written reports ➤ Regular written reports ➤ Summary written reports
	<p>Organization of the written report -</p>	<p>Format</p>	<ul style="list-style-type: none"> ➤ Title ➤ Objectives ➤ Scope ➤ Findings, conclusions and opinions ➤ Recommendations ➤ Auditee's views ➤ Summary
<p>BEHAVIOURAL ASPECTS ENCOUNTERED IN A MANAGEMENT AUDIT</p>	<ul style="list-style-type: none"> ➤ Staff/line conflict: Management auditors are staff. And line people in the sense all members of other departments of the organization ➤ Control - As the management auditor is expected to evaluate the effectiveness of controls, there is fear that his actions when reported are likely to cause adverse effect on those who receive the auditor's report, viz., causes of antagonism are as follows: <ul style="list-style-type: none"> • Fear of criticism stemming From adverse audit findings. • Fear of changes in day-today working habits • Punitive action by • Insensitive audit practices • Hostile audit style 		
	<p>Solution to behavioral problems</p>	<ul style="list-style-type: none"> ➤ Auditee may improve if the auditor acts and is perceived as a professional advisor and consultant. 	

		<ul style="list-style-type: none"> ➤ In any event, there is a need to demonstrate to the extent possible that: <ul style="list-style-type: none"> a) The audit is part of an overall programme mandated by higher - level authority b) The objective of the review is to provide maximum service c) The review will be conducted with minimum interference with regular operations d) The responsible officers will be kept Fully informed and have an opportunity to review Findings and recommendations before any audit report is formally released. ➤ Constructive criticism: convince the auditees that his approach is one of mutual problem solving rather than one of fault finding, ➤ Reporting methods: convey effectively his role by adopting a friendly but Firm tone in his report. ➤ Participative approach: auditors must candidly recognize that they are appraising many deficiencies from hindsight. If they recognise this limitation internal auditing becomes a co-operative enterprise, it will not then be regarded as the "secret police" of the home office. Team spirit is developed and the auditors and the auditee endeavour to achieve the common goal. <p>Case-1: Auditor objective: Auditee offensive: Management's apathy</p> <p>Case-2: Auditee progressive: Auditor cantankerous: Management indifferent</p> <p>Case-3: Auditor progressive- Auditee appreciative: Management objective</p>
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OPERATIONAL AUDIT

INTERNAL AUDITING AND OPERATIONAL AUDITING	The definition of internal auditing given by the Institute of Internal Auditors (IIA), New York, in Fact equals internal auditing with operational auditing. According to this definition, internal auditing is an independent appraisal activity within an organisation for the review of operations as a service to organisation. Naturally, when an auditor is concerned with the appraisal of operations, he be comes an operational auditor.
IIA PUBLICATION DEFINES OPERATIONAL AUDITING AS	Operational auditing is a systematic process of evaluating an organisation's effectiveness efficiency and economy of operations under management's control and reporting to appropriate persons the results of the evaluation along with recommendations for improvement.

	<p>Operational auditing concentrates on effectiveness, efficiency and economy of operations and therefore it is future oriented. It does not end with the reporting of the findings but also recommends the steps for improvement in Future.</p> <p>At this stage it must be conceded that operational auditing is a newly emerged term.</p> <p>According to Cadmus "Operational Auditing is not different from internal auditing, it is merely an extension of internal auditing into operational areas. And it is characterized in both Financial and operational areas.</p>		
DIFFERENCES	<p>A. Perception 1A: Loss — Wastage — Frauds. OA : Risk Management Maintenances — Customer Complains</p> <p>B. Issues Both are into assessment of policies, plans, procedures and records, but should not develop and install procedures and systems, prepare records or engage in any other activity which the normally would be expected to review and appraise</p>		
OBJECTIVES	<p>OA: Fulfillment of plans + knowledge of Biz; plans, systems, controls, standards. 1A : Modern era AA Also Covers above.</p>		
Why Operational Audit?	<table border="1" style="width: 100%;"> <tr> <td style="width: 30%;">Qualities of Operational Auditor</td> <td> <ul style="list-style-type: none"> ➤ He should ask the who, why, how of everything. ➤ Try to visualise whether simpler alternative means are available to do particular work. ➤ He should be persistent and should possess an attitude of skepticism. ➤ He should not give up or feel satisfied easily. ➤ He should imbibe a constructive approach rather than a Fault – finding approach and ➤ He should consider a Fault or mistake found in the course of audit more as a guide to effect improvement than to treat the fault as a sort of crime. </td> </tr> </table>	Qualities of Operational Auditor	<ul style="list-style-type: none"> ➤ He should ask the who, why, how of everything. ➤ Try to visualise whether simpler alternative means are available to do particular work. ➤ He should be persistent and should possess an attitude of skepticism. ➤ He should not give up or feel satisfied easily. ➤ He should imbibe a constructive approach rather than a Fault – finding approach and ➤ He should consider a Fault or mistake found in the course of audit more as a guide to effect improvement than to treat the fault as a sort of crime.
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Why Operational Audit?	<p>Management is at a distance from actual operations due to layers of delegation of responsibility separating it From actualities in the organisation.</p> <p>Operational audit is considered as a specialised management information tool to fill the void that conventional information sources fail to fill. Conventional sources Fail to provide information for the best direction of the departments shortcomings of these sources can be stated as under:</p> <ul style="list-style-type: none"> ➤ Executives and managers are too preoccupied ➤ Managers relied upon For transmitting information than for analysing situations. ➤ not necessarily objective 		

	<ul style="list-style-type: none"> ➤ Conventional internal audit reports are often routine and mechanical in character and have a definite leaning towards accounting and Financial information. ➤ Other performance reports contained in the annual audited accounts and the routine reports prepared by the operating departments have their own Limitations. 						
Type of Operational Audits	Are three broad categories of operational auditors:						
	<table border="1"> <tr> <td>Functional Audits</td> <td>Functions are a means of categorizing the activities of a business, such as the billing function or production function. A functional audit has the advantage of permitting specialization by auditors.</td> </tr> <tr> <td>Organization at Audits</td> <td>An operational audit of an organization deals with an entire organizational units, such as a department, branch, or subsidiary.</td> </tr> <tr> <td>Special Assignments</td> <td>Examples include determining the cause of an ineffective IT system, investigating the possibility of fraud in a division</td> </tr> </table>	Functional Audits	Functions are a means of categorizing the activities of a business, such as the billing function or production function. A functional audit has the advantage of permitting specialization by auditors.	Organization at Audits	An operational audit of an organization deals with an entire organizational units, such as a department, branch, or subsidiary.	Special Assignments	Examples include determining the cause of an ineffective IT system, investigating the possibility of fraud in a division
Functional Audits	Functions are a means of categorizing the activities of a business, such as the billing function or production function. A functional audit has the advantage of permitting specialization by auditors.						
Organization at Audits	An operational audit of an organization deals with an entire organizational units, such as a department, branch, or subsidiary.						
Special Assignments	Examples include determining the cause of an ineffective IT system, investigating the possibility of fraud in a division						
OBJECTIVES OF OPERATIONAL AUDIT	<ul style="list-style-type: none"> ➤ Appraisal of controls, (most appropriate) ➤ Evaluation of performance - Depends on standards availability. ➤ Appraisal of objectives and plans, and the aim of operational auditing is to appraise operations and controls and their adherence to prescribed or laid down policies and not to go into the question of appropriateness of plans and objectives. However, the operational auditor may look into the aspects like whether objectives are clearly spelt out and properly communicated to the personnel responsible for implementation and whether the personnel have understood the objectives in the sense meant by the management. ➤ Appraisal of organisational structure. This is an important element of the internal control design. <ul style="list-style-type: none"> • Is the organisational structure in conformity with management objectives? • Whether the organisational structure is drawn up on the basis of matching of responsibility and authority? • Whether the tine of responsibility from the top to the bottom is clearly discernible from the structure? • Whether the delegation of responsibility and authority at each stage is clear and overlapping are avoided? 						
REVIEW OF SYSTEMS AND PROCEDURES	The review of systems and procedures is to improve the methods, to get away From the old ways and traditional routines and to reduce the cost in completing and processing the paper work - eliminating waste, duplication and inefficiencies. In reviewing any system or procedure, the management auditor must concern himself with its purpose as well as its design and then he must decide on its merits as the best serving the interests of the enterprise.						

	<p>In the study of the systems and procedural functions, the auditor should ask himself:</p> <ul style="list-style-type: none"> ➤ Is the function properly located in the organisation? ➤ Do the staff personnel have the necessary training and experience to perform the work? ➤ Has a definite programme been established and has been taken for its attentive accomplishment? ➤ Is productivity satisfactory? <p>The evaluation of a system or a procedure actually includes three separate considerations. First, is the system or procedure meeting all of the current requirements? Second, is it operating effectively? And third, what is the degree of effectiveness?</p>
	<p>Differences between Financial and Operational Auditing</p> <p>The major differences between financial and operational auditing can be described as follows:</p> <ol style="list-style-type: none"> i. Purpose - The Financial auditing is basically concerned with the opinion that whether the historical information recorded is correct or not, whereas the operational auditing emphasizes and effectiveness and efficiency of operations for future performance. ii. Area - Financial audits are restricted to the matters directly affecting the appropriateness of the presented Financial statements but the operational auditing covers all the activities that are related to efficiency and effectiveness of operations directed towards accomplishment of objectives of organization. iii. Reporting - The financial audit report is sent to all stock holders, bankers and other persons having stake in the Organisation. However the operational audit report is primarily for the management. iv. End Task - The financial audit has reporting the findings to the persons getting the report as its end objective, however, the operational auditing is not limited to reporting only but includes suggestions for improvement also.
<p>APPENDIX</p>	<p>The Following Standards on Internal Audit are recommendatory in nature. The Standards shall become mandatory from such date as notified by the council:</p> <p>SIA 1: Planning an Internal Audit SIA 2: Basic Principles Governing Internal Audit SIA 3: Documentation. SIA 4: Reporting SIA 5: Sampling SIA 6: Analytical Procedures</p>

	<p>SIA 7: Quality Assurance in Internal Audit SIA 8: Terms of Internal Audit Engagement. SIA 9: Communication with Management SIA 10: Internal Audit Evidence SIA 11: Consideration of Fraud in an Internal Audit. SIA 12: Internal Control Evaluation SIA 13: Enterprise Risk Management SIA 14: Internal Audit in an Information Technology Environment SIA 15: Knowledge of the Entity and its Environment. SIA 16: Using the Work of an Expert. SIA 17: Consideration of Laws and Regulations in an Internal Audit. SIA 18: Related Parties</p>
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CHAPTER-15 LIABILITIES OF AUDITOR

<p>TAKING ASSISTANCE IN THE DISCHARGE OF HIS DUTIES</p>	<p>Contracts involving personal skill, or other personal qualifications normally cannot be assigned. Therefore, follows that the work of an auditor being of a personal character, it must be performed either by him or by his persons under his supervision since he himself remains finally responsible.</p> <p>Only to ensure that this scheme shall be adhered to in all cases, clause (12) of Part I of First Schedule to the Chartered Accountants (Amendment) Act, 2006 makes it obligatory that reports on financial statements would be signed either by the member or his partner.</p> <p>They cannot ordinarily shift any part of this liability to their employees.</p>	
	<p>Such legal position is clearly borne by the following extracts from the judgements in two renowned cases:</p>	<ol style="list-style-type: none"> 1. In Henry Squire (Cash Chemists) Ltd. v. Ball Baker & Co.: "The principal must not excuse himself for his clerk's negligence by saying that he employed a clerk." 2. In the Superintendent of Police v. M. Rajamany: "No auditor can escape from personal liability by taking shelter under the misconduct of his own employees." <p>Despite the fact the principal is responsible for the misdemeanor and misdeeds of his employees, in order that some of them as are qualified may discharge their duties, which are assigned to them with adequate skill and care, the Council has issued the following Council General Guidelines, 2008 a member of the Institute who is an employee shall exercise due diligence and shall not be grossly negligent in the conduct of his duties."</p> <p>In the absence of this clause, only the Chartered Accountant who had signed the report would be liable and it would not be possible to reach the employee chartered accountant on grounds of misconduct.</p>
<p>PROFESSIONAL NEGLIGENCE</p>	<p>Negligence, which is culpable, generally consists of under mentioned three elements:</p>	

	<p>a) existence of duty or responsibility owed by one party to another to perform some act with certain degree of care and competence;</p> <p>b) occurrence of a breach of such duty; and</p> <p>c) loss or detriment, being suffered by the party to whom the duty was owed as a result of negligence.</p> <p>When a loss has been suffered by a third party who is not privy to the arrangement between the clients and the auditor For determining whether he is liable, it is necessary to find out whether the auditor owed any duty to him.</p> <p>This will be apparent from the summary of legal decisions discussed hereinafter.</p> <p>The evolution of law in this regard varies widely in England and the United States. So far as our country is concerned, we should say that much headway has not been made. Hence, it will be highly instructive to analyse the situation under the following three heads:</p> <p>Direct case on an Accountant's liability to third parties: The question of Accountant's liability to third parties directly came up For consideration in England in the case of Candler v. C-Christmas & Co.</p>
	<p>CASE 1: Case of Candler v. Crane Christmas & Co.</p> <p>Findings of the Case: A firm of accountants had been engaged by a company to prepare the company's accounts. The accountants knew that the statements of account would be shown to third parties. Relying on the statements of account reported upon by the accountants, the plaintiff had invested money in the company and it was lost. The statements in question had been prepared negligently but there was no Fraud.</p> <p>Lord Denning: In my opinion Accountants owe a duty of care not only to their own clients; but also to those who they know will rely on their accounts in the transactions for which these accounts are prepared."</p>
	<p>CASE 2: Hedley Byrne & Co. Ltd. v. Heller at Partners Ltd.</p> <p>The House of Lords upheld Lord Denning's opinion in that case.</p>
	<p>CASE 3: Case of Jeb Fasteners, Marks, Bloom and Co.</p> <p>Findings of the Case: Jeb Fasteners - In 1975, Marks, Bloom and Co., the defending firm of auditor reported on the annual financial statements of B.G fasteners Ltd. For the year ended 31 October, 1974. Stock had been valued at net realisable value of £2. instead of</p>

		<p>at cost of £11,000 resulting in overstated income and balance sheet Figure. The auditors were aware of the company’s liquidity problems, and had discussions with Jeb Fasteners, the plaintiffs, at time of takeover negotiations.</p> <p>Jeb Fasteners subsequently purchased the company, but the takeover was not a success. Consequently, Jeb sued the auditors on the grounds that they made into purchasing the company by the mis-stated financial statement, and that the auditors had a duty of care to persons whom they could reasonably foreseen would rely on their audit report.</p> <p>Judgement/ Decision: Justice Woolf ruled that such a duty of care did exist, but the auditors escaped liability on the grounds that the alleged negligence was not the cause of the loss. The judge ruled that the primary purpose of the takeover appeared to be the acquisition of the services of the two B.G. directors, and that a purchase would probably have taken place on the same basis even had the true financial position been known.</p>
	<p>CASE 4: Case of CAPARO industries V. Touche Ross</p>	<p>Findings of the Case: CAPARO Industries V. Touche Ross -M/s. Touche Rass, a Firm of accountants had appealed to the House of Lords From a decision of the Court of Appeal which held that auditors could be sued by an investing shareholder for inaccuracy in accounts or misleading accounts by which a pre-tax profit should have been shown as a loss. On the facts, it was alleged that CAPARO would not have bid for the takeover of Fidelity, a public company, if the true accounts were known.</p> <p>The auditors owed no duty of care to the members of the public who retied on the accounts in deciding to buy shares.</p> <p>The purpose of annual accounts so Far as members are concerned, was to enable them to question past management, to exercise voting rights and to influence Future policy management.</p>

		<p>It is interesting to note that Touche Ross, the auditors in the case, made an out of court settlement with Caparo of €1 .35m in July, 1994 to avoid any further legal action. They denied any negligence, a position they have maintained throughout the case.</p> <p>Subsequent to the Caparo case, three more cases have endorsed its doctrine. James Mc Naughton Paper Group Ltd v Hicks Anderson and Co (1991), Berg Sons and Coand others v, Adams and others (1992), Goloo and others v Bright Grahame and Murray (1993).</p>
	<p>CASE 5:</p>	<p>Only one case, Morgan Crucible Co PLC v Hill Samuel and Co Ltd (1991) has threatened to dilute the effects of the Caparo decision. The facts of the case were that company taking over another, relying on information provided by the auditor of the target company, as in Caparo it was held the auditor had a duty of care in that, whereas in the Caparo case the audited accounts had been drafted for one purpose but had been retied upon for a different purpose, in this case, the opinion had been relied upon for the purpose for which it was issued. The case was settled out of court.</p>
<p>AMERICAN SCENE:</p>	<p>From a legal stand – point, there are two classes of third parties:</p> <div style="text-align: center;"> <p>Two classes of third parties:</p> <pre> graph TD A[Two classes of third parties:] --> B[Primary beneficiary] A --> C[Other beneficiary] B --> D[Identified to the auditor by name prior to the audit] C --> E[unnamed third parties] </pre> </div>	
	<p>Liability towards Primary Beneficiaries</p>	<p>Ultramares Corp. v. Touche (now deloitte and Touche) Findings of the Case: Ultramares upheld the privity of contract doctrine under which third parties cannot sue auditors for ordinary negligence. However, judge Cardozo's decision extended to primary beneficiaries the rights of one in privity of contract. Hence, Ultramares as a primary beneficiary could sue and recover for losses suffered because of the auditor's ordinary negligence.</p>

	<p>Liability towards Other Beneficiaries</p> <p>-</p>	<p>A Foreseen Class: The First shift away From Ultramares occurred in the form of judicial acceptance of the specifically foreseen class concept. This concept is explained as Follow:</p> <p>Example If the client informs the CPA that the audit report is to be used to obtain a bank Loan, all banks are foreseen parties, but trade creditors and potential stockholders would not be part of the Foreseen class.</p> <p>The liability is limited to losses suffered through reliance on the information in a transaction known by the auditor or a similar transaction. In the above instance, this means that the accountant would not be liable if the audit report was used by a bank to invest capital in the client's business in exchange For common stock instead of granting a loan.</p> <p>Example Foreseeability is almost universally used in product liability cases when the manufacturer's negligence causes the physical injury. This concept was first applied in an audit negligence case in the early 1980s. Rusch Factors Inc v. Levin (1968)</p>
	<p>Rush Factors Inc. vs. Levin</p>	<p>Findings of the Case: In Rush Factors Inc. vs. Levin (1968), the plaintiff had asked the defendant accountant to audit the Financial statements of a corporation seeking a loan. The certified statements of a indicated that the potential borrower was solvent when, in fact, it was insolvent. Rush Factors sued the auditor for damages resulting from its reliance on negligent and fraudulent misrepresentations in the Financial statements. The defendant asked for dismissal on the basis of lack of privity of contract.</p> <p>Judgement/ Decision: The court ruled in favour of the plaintiff.</p>
<p>THE INDIAN SCENE</p>	<p>Commissioner of Income Tax v. G.M. Dandekar:</p>	<p>This is the only decision on the auditor's liability to a third party by an Indian Court.</p>
	<p>Case of, Commissioner of Income Tax v. G.M. Dandekar</p>	<ul style="list-style-type: none"> Findings of the Case: Mr. Dandekar had been engaged by Messrs A. Mohamad & Co., Madras and had prepared the statements of account and Income-tax Return on the basis of account produced to

		<p>him. During the course of assessment, it was discovered that Messrs. Mohamad & Co. had maintained two sets of account-regular Day Books and ledgers For the open market transactions and a separate book for the black market transactions. While the former contained detailed entries, relative to daily transactions. the latter contained only consolidated entries, made at the end of the week of the transactions of that week. At the end of the Financial year, all the weekly entries in the separate sets of books of account were to called up and were entered in the regular books of account. Mr. Dandekar had examined only the regular books of account of the assessee and prepared the statements of account and the Income-tax Return on the basis of these units. All the statements were signed by him and there was also endorsement at the Foot of the Balance Sheet that it had been verified and Found to be correct. Mr. Dandekar had forwarded the statements of account to the Income-Tax Officer and, while doing so had stated particulars o' books of account that he had examined.</p> <ul style="list-style-type: none"> Judgement/ Decision: The Accountant is under a duty to prepare and resend correct statements of account of the assessee and he should, of course, neither suggest nor assist in the preparations of false accounts. But, he is under no duty to investigate whether the accounts prepared by the assesses are correct or not. The charge is that he owed a duty to the Department to himself investigate the truth and correctness of the accounts of the assessee and not merely to act as their Post Office it transmitting them. We do not agree that the respondent is under any such duty to the Department and, therefore, no question of negligence arises."
<p>CASES CONCERNING THE CIVIL LIABILITY OF AUDITORS FOR NEGLIGENCE</p>	<p>London Oil Storage Co. v. Seear Hasuilt St Co. (1904):</p>	<p>In this case, the auditors were charged with negligence For Failure to discover the misappropriation of the petty cash balance, which was shown by the petty cash book at 799 but in fact was only 30. The audit or was found guilty of negligence in not verifying the petty cash balance as part of the audit; but the damages awarded were limited to €5.5sh. on</p>

		the ground that the damages suffered were not due to the conduct of the auditor but that of directors who were guilty of gross negligence in allowing the balance in the hands of the Petty Cashier to increase to such a large amount.
	Arthur E. Green & Co. v. The Central. Advance and Discount Co. Ltd. (1901)	The claim filed by the liquidator of the company against the auditors For negligence therefore, succeeded.
	Pendleburys Ltd. v. Ellis Green St Co. (1936):	The charge in this case was that due to Failure on the part of the auditor to verify the amount recorded and received for cash sales, the fraud of the cashier had not been discovered. But the charge did not succeed since the auditors have repeatedly brought the lack of internal check on 'cash receipts to the attention of the three directors who were the only shareholders and debenture holders of the company.
	Leads Estate and Investment Society Ltd. v. Shepherd (1887)	In this case action was brought by the liquidators against the auditors under a civil action for the recovery for amounts paid as dividend out of capital . In examining the balance sheet, the auditor had not considered the provision in the Articles and the balance sheet was not properly drawn up. In the course of the judgement, the learned judge observed that it was the duty of the auditor in auditing the accounts of the company not to confine himself to verifying the arithmetical accuracy of the balance sheet, but to enquire into its substantial accuracy, and to ascertain that it contained the particulars specified in the Articles of Association, and was properly drawn up so as to contain a true and correct representation of the company's affairs. The auditor was found negligent by the Court.
	Armitage v. Brewer St Knot (1942) ACTC (P 836)	In this case, action was brought by Mr. Joseph Armitage for alleged negligence in auditing the plaintiff's books by reason of which defalcations aggregating to €1440 were not detected. The defalcations consisted in Fraudulent alterations of time sheets and petty cash vouchers.

		<p>The plaintiff had arranged with the auditor that they would vouch all payments with the receipts entered in the Petty Cash Account, check calculations and additions of wages sheets, check totals of wages sheets into wages book and check weekly totals with other detailed provisions.</p> <p>Such a detailed audit had been called for since the plaintiff wanted protection against his staff. A special fee was demanded and paid for this work. During the course of the hearing, it transpired that the auditors had not examined the books of account with sufficient care as a result whereof the Fraud committed by the cashier had remained undetected.</p> <p>The auditors were held guilty of negligence and a damage of £1259 was awarded against them.</p>
	<p>Tri-Sure India. Ltd. v. A.F. Ferguson & Co.:</p>	<p>Tri-Sure India Limited issued a prospectus of February 75 inviting public to subscribe its share. The prospectus contained, inter alia, the report of the auditors (the defendants) on the accounts of the company for the year 1973-74 which showed that there was an abnormal rise in the rate of profits for the year - 1973 -74. The public issue was over-subscribed and the company proceeded to allot the shares as per the term of the issue. An investigation later revealed that sales figures for 1973-74 had been manipulated by a whole time director of the company with the active co - operation of other top officials of the company. On discovery of this, the company offered to refund all moneys which were subscribed by the allottees and also proceeded to sue the auditors for damages of Rs 63.85 lakhs. The company alleged that the auditors failed to examine and ascertain any satisfactory explanation for steep increase in the rate of gross and net profits.</p> <p>The Court held that the plaintiffs were not able to prove that the auditors were negligent in the performance of their duties. The suit was, therefore, dismissed.</p>
<p>CIVIL LIABILITIES UNDER THE</p>	<p>THE</p>	<p>Lord Justice Topes once famously remarked that "The Auditor is a watchdog and not bloodhound."</p>

<p>COMPANIES ACT</p>			
	<p>Damages for negligence:</p> <p>Civil liability for mis-statement in prospectus under section 35 of the-Companies Act, 2013, are:</p> <p>Where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as consequence thereof, the company and every person who – is an expert referred to in sub -section (5) of section 26,</p> <p>It may be noted that the term "expert" as defined in Section 2(38) of the Companies Act, 2013 includes an engineer, a valuer, a chartered accountant, a company secretary, a cost accountant and any other person who has the power or authority to issue a certificate in pursuance of any law For the time being in force.</p> <p>The liability would arise if the written consent of the auditor to the issue of the prospectus, including the report purporting to have been made by him as an "expert" has been obtained.</p>		
	<p>Liability for misfeasance</p> <p>The term "misfeasance" implies a breach of trust or duty. The auditor of company would be guilty of misfeasance if he has been guilty of any breach of trust or negligence in the performance of his duties which has resulted in some loss or damage to the company or its property.</p> <p>A few cases in which action has been brought against the auditors under misfeasance provisions of the Companies Act are summarised below:</p>		
	<table border="1"> <tr> <td data-bbox="480 1483 662 2068"></td> <td data-bbox="662 1483 1406 2068"> <p>The London and general bank, (1895) held -</p> <p>The auditor who does not report, to the shareholders the facts of the case, when the balance sheet is not properly drawn up, is guilty of misfeasance.</p> <p>The charge against the auditor in this case was that though he had submitted a detailed report to the directors, as regards loans and overdrafts granted to customers, in respect of which the security lodged was wholly insufficient and had expressed his misgivings as regards recovery of interest on these accounts, included in the Profit and Loss Account, he had neither disclosed the position to the shareholders nor he had</p> </td> </tr> </table>		<p>The London and general bank, (1895) held -</p> <p>The auditor who does not report, to the shareholders the facts of the case, when the balance sheet is not properly drawn up, is guilty of misfeasance.</p> <p>The charge against the auditor in this case was that though he had submitted a detailed report to the directors, as regards loans and overdrafts granted to customers, in respect of which the security lodged was wholly insufficient and had expressed his misgivings as regards recovery of interest on these accounts, included in the Profit and Loss Account, he had neither disclosed the position to the shareholders nor he had</p>
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			made any reference to the report which he had laid before the directors. The words in his report, "the value of assets as shown on the Balance Sheet is dependent upon realisation etc." did not contain any warning to shareholders and the mere presence of these words was not enough to excite suspicion. The Court observed that the duty of the auditor was to convey information and not to arouse enquiry and held that the auditor, by way of damages, was liable to refund the amount of the second dividend (declared in 1892) on the ground that he was aware of the critical position of the affairs and thus had acted negligently in not reporting the Facts to the shareholders although he had reported them to directors. As regards the first dividend (declared in 1891), the auditor was not held liable, as he was of the opinion that the evidence was not sufficiently strong to establish a case of misfeasance against him, though he was guilty of an error of judgement.
		Kingston Cotton Mills Co. Ltd. (1896) , held -	That it is not the duty of the auditor to take stock and that he is not guilty of negligence if the certificate of a responsible official is accepted in the absence of suspicious circumstances Lopes L.J. exonerating (Relieving) the auditors of the charge of negligence, in the course of judgement, made remarks to the following effect: 'He is a watch dog, but not a blood hound' .
		The Irish Woolen Co. Limited v. Tyson and others (1900) Act L.R. 23 , held -	That an auditor is liable For any damages sustained by a company by reasons of falsification of accounts which might have been discovered by the exercise of reasonable care and skill in the performance of the audit. In this case, under a special agreement with the company, the auditor was required to conduct a monthly audit, despite the fact, the profit disclosed by the profit & loss account was found to have been

			<p>inflated by the suppression of certain purchase invoices outstanding at the date of the balance sheet though the goods received in respect thereof had been included in the closing stock.</p> <p>The learned judge hearing the case found that the suppression of invoices would have been detected if the auditor had called for the creditors' statements of account on the basis of which payment had been ordered, in the period subsequent to the audit, and had compared them with ledger balance; also, if the entries in the ledger accounts were checked with relevant invoices, it would have been discovered that these had not been posted on the true dates.</p> <p>On these Facts, he concluded that if due care and skill had been exercised, the suppression of the invoices would have been discovered and held the auditor liable for the damages which the company had suffered due to understatement of liability in the Balance Sheet.</p>
		<p>City Equitable Fire Insurance Co. Ltd., held -</p>	<p>The principal charge against the auditors was that they had failed to detect and report to the shareholders that a number of company's securities, which were in the custody of Ellis & Co. were being pledged by the firm to its customers.</p> <p>The auditor had relied on the certificate of Ellis & Co. that these securities were held by them.</p> <p>The master of Rolls, on a consideration of the evidence led in this case, showed that it was customary for the auditor to obtain certificate from banks in respect of securities Lodged with them and that the certificates were not accepted from brokers. He made the following obiter dicta which is of great significance to auditors.</p>
		<p>Westminster Road</p>	<p>In this case, action had been brought against the auditor by the liquidator of the company in respect of payment of</p>

		Construction and Engineering Co. Ltd. (1932) , held-	dividend when there were in fact no profits of which it could be paid. Negligence was alleged in respect of over valuation of work in progress, omission of liabilities, etc. The Court held that the auditor was liable to refund to the company the amount of dividend wrongly declared, with interest and costs.
		S.P. Catterson and Sons Ltd. (1947) , held -	That the primary responsibility for the accountant of a company is of those who are in control of the company i.e. the directors. In the case, an application had been made by the liquidator that the auditor of the company had been negligent in the performance of his duty and thus was liable to compensate the company in respect of amounts misappropriated by an employee of the company, which had become irrecoverable. Though the fact that the defalcation had occurred was accepted, the auditor contended that he had drawn the attention of the directors to the weakness of the system of recording cash and credit sales and had recommended its alteration; notwithstanding this, the system had been continued. Also, that the directors had failed to check adequately the cash records, at the time money was duly handed over, day to day, by the manager.
		Continental Vending Machine Corporation (1970) An American Case -	In this case, the auditor was held guilty of not having reported a known fact. The President of the Continental Vending Machine Corporation caused the diversion of a substantial sum of money of the Corporation to his benefit by canalising it through an associated concern the audit of which was conducted by another. A substantial part of the security for this accommodation consisted of securities of the Continental Vending Co., itself. This was not reported and since the amount advanced by this company became irrecoverable, the

		<p>auditors were held guilty of gross negligence.</p> <p>The Court held that though in ordinary case disposition of funds advanced by the client to its affiliates need not be disclosed by the auditor, such a disclosure becomes necessary in cases of: (i) looting; (ii) known dishonesty by a high official; (iii) corporation being operated to a material extent for the private benefit of its President; and (iv) dishonest diversion of Funds.</p> <p>Thus the Court laid down a special rule for disclosure and emphasised that an auditor's approach should not necessarily be limited to the mere compliance with the accepted standards but should primarily be governed by the objective to establish an honest and fair representation of financial facts.</p> <p>Damages must be suffered: Courts have held that the amount of loss should be made good by the auditor. Where, however, the loss has been occasioned through negligence of directors, the fault of the auditor in failing to verify the asset has been considered to be only technical and only nominal penalty has been imposed.</p> <p>For instance, in the case of London Oil Storage Co. Ltd. v. Seear Husluck and Co. E 5. 5sh was awarded as damages against the auditor, although the loss was much more, on the ground that professional negligence had not occasioned the loss.</p> <p>Armitage v. Brewer and Knot, the auditors were held responsible even For the amount of defalcations which has taken place subsequent to their failure to detect fraud</p>
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			<p>It is the only case in which the principle of consequential damages has been applied to audit claims.</p> <p>If an auditor omits to detect a defalcation by an employee and, in the following year, before there is a chance of any further audit, the employee emboldened by the non-detection of the defalcation, embezzles a larger sum, the auditor would be liable both For the original loss which he had failed to detect and the subsequent loss suffered by the employer.</p>
CRIMINAL LIABILITY UNDER THE COMPANIES ACT	Criminal liability For Misstatement in Prospectus	<p>As per Section 34 of the Companies Act, 2013, where a prospectus issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorises the issue of such prospectus shall be liable under section 447.</p> <p>This section shall not apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe.</p>	
	Punishment for false statement	<p>According to Section 448 of the Companies Act, 2013 if in any return, report certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made there under, any person makes a statement –</p> <ul style="list-style-type: none"> a) which is false in any material particulars, knowing it to be false; or b) which omits any material fact, knowing it to be material, he shall be Liable under section 447. 	
	Direction by Tribunal in case auditor acted in a fraudulent manner	<p>Refer sub-section (5) of the section 140</p>	
	Cases in which an auditor has been held to have incurred	Dambell Banking Co. Ltd. (1900)	<p>From the facts provided, it was clear that the accounts were not only false but materially false; letters from the auditors to the managers showed that they (the auditors) thought that overdrafts were bad although taken in as good.</p>

	criminal liability		<p>They had told the managers that they held strong' views about the overdraft, but did not state those views in their certificates to the shareholders.</p> <p>The jury found all the defendants (including the auditors) guilty, and they were sentenced to various terms of imprisonment.</p>
		Farrow's Bank Ltd. (1921)	<p>In this case, there had been a considerable writing up assets, obviously to show profits available for dividends. In one case a piece of property that cost €5,500 was written up £7,80,000.</p> <p>The auditor was in the company's regular employment as its accountant and was convicted on various charges of conspiracy and fraud in connection with the published accounts of the bank, and sentenced to 12 months imprisonment.</p>
		Rex v. Lord Kyisant and Another (1931) - (Known as the Royal Mail Steam Packet Company's Case):	<p>The Facts of the case briefly were that the Profit and Loss Account for the year 1926 showed, 'Balance for the year, including dividends on shares in allied and other companies, adjustment of taxation reserves, less depreciation of Fleet £4,30,212.</p> <p>Actually this apparent surplus had been arrived at on including undisclosed credits of €5,50,000 From excess Profit Duty, £2,75,000 from Income tax Reserve and £25,776 From investment Profit. If this was not done there would have been a considerable deficit. In 1927, with practically identical wording, a surplus of £2,24,907 was raised to €4,37,293 by similar credits totaling £2,12,386. It must be added that almost the entire amounts of these credits had no relation to the trading of the respective years 1926 and 1927.</p>

			<p>The contention of the crown was that such item, in the accounts conveyed "a deliberate False representation to the shareholders that the company was making a trading profit when, in Fact, it was making a trading loss."</p> <p>The company, in Fact, had been drawing upon its secret or hidden reserves From 1921 to 1927.</p> <p>The adjustment of these special credits enabled the company to pay its debenture interest, and dividends on both the preference and ordinary stocks.</p> <p>Note: The decision in the case has been principally responsible For the change in the phraseology of the auditor's report From 'true and correct' to `true and fair' requiring a Fuller disclosure of any non-trading income or that not belonging to the year, adjusted in the Profit and Loss Account.</p>
		<p>Official Liquidator Karachi bank v. the directors, etc. of Karachi bank Ltd. (1932) -</p>	<p>The directors of the Bank made a statement in the balance sheet that the profit earned by the bank in 1927 amounted to Rs 15,608. The amount of profit had been arrived at on taking credit For a sum of Rs 45,214, an amount held in suspense for bad or doubtful items of interest. It was held that the official Liquidator should prosecute the managing directors, manager and the auditors For an offence under section 232 of the Indian Companies Act, 1913 (now section 448) of the Companies Act, 2013.</p> <p>Wild J.C. said "What the Directors of the bank have done is to show a cash profit for the year by adding in a sum which is due, no doubt, but was never paid and was never likely to be paid. The balance sheet, therefore, contains a false statement and a very material one and I am unable to see how it can be argued that it was not intended to be misled."</p>

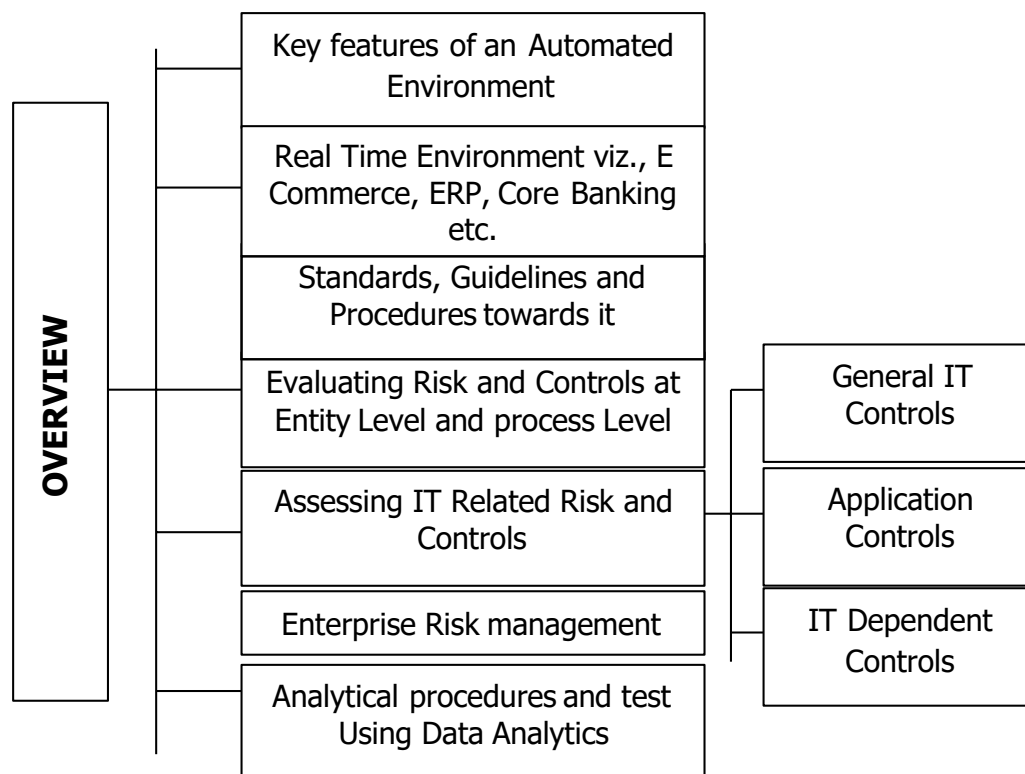
<p>CASES CONCERNING THE MISCONDUCT OF AUDITOR UNDER THE CHARTERED ACCOUNTANTS ACT</p>	<p>Case of Deputy Secretary of The Government of India, Ministry of Finance v.S. N. Dass Gupta:</p>	<p>It was alleged that the bank had resorted to manipulation of accounts on an extensive scale.</p> <p>One of the charges was that in 1944 the bank has shown in its Fixed Deposit Ledger certain large sums as having been received on Fixed deposit From certain concerns in which the Managing Director was interested but the Cash Book of the bank did not show any corresponding entries on the relevant dates.</p> <p>Another charge was that though the auditor had certain doubts as regard loans advanced against fixed deposits, he had not stated the position clearly.</p> <p>It was also alleged that on a certain date in 1944 the Cash Book showed a cash balance of Rs 5,00,000 although the actual balance on the date was a little over Rs 1,000.</p> <p>The auditor in defence submitted that he had not verified the cash balance in hand and had mentioned this fact in his Special Report.</p> <p>It was held that the respondent has committed a grave wrong and in consequence he was suspended From the membership of the institute For two years.</p>
	<p>Case of Controller of Insurance vs H. C. Das:</p>	<p>In this case, action was brought against Messers H.C. Dass & Co. by the Central Government in the matter of audit of accounts of Bhagya Laxmi Insurance Limited.</p> <p>The auditors had audited the accounts of the company From 1936 until 1951 and had issued the certificate required under Regulations 7(c) and 7(d) of Part I of the First Schedule to the Insurance Act, 1938.</p> <p>On the appointment of the administrator subsequently under Section 52A of the Insurance Act, a number of irregularities were discovered. The principal defence of the auditor in respect of the charges was that he had relied on statements of the management in regard to matters included in the statements certified by him.</p>
		<p>Judgement / Decision: During the course of the judgement, the learned judge made the Following observation:</p>

			<p>"An auditor who construes his duty to shareholders or policy holders too narrowly and who passes and approves of whatever is stated to him by the management of the company whose accounts he audits does not serve the shareholders with the loyalty or efficiency expected of him and constitutes instead of a source of security to the shareholders, a positive danger to them."</p> <p>The auditor was held guilty of gross negligence.</p>
LIABILITIES UNDER INCOME TAX ACT 1961	<div style="border: 1px solid black; padding: 5px; width: fit-content; margin: 0 auto;">Auditor's liabilities under the Income Tax Act, 1961</div>		
	<div style="border: 1px solid black; padding: 5px; width: 20%; margin: 0 auto;">Under Section 288</div>	<div style="border: 1px solid black; padding: 5px; width: 20%; margin: 0 auto;">Under Section 278</div>	<div style="border: 1px solid black; padding: 5px; width: 20%; margin: 0 auto;">Under Rule 12A of the Income Tax Rules</div>
	Under Section 288	<p>A person who has been convicted of any offence connected with any Income Tax proceeding or on whom a penalty has been imposed under the said Act (except under clause (ii) of sub section (1) of Section 271) is disqualified from representing an assesses. The Chief Commissioner/Commissioner of Income Tax has been given powers to determine the period of a such disqualification of person.</p>	
		Section 288 (4) & (5) of the Income Tax Act, 1961	<p>Sub section 4 of Section 288 of the Income Tax Act: No person -</p> <ul style="list-style-type: none"> a) who has been dismissed or removed from Government service after the 1st day of April, 1938; or b) Who has been convicted of an offence connected with any income tax proceeding or on whom a penalty has been imposed under this Act, other than a penalty imposed on him under [clause(ii) of sub section (1) of section 271 [or clause(d) of sub - section (1) of section 272A]; or c) who has become an insolvent; or d) who has been convicted by a court for an offence involving

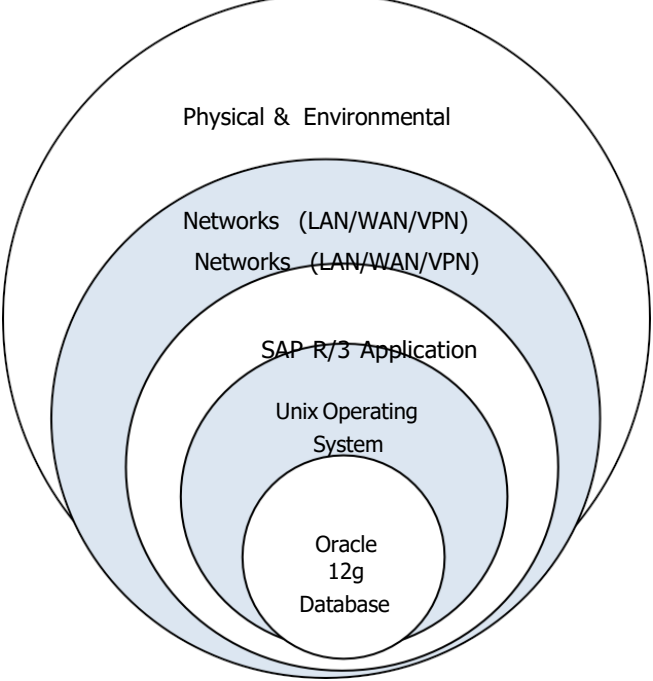
			<p>fraud, shall be qualified to represent an assessee under sub-section (1), for all times in the case of a person referred to in clause (a),</p> <p>For such time as the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may, by order determine in the case of a person referred to in clause (b),</p> <p>for the period during which the insolvency continues in the case of a person referred to in clause (c),</p> <p>For a period of ten years from the date of conviction in the case of a person referred to in clause (d).</p>
	Under Section 278	-	"If a person abets or induces in any manner another person to make and deliver an account or a statement or declaration relating to any income [or any Fringe benefits] chargeable to tax which is false and which he either knows to be false or does not believe to be true or to commit an offence under sub-section (1) of section 276C, he shall be punishable,
		Section 278 of the income Tax Act, 1961:	<p>i. in a case where the amount of tax, penalty or interest of the Income which would have been evaded, if the declaration, account or statement had been accepted as true, or which is willfully attempted to be evaded, exceeds [twenty five] hundred thousand rupees, with rigorous imprisonment for a term which shall not be less than 6 months but which may extend to 5 years and with fine;</p> <p>ii. in any other case, with rigorous imprisonment for a term which shall not be less than 3 months but which may extend to 2 years and with fine</p>
	Under Rule 12A of the Income Tax Rules:		Thus if this report contains any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to 7 years and to a fine.

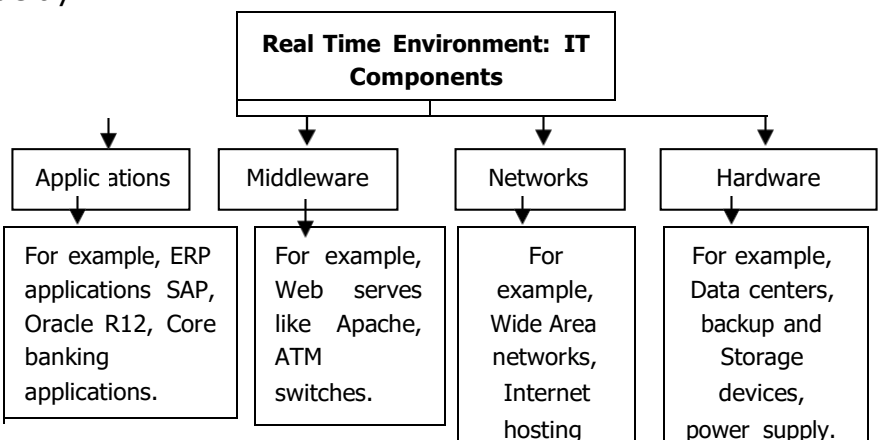
	Under Section 271J of the Income tax Act:	As per new section inserted by the Finance Act, 2017 if an accountant or a merchant banker or a registered valuer, furnishes incorrect information in a report or certificate under any provisions of the Act or the rules made there under, the Assessing Officer or the Commissioner (Appeals) may direct him to pay a sum of 10000 rupees for each such report or certificate by way of penalty.
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CHAPTER-16 AUDITING IN AN AUTOMATED ENVIRONMENT



KEY FEATURES OF AN AUTOMATED ENVIRONMENT	<p>An automated environment is an ecosystem that combines people, processes and technology within an overall business environment.</p> <table border="1" style="width: 100%;"> <thead> <tr> <th style="text-align: center;">Category of Business Applications</th> <th style="text-align: center;">Example of Category</th> </tr> </thead> <tbody> <tr> <td>Packaged software (also called off-the-shelf applications) used by micro and small business.</td> <td>For example, Tally, QuickBooks.</td> </tr> <tr> <td>Small ERPs used in small to medium business.</td> <td>For example, Tally ERP, SAP Business One, Focus ERP.</td> </tr> <tr> <td>ERP applications used in medium to large companies.</td> <td>For example, SAP R/3, Oracle R12 Enterprise Business Suite.</td> </tr> </tbody> </table>	Category of Business Applications	Example of Category	Packaged software (also called off-the-shelf applications) used by micro and small business.	For example, Tally, QuickBooks.	Small ERPs used in small to medium business.	For example, Tally ERP, SAP Business One, Focus ERP.	ERP applications used in medium to large companies.	For example, SAP R/3, Oracle R12 Enterprise Business Suite.
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ERP applications used in medium to large companies.	For example, SAP R/3, Oracle R12 Enterprise Business Suite.								

	<p>layers of an automated environment</p>	<ul style="list-style-type: none"> ➤ Databases - Oracle 12g, MS-SQL Server; ➤ Operating systems - Windows, Unix, Linux; ➤ Storage devices - disks, tapes, network storage; ➤ Network devices - switches, routers and firewalls; ➤ Networks - local area networks, wide area networks, virtual private networks, etc.; ➤ Physical and environmental – access to IT Facilities, CCTVs, temperature control, Firefighting equipment, etc. 
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<p>KEY CONCEPTS OF AUDITING IN REAL – TIME ENVIRONMENT SUCH AS E – COMMERCE, ERP, CORE BANKING, ETC.</p>	<p>A real-time environment is a type of automated environment in which business operations and transactions are initiated, processed and recorded immediately as they happen without delay.</p>  <pre> graph TD Root[Real Time Environment: IT Components] --> Applications Root --> Middleware Root --> Networks Root --> Hardware Applications --> Ex1[For example, ERP applications SAP, Oracle R12, Core banking applications.] Middleware --> Ex2[For example, Web serves like Apache, ATM switches.] Networks --> Ex3[For example, Wide Area networks, Internet hosting] Hardware --> Ex4[For example, Data centers, backup and Storage devices, power supply.] </pre>
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<p>UNDERSTANDING AND DOCUMENTING</p>	<p>Understanding of the automated environment of a company is required as per SA 315. auditor's understanding of the automated environment should include the Following:</p> <ul style="list-style-type: none"> ➤ The applications that are being used by the company;
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<p>AUTOMATED ENVIRONEMNT</p>	<ul style="list-style-type: none"> ➤ Details of the IT infrastructure components for each of the application; ➤ The organisation structure and governance; ➤ The policies, procedures and processes Followed; ➤ IT risks and controls. <p>The auditor is required to document the understanding of a company's automated environment as per SA 230.</p>	
<p>CONSIDERATION OF AUTOMATED ENVIRONEMNT AT EACH PHASE OF AUDIT CYCLE</p>	<p>In a controls-based audit, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. In this approach, the considerations of automated environment will be relevant at every phase as given below:</p> <ul style="list-style-type: none"> ➤ during risk assessment, consider risk arising From the use of IT systems at the company; ➤ when obtaining an understanding of the business process the use of IT systems applications should be considered; ➤ while assessing the entity level controls the aspects related to IT governance need to be understood and reviewed; ➤ pervasive controls including segregation of duties, general IT controls and applications should be considered and reviewed; ➤ during testing phase, the results of general IT controls would impact the nature, timing and extent of testing; ➤ when testing of reports and information produced by the entity (IPE) generated through IT systems and applications; ➤ at completion stage, evaluation of control deficiencies may require using data analytics and CAATs. 	

	Planning Execution Completion	Risk Assessment	Understand and Evaluate	Test For Operating Effectiveness	Reporting
		<ul style="list-style-type: none"> • Identify significant accounts and disclosures. • Qualitative and Quantitative considerations. • Relevant Financial Statement Assertions (ESA). • Identify likely sources of misstatement Consider risk arising from use of IT systems. 	<ul style="list-style-type: none"> • Document understanding of business processes using Flowcharts / Narratives. • Prepare Risk and Control Matrices (RCM). • Understand design of controls by performing walkthrough of end-to-end processes. • Process wide considerations for Entity Level Controls, Segregation of Duties. 	<ul style="list-style-type: none"> • Assess Nature, Timing and Extent (NTE) of controls testing. • Assess reliability of source data; completeness of population. • Testing of key reports and spreadsheets. • Sample testing. • Consider competence and independence of staff/team performing controls 	<ul style="list-style-type: none"> • Evaluate Control Deficiencies. • Significant deficiencies, Material weaknesses. • Remediation of control weaknesses. • Internal Controls Memo (ICM) or Management Letter. • Auditor's report.

			<ul style="list-style-type: none"> IT General Controls, Application Controls. 	testing	
<p>ENTERPRISE RISK MANGEMENT OVERVIEW</p>	<ul style="list-style-type: none"> ➤ Risk is the possibility that an event will happen which prevents a company From achieving business objectives. ➤ Risk Management is a combination of process, people, tools and techniques through which companies identify, assess, respond, mitigate and monitor risks. ➤ Enterprise Risk Management is a Formal program or Framework that is implemented across an enterprise or company For enabling risk management. <p>The Companies Act, 2013 requires the board report to include a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the board may threaten the existence of the company.</p>				
	<p>Internal control Frameworks Enterprise Risk Management program</p>	<ul style="list-style-type: none"> ➤ The internal control framework of a company is not separate, though it is an integral part of an Enterprise Risk Management program. ➤ The scope of an Enterprise Risk Management program is much broader than an internal control Framework and encompasses both internal and external factors that are relevant to business strategy, governance, business process and transaction and activity level. ➤ The focus of an internal control Framework is primarily around financial reporting, operations and compliance risks associated with an 			

		account balance, business process, transaction and activity level, which Form a sub - set of the overall enterprise risks.		
	The risk assessment process involves considerations for	<ul style="list-style-type: none"> ➤ qualitative and quantitative Factors; ➤ definition of key performance and risk indicators; ➤ risk appetite; ➤ risk scores, scales and maps; ➤ use of data & metrics; ➤ benchmarking. 		
	A typical risk assessment process would be as given below	<ul style="list-style-type: none"> ➤ Define business objectives and goals ➤ Identify events that affect achievement of business objectives ➤ Assess likelihood and impact ➤ Respond and mitigate risks Assess residual risk 		
ASSESSMENT IT – RELATED RISKS AND CONTORLS	<ul style="list-style-type: none"> ➤ Entity level aspects of risks that are related to the governance, organization and management of IT. ➤ Risks in the IT processes and procedures being followed. ➤ IT risks at each layer of the automated environment. <p>The controls that are put in place to mitigate the IT risks and to maintain the confidentiality, integrity, availability and security of data are as follows:</p> <ul style="list-style-type: none"> ➤ General IT Controls; ➤ Application Controls; ➤ IT-Dependent Conrols. 			
	"General IT controls	<p>"General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, miniframe, and end-user environment. General IT - controls that maintain the integrity of information and security of data commonly include controls over the Following:" (SA 315)</p> <ul style="list-style-type: none"> ➤ Data center and network operations; ➤ Program change; ➤ Access security; ➤ Application system acquisition, development, and maintenance 		
	The illustration below is an overview of the Control objectives and activities for each area of General IT Controls	Data Centre and Network Operations	Program Change	Access Security
		Objective	Objective	Objective
		To ensure that modified system continue to meet financial reporting objectives	To ensure that modified system continue to meet financial	To ensure that access to programs and data authenticatd and

			reporting objectives	authorized to meet financial reporting objectives.
		<p>Activities:</p> <ul style="list-style-type: none"> ➤ Overall Management of computer operations activities ➤ Batch jobs-preparing, scheduling and executing ➤ Backups-monitoring, storage & retention ➤ Performance monitoring –operating system, database and networks ➤ Recovery from Failure-BCP, DRP ➤ Help Desk Functions-recording, monitoring & tracking ➤ Service level Agreements – monitoring & compliance ➤ Documentat ion— operations manuals, service reports 	<p>Activities:</p> <ul style="list-style-type: none"> ➤ Change Management Process – definition, roles & responsibilities ➤ Change Requests-record, manage, track ➤ Making changes – analyse, design, develop ➤ Test Changes test plan, test cases, UAT ➤ Apply Changes in Production ➤ Emergency & Minor Changes ➤ Documentation – user/technical manuals ➤ User Training 	<p>Activities:</p> <ul style="list-style-type: none"> ➤ Security Organization & Management ➤ Security Policies & Procedures ➤ Application Security Data ➤ Security Operating System ➤ Network Security - internal network, perimeter network ➤ Physical Security— access controls, environment controls ➤ System Administration & Privileged Account-Sysadmins , DBAs, Super users
	Application Controls	Application controls include both automated or manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and		

		<p>help in ensuring the completeness, accuracy and integrity of data in those systems</p>								
	<p>IT dependent controls</p>	<p>IT dependent controls are basically manual controls that make use of some form of data or information or report produced from IT systems and applications. In this case, even though the control is performed manually, the design and effectiveness of such controls depend on the reliability of source data.</p>								
	<p>General IT Controls vs. Application Controls</p>	<ul style="list-style-type: none"> ➤ These two categories of control over IT systems are interrelated. ➤ The relationship between the application controls and the General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems. 								
<p>EVALUATING RISKS AND CONTROLS AT ENTITY LEVEL AND PROCESS LEVEL</p>	<p>The controls that operate across a company at all levels i.e., from board and top management to the department and transaction level are known as entity level controls or ELCs.</p> <div style="text-align: center; border: 1px solid black; padding: 10px;"> <p>Internal Control Framework</p> <table border="1" style="margin: auto;"> <tr> <td style="width: 80%; text-align: center;">Control Environment</td> <td rowspan="5" style="width: 20%; text-align: center; vertical-align: middle;">Internet Control Components Other than</td> </tr> <tr> <td style="text-align: center;">Risk Assessment</td> </tr> <tr> <td style="text-align: center;">Information & Communication</td> </tr> <tr> <td style="text-align: center;">Monitoring</td> </tr> <tr> <td style="text-align: center;">Control Activities</td> </tr> <tr> <td style="text-align: center;">Process Level Transaction Controls</td> <td></td> </tr> </table> </div>		Control Environment	Internet Control Components Other than	Risk Assessment	Information & Communication	Monitoring	Control Activities	Process Level Transaction Controls	
Control Environment	Internet Control Components Other than									
Risk Assessment										
Information & Communication										
Monitoring										
Control Activities										
Process Level Transaction Controls										
	<p>The characteristics of ELCs include the following</p>	<ul style="list-style-type: none"> ➤ known as pervasive ➤ ELCs are part of a company's overall internal control framework ➤ Subjective by nature 								
	<p>There are direct entity level controls and indirect entity level controls.</p>	<p>i. Direct ELCs operate at a level higher than business activity or transaction Level such as a business process or sub-process level, account balance level, at a sufficient level of precision, to prevent, detect or correct misstatement in a timely manner. Examples include:</p> <ul style="list-style-type: none"> ➤ Business performance reviews; 								

		<ul style="list-style-type: none"> ➤ Monitoring of effectiveness of controls activities by Internal Audit function; <p>ii. Indirect ELCs do not relate to any specific business process, transaction or account balance and hence, cannot prevent or detect misstatements. However, they contribute indirectly to the effective operation of direct and other control activities.</p> <p>Examples include:</p> <ul style="list-style-type: none"> ➤ Company code of conduct and ethics policies; ➤ Human resource policies; ➤ Employee job roles & responsibilities.
	The auditor is required to obtain an understanding of	<ul style="list-style-type: none"> ➤ how business processes operate; ➤ the relevant information systems used in the processing of business transactions and activities; ➤ the risks and controls pertaining to the information systems and underlying infrastructure; ➤ reliability of information generated From systems. ➤ Auditors are required to understand, evaluate and validate the entity level controls as a part of an audit engagement. ➤ The results of testing entity level controls could have an impact on the nature, timing and extent of other audit procedures including testing of controls
		<p>The following example shows how the auditor performs an understanding and evaluation of the whistle-blower policy in a company:</p> <ul style="list-style-type: none"> ➤ Does the company have a whistle-blower policy? ➤ Is this policy documented and approved? ➤ Has the whistle-blower policy been communicated to all the employees? ➤ Are employees aware of this policy and understand its purpose and their obligations? ➤ Has the company taken measures viz., training, to make the employees understand the contents and purpose of the policy? ➤ Does the company monitor effectiveness of the policy from time-to-time? ➤ How does the company deal with deviations and non-compliance?
	Process Level Risks and Controls	<ul style="list-style-type: none"> ➤ In an audit of financial statements the auditor determines the significant account balances and disclosures. Auditing standards (SA 315) require the auditor to understand the business

	<p>process that makes up an account balance or financial statement line item (FSLI).</p> <ul style="list-style-type: none"> ➤ A business process is a sequence of activities that take place from the initiation of a transaction, recording it, approving, posting accounting entries and reporting. A business process is typically made up of sub-process - a logical grouping of related activities. ➤ Understanding the business process helps the auditor in identification of risks and controls within each process, sub-process and activity. ➤ The auditor should document this understanding of the company's business process and flow of transactions in the audit file in accordance with SA 230.
<p>USING RELEVANT ANALYTICAL PROCEDURES AND TESTS USING DATA ANALYTICS</p>	<p>Generating and preparing meaningful information From raw system data using processes, tools, and techniques is known as Data Analytics.</p> <p>The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs.</p> <p>When auditing in an automated environment, auditors can apply the concepts of data analytics for several aspects of an audit including the following:</p> <ul style="list-style-type: none"> ➤ preliminary analytics; ➤ risk assessment; ➤ control testing; ➤ non-standard journal analysis; ➤ evaluation of deficiencies; ➤ fraud risk assessment <div style="text-align: center;"> <pre> graph LR A[Understand Business Environment including IT] --> B[Define the Objectives and Criteria] B --> C[Identify Source and Format of Data] C --> D[Extract Data] D --> E[Verify the Completeness and Accuracy of Extracted data] E --> F[Apply Criteria on Data Obtained] F --> G[Validate and Confirm Results] G --> H[Report and Document Results and Conclusions [SA 230]] </pre> </div>
<p>STANDARDS, GUIDELINES AND PROCEDURES – USING RELEVANT FRAMEWORKS AND BEST PRACTICES</p>	<ul style="list-style-type: none"> ➤ Standards on Auditing issued by ICAI ➤ Section 143 of Companies Act 2013 ➤ Sarbanes Oxley Act of 2002 ➤ ISO 27001:2013 is the Information Security Management System (ISMS) ➤ ITIL (Information Technology Infrastructure Library) and ISO 20000 ➤ The Payment Card Industry — Data Security Standard or PCI-DSS,

	<ul style="list-style-type: none">➤ framework under the Statements on Standards for Attest Engagements (SSAE) No.16<ul style="list-style-type: none">○ SOC 1 for reporting on controls at a service organization relevant to user entities' inter: control over financial reporting (ICFR).○ SOC 2 and SOC 3 For reporting on controls at a service organization relevant to security, availability, processing integrity, confidentiality or privacy i.e., controls other than ICFR.○ While SOC 1 and SOC 2 are restricted use reports, SOC 3 is general use report.➤ Control Objectives for Information and Related Technologies (CoBIT)➤ The Cyber security Framework (CSF)
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CHAPTER-17

TAX AUDIT

INTRO & APPLICABILITY & DEFINITION

Audit under the Income-Tax Act, 1961

The Income-tax Act, 1961 (here in after referred to as the Act) contains several provisions For audit of accounts of charitable trusts, non-corporate assesses and other assesses to meet the specific objectives of the Act. Under the Act, several sections such as 12A, 35D, 35E, 44AB, 801A, 80-IAB, 80-ID, 80-IE,142(2A), etc., require audit accounts For tax purposes.

Tax Audit u/s 44AB of the Income-Tax Act, 1961

1. **Applicability:** Sec. 44AB is applicable to the following classes of assessees –
 - a) Assessee carrying on any business where **Total Sales or Turnover or Gross Receipts** exceeds **Rs 100 Lakhs**, or
 - b) Assessee carrying on profession where **Gross Receipts exceeds Rs 50 Lakhs**, or
 - c) Assessee carrying on business referred to u/s 44AE 4488 / 44BBB and declaring lower income than prescribed under those Sections or u/s 44AD (where the limit of presumptive taxation For businesses is increased to 2 Crores) and claiming lower income but more than the basic exemption limit (presently of 2.5 lakhs)
2. **Audit:** The audit shall be conducted by an Accountant as explained u/s 288 of the Income-Tax Act, 1961 which includes Chartered Accountant and any person qualified to be an auditor under Companies Act
3. **Specified date for Filing of Report:** 30 September of relevant assessment year (electronically only)
4. **Forms of Report: Prescribed under Rule 3G**

Nature of Person	Audit Report	Form
In case of a person who carries on business or profession and who is required by or under any law to get his accounts audited	Form3CA	Form3CD
In case of person who carries on business or profession but not being a person refer red to above.	Form3CB	Form3CD

A Co-operative Society having receipts above Rs 100 Lakhs gets its accounts audited by a person eligible to do audit under Co-operative Societies Act, 1912, who is not a Chartered Accountant. State with reasons whether such Audit Report can be furnished as Tax Audit Report u/s 44AB of the Income Tax Act, 1961.

In a case where such person is required by or under any other law to get his accounts audited, it shall be sufficient compliance with the provisions of this section i f such person gets the accounts of such business or profession audited under such law before the specified date and furnishes by that date there port of the audit as

required under such other law and a further report by an accountant in the form prescribed under this section.

Can a Tax Audit be conducted For a period other than the Financial year?

1. **Audit Report when Previous Year and Accounting Year are different:** In case of a Company, where t-previous year and accounting year are different the Tax Auditor would have to carry out the Tax Audit in respE: of the period covered by the relevant Financial year and submit his report in Form 3CB only.
2. **Conclusion:** In the given case, in view of the above Circular, Tax Audit can be conducted only in respect of the Financial Year and not for the year ending 30thSeptember. So, the Chief Accountant's claim is not valid.

Assessee carrying presumptive income business and other business, tax audit limits how determined?

In the case of a person carrying on businesses covered by sections 44AE, 44BB or 44BBB and opting for presumptive taxation, tax audit requirement would not apply in respect of such businesses, If such person is carrying on other business (es) not covered by presumptive taxation, tax audit requirements would apply in respect thereof i f turnover of such business(es), other than the business covered by presumptive taxation thereof, exceed Rs 100 lakhs one crore rupees).

Assessee carrying business as well as profession, tax audit applicability how determined?

In such a case if his professional receipts are, say, 27 lakhs but his total sales, turnover or gross receipts in business are, say, 72 lakhs, it will be necessary for him to get his accounts of the profession and also the accounts of the business audited because the gross receipts from the profession exceed the limit of rupees 25 lakhs.

If however, the professional receipts are, say, 21 lakhs and total sales turnover or gross receipts from business say, rupees 86 lakhs it will not be necessary for him to get his accounts audited under the above section, because his gross receipts from the profession as well as total sales, turnover or gross receipts from the business are below the prescribed limits.

It may, however, be noted that in cases where the assessee carries on more than one business activity, the **results all business activities should be clubbed together**. In other words, the aggregate sales, turnover and/or gross receipts of all businesses carried on by an assessee would be taken into consideration in determining whether the prescribed limit (Presently Rs 1 crore w.e.f. A.Y. 2013-14) as laid down in this section has been exceeded or not.

However, where the business is covered by section 44B or 44BBA turnover of such business shall be excluded. Similarly, where the business is covered by section 44AD or 44AE and the assessee opts to be assessed under respective sections on presumptive basis, the turnover thereof shall be excluded.

An assessee, has income exempted From tax but has turnover of more than 100 Lacs, is required to get tax audit done?

Such cases may cover those assessees who are wholly outside the purview of income-tax law as well as those income is otherwise exempt under the Act. Section 44AB nor any other provisions of the Act stipulate exemption from the compulsory tax audit to any person whose income is exempt from tax. This section makes it mandatory every

person carrying on any business or profession to get his accounts audited where conditions laid down in the section are satisfied and to furnish the report of such audit in the prescribed form.

A trust/association/institution carrying on business may enjoy exemptions as the case may be under sections 10(21), 10(23A), 10(23B) or section 10(23BB) or section 10(23C) or section 11. A co-operative society carrying on business may enjoy deduction under section 80P. Such institutions/associations of persons will have to get their accounts audited and to furnish such audit report for purposes of section 44AB if their turnover in business exceeds the prescribed limit.

But an agriculturist, who does not have any income under the head "Profits and gains of business or profession" chargeable to tax under the Act and who is not required to file any return under the said Act, need not get his accounts audited for purposes of section 44AB even though his total sales of agricultural products may exceed the prescribed limit

Is tax audit report a substitute for reports / certificates under other section like 80 1A, IB etc?

No. those are independent of requirement of tax audit.

Assessee has disclosed income of Less than 100 lacs, but Assessing Officer is of the opinion that the turnover is an 100 Lacs, can he order for Tax Audit?

No, This section applies only if the turnover exceeds the prescribed limit according to the accounts maintained by the assessee. If the Assessing Officer wants the assessee to get his accounts audited in cases where the figures of turnover as appearing in the books of account of the assessee do not exceed the prescribed limits, he has no option but to pass an order under section 142(2A) directing the assessee to get his accounts audited from a chartered accountant as may be nominated by the Commissioner of Income-tax or the Chief Commissioner of Income-tax.

Penalties for not submitting tax audit report?

As such, the failure of a person, to get his accounts audited in respect of any previous year or Furnish a copy of such report as required under section 44AB may attract a penalty equal to 0.5% of the total sales, turnover or gross pts, or Rs 1.5 lakh whichever is less. However, in view of the specific provisions contained in section 273B, no penalty is imposable under section 271 B on the assessee for the above failure if he proves that there was reasonable for the said failure. The onus of proving reasonable cause is on the assessee.

Some of the instances where Tribunals/Courts have accepted as "reasonable cause" are as Follows:

- a) Resignation of the tax auditor and consequent delay;
- b) Bona Fide interpretation of the term 'Rs turnover' based on expert advice;
- c) Death or physical inability of the partner in charge of the accounts;
- d) Labour problems such as strike, lock out for a long period, etc.;
- e) loss of accounts because of fire, theft, etc. beyond the control of the assessee;
- f) Non-availability of accounts on account of seizure; (g) Natural calamities, commotion, etc.

Definition of Turnover?

The term 'turnover' for the purposes of this clause may be interpreted to mean the aggregate amount for which sales are effected or services rendered by an enterprise.

If sales tax and excise duty are included in the sale price, no adjustment in respect thereof should be made for considering the quantum of turnover.

Trade discounts can be deducted from sales but not the commission allowed to third parties.

If, however, the Excise duty and / or sales tax recovered are credited separately to Excise duty or Sales tax Account (being separate accounts) and payments to the authority are debited in the same account, they would not be included in the turnover.

However, sales of scrap shown separately under the heading 'miscellaneous income' will have to be included in turnover.

Applying the above generally accepted accounting principles, a few typical cases may be considered:

- i. Discount allowed in the sales invoice will reduce the sale price and, therefore, the same can be deducted From the turnover.
- ii. Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and is not related to turnover. The same should not be deducted from the figure of turnover.
- iii. Turnover discount is normally allowed to a customer if the sales made to him exceed a particular quantity. This being dependent on the turnover, as per trade practice, it is in the nature of trade discount and should be deducted from the figure of turnover even if the same is allowed at periodical intervals by separate credit notes.
- iv. Special rebate allowed to a customer can be deducted from the sales if it is in the nature of trade discount it is in the nature of commission on sales, the same cannot be deducted from the figure of turnover.
- v. Price of goods returned should be deducted from the figure of turnover even if the returns are from the sales made in the earlier year/s.
- vi. Sale proceeds of fixed assets would not form part of turnover since these are not held for resale.
- vii. Sale proceeds of property held as investment property will not form part of turnover.
- viii. Sale proceeds of any shares, securities, debentures, etc., held as investment will not form part of turnover. However if the shares, securities, debentures etc., are held as stock-in-trade, the sale proceeds thereof form part of turnover.

How is Turnover determined for the purpose of Tax Audit u/s 44AB?

Items included in Turnover	Items excluded in Turnover
i. Profits on sale of a licence granted under the Imports (Control) Order, 1955	1. Discount allowed in the Sales Invoice.

<ul style="list-style-type: none"> ii. Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India; iii. Any duty of customs or excise re-paid or repayable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1995; iv. The aggregate of gross income by way of interest received by the money lender; v. Commission, brokerage, service and other incidental charges received in the business of chit funds; vi. Reimbursement of expenses incurred (e.g. packing, forwarding, freight, insurance, travelling etc.) and if the same is credited to a separate account in the books, only the net surplus on this account should be added to the turnover for the purposes of Section 44AB; vii. The net exchange rate difference on export sales during the year on the basis of the principle explained in (vi) above will have to be added; viii. Hire charges of cold storage ix. Liquidated damages; x. Insurance claims - except for fixed assets; xi. Sale proceeds of scrap, wastage etc. unless xii. Gross receipts including lease rent in the business of operating lease; xiii. Finance income to reimburse and reward the lessor for his investment and services; xiv. Hire charges and instalments received in the course of hire purchase; xv. Advance received and forfeited from customers 	<ul style="list-style-type: none"> 2. Cash Discount allowed in a Sales Invoice. 3. Turnover Discount. 4. Special Rebate allowed to Customers. 5. Price of goods returned. 6. Sale proceeds of Fixed Assets. 7. Sale proceeds of assets held as Investments. 8. Rental Income, unless the same is assessable as Business Income. 9. Dividends on Shares, except in the case of an assessee dealing in shares. 10. Income by way of Interest, unless assessable as Business Income. 11. Reimbursement of Customs Duty and other charges collected by a Clearing Agent. 12. Advertisement charges received by a Recruiting Agent or Advertising Agent by way of reimbursement of expenses incurred by him. 13. Amount received by Travelling Agents from clients, for payment to Airlines, Railways, etc. 14. Share of Profit of a Partner of a Firm. 15. Write back of amounts payable or provisions which are no longer required.
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Computation of Gross Receipts / Turnover for the following businesses –

Nature of Business	Gross Receipts/Turnover
Selling Agent entitled only for Commission.	Commission Received/Receivable.

Selling Agent who is vested with the rights of property, risk and reward in relation to goods sold.	Sate Price Received/Receivable.
Consignment Agent.	Commission Earned.
Building Contractor.	Gross Receipts including value of material supplied.
Speculation Business	Net Gain from speculation is considered as Turnover, since "actual delivery" of scrips or items is not made.
Money Lending Business.	Interest Earned.
Chit Fund Business.	Commission Income, Brokerage Income, Service Charges and Other Incidental Charges.
Leasing Business	Operating Lease: Gross Receipts including Lease Rent. Financial Lease: Lease Rent or Interest on inancing.
Share Brokers.	Dealing on behalf of Customers: Only Brokerage. Dealing on Personal Account: Sate Value.

How is turnover or gross receipts in respect of transactions in shares, securities and derivatives defined?

The turnover or gross receipts in respect of transactions in shares, securities and derivatives may be determined in the Following manner.

a) Speculative transaction:

A speculative transaction means a transaction in which a contract For the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips.

As such, in such transaction the difference amount is 'turnover'. In the case of an assessee undertaking speculative transactions there can be both positive and negative differences arising by settlement of various such contracts during the year. Each transaction resulting into whether a positive or negative difference is an independent transaction. Accordingly, the aggregate of both positive and negative differences is to be considered as the turnover of such transactions for determining the liability to audit vide section 44AB.

b) Derivatives, futures and options:

Such transactions are completed without the delivery of shares or securities. These are also squared up by payment of differences. The contract notes are issued For the Full value of the asset purchased or sold by entries in the books of account are made only for the differences. The transactions may be squared up any time on or before the striking date. The buyer of the option pays the premia. The turnover in such types of transactions is to be determined as follows:

- i. The total of Favorable and unfavorable differences shall be taken as turnover.
- ii. Premium received on sate of options is also to be included in turnover.
- iii. In respect of any reverse trades entered, the difference thereon, should also form part of the turnover.

i. **Delivery based transactions:**

Where the transaction for the purchase or sale of any commodity including stocks and shares is delivery base whether intended or by default, the total value of the sales is to be considered as turnover.

Hari deals in a commodity and purchase and sales of that commodity is ultimately settled otherwise than by the actual delivery. During the financial year he purchased the commodity worth Rs 55,00,000 and sold the same commodity for 104,00,000 and the contract was settled otherwise than by the actual delivery. Hari seeks your advice whether he is Liable for Tax Audit u/s 44AB of the Income Tax Act. Advise.

1. A Speculative Transaction is a transaction in which a contract for the purchase or sale of any commodity, including Stocks and Shares, is periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity or scripts. Thus, in the above case, Haider deals as a Speculator.
2. For an assessee doing speculative transactions, there can be both positive and negative differences arising by settlement of various contracts during the year. Each transaction resulting into whether a positive or negative difference is an independent transaction. So, the aggregate of both positive and negative differences is to be considered as the Turnover of such transactions for determining the liability to audit u/s 44AB.
3. In the above case, the difference amount i.e. 'Turnover' = Rs 104 Lakhs less Rs 55 Lakhs, = Rs 49 Lakhs. Hence Hari is not liable for Tax Audit u/s 44AB of the Income Tax Act, 1961.

Write short notes on the appointment and removal of Tax Auditor

Appointment:

- a) A CA in practice or a CA Firm can be appointed as Tax Auditor, by the authorized persons, e.g. in case of Company, the Board of Directors or the Officer authorised by it can appoint the Tax Auditor.
- b) An employee of an assessee or an employee under the same management cannot be a Tax Auditor.
- c) Tax Audit of a CA Firm cannot be conducted by any Partner or Employee of the Firm.

d) The tax auditor is required to upload the tax audit report directly in the e-filing portal

"Accountant" means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 who holds a valid certificate of practice under sub-section (1) of section 6 of that Act, but does not include [except for the purposes of representing the assessee under sub-section (1)]—

- a. in case of an assessee, being a company, the person who is not eligible For appointment as an auditor of the said company in accordance with the provisions of sub-section (3) of section 141 of the Companies Act, 2013 (18 of 2013); or
- b. in any other case,—
 - i. the assessee himself or in case of the assessee, being a firm or association of persons or Hindu undivided family, any partner of the firm, or member of the association or the family;
 - ii. any relative of any of the persons referred to in sub-clause above
 - iii. an officer or employee of the assessee;

- iv. an individual who is a partner, or who is in the employment, of an officer or employee of the assessee;
- v. an individual who, or his relative or partner –
 - I. is holding any security of, or interest in, the assessee:
Provided that the relative may hold security or interest in the assessee of the face value not exceeding one hundred thousand rupees;
 - II. is indebted to the assessee:
Provided that the relative may be indebted to the assessee for an amount not exceeding one hundred thousand rupees;
 - III. has given a guarantee or provided any security in connection with the indebtedness of any third person to the assessee:
Provided that the relative may give guarantee or provide any security in connection with the indebtedness of any third person to the assessee for an amount not exceeding one hundred thousand rupees;
- vi. a person who, whether directly or indirectly, has business relationship with the assessee of such nature as may be prescribed;
- vii. a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.

4. **Appointment of an Auditor in case of non-payment of Undisputed Fees:** A CA in practice shall not accept the appointment as Tax Auditor, in case the Undisputed Audit Fee of another CA for carrying out the Statutory Audit under the Companies Act, or various other statutes has not been paid. This prohibition does not apply to a Sick Unit.

Note: Undisputed Audit Fee is the provision For Audit Fee in accounts signed by both the Auditee and the Auditor. Sick Unit is a unit whose Net Worth is negative.

5. **Ceiling Limit:** A Member in practice shall not accept, in a Financial year, more than 60 Tax Audit assignments in a financial year. Further points in this regard are –

6.

Situation	Ceiling Limit
For Individual CA's or Proprietary Firms	60 Tax Audits
For Partnership Firms	60 Tax Audits per Partner of the Firm
When a CA is a Partner in a number of Firms	60 Tax Audits on his account in all the Firms taken together in which he is a Partner or Proprietor.
Where the Partner of a Firm also holds office in his individual capacity	60 Tax Audits in his individual capacity and all Firms taken together.

Additional Points:-

a) **Each Year's Audit:** In computing the 60 Tax Audit assignments, each year's audit would be taken as a separate assignment. The number of such assignments, which a CA or any Partner of his Firm has accepted whether singly or in combination with any other CA in Practice or Firm of such CAs, shall be taken into account.

- b) **Corporate & Non-Corporate:** Tax Audit Assignments means Tax Audit assignments in a Financial Year whether in respect of corporate or non-corporate assessees.
- c) **Exclusions:** Audits u/s 44AD, 44AE and 44AF of IT Act shall not be taken into account for computing ceiling limit.
- d) **HO and Branch:** Audit of Head Office and Branch Offices of a Concern shall be regarded as one Tax Audit assignment. Also, Audit of one or more branches of the same concern by one CA in practice shall be construed as only one Tax Audit assignment.
- e) **Part-Time Practice:** A CA being a part-time practicing Partner of a Firm shall not be taken into account for the purpose of reckoning the Tax Audit Assignments of the Firm.
- f) **Records:** A CA in practice shall maintain a record of the Tax Audit assignments accepted by him in each Financial year in the format prescribed by ICAI.

7. Removal of Auditor:

- a) There is no specific procedure for removal of Tax Auditor appointed u/s 44AB of IT Act. However it is possible for the Management to remove a Tax Auditor on valid grounds (e.g. delay in submission of Audit Report by the Auditor). However he cannot be removed on the ground that he has given or is likely to give an Adverse Report.
- b) No other CA should accept the audit assignment, if the removal of his predecessor is not on valid grounds. A in practice shall follow the direction given by ICAI to him, being the Incoming Auditor(s), not to accept the appointment as Auditor(s), in the case of unjustified removal of the earlier Auditor(s).

Explain whether an Auditor conducting Tax Audit 'certifies' or 'reports' on information contained in the Statement of Particulars attached to the Tax Audit Report u/s 44AB of the IT Act, 1961.

Is a Tax Auditor concerned with the Truth & Fairness of Financial Statements, or is his duty Limited only to reporting under Income Tax Act, 1961?

1. **Report u/s 44AB:** The Tax Auditor has to submit the audit report in Form 3CA / 3CB. The report requires the Auditor to give his opinion as to whether or not the financial statements (Balance Sheet and P&L / Income & Expenditure Account) audited by him give a "true and fair view".
2. **Form 3CD:** The annexure to the report in Form 3CD contains Statement of Particulars in respect of certain specified matters, and the Tax Auditor has to report whether the particulars are "true and correct".
3. **Report vs Certificate:**
 - a) The word "Certificate" is used where the Auditor verifies the accuracy of the facts, but the term "Report" is used in case of an Auditor expresses his opinion.

b) Since the prescribed format uses the words "True and Correct", it can be said that the Tax Auditor certifies the information contained in the Statement of Particulars.

4. **Judgement:** However, several items in the Statement of Particulars, e.g. Clause 12 requires the Auditor to give an opinion, whether the Stocks are properly valued and the method of valuation is consistently adopted. These involve judgement / expression of opinion on specific matters referred to the Auditor. In giving his opinion, the Auditor will have to use his professional skill and expertise, apply audit tests, refer Standards on Auditing & Guidance Notes, consider the principles of materiality, etc.

5. Audit under Other Law & Tax Audit:

- If the accounts have been audited under any other law by a Statutory Auditor, the Tax Auditor need not conduct the audit once again on the truth and fairness of Financial Statements. In such cases, the Tax Auditor has to annex a copy of the audited accounts and Auditor's Report and other documents forming part of these accounts to his report (i.e. in Form 3CA). This is applicable even when the accounts are already audited by a non-CA (e.g. for Co-operative Societies, where the Statutory Auditor need not be a CA).
- However, the Tax Auditor should conduct his own verification in the prescribed form (for Form BCD) For expressing his opinion as to whether these are true and correct.

6. Conclusion:

- The Tax Auditor's work does not involve just verifying the Figures with the documents and books of accounts, but also requires him to exercise his judgement, which may at times lead to different figures by different persons reporting thereon.
- Tax Audit is not a mere certification work, rather it is a Reporting Engagement. Thus, it can be said that the Tax Auditor conducting Tax Audit "reports" on certain information, apart From "certifying" certain matters contained in the Statement of Particulars attached to the Tax Audit Report.

Can a Tax Audit be done before the Statutory Audit?

1. Form No.3CA requires the Tax Auditor to enclose a copy of the Audit Report conducted by the Statutory Auditor, the Auditor of the Financial Statements, as the case may be.
2. Where a Statutory Auditor has not been appointed by the Authorities concerned or where the report of the Statutory Auditor is not available for whatever reasons, it will be possible for the Tax Auditor to give his report in form No.3CB and to certify the relevant particulars in Form 3CD. This is particularly important in those cases where Assessee concerned has suffered losses in the relevant accounting year.
3. In such cases, the Tax Auditor will have to conduct the Financial Audit as well in order to enable him to certify whether or not the accounts reported upon by him give a true and Fair view of the state of affairs of the Assessee whose accounts are audited by him u/s 44AB.

Can a Tax Audit Report be revised? If so, state the circumstances.

1. Normally, the report of the Tax Auditor cannot be revised later. However, when the accounts are revised in the following circumstances, the Tax Auditor may have to revise his Tax Audit Report also.
 - Revision of accounts of a Company after its adoption in the Annual General Meeting,
 - Change in Law with retrospective effect,
 - Change in interpretation of Law, e.g. CBDT Circulars, Notifications, Judgements, etc.
2. The Tax Auditor should state that it is a Revised Report, clearly specifying the reasons for such revision, with a reference to the earlier report.

Is a Tax Auditor responsible if he does not complete the audit and give his Audit Report before the specified date?

1. Sec. 44AB does not give any discretion to the Tax Authorities to extend the time limit For completion of audit. So, the audit has to be completed within the prescribed time limit.
2. It is the professional duty of the CA to ensure that the audit accepted by him is completed before the due date. Hence, it is necessary that no CA should accept audit assignments which he cannot complete within the above time frame.
3. If there is any unreasonable delay on his part, he is answerable to the ICAI if a complaint is made by the Client.
4. However if the delay in the completion of audit is attributable to his Client, the Tax Auditor cannot be held responsible.

Is the Tax Auditor responsible If the Assessee conceals the particulars of income? Bring out the duties of an Auditor in this regard.

1. The liability of the Tax Auditor in respect of tax audit will be the same as in any other audit assignment. When any question relating to the audit conducted by a Tax Auditor arises, he is answerable to the Council of the ICAL IT matters concerning tax audit, ICAI's disciplinary jurisdiction will prevail.
2. if the assessee is found guilty of having concealed the particulars of his income, it does not automatically mean that the Tax Auditor is also responsible for the same.
3. If the AO comes to the conclusion that the Tax Auditor was grossly negligent in the performance of his duties, he can refer the matter to the ICAI so that appropriate action can be taken against the Tax Auditor under the CA Act
4. IF the actual work relating to examination of books and records is done by a Qualified Assistant in a Firm of CAs and the Partner of the Firm signing the Audit Report has relied upon his work, action for professional negligence can be initiated against the Member who has signed the report. In such case, the Member may prove that he has taken due care and diligence in the performance of his duties and is not aware of any reason to believe that he should not have so relied. IF the Qualified Assistant (whether or not holding the Cop) is found to be grossly negligent in the performance of his duties, the ICAI can take disciplinary action against him.

Tax Audit of Branches, particularly foreign branches?

An assessee may have one or more branches in or outside India. Separate or same auditor may be appointed for branches.

The accounts of foreign branches are normally audited by the professional accountants overseas. The results of such branches are also incorporated in the consolidated accounts prepared in this country. In the case of foreign branches the relevant information in respect of such branches as is required by Form No. 3CD, may be obtained by the tax auditor in India from the assessee who should obtain the same from the overseas auditor who had audited the amounts of such foreign branches. The tax auditor in India while certifying the information in Form No. 3CD may rely upon the information obtained by him from the overseas auditor and while submitting his consolidated report in Form No. 3CD he should specifically point out in his audit report as under:-

"I/We have taken into consideration the audit report and the audited statements of accounts, and particulars received from the auditors, appointed under the relevant law, of the overseas branches not audited by me/us".

Financial statements prepared on basis other than accrual what caution to be kept in mind?

Financial Statements prepared on a basis other than accrual –

With regard to the Fundamental accounting assumption of accrual, the Council has made a specific announcement that in respect of (a) Sole proprietary concerns/individuals, (b) Partnership Firms, (c) Societies registered under the Societies Registration Act, (d) Trusts, (e) Hindu undivided families and (F) Association of persons, the auditor should examine whether the financial statements have been prepared on accrual basis.

In case where the statute governing the enterprise requires the preparation and presentation of financial statements basis but the financial statements have not been so prepared, the auditor should qualify his report.

On the other hand where there is no statutory requirement for preparation and presentation of financial statements on accrual basis, and the Financial statements have been prepared on a basis other than 'accrual', the auditor should describe in his audit report, the basis of accounting Followed, without necessarily making it a subject matter of a ration.

In such a case the auditor should also examine whether those provisions of the AS which are applicable in the context of the basis of accounting followed by the enterprise have been complied with or not and consider making suitable rations in his audit report accordingly.

REPORTING ASPECTS

Particulars to be furnished in Form No. 3CD

PART – A

1.	Name of the assessee	
2.	Address	

3.	Permanent Account Number		
4.	Whether the assessee is liable to pay indirect tax like excise duty, service tax, sales tax, customs duty, etc. If yes, please Furnish the registration number or any other identification number allotted for the same		
5.	Status		
6.	Previous year		
7.	Assessment year		
8.	Indicate the relevant clause of section 44AB under which the audit has been Conducted		
			from _____ to _____

Clause 9(a):

If Firm or Association of Persons, indicate names of partners/members and their profit sharing ratios.

Clause 9(b):

If there is any change in the partners or members or in their profit sharing ratio since the last date of the preceding year, the particulars of such change. Their profit sharing ratios (%) have to be stated. The details of partners or members during the entire previous year have to be furnished. The tax auditor should obtain certified copies of the deeds, documents, understanding, notice of changes etc. certified copies of the acknowledgment, if any, evidencing filing of documents with the concerned authorities, if registered.

Clause 10(a):

Nature of business or profession (if more than one business or profession is carried on during the previous year, nature of every business or profession).

Clause 10(b):

If there is any change in the nature of business or profession, the particulars of such change.

Explanation for Clauses 10(a) and 10(b):

The sector in which the business or profession falls such as manufacturing, trading, commission agent, builder, contractor, professionals, service sector, financial service sector or entertainment industry.

In the case of restructuring, if any line of activity is being hived off, the same may also be reported.

Clause 11(a):

Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed.

Clause 11(b):

List of books of account maintained and the address at which the books of account are kept. (In case books of account are maintained in a computer system, mention the books of account generated by such computer system. If the books of accounts are not kept at one location, please furnish the addresses of locations along with the details of books of accounts maintained at each location.)

Clause 11(c):

List of books of account and nature of relevant documents examined.

Explanation for Clauses 11(a), 11(b), and 11(c):

As per Rule 6F every person carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorised representative or film artist and whose total gross receipts exceed one 150,000 rupees in all the three years immediately preceding the previous year, or where the profession has been newly set up in the previous year, his total gross receipts in the profession for that year are likely to exceed the said amount, is required to maintain the following books of account:

1. Cash book.
2. Journal, if the accounts are maintained according to the mercantile system of accounting.
3. Ledger.

The tax auditor should obtain from the assessee a complete list of books of account and other documents maintained him (both financial and non-financial records) and make appropriate marks of identification to ensure the identification of the books and records produced before him For audit.

In case, where books of accounts are maintained and generated through computer system, the auditor should obtain from the assessee the details of address of the place where the server is located or the principal place of business / Head office or registered office by whatever name called and mention the same accordingly in clause 11(b).

Clause 12:

Whether the profit and loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant sections (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB Chapter XII-G, First Schedule or any other relevant section).

Where the profits and gains of the business are assessable to tax under presumptive basis under any of the sections below, the amount of such profits and gains credited/debited to the profit and loss account should be indicated under this clause:

S.No	Section	Business covered
1.	44AD	Eligible business
2.	44AE	Transport business
3.	44B	Shipping business of a non-resident
4.	44BB	Providing service or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils
5.	44BBA	Operation of aircraft by non-resident
6.	44BBB	Civil construction etc. in certain turnkey power project by non-residents
7.	Chapter XII-G	Special provisions relating to Shipping Companies (Section 115V to 115VT)

8.	First Schedule	Insurance Business
9.	Any other relevant section	This refers to the sections not listed above under which income may be assessable on presumptive basis like section 44D and section 115A(1)(b) and will include any other section that may be enacted in future for presumptive taxation

The amount to be mentioned under this clause means the amount included in the profit and loss account.

Clause 13(a)

Method of accounting employed in the previous year.

Clause 13(b)

Whether there had been any change in the method of accounting employed vis-a-vis the method employed in the immediately preceding previous year.

Clause 13(c)

If answer to (b) above is in the affirmative, give details of such change, and the effect thereof on the profit or loss.

Serial number	Particulars	Increase in profit (Rs)	Decrease in profit (Rs)

Clause 13(d)

Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2).

Clause 13(e)

If answer to (d) above is in the affirmative, give details of such adjustments:

		Increase I profit (Rs)	Decrease in profit (Rs)	Net effect (Rs)
ICDS I	Accounting Policies			
ICDS II	Valuation of Inventories			
ICDS III	Construction Contracts			
ICDS IV	Revenue Recognition			
ICDS V	Tangible Fixed Assets			
ICDS VI	Changes in Foreign Exchange Rates			
ICDS VII	Governments Grants			
ICDS VIII	Securities			
ICDS IX	Borrowing Costs			
ICDS X	Provisions, Contingent Liabilities and Contingent Assets			

Total				
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Clause 13(f)

Disclosure as per ICDS:

- i. ICDS I-Accounting Policies
- ii. ICDS I1-Valuation of Inventories
- iii. ICDS III-Construction Contracts
- iv. ICDS IV-Revenue Recognition
- v. ICDS V-Tangible Fixed Assets
- vi. ICDS VII-Governments Grants
- vii. ICDS IX Borrowing Costs
- viii. ICDS X-Provisions, Contingent Liabilities and Contingent Assets".

The Finance Act, 2014 has amended section 145 w.e.f AY 2015 -16 to the effect that the words 'accounting standards' be replaced with the words 'income computation and disclosure standards'.

As per the memorandum, such an amendment has been made in order to clarify that the standards notified under section 145(2) are only meantfor computation of income and disclosure of information and the assessee need not maintain books of account on the basis of AS notified under the Income-tax Act, 1961.

The Accounting Standards issued by [CAI/ Companies Accounting Standard Rule, 2006 would still be required to be followed by the assessee, for preparation of financial statements.

Clause 14(a)

Method of valuation of closing stock employed in the previous year.

Clause 14 (b)

Details of deviation, if any, from the method of valuation prescribed under section 145A, and the effect thereof on profit or toss, please furnish:

Serial number	Particulars	Increase in profit (Rs)	Decrease in profit (Rs)

Explanation for Clauses 14(a) and (b): The method of valuation of closing stock is to be stated under this clause.

The details of deviation, if any, from the method of valuation prescribed under section 145A, and the effect thereof on :Fait or loss have to be stated under clause 14(b).

Clause 15:

Give the following particulars of the capital asset converted into stock-in- trade:-

- a) Description of capital asset;
- b) Date of acquisition;
- c) Cost of acquisition;
- d) Amount at which the asset is converted into stock-in-trade.

Under clause (a) description of the capital asset is required to be mentioned for example shares, security, land, plant, machinery etc.

Under clause (d) an amount may not be the fair market value as on the date of conversion or treatment as stock-in-trade. If a value other than carrying cost is recorded then the auditor has to examine the basis of arriving at such a value. The valuation of stock-in-trade is to be examined with reference to AS-2 – Valuation of Inventories. Non-compliance with AS-2 is to be suitably qualified in the main audit report.

Clause 16:

Amounts not credited to the profit and loss account, being, -

- a) the items Falling within the scope of section 28;
- b) the proforma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax, where such credits, drawbacks or refunds are admitted as due by the authorities concerned;
- c) escalation claims accepted during the previous year;
- d) any other item of income;
- e) capital receipt, if any.

Under sub-clause (e), capital receipt, an illustrative list of capital receipts which, if not credited to the profit and loss account, are to be stated under this sub-clause.

- a) Capital subsidy received in the form of Government grants which are in the nature of promoters' contribution i.e., they are given with reference to the total investment of the undertaking or by way of contribution to its total capital outlay. For e.g. Capital Investment Subsidy Scheme.
- b) Government grant in relation to a specific fixed asset where such grant is shown as a deduction from the gross value of the asset by the concern in arriving at its book value.
- c) Compensation for surrendering certain rights.
- d) Profit on sale of fixed assets/investments to the extent not credited to the profit and loss account.

Clause 17:-

Where any land or building or both is transferred during the previous year For a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C, please furnish:

Details of property	Consideration received or accrued	Value adopted or assessed or assessable
Nature, Address		Reg Sale Deed

For reporting the value adopted or assessed or assessable, the auditor should obtain from the assessee a copy of the registered sale deed in case, the property is registered. In case the property is not registered, the auditor may verify relevant documents from relevant authorities or obtain third party expert like lawyer, solicitor representation

Clause 18:

Particulars of depreciation allowable as per the Income-tax Act, 1961 in respect of each asset or block of assets, as the case may be, in the following form:-

- a) Description of asset/block of assets.
- b) Rate of depreciation.

- c) Actual cost or written down value, as the case may be.
- d) Additions/deductions during the year with dates; in the case of any addition of an asset, date put to including adjustments on account of –
 - i. Central Value Added Tax credits claimed and allowed under the Central Excise Rules, 1944, in respect of assets acquired on or after 1st March, 1994,
 - ii. change in rate of exchange of currency, and
 - iii. subsidy or grant or reimbursement, by whatever name called.
- e) Depreciation allowable.
- f) Written down value at the end of the year.

Having regard to the nature of requirements prescribed, it may be necessary for the tax auditor to examine:

- a) Classification of the asset
- b) Classification thereof to a block
- c) The working of actual cost or written down value
- d) The date of acquisition and the date on which it is put to use
- e) The applicable rate of depreciation
- f) The additions / deductions and dates thereof
- g) Adjustments required - specified as well as on account of sale, etc.

The additions/deductions during the year have to be reported, with dates.

Where any addition was made, the date on which the asset was put to use is to be reported. In respect of deductions, the sale value of the assets disposed of along with dates should be mentioned.

To ascertain when the asset has been put to use, the tax auditor could call for basic records like production records/installation details/excise records/service tax records/records relating to power connection for operating the machine and any other relevant evidence.

Details have to be given in respect of adjustments on account of three Factors, CENVAT claimed and allowed, adjustment relates to the change in the rate of exchange of currency and adjustment relates to the subsidy or grant or reimbursement, by whatever name called.

Finally, the amount of depreciation allowable and the WDV at the year end have to be stated. The tax auditor will need to verify the claim of additional depreciation under this clause as well.

Wherever, the full deduction of the cost of capital goods is allowed (e.g. expenditure on Scientific Research u/s. 35) -the auditor should verify that the cost of such asset is not included in the block of assets for the purpose of depreciation.

Clause 19:

Amounts admissible under sections:

Section	Amount debited to profit and loss account	Amounts admissible as per the provisions of the income-tax Act, 1961 and also fulfills the conditions. If any specified under the relevant provisions of Income-tax Act, 1961 or Income-

		tax Rules, 1962 or any other guidelines, circular, etc., issued in this behalf.
32AC		
33AB		
33ABA		
35(1)(i)....		
35(1)(ii)		
35(1)(iia)		
35(1)(iii)		
35(1)(iv)		
35(2AA)		
35(2AB)		
35ABB		
35AC		
35AD		
35CCA		
35CCB		
35CCC		
35CCD		
35DD		
35DDA		
35E		

The Tax Auditor should indicate the amount debited to the Profit & Loss Account and the amount actually admissible in accordance with the applicable provisions of law.

The amount not debited to the Profit & Loss Account but admissible under any of the Sections mentioned in the clause have to be stated.

Where under any section an assessee is eligible for deduction under one or more of the sub- sections of the said section, the Tax Auditor should certify the amount of deduction available under each sub-section separately in the applicable part, i.e. the amount deductible in respect of the amount debited to Profit & Loss Account and the amount not debited to the Profit & Loss Account.

Clause 20 (a):

Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend. [Section 36(1)(ii)].

Clause 20 (b):

Details of contributions received From employees for various funds as referred to in section 36(1)(va):

Serial number	Nature of fund	Sum received from employees	Due date for payment	The actual amount paid	The actual date of payment to the concerned authorities

Under Clause 20(b), the requirement is only in respect of the disclosure of the amount and the tax auditor is - expected to express his opinion about its allow ability or

otherwise. The tax auditor should verify the employment / contract details of the employees so as to ascertain the nature of payments.

He should verify the agreement under which employees have to make contributions to provident fund and other welfare Funds.

The ledger account of contributions from employees should be reviewed; the due dates of and the actual dates of Dap-lent should be verified with the evidence available.

The tax auditor can apply test checks and compliance tests to satisfy himself that the system of recovery and remittance is proper.

Cause 21(a):

Please furnish the details of amounts debited to the profit and loss account, being in the nature of Capital, personal, advertisement expenditure etc.:

Nature	Serial number	Particulars	Amount in Rs
Capital Expenditure			
Persona(Expenditure			
Advertisement expenditure in any souvenir, brochure, tract, pamphlet or the like published by a political party			
Expenditure incurred at clubs being entrance fees and -subscriptions			
Expenditure incurred at clubs being cost for club services and facilities used,			
Expenditure by way of penalty or fine for violation of any law for the time being force			
Expenditure by way of any other penalty or fine not covered above			
Expenditure incurred for any purpose which is an offence or which is prohibited by law			

Expenditure of Capital nature:

Expenditure is not allowable in computing business income unless specifically provided in any sections of the Act.

Expenditure of personal nature:

Personal expenses debited to the profit and loss account are to be specified under this sub- clause as they are not deductible in the computation of total income under section 37.

Expenditure on advertisement in any souvenir, brochure, tract, pamphlet or the like, published by a political party:

Section 37(2B) provides that no allowance shall be made in respect of expenditure incurred by an assessee advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party.

Expenditure incurred at clubs being cost for club services and facilities used, entrance fees and subscriptions:

The payments may be for entrance fees as well as membership subscription and for catering and other services by the club, both in respect of directors and other employees in case of companies and for partners or proprietors in other cases.

If they are personal in nature, they are to be shown separately under Clause 21(a) referred to earlier. This clause requires reporting of particulars and the amount of such expenses incurred in the respective fields.

Expenditure by way of penalty or fine for violation of any law for the time being in force; Expenditure by way of penalty or fine not covered above; Expenditure incurred for any other purpose which is an offence or is prohibited by law:

The tax auditor should obtain in writing from the assessee the details of all payments by way of penalty or fine for violation of any laws have been made and paid or incurred during the relevant previous year

Clause 21(b):**Amounts inadmissible under section 40(a):****i. as payment to non-resident referred to in sub-clause (i)****A. Details of payment on which tax is not deducted:**

- I. date of payment
- II. amount of payment
- III. nature of payment
- IV. name and address of the payee

B. Details of payment on which tax has been deducted but has not been paid during the previous year or in the subsequent year before the expiry of time prescribed under section 200(1)

- I. date of payment
- II. amount of payment
- III. nature of payment
- IV. name and address of the payee
- V. amount of tax deducted

ii. as payment referred to in sub-clause (ia)**A. Details of payment on which tax is not deducted:**

- I. Date of payment
- II. Amount of payment
- III. Nature of payment
- IV. Name and address of the payee

- B. Details of payment on which tax has been deducted but has not been paid on or before the due date specified in sub-section (1) of section 139.
 - I. Date of payment
 - II. Amount of payment
 - III. Nature of payment
 - IV. Name and address of the payer*
 - V. Amount of tax deducted
 - VI. Amount out of
 - VII. deposited, if any

iii. **Under sub-clause (ic) [wherever applicable]**

iv. **Under sub-clause (iia)**

v. **Under sub-clause (lib)**

vi. **Under sub-clause (iii)**

- A. Date of payment
- B. Amount of payment
- C. Name and address of the payee

vii. **Under sub-clause (iv)**

viii. **Under sub-clause (v)**

should be read as "payee" for proper reporting.

This clause is substantially expanded to furnish detailed information for deduction and deposit of TDS. In case of voluminous nature of the information, the tax auditor can apply materiality principles, tests checks and compliance tests For verifying the information required to be provided under this clause.

Clause 21(c):

Amounts debited to profit and loss account being, interest, salary, bonus, commission or remuneration inadmissible under section 40(b) / 40(ba) and computation thereof.

Inadmissible amount under section 40(b) / 40(ba) and such information is also required to be given in respect of interest/ remuneration paid to a member of an Association of persons (AOP)/Body of individuals (BOI)

The tax auditor may note that the information required to be reported is the amount of inadmissible expenditure as section 40(b) or 40(ba) and not the total amount debited to profit and loss account.

Clause use 21(d):

Disallowance/deemed income under section 40A(3).

A. On the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A(3) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, please furnish the details:

Serial number	Date of Payment	Nature Payment	Amount	Name and Permanent Account Number of the payee, if available

For the purpose of furnishing the above particulars, the tax auditor should obtain a list of all cash payments -respect of expenditure exceeding Rs 20,000 (Rs 35000/- in case of plying, hiring or leasing goods carriages w.e.f. 1.10.2009) made by the assessee during the relevant year which should include the list of payments exempted in terms of Rule 6DD with reasons. This list should be verified by the tax auditor with the books of account order to ascertain whether the conditions for specific exemption granted under clauses (a) to (l) of Rule 6DD are satisfied.

Clause 21(e):

Provision for payment of gratuity not allowable under section 40A(7).

The tax auditor should call for the order of the Commissioner of Income-tax granting approval to the gratuity fund, verify the date from which it is effective and also verify whether the provision has been made as provided in the trust deed.

In case the provision made for payment of gratuity is not allowable under section 40A(7), the same is to be stated under this sub-clause.

Clause 21(f):

Any sum paid by the assessee as an employer not allowable under section 40A(9).

Under section 40A(9) any payment made by an employer towards the setting up or formation of or as contribution to any Fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860, or other institutions (other than contributions to recognised provident fund or approved superannuation fund or notified pension scheme or approved gratuity fund) is not allowable.

Clause 21(g):

Particulars of any liability of a contingent nature.

The tax auditor may look into particular items of contingent liabilities of the earlier year in order to determine whether or not any items has been charged to the profit and loss account of the current year and if so, whether the liability continues to be contingent in nature.

Clause 21(h):-

Amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of the total income.

While carrying out such examination the tax auditor is entitled to rely on the management representation.

The tax auditor will verify the amount of inadmissible expenditure as estimated by the assessee with reference to established principles of allocation of expenditure based on logical parameters like proportion of exempt and taxable come recorded, turnover, man hours spent to earn the relevant income etc.

Clause 21(i):

Amount inadmissible under the proviso to section 36(1)(iii).

Amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was put to use, shall not be allowed as a deduction.

Clause 22:

Amount inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006.

Section 23 of the MSME Act lays down that an interest payable or paid by the buyer, under or in accordance with the provisions of this Act, shall not for the purposes of the computation of income under the Income-tax Act, 1961 be allowed as a deduction.

The inadmissible interest has to be determined on the basis of the provisions of the MSME Act.

The tax auditor while reporting in respect of clause 22 should take the following steps:

- a) The auditor should seek information regarding status of the enterprise i.e. whether the same is covered under the Micro, Small and Medium Enterprises Development Act, 2006.
- b) Since Section 22 of the Micro, Small and Medium Enterprises Development Act, 2006 requires disclosure of information, the tax auditor should cross check the disclosure made in the financial statements.
- c) Obtain a full list of suppliers of the assessee which fall within the purview of the definition of "Supplier" under section 2(n) of the Micro, Small and Medium Enterprises Development Act, 2006. It is the responsibility of the auditee to classify and identify those suppliers who are covered by this Act.
- d) Review the list so obtained.
- e) Verify from the books of account whether any interest payable or paid to the buyer in terms of section 16 of the MSME Act has been debited or provided for in the books of account.
- f) Verify the interest payable or paid as mentioned above on test check basis.
- g) Verify the additional information provided by the auditee relating to interest under section 16 in his financial statement.
- h) If on test check basis, the auditor is satisfied, then the amount so debited to the profit and loss account should be reported under clause 22.

Clause 23:

Particulars of payments made to persons specified under section 40A(2)(b).

Section 40(A)(2) provides that expenditure for which payment has been or is to be made to certain specified persons the section may be disallowed if, in the opinion of the Assessing Officer, such expenditure is excessive or unreasonable having regard to:

- i. the fair market value of the goods, services or facilities for which the payment is made; or
- ii. For the legitimate needs of business or profession of the assessee; or
- iii. the benefit derived by or accruing to the assessee from such expenditure.

The section enjoins on the Assessing Officer the power to fix the quantum of disallowance. The following steps may be taken by the tax auditor in this connection:

- a) Obtain full list of specified persons as contemplated in this section.
- b) Obtain details of expenditure/payments made to the specified persons.
- c) Scrutinise all items of expenditure/payments to the above persons.

- d) It may be difficult to locate all such payments and it may also involve a time consuming effort. It is, however possible to Localise the area of enquiry.

Clause 24:

Amounts deemed to be profits and gains under section 32AC, 33AB or 33ABA or 33AC.

The auditor is required to report the deemed income chargeable as profits and gains of business under the circumstances specified in sub sections (2) of section 32AC.

Clause 25:

Any amount of profit chargeable to tax under section 41 and computation thereof (Liabilities not payable) The tax auditor should obtain a list containing all the amounts chargeable under section 41 with the accompany evidence, correspondence, etc.

Clause 26:

In respect of any sum referred to in clause (a), (b), (c), (d), (e) or (f) of section 43B, the liability for which:-

- A. pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year and was
- a) paid during the previous year;
 - b) not paid during the previous year;
- B. was incurred in the previous year and was
- a) paid on or before the due date for furnishing the return of income of the previous year under section 139(1);
 - b) not paid on or before the aforesaid date.
- (State whether sales tax, customs duty, excise duty or any other indirect tax, levy, cess, impost etc. is passed through the profit and loss account.) The tax auditor should identify such items and maintain the same in his working papers.

Clause 27(a):

Amount of Central Value Added Tax credits availed of or utilized during the previous year and its treatment in profit and loss account and treatment of outstanding Central Value Added Tax credits in the accounts.

Tax auditor should check relevant statutory records maintained under the Central Excise Rules, 2002 and the records maintained under CENVAT Credit Rules, 2004 and ascertain there from the amount of credit on eligible inputs, input services and the capital goods and the amount utilised during the previous year.

The tax auditor should verify that there is a proper reconciliation between balance of CENVAT credit in the accounts and relevant excise and service tax records.

The tax auditor should report the amount of CENVAT availed and utilised under this sub-clause.

The tax auditor should maintain the following information in his working papers For the purpose of reporting in the format provided in the e-filing utility:

CENVAT	Amount	Treatment in Profit & Loss Accounts

Clause 27(b):-

Particulars of income or expenditure of prior period credited or debited to the profit and loss account.

It may be noted that information under this clause would be relevant only in those cases where the assessee Follows system of accounting.

Tax auditor should maintain the Following information in his working papers File for the purpose of reporting in the format provided in the e-Filing utility:

Sr. No	Type	Particulars	Amount	Prior Period to which it relates Year in yyyy-yy format)

Clause 28:-

Whether during the previous year the assessee has received any property, being share of a company not being a any in which the public are substantially interested, without consideration or For inadequate consideration as referred to in section 56(2)(viiia), if yes, please furnish the details of the same.

Section 56(2)(viiia) provides that where a firm or a company not being a company in which the public are substantially interested, receives, in any previous year any property being shares of a company (not being a company in which the s substantially interested,

- i. Without consideration, the aggregate fair value of which exceeds rupees Fifty thousand, the whole of the aggregate fair market value of such property
- ii. For a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty/ thousand rupees, the aggregate Fair market value of such property as exceeds such consideration shall be chargeable to income-tax under the head "Income From other sources"

Clause 29:-

Whether during the previous year the assessee received any consideration For issue of shares which exceeds the fair market value of the shares as referred to in section 56(2)(viiib), if yes, please furnish the details of the same.

Section 56(2)(viiib) provides that where a company, not being a company in which the public are substantially interested, receives, in any previous year, From any person being a resident, any consideration for issue of shares that, exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the Fair market value of the shares shall be chargeable to income-tax under the head "Income From other sources".

The provisions of this clause are not applicable where the consideration is received:

- a) by a venture capital undertaking From a venture capital company or a venture capital fund

- b) by a company From a class or classes of persons as may be notified by the Central Government in this behalf.

Since section 56(2)(viib) is applicable to companies in which public is not substantially interested, reporting under this clause is to be done only for corporate assesseees.

Clause 30:

Details of any amount borrowed on hundi or any amount due thereon (including interest on the amount borrowed) repaid, otherwise than through an account payee cheque. [Section 69D].

For this purpose, the tax auditor should obtain a complete list of borrowings and repayments of hundi loans otherwise than by account payee cheques and verify the same with the books of account.

Clause 31 (a)*

Particulars of each loan or deposit in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year:-

- i. name, address and permanent account number (if available with the assessee) of the lender or depositor;
- ii. amount of loan or deposit taken or accepted;
- iii. whether the loan or deposit was squared up during the previous year;
- iv. maximum amount outstanding in the account at any time during the previous year;
- v. whether the loan or deposit was taken or accepted otherwise than by an account payee cheque or an acc: payee bank draft.

*(These particulars need not be given in the case of a Government company, a banking company or a corporation established by a Central, State or Provincial Act.)

As per this section, no person shall take or accept from any other person any loan or deposit otherwise than by an account payee cheque or account payee bank draft if aggregate amount is 20000 rupees or more.

If the total of all loans/deposits from a person exceed Rs 20,000/- but each individual item is less than Rs 20,000/-, the information will still be required to be given in respect of all such entries starting from the entry when the balance reaches Rs 20,000/- or more and until the balance goes down below Rs 20,000/.

As per the proviso to section 269SS, the provisions of section 269SS shall not apply to any loan or deposit take or accepted from, or any loan or deposit taken or accepted by -

- a) Government;
- b) any banking company, post office savings bank or co-operative bank;
- c) any corporation established by a Central, State or Provincial Act;
- d) any Government company
- e) such other institution, association or body or class of institutions, associations or bodies which the Central Government may notify.

These particulars need not be given in case of a Government Company, a banking company or a corporation established by a Central, State or Provincial Act.

Clause 31(b):

Particulars of each repayment of Loan or deposit in an amount exceeding the limit specified in section 269T made during the previous year:-

- i. name, address and permanent account number (if available with the assessee) of the payee;
- ii. amount of the repayment;
- iii. maximum amount outstanding in the account at any time during the previous year;
- iv. whether the repayment was made otherwise than by account payee cheque or account payee bank draft.

(The particulars (i) to (iv) above need not be given in the case of a repayment of any loan or deposit taken or accepted from Government, Government company, banking company or a corporation established by a Central, State or Provincial Act.)

As such, all repayments made to any person where the Loan or deposit along with interest is Rs 20,000 or more are to be reported under this sub-clause, even though the amount of repayment may be Less than Rs 20,000. The tax auditor should verify such repayments and report accordingly.

Clause 31(c):

Whether the taking or accepting loan or deposit, or repayment of the same were made by account payee cheque drawn on a bank or account payee bank draft based on the examination of books of account and other relevant documents

(The comment above need not be given in the case of a repayment of any loan or deposit taken or accepted from Government, Government company, banking company or a corporation established by a Central, State or Provincial Act.)

Section 269T does not exclude loans repaid by Government companies, banking companies, corporation established by a Central, State or Provincial Act from the scope of its applicability. As such, details of repayment made by such entities are to be shown.

Clause 32(a)

Details of brought Forward loss or depreciation allowance, in the following manner, to the extent available:

Sl No.	Assessment year	Nature of loss/allowance (in rupees)	Amount as returned (in rupees)	Amount as assessed (give reference to relevant order)	Remarks.

Clause 32(b)

Whether a change in shareholding of the company has taken place in the previous year due to which the losses incurred prior to the previous year cannot be allowed to be carried forward in terms of section 79.

Section 79 of the Act provides that in the case of a company, not being a company in which the public are substantially interested, where a change in shareholding has taken place in a previous year, then no loss incurred in any year prior to the previous year shall be carried Forward and set off against the income of the previous year unless on the last day of that previous year and on the last day of the previous year in which the loss was incurred, the shares of the company carrying not less than 51% of the voting power were beneficially held by the same persons.

Clause 32(c):

Whether the assessee has incurred any speculation loss referred to in section 73 during the previous year, If yes, please furnish the details of the same.

Clause 32(d):

Whether the assessee has incurred any loss referred to in section 73A in respect of any specified business during the previous year, if yes, please furnish details of the same.

Section 73A provides for provisions relating to carry forward and set off of losses by specified business. It provides that any loss, computed in respect of any specified business referred to in section 35AD shall not be set off except against profits and gains, if any, of any other specified business.

Clause 32(e):

In case of a company, please state that whether the company is deemed to be carrying on a speculation business referred in explanation to section 73, if yes, please furnish the details of speculation loss if any incurred during the previous year.

Clause 33:

Section - wise details of deductions, if any, admissible under Chapter VIA or Chapter III (Section 10A, Section 10AA).

Section under which deduction is claimed	Amounts admissible as per the provision of the Income Tax Act, 1961 and fulfils the conditions, if any, specified under the relevant provisions of Income Tax Act, 1961 or income Tax Rules,1962 or any other guidelines, circular, etc., issued in this behalf.

Chapter VIA of the Act deals with various deductions which have to be given effect to by way of allowance from gross total Income of the assessee and they have been categorised under the Act as follows:

- A. Deduction in respect of certain payments.
- B. Deduction in respect of certain incomes.
- C. Other Deductions.

Some sections in Chapter VIA such as section 80-G (donations), Section 80-GGB/80-GGC (contributions to political parties), section 80-JJAA (wages of new workmen) etc. relate to the expenditure incurred by an assessee. There are other sections such as section 80-P (income of co-operative societies), 80-JJA (certain specified business relating treatment of biodegradable waste) etc. which relate to income of the assessee.

Clause 34 (a)

Whether the assessee is required to deduct or collect tax as per the provisions of Chapter XVII-B or Chapter XVII-BB, If yes please furnish:

Tax deduction and collection Account Number (TAN)	Section	Nature of payment	Total amount of payment or receipt of the nature specified in column (3).	Total amount on which tax was required to be deducted or collected out of (4)	Total amount on which tax was deducted Of collected at specified rate out of (5)	Amount of tax deducted or collected out of (6)	Total amount on which tax was deducted or collected at less than specified rate out of (7)*	Amount of tax deducted or collected on (8)	Amount of tax deducted, deposited to the credit of the Central Government out of ^{**} (6) and ^{***} (8)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)

Clause 34 (b):

Whether the assessee has Furnished the statement of tax deducted or tax collected within the prescribed time. If not, please furnish the details:

Tax deduction and collection Account Number (TAN)	Type of Form	Due date for furnishing	Date of furnishing, if furnished	Whether the statement of tax deducted or collected contains information about all transactions which are required to be reported

Clause 34(b) also requires the auditor to report the transactions with regard to each TAN for which tax has been deducted but the return has either not been Filed or has been Filed after the expiry of the prescribed time. Lastly, the auditor is required to state as to whether the statement of tax deducted or collected, which has been furnished beyond prescribed time contains information about all the transactions which are required to be reported.

Clause 34 (c):

Whether the assessee is liable to pay interest under section 201(1A) or section 206C (7). IF yes, please Furnish:

Tax deduction and collection Account Number (TAN)	Amount of interest under section 201(1A)/206C(7) is payable	Amount paid out of column (2) along with date of payment.

Clause 35 (a):

In the case of a trading concern, give quantitative details of the principal items of goods traded:

- i) Opening stock;
- ii) Purchases during the previous year;
- iii) Sales during the previous year;
- iv) Closing stock;
- v) shortage / excess, if any.

The tax auditor should obtain certificates from the assessee in respect of the principal items of goods traded, the balance of the opening stock, purchases, sales and closing stock and the extent of shortage/ excess/damage and the reasons thereof.

Clause 35 (b):

In the case of a manufacturing concern, give quantitative details of the principal items of raw materials, finished products and by-products:

A. Raw materials:

- i) opening stock;
- ii) purchases during the previous year;
- iii) consumption during the previous year;
- iv) sales during the previous year;
- v) closing stock;
- vi) yield of finished products;
- vii) percentage of yield;
- viii) shortage / excess, if any.

B. Finished products / By-products:

- i) opening stock;
- ii) purchases during the previous year;
- iii) quantity manufactured during the previous year;
- iv) sales during the previous year;
- v) closing stock;
- vi) shortage / excess, if any.

Clause 36:

In the case of a domestic company, details of tax on distributed profits under section 115-0 in the following form:-

- a) total amount of distributed profits;
- b) amount of reduction as referred to in section 115-0(1A)(i);
- c) amount of reduction as referred to in section 115-0(1A)(ii);
- d) total tax paid thereon;
- e) dates of payment with amounts.

Tax auditor has to report on profit distributed during the Financial year and therefore, the amount of tax worked and paid out on such distributed profit at the prescribed

rate plus surcharge at the applicable rate on the tax along with the education cess thereon has to be reported against this clause.

The amount of the dividend referred to in sub-section (1) is to be reduced by the amount referred to in sub-section (1A).

Clause 37:

Whether any cost audit was carried out, if yes, give the details, if any, of disqualification or disagreement on any, matter/item/value/ quantity as may be reported/identified by the cost auditor.

Clause 38:

Whether any audit was conducted under the Central Excise Act, 1944, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/quantity as may be reported/ identified by the auditor.

Clause 39:

Whether any audit was conducted under section 72A of the Finance Act, 1994 in relation to valuation of taxable services, if yes, give the details, if any, of disqualification or disagreement on any matter / item / value / quantity as may be reported / identified by the auditor.

Clause 40:

Details regarding turnover, gross profit, etc., for the previous year and preceding previous year:

Serial number	Particulars	Previous year	Preceding previous year
1.	Total turnover of the assessee		
2.	Gross profit/turnover		
3.	Net profit/turnover		
4.	Stock-in-trade/turnover		
5.	Material consumed/finished goods produced		

(The details required to be Furnished for principal items of goods traded or manufactured or services rendered)

Clause 41:

Please furnish the details of demand raised or refund issued during the previous year under any tax laws other than income Tax Act, 1961 and Wealth tax Act, 1957 along with details of relevant proceedings.

AUDIT OF PUBLIC TRUSTS

Section 12A of the Act deals with the conditions as to registration of trust etc. According to this section, exemption from Income tax would be available under sections 11 and 12 of the Income tax Act in relation to the income of any trust or institution provided the following conditions are satisfied:

Where the total income of the trust or institution as computed under this Act, without giving effect to the provisions of Sections 11 and 12 exceeds the maximum amount

which is not chargeable to income tax in any previous year i.e. Rs 2,50,000 For the A.Y. 2016-17, the accounts of the trust or institution for that year have been audited by an accountant as defined in the explanation below sub-section (2) of Section 288. Rule 17B of the Income tax Rules, 1962 provides that the report of audit of accounts of a trust or institution which is required to be furnished under Clause (b) of Section 12A should be in Form No. 10B:

a) Preliminary:

- i) Obtain a resolution from the trust specifying the appointment as also indicating the scope of audit.
- ii) Obtain a Letter of appointment From the trust.
- iii) Obtain a certificate as to the opening balances of assets and liabilities and the fund.
- iv) Obtain a list of books of accounts which are maintained by the trust.
- v) Obtain a certificate from the trust as to the system of accounting and internal control. (vi) Obtain From the trust a list of the institutions/ activities run/carried out by the trust.
- vi) Obtain from the trust a certified true copy of the Deed of Trust.

b) Routine Checking:

- (i) Check the books of account and other records having regard to the system of accounting and internal control.
- (ii) Vouch the transactions of the trust to satisfy that:
 - (a) the transaction falls within the ambit of the trust;
 - (b) the transaction is properly authorised by the trustees or other delegated authority as may be permissible in law;
 - (c) all incomes due to the trust have been properly accounted for on the basis of the system of accounting Followed by the trust;
 - (d) all expenses and outgoings appertaining to the trust have been recorded on the basis of the system of accounting followed by the trust; and
 - (e) amounts shown as applied towards the object of the trust are covered by the objects of the trust as specified in the document governing the trust.
- (iii) Obtain a trial balance on the closing date certified by the trustees.
- (iv) Obtain the Balance Sheet and Profit & Loss Account of the trust authenticated by the trustees and check the same with the trial balance with which they should agree.

c) Accounting principles:

The auditor should follow, i.e. generally accepted accounting principles and ascertain the accuracy, truth and fairness of the balance Sheet and profit & Loss Account.

In particular, the auditor will scrutinize that:

- i. All assets of the trust are verified;
- ii. The assets of the trust have been properly valued and depreciation duly provided for;
- iii. All liabilities of the trust are properly accounted for;
- iv. The investments of the trust are properly classified and indicated and market values shown; and

- v. Outstanding due to the trust are properly accounted for and their recoverability examined and provision made for irrecoverable.

d) Annexure to the Audit Report:-

- i. Obtain from the trustees, a certified list of persons covered by Section 13(3)
- ii. Obtain from the trustees, a statement enlisting the various items specified in the Annexure to Form No. 10B and giving the information against each item together with explanatory or supporting schedules.

QUESTIONS

Q1:- A. Co- operative society having receipts over 2 crores has appointed Mr. D as the statutory auditor –Mr. D is eligible to do the same under the state Co-operative Societies Act, Mr. D is not a chartered accountant, Mr. D is also appointed to conduct the tax audit of the society under section 44 AB of the Income Tax Act, 1961, Comment
(Nov. 2017)

Q2:- As an auditor appointed under section 44AB of the Income Tax Act, 1961, how would you verify and report on the following:

- i. The assessee has borrowed Rs 50 lakhs From various persons partly in cash and partly by account payee cheque
- ii. The assessee has paid rent of Rs 5 lakhs for premises to his brother.

(Nov. 2017)

Q3:- Mr. Ram, a Chartered Accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivers to the Income Tax Authorities a false declaration. What are the liabilities of Mr. Ram under Income Tax Act, 1961?
(May 2017)

Q4:- M/s. SB & Co. has been appointed as tax auditor under section 44 AB of Income Tax Act, 1961 by Woodcraft Interior Consultants, a professional partnership firm, having turnover 1.25 Crores. M/s. RS & Co. are the statutory auditors of the firm but they are unable to give their report on the financial statements of the Firm. M/s. SB & Co., have, however, completed their tax audit and want to issue their reports. Comment.
(May 2017)

Q5:-

a) ABC Pvt. Ltd. and XYZ Pvt. Ltd. are the Companies in which public are not substantially interested. During the previous year 2015-16, ABC Pvt. Ltd. received some property being shares of XYZ Pvt. Ltd. The details of which are provided below:

No. of Shares	1000	
Face Value	Rs 10 per share	
Aggregate Fair Market Value		Rs 1,00,000
Consideration Value	Nil	

As the tax auditor how would you deal with the situation? **(May, 2016)**

- b) You are appointed as tax auditor of Mr. X, a practicing advocate in Agra. During the previous year he collected Service Tax of Rs 7 lakhs but utilized for personal use. The Commissioner of Central Excise issued a show cause notice to him why the tax collected by him is not deposited to the Government account. He appeared before the Commissioner and stated his inability to pay the sum due to financial crisis. The proceedings are still pending. Mr. X requests you not to disclose his Service Tax registration details while Fitting particulars to be furnished in Form No. 3CD. As a tax auditor how would you deal with this?

(May, 2016)

Q6:- What can be the possible instances of capital receipt which, if not credited to the Profit and Loss Account, needs to be reported in Form 3CD? **(November, 2015)**

Q7:- Comment with respect to computation of total sales, turnover or gross receipts in business exceeding the prescribed limit under Section 44 AB of Income Tax Act, 1961 and VAT law.

- i. Discount allowed in the sales invoice
- ii. Cash discount
- iii. Price of goods returned related to earlier year
- iv. Sale proceeds of fixed assets.

(May, 2015)

Q8:- XYZ Ltd. pays 90000 for its 6 employees to a Hotel as boarding and lodging expenses of such employees for conference. The Company pays the amount in cash to the Hotel. The Hotel gives 6 bills each amounting to Rs 15000. The Company contends that each bill is within the limit, so there is no violation of the provisions of the Income Tax Act, 1961. As the tax auditor, how would you deal with the matter in your tax audit report for the Assessment Year 2014-15? **(November, 2014)**

Q9:- Mr. A engaged in business as a sole proprietor presented the following information to you for the FY 12-13. Turnover made during the year Rs 124 Lacs. Goods returned in respect of sales made during FY 10-11 is Rs 20 lacs not included in the above. Cash discount allowed to his customers Rs 1 lac for prompt payment. Special rebate allowed to customer in the nature of trade discount Rs 5 Lacs. Kindly advise him whether he has to get his accounts audited u/s 44AB of the Income Tax Act, 1961.

(November, 2013)

Q10:- While writing the audit program for tax audit in respect of A Ltd you wish to include possible instances capital receipt if not credited to Profit & Loss Account which needs to be reported under clause 13(e) of form 3CD. Please elucidate possible instances.

(May, 2013)

Q.11:- As an auditor of a partnership Firm under section 44AB of the Income Tax Act, 1961, how would you report the following:

i) Capital expenditure incurred for scientific research assets.

(November, 2012) (May, 2006)

ii) Expenditure incurred at clubs.

Q.12:- T Ltd's previous year ended on 31st March 2012. During that period it made a claim for refund of customs duty which was admitted as due by the customs authorities during April 2012. T Ltd neither credited the claim in the profit and loss account nor reported the same in clause 13(b) of Form 3CD for the reason that this has been admitted as due by the authorities only in the next financial year. Further T Ltd had changed the method of determination of cost formula for the purpose of stock valuation from FIFO basis to Weighted Average Cost basis, but that was also not reflected in clause 1(b) of Form 3CD which requires reporting on change in accounting method employed. Comment.

(May, 2012)

Q.13:- Briefly explain the steps involved in Audit under Indirect Tax. **(November, 2011)**

Q.14:- As a tax auditor, how would you deal and report the Following:

(i) An assessee has borrowed Rs 50 lakhs from various persons. Some of them by way of cash and Some of them by way of Account payee cheque / Draft.

(ii) An assessee has paid Rent to his brother Rs 2,50,000/- and paid interest to his sister Rs 4,00,000/-

(iii) An assessee has incurred payment to clubs.

(November,

2011)

Q.15:- While conducting the tax audit of A & Co. you observed that it made an escalation claim to one of its customer but which was not accounted as income. What is your reporting responsibility?

(May, 2011)

Q.16:- Mr. R, the Tax Auditor finds that some payments inadmissible under Section 40A (3) were made, and advised the client to report the same in form 3CD. The client contends that cash payments were made since the other parties insisted upon the same and did not have Bank Accounts. Comment.

(November, 2010)

Q.17:- Write a short note on Major steps required in preparation of Tax audit under VAT.

(May, 2010)

Or

What are the steps For the Audit under the State level 'Value Added Tax' (VAT)?

(November, 2007)

Q18)

a) ABC Printing Press, a proprietary concern, made a turnover of above Rs 43 lacs for the year ended 31.03.2009. The Management explained its auditor Mr. Z, that it undertakes different job work orders from customers. The raw materials required For every job are dissimilar. It purchases the raw materials as per specification/requirements of each customer, and there is hardly any

balance of raw materials remaining in the stock, except pending work-in-progress at the year end. Because of variety and complexity of materials, it is rather impossible to maintain a stock-register. Give your comments.

(November, 2009)

- b) A Co-operative Society having receipts above Rs 40 lakhs gets its accounts audited by a person eligible to do audit under Co-operative Societies Act, 1912, who is not a Chartered Accountant. State with reasons whether such audit report can be furnished as tax audit report under Section 44 AB of the Income Tax Act, 1961?

(November, 2009)

Q.19:- Discuss briefly Accounting standards to be followed by assesseees under the Income-tax Law. **(November, 2009)**

Q.20:- Draft an Audit programme for conducting the audit of a Public Trust registered under section 12A of the Income Tax Act, 1961. **(June, 2009)**

Q.21:- As the tax auditor of a non-corporate entity u/s 44AB of the Income Tax Act, 1961, how would you ensure compliance of section 145 of the Income Tax Act, 1961?

(June, 2009)

Q.22:- State whether a Tax audit report can be revised and if so state those circumstances.

(November, 2008)

Q23:- As the tax auditor of a Company, how would you report on payments exceeding Rs 20,000 made in cash to a supplier against an invoice for expenses booked in an earlier year?

(May, 2008)

Q.24:- Write a short note on Accounting ratios in Form 3 CD of Tax Audit.

(November, 2007)

Q.25:- Write a short note on Method of accounting in Form No. 3CD of Tax Audit.

(May, 2007)

Q.26:- Labour charges paid on which tax is deducted at source at an inappropriate rate. As a tax auditor, how would you report?

(May, 2006)

Q.27:- Enumerate some of the areas of concern in an audit of indirect taxes.

(November, 2005)

Q.28:- As a tax auditor, which are the accounting ratios required to be mentioned in the report in case of manufacturing entities? Explain in detail any one of the above ratios and how does it help the tax auditor in his analytical review.

(November, 2005)