

**B= AUDIT UNDER DIRECT TAX LAWS**

Applicability of Tax Audit u/s 44 AB

- Profession gross receipts > Rs.50 Lac in any previous year {Clause (b) of 44 AB} OR
- Business Turnover/ Total Sales/ Gross receipts > Rs.1 Cr in any previous year {Clause (a) of 44 AB} OR
- Person carrying business referred u/s 44AE/44BB (Exploration of mineral oil)/ 44BBB (Foreign co engaged in Civil Construction) & declaring lower income than prescribed under those sections in PY {Clause (c) of 44 AB}. OR
- Person carrying business u/s 44 AD & declaring lower income than 44 AD & his income > max exempted limits {Clause (d) of 44 AB}

**Note: -**

- \* Where all assessee is proprietor of more than one concern, aggregate of all the businesses to be taken into consideration for the purposes of compliance with the provisions of Sec.44AB
- \* Under Section 44 AD, income would be presumed to be 8 % of the total turnover of the assessee, only if the total turnover of the assessee is less than 2 crore. In case, the total turnover , of the assessee is more than Rs 2 crore, income would be computed as per the normal provisions of the Income Tax Act. If payments are received digitally, 8% shall be taken at 6 %.It implies that even if the turnover of the assessee exceeds 1 crore , tax audit will not be applicable if the assessee opts for Section 44 AD .However, this scheme is not available for professionals, commission agents and company assesses.
- \* Clause (c ) of Section 44 AB provides that if the assessee carries on presumptive business, tax audit is required if he claims his income to be lower than presumptive income deemed under those sections.
- \* Requirements of Section 44 AB is a general requirement covering the overall position of accounts of assessee. This applies to the consolidated accounts of the assessee for the relevant previous year covering the results of all units owned by the assessee.

**ILLUSTRATIONS ON APPLICABILITY OF TAX AUDIT PROVISIONS**

**DB Pvt Ltd. has total turnover of 125 Lac for the FY 2017-18** = Section 44AD is not applicable to company ASSESSEE, hence Limit of 2 Cr is not applicable to DB Pvt Ltd and it has to conduct the Audit of Books of Accounts under section 44AB of the Act for the FY 2017-18 as turnover exceeds 1crore.

**ABC & Co. (partnership firm) engaged in trading Electronic goods having a turnover of 165 lacs for FY 2017-18** = Section 44AD is applicable to Partnership Firm. Thus, ABC & Co. can declare the minimum profit @ 8% of the turnover as its turnover during the PY 2017-18 does not exceed 2 Cr. If the firm do not opt for presumptive income scheme under section 44AD, it has to get books of accounts audited u/s 44AB of the Act.

**Mr. A, Commission Agent has commission receipts of 137 Lac during FY 2017-18** = Though Section 44AD is applicable to an Individual, it is not applicable to Commission income. In the given case, since, Mr. A, earns the commission income, he cannot take benefit of section 44AD. His total turnover during FY 2017-18 in respect of commission income exceeds 1 Cr., he has to get his books of accounts audited u/s 44AB of the Act.

**Mr. Vishal R, owning an Agency of Samsung Mobile for the city of Pune and make turnover of 87 Lac during the FY2017-18** = Though Section 44AD is applicable to an Individual, it is not applicable to Commission income. In the given case, since, Mr. Vishal earn the commission income, he cannot take benefit of 44AD. His total turnover during FY 2017-18 in respect of commission income does not exceeds 1 Cr, therefore, he need not to get his books of accounts audited u/s 44AB of the Act.

CLAUSE	PARTICULARS TO BE FURNISHED U/S 44AB OF INCOME-TAX ACT, 1961
1	<u>Name Clause:</u> - Person whose accounts are being audited u/s 44AB to be given.
2	<u>Address Clause:</u> - Address same as communicated by Person to Income-tax Dept. for assessment purposes as on date of signing of audit report.
3	PAN allotted to Person indicated. (in E-filing = PAN is mandatory)
4	<p>Details of IDT Registration (Person liable to pay IDT like Excise, Service Tax, GST, VAT, Custom (If yes, please furnish Registration no. or any other identification number allotted for same)</p> <p><b>The tax auditor is required to report the GST Registration no of the assessee. If the auditor is prima facie of the opinion that the assessee is required to get himself under indirect tax law but he is not registered under the said law, he is required to report same appropriately</b></p>
5	Status of Person mentioned (Individual, HUF, Co, Firm, AOP etc.)
6	Previous Year (Period of previous year to be stated)
7	AY relevant to previous year for which accounts being audited = mentioned.
8	Under which Clause of Sec 44AB audit conducted = mentioned by auditor.
9	<p>(a) If firm or AOP, indicate names of partners/members &amp; PSR.</p> <p>(b) If change in partners/ members/ PSR since last date of preceding year = particulars of change.</p>
10	<p>(a) Nature of business or profession (If &gt; 1 business or profession carried in previous year = Nature of every business or profession)</p> <p>(b) If change in nature of business or profession = particulars of such change.</p>
11	<p>(a) Whether BOA prescribed u/s 44AA (If yes = List of books so prescribed) (Example: - Mentioning Stock book and register not maintained).</p> <p>(b) List of BOA maintained &amp; address at which BOA are kept. (In case BOA maintained in a computer system, mention BOA generated by such computer system. If BOA are not kept at 1 location, please furnish Addresses of locations along with details of BOA maintained at each location)</p> <p>(c) List of BOA &amp; nature of relevant documents examined.</p>
12	Whether P/L includes any profits & gains assessable on presumptive basis. {If yes indicate amount & section (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, etc.)}
13	<p>(a) Method of accounting employed in previous year</p> <p>(b) Whether change in method of accounting employed in comparison to method in previous year</p> <p>(c) If answer to (b) above is in affirmative = give details of such change &amp; effect thereof on P/L.</p> <p>(d) Details of deviation in method of accounting employed in previous year from AS prescribed u/S 145 &amp; effect on P/L.</p>

14	→	<p>(a) Method of valuation of closing stock employed in previous yr. (Link with AS-2 i.e. FIFO to LIFO but if change is LIFO to FIFO = reporting required but we will mention that this is a bona fide change and meets requirement of AS-2.)</p> <p>(b) If deviation from method of valuation prescribed u/s 145A &amp; effect on P/L</p>
16	→	<p><u>Amounts not credited to P/L being: -</u></p> <p>(a) Items falling in Scope of section 28. (b) Performa credits, drawbacks, refund of duty of customs or excise or service tax or sales tax or VAT (c) Escalation claims accepted during the previous yr. (d) Any other item of income. (e) Capital receipt (i.e. Capital receipts Taxable u/h PGBP &amp; not Capital Gain) {CG goes CP}</p> <ul style="list-style-type: none"> <li>• C = Capital subsidy in nature of promoter contribution.</li> <li>• G = Govt. Grants for Fixed Assets.</li> <li>• C = Compensation for surrender of Certain Rights.</li> <li>• P = Profit on Sale of Fixed Assets.</li> </ul>
17	→	<p>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 SG referred to in section 43CA or 50C, please furnish: - Details of property, Consideration received or accrued, Value adopted or assessed or assessable.</p>
18	→	<p>Particulars of depreciation allowable in Income-tax Act, 1961 of each asset or block of assets.</p>
19	→	<p>Capital expense on scientific research assets &amp; entire Sec 35 series of PGBP &amp; 32 AC, AB, ABA. <b>In the list of weighted deductions Section 32 AD has been added i.e. where Companies get the deduction for investment allowance.</b></p>
21	→	<p>(a) Furnish details of amount debited to P/L, being in nature of capital, personal, advertisement exp. etc. (i.e. Any expenditure not disallowed u/s 37 or personal expense not debited in P &amp; L. (Ex: - Expenditure incurred on club, If same is incurred by co to meet personal exp. of Director report.)</p> <p>(b) Amounts inadmissible u/s 40(a) (i.e. when TDS not deducted or not deducted in due date = give details of amount, date of payment, Name &amp; Address of payee)</p> <p>(c) Amt. debited to P/L= interest, salary, bonus, commission or remuneration inadmissible u/s 40(b)/40(ba)</p> <p>(d) Disallowed income/ expenses i.e. Disallowance/deemed income under section 40A (3). (i.e. Cash payment &gt; Rs.10000. However exceptions given in Rule 6DD must be kept in mind).</p>
22	→	<p>Amount inadmissible u/s 23 of Micro, Small &amp; Medium Enterprises Development Act, 2006.</p>
23	→	<p>Particulars of payments made to persons specified under section 40A (2) (b) (Related party). <u>Example: - Rent paid to brother-Report in form 3CD.</u> Also check if payment is excessive (&gt; FMV or legitimate needs of business).</p>
24	→	<p>Amounts deemed to be Profits &amp; Gains u/s 32AC, 33AB or 33ABA or 33AC</p>
25	→	<p>Amount of profit chargeable to tax u/s 41 &amp; computation thereof.</p>
28	→	<p>In previous year person Received Property/ <b>Received shares</b> (share of co not being co in which public are substantially interested) without consideration or for inadequate consideration u/s 56(2) (vii a) &amp; If yes = furnish details</p>

29	→	In previous yr Person got consideration for <b>Issue of shares which exceeds the FMV of a company in which public is not substantially interested- 56(2)(vii b)</b> & If yes = Furnish details of it																
31	→	Particulars of each loan or deposit in amount > limit u/s 269SS (taken or accepted >20000) or 269 T (repayment > 20000) in cash. (Furnish details such as PAN, Amount, Name, Address & Payment Mode. )																
32	→	Details of brought forward loss or depreciation allowance, incurred any speculation loss, incurred any loss referred to in Sec 73A on any specified business in previous yr, change in shareholding due to which losses can't be allowed to be carried forward u/s 79.																
33, 34	→	If Person is required to deduct or collect tax, furnished statement of tax deducted or tax collected in prescribed time, liable to pay interest u/s 201(1A) or section 206C(7).																
35	→	* If Trading concern = give quantitative details of principal items of goods traded * If a manufacturing = give quantitative details of principal items of RM, FG & by-products (Opening Stock, Purchases & Sales)																
36	→	If domestic company = Details of Tax on Distributed Profits.																
37, 38, 39	→	Whether Cost audit (37)/ Audit under Central Excise Act (38)/ Special Audit u/s 72A of Finance Act was carried out (39). If yes = give details of disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/ identified by Auditor.																
40	→	<p>Details on Turnover, Gross profit, etc. for previous year &amp; preceding previous year (A/c Ratios)</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 10%;">S.N.</th> <th style="width: 40%;">Particulars</th> <th style="width: 20%;">Previous Year</th> <th style="width: 30%;">Preceding PY</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">1</td> <td style="text-align: center;">Total Turnover</td> <td style="text-align: center;">XX</td> <td style="text-align: center;">XXX</td> </tr> <tr> <td style="text-align: center;">2</td> <td style="text-align: center;">Gross Profit/ Turnover</td> <td style="text-align: center;">XX</td> <td style="text-align: center;">X</td> </tr> <tr> <td style="text-align: center;">.....</td> <td style="text-align: center;">.....</td> <td style="text-align: center;">.....</td> <td style="text-align: center;">.....</td> </tr> </tbody> </table>	S.N.	Particulars	Previous Year	Preceding PY	1	Total Turnover	XX	XXX	2	Gross Profit/ Turnover	XX	X	.....	.....	.....	.....
S.N.	Particulars	Previous Year	Preceding PY															
1	Total Turnover	XX	XXX															
2	Gross Profit/ Turnover	XX	X															
.....	.....	.....	.....															
41	→	Furnish details of demand raised or refund issued in previous yr under any tax laws other than Income-tax Act, 1961 and Wealth tax Act, 1957 with details of relevant proceedings.																

**Guidance Note on Tax Audit by ICAI**

- A CA can accept maximum 60 tax audit assignments.
- Clarification issued by Institute on Tax Audit Assignments = Tax audit reports may be signed by partners in any manner whosoever in accordance with specified audit limits.
- 1 partner can individually sign all tax audit reports subject to specified tax audit assignment limits on behalf of all partners in firm of CAs in practice or all partners of the firm can collectively sign tax audit reports.
- Ex: - 6 partners = 360 tax audit assignments be accepted & even 1 partner can sign all 360 Tax audit report

**The tax auditor should therefore obtain a certificate from the assessee regarding all such advances received towards transfer of capital assets which have forfeited during the year.**

**40 A(3)** → Where any expenditure in respect of which payment is made in excess of 10,000 at a time otherwise than by Account-payee CHEQUE or draft, 100% of such payment shall be disallowed.

**CLAUSE 29 in FORM 3CD**

**Clause 29A =**

**The auditor is required to report whether any amount is taxable under the head IFOS u/s 56(2)(ix). If yes, the auditor is required to furnish the following: -**

**\* Nature of Income**

**\* Amount thereof**

Income from other sources u/s 56(2)(ix)- Advance received for capital asset and sale didn't take place and advance received is forfeited. This amount forfeited is to be shown as income from other sources u/s 56(2)(ix) {i.e. Forfeiture of Advance received towards the transfer of a capital asset will be taxable under the head IFOS.

**Clause 29B =**

**Tax auditor is required to report whether any amount is taxable under the head IFOS u/s 56 (2) (x).**

**If yes, the auditor is required to furnish the following: -**

**\* Nature of Income**

**\* Amount thereof**

Income from other sources u/s 56(2)(x)- i.e. Any sum received without consideration in excess of 50000 or Stamp duty value which exceeds 50000 or more or In sale of any immovable property where consideration exceeds 105 % of stamp value is to be shown as IFOS u/s 56(2)(x).

**INSERTION OF CLAUSE 30A & 30B in FORM 3CD**

**Clause 30A =****30 A- Primary Adjustment**

The Tax auditor is required to report: -

- (a) whether any primary adjustment is needed u/s 92 CE
- (b) Whether the excess money available with the associate enterprise has been repatriated in India
- (c) if yes whether repatriated to India within the prescribed time limit.
- (d) if not repatriated what is the imputed interest income on excess money not been received in prescribed time.

*No secondary adjustment is required if the amount of primary adjustment made in any previous year does not exceed 1 crore.*

**Eg1. 50 Lac worth goods purchased from associate enterprise outside India and paid 60 Lac. i.e. primary adjustment is only Rs. 10 Lac. So reporting under clause not needed**

**Eg2- Say goods are purchased from associated enterprise o/s India. FMV- Rs 90 Cr. Purchased at Rs 105 Cr. 15 Cr is excess payment o/s India. So it is the primary adjustment needed.**

**Clause 30B = Limitation on Interest Deduction: -**

30B (a) = Whether assessee incurred expense in PY by interest or similar nature > 1 Crore in 94B?(Yes/No)

30B (b) = If yes, please furnish the following details:- \* Expenditure by way of interest or of similar nature incurred

\* Earnings before interest, tax, depreciation and amortization (EBITDA) during the previous year

\* Expenditure by way of interest or of similar nature as per (i) above which exceeds 30% of EBITDA

\* Details of interest expenditure brought forward as per subsection (4) of section 94B: A.Y. Amount

\* Details of interest expenditure carried forward as per subsection(4) of section 94B

**Ex -interest expense of co for CY- 200 Cr & EBIDTA-500 Cr = Here, interest deduction can be claimed up to 30 % of EBIDTA i.e. 30 percent of 500 Cr i.e. 150 Cr. 50 Cr of interest expenditure will be carried forward. The tax auditor is required to report about the same.**

**30 C - Impermissible Avoidance agreement; However, the applicability of this clause is deferred till 1/4/2019**

**Amendment in CLAUSE 31 OF FORM 3CD**

**Clause 31 (a) = Particulars of each loan or deposit > limit specified in Sec 269SS taken or accepted in previous year: -**

- \* Name, address & PAN (if available with assesses) of lender or depositor
- \* Amount of loan or deposit taken or accepted
- \* Whether loan or deposit was squared up in previous yr
- \* Max amt outstanding in a/c at any time in previous yr
- \* Whether loan or deposit taken or accepted by CHEQUE/ DD/ ECS through bank account
- \* If loan or deposit was taken or accepted by CHEQUE/ DD, whether same was a/c payee cheque  
(These particulars not be given if Govt. co, bank or corporation established by CG, SG or Provincial Act)

**31 (b) -** Accepting a specified sum

**31 (c) -** Whether Repayment of loan is done in Py, mode etc

**31 (d) -** Details of repayment of those loans originally accepted in cash

**Clause 31 (e) = Particulars of repayment of loan or deposit or specified advance > limit specified in Sec 269T received by CHEQUE/ DD which is not account payee during previous year: -**

- \* Name, address & PAN (if available with assesses) of lender or depositor
- \* Amt of loan or deposit or specified advance received by CHEQUE/ DD which isn't a/c payee cheque in previous yr
- \* Whether loan or deposit was squared up during previous year

**Clause 31(b a): -** Particulars of receipt in an amount exceeding the limits specified in Sec 269 ST in aggregate from a person in a day or in respect of a single transaction relating to one event or occasion from a person during the PY, where such receipt is otherwise than by cheque or bank draft or use of electronic clearing system through a bank account( i.e. cash received of more than 2 Lac in a single day or for a single event)

- (i) Name, address and PAN      (ii) Nature of transaction      (iii) Amount of receipt      (iv) Date of receipt  
{ie in excess of 2 Lac from a single person in a single day in respect of a single transaction or multiple transactions relating to one event or occasion. Ex-I received more than 2 Lac from my client in Cash-I will have to report name, address, pan, Nature of receipt, amount date.

**Clause 31(bb): -** Particulars of Receipts in an amount exceeding the limits specified in Sec 269 ST in aggregate from a person in a day or in respect of a single transaction relating to one event or occasion from a person during the PY, received by cheque or bank draft (not being an account payee cheque or demand draft

- (i) Name, address and PAN  
(ii) Amount of receipt      {Ex 2- I received more than 2 Lac from my client from cheque/draft which is not an account payee cheque or draft, then report Name, address and Pan and Amount.}

**Clause 31(b c): -** Particulars of each payment made in an amount exceeding the limits specified in Sec 269 ST in aggregate from a person in a day or in respect of a single transaction relating to one event or occasion from a person during the PY, where such payment is otherwise than by cheque or bank draft or use of electronic clearing system through a bank account( ie cash paid more than 2 Lac in a single day or for a single event): -

- (i) Name, address and PAN      (ii) Nature of transaction  
(iii) Amount of receipt      (iv) Date of receipt

**Clause 31 (b d): -** Particulars of payments in an amount exceeding the limits specified in Sec 269 ST in aggregate from a person in a day or in respect of a single transaction relating to one event or occasion from a person during the PY, paid by

cheque or bank draft (not being an account payee cheque or demand draft): - (i) Name, address and PAN (ii) Amt of receipt

- NOTE: -**
- \* Sec 269 SS of Income Tax Act = Loan/ deposit > 20,000 to be only by CHEQUE/ DD/ ECS
  - \* Sec 269 T of Income Tax Act = Loan/ deposit > 20,000 to be only by CHEQUE/ DD/ ECS
  - \* Sec 44AB apply when turnover exceeds 1 Cr but benefit 44AD is available (i.e. option of 8% presumptive income or 6 % if digital payment is made) if turnover is up to 2 cr.
  - \* Sec 44AD tax audit N/A to commission income.

**COMPARATIVE ANALYSIS**

<u>Clause 31 b a</u>	<u>Clause 31 bb</u>	<u>Clause 31 b c</u>	<u>Clause 31 b d</u>
<p><b>Tax auditor is required to report the following if amount of more than 2 lac is received in CASH</b></p> <p><b>in a single day or for a single event in previous year: -</b>  <b>Name, address &amp; PAN, Nature of transaction, Amount of receipt, Date of receipt.</b></p>	<p><b>Tax auditor is required to report the following if amount of more than 2 lac is received in CHEQUE OR BANK DRAFT</b></p> <p><b>(other than account payee CHEQUE or DD) in a single day or for a single event in previous year: -</b>  <b>Name, address &amp; PAN &amp; Amount of receipt.</b></p>	<p><b>Tax auditor is required to report the following if amount of more than 2 lac is paid in CASH</b></p> <p><b>in a single day or for a single event in the previous year: -</b>  <b>Name, address &amp; PAN, Nature of transaction, Amount of payment, Date of payment.</b></p>	<p><b>Tax auditor is required to report the following if amount of more than 2 lac is paid in CHEQUE OR BANK DRAFT</b></p> <p><b>(other than account payee CHEQUE or DD) in a single day or for a single event in previous year: -</b>  <b>Name, address &amp; PAN &amp; Amount of payment .</b></p>

The amount of 2 Lac has been specified in Section 269 ST of the Income Tax Act, 1961.

**INSERTION OF CLAUSE 36A in FORM 3CD**

**Clause 36A =**

**(a) = whether ASSESSEE received amount in the nature of dividend in clause (22) of Section 2.**

**(b) = If yes, please furnish the following details:-**

- \* Tax auditor obtain from the taxpayer a certificate containing a list of closely held co in which he is beneficial owner
- \* Obtain certificate from taxpayer giving particulars of loans or advances received by concern of his substantial interest
- \* Include appropriate remarks of his inability to independently verify the info & reliance on certificates obtained Above
- \* Verify Form 26AS if taxpayer to know if the closely held company has deducted tax at source
- \* Whether Amount is chargeable to tax as dividend 2(22)(e) been a subject matter of litigation = needs to consider

**INSERTION OF CLAUSE 42 in FORM 3CD**

Tax auditor to review Due diligence procedures carried out by taxpayer in accordance with Rule 114H & results of such procedures. Tax auditor should review list of Reportable Accounts identified by due diligence process and the information to be maintained and reported by Taxpayer. In case any reportable account has been omitted, or there is any error or omission in Form 61B, the same may be reported under the Form No. 3CD. The auditor should verify if the taxpayer has filed Form No. 61B for correcting errors or omissions in the form filed originally.

**(a) Whether ASSESSEE is required to furnish statement in Form No.61 or Form No. 61A or Form No. 61B? (Yes/No)**

**(b) If yes, please furnish: -**

- \* I have entered in transaction > 2 Lac with a person who has not quoted the pan. Hence he has furnished form 60.
- \* I am required to file form 60 i.e. receiver of form 60 has to file form 61.
- \* Form 61- Receiver of Form 60
- \* Form 61 A - Specified financial transactions- Ex Cash deposits > 10 Lac, BB of share of amount exceeding 10 Lac etc.
- \* Form 61 B - FATCA- Foreign Account Tax compliance Act

42 (a)	Income Tax Dpt. Reporting entity ID No.	Type of Form	Due date for furnish	Date of furnish	Whether form contains info on transactions required to be reported	If not please furnish list of the details/transactions which are not reported

**INSERTION OF CLAUSE 43 in FORM 3CD**

**Clause 43 = CBCR**

**(a) Whether the ASSESSEE or its parent entity or alternate reporting entity is liable to furnish the report as referred to in subsection (2) of section 286 (Yes/No)**

**(b) If yes, please furnish the following details: -**

- \* Whether report been furnished by assessee or its parent or alternate reporting entity
- \* Name of parent entity
- \* Name of alternate reporting entity (if applicable)
- \* Date of furnishing of report

Clause 43 has been newly introduced in Form No. 3CD. The Finance Act, 2016 by introducing Section 286 in the Act, has introduced provisions relating to the Country by Country Report (CbCR) and Master File pursuant to the adoption of OECD's Base Erosion and Profit Shifting (BEPS), Action Plan 13 in India. Under Section 286, an international group has to furnish CbCR containing information about the whole group comprising of various constituent entities.

Such a report is to be filed in India if the parent entity is resident of India or the international group has appointed a constituent entity which is resident in India to file CbCR on behalf of the whole group.

The report under Section 286(2) is filed by parent entity which is resident in India or the alternate reporting entity which is resident in India. For tax audit for the assessment year 2018-19, the tax auditor should comment upon report Section 286(2) that was required to be filed on or before 31 March 2018.

The tax auditor should verify if the taxpayer is required to file Form 3CEAC based on satisfaction of the conditions prescribed. The tax auditor should also verify if the taxpayer whose parent is a non-resident has filed Form No. 3CEAC.

**Tax auditor may obtain a necessary certificate from the taxpayer in respect of constitution of the international.**

**Clause 44: -**

**Break-up of total expenditure of entities registered or not registered under the GST: -**

Sl. No.	Total amount of Expenditure incurred in year	Expenditure in respect of entities registered under GST				Expenditure in respect of entities registered under GST Expenditure
		Relating to goods or services exempt from GST	Relating to entities falling under composition scheme	Relating to other registered entities	Total payment to registered entity	
1	2	3	4	5	6	7

# PEER REVIEW

**Meaning**

- "Peer" means a person of similar standing.
- "Review" means conduct of re- examination or retrospective evaluation of the subject matter.
- "Peer review" = Review of work done by professional, by another professional of similar standing.
- A regulatory mechanism to monitor performances of professionals to maintain quality of service expected of them for enhancing reliance placed by users of FS for economic decision-making.

**OBJECTIVES**

**To Ensure that in carrying out assurance service assignments, members of Institute: -**

- Comply to Technical, Professional & Ethical Standards as applicable including other regulatory requirements &
- Have in place proper systems including documentation for maintaining the quality of the assurance services.
- Objective of peer review is not to find out deficiencies but to improve quality of services rendered by members
- Provide guidance to members to improve their performance & adherence to statutory & regulatory requirement.
- It seeks to identify and address patterns of non-compliance with quality control standards.

**SCOPE/ FOCUS**

**Peer Review applies to all assurance services provided by Practice Unit. While carrying out review, reviewer examines assurance engagement records of Practicing Unit (PU) so as to cover following: -**

- Comply to Technical, Professional & Ethical Standards.
- Quality of reporting.
- Systems & procedures to carry assurance services.
- Comply to directions or guidelines of Council

**Areas excluded from Scope of Peer Review = Assurance Services: -**

It is Used interchangeably with Audit Services, Attestation & Audit Functions but not include following: -

- Management Consultancy Engagements.
- Engagement for Due diligence.
- Representation before various Authorities.
- Testifying as an expert witness.
- Engagements to prepare tax returns or advising clients in tax matters & for the compilation of FS.
- Engagements solely to assist Client in preparing, compiling or collating info other than financial statements.
- Providing expert opinion on points of principle, such as Accounting Standards or the applicability of certain laws

## PRELIMINARY REPORT UNDER PEER REVIEW

**In peer review, after completing on-site Review, if Reviewer finds procedures are deficient or non-compliant noticed by him or if there are other matters where he wants to seek clarification, then: -**

**Contents of Preliminary Report**

- Reviewer to communicate his findings in Preliminary Report to PU before making Report to Board.
- No preliminary report is required in case no deficiencies or non- compliance are noticed by reviewer.
- Reviewer should prepare the report on his letterhead.
- Report be dated & contain reviewer's sign & membership no. & reviewer's code number allotted by Board.
- Preliminary Report is addressed to the practice unit.

- \* Findings of Peer Reviewer.
- \* Assess the conclusions drawn from the review indicating deficiencies to be reported upon.
- \* Mentioning areas where procedures of PU found deficient
- \* Contain paragraph that discusses scope of review performed = If Reviewer draws a conclusion that there existed a limitation on scope of review = communicate it to PU by such Preliminary Report.

**EXPLAIN STAGEWISE APPROACH ADOPTED BY PEER REVIEW**

- Reviewer should Gain Understanding of Engagement letter
- No. of assurance engagements to be selected = requires judgment based on evaluation of replies
- Reviewer should examine that Policies & procedures for acceptance of audit complied & documented
- Reviewer may follow Compliance & Substantive Procedures in peer review process.

• Reviewer while evaluating records may consider the following: -

- Determine issues, matters, problems in engagement considered, resolved & documented.
- Determine adequate audit evidence for engagement is obtained to support conclusions drawn
- Determine significant decisions relating to engagement, use of professional judgment, resolution of significant matters have been properly documented.

<b>Methods of Collection of evidences by PEER REVIEWER</b>	<b>Inspection</b>	Consists of examination of documentation & other records maintained by PU.
	<b>Observation</b>	* Consists of witnessing a procedure or process being performed by others. * Ex: - While conducting on-site review reviewer reviews performance of internal control.
	<b>Inquiry</b>	* Seeking appropriate info from partner/sole proprietor or knowledgeable persons in PU. * Inquiries may originate from responses to the questions given in Questionnaire. * Inquiries may arise from inspection of documentation maintained by the practice unit.

**MANDATORY REQUIREMENT FOR PEER REVIEW**

Level 1 P.U.	Level 2 P.U.	Level 3 P.U.
Once in 3 yrs.	Once in 4 yrs.	Once in 5 yrs.
Central Statutory Auditor of Public/ Pvt. Sector Banks/ Foreign Banks/ PFI/ Insurance Co.	Statutory Auditor of Co: - Net worth > 5Cr & Annual Turnover > 50 Cr	Others
Statutory Auditor of Asset Management Co/ Mutual Fund	Statutory/ Internal Auditor / Concurrent/ Tax Audit of Insurance co/ Bank/ NBFC	Others
Entities raising > 50 Cr funds from Loans/ Donations/ Subsidies.	-	-
Once in 3 yrs.	Once in 4 yrs.	Once in 5 yrs.

**PEER REVIEW PROCESS** = Select PU & Appointment of Reviewer + Planning + Execution + Reporting

**REPORTING STAGE**

Peer Review Report to address his report of compliance or otherwise on following areas of control	Peer Review Report of Reviewer
<p><i>(For IPO, Staff Recruitment &amp; development &amp; office admin)</i></p> <ul style="list-style-type: none"> <li>Independence.</li> <li>Maintenance of Professional skills and standards.</li> <li>Outside Consultation.</li> <li>Staff recruitment, Supervision and Development.</li> <li>Office Administration</li> </ul> <p><u>Further Discussion/ Communication of Findings:</u> -</p> <ul style="list-style-type: none"> <li>* After completing the on-site Review, the Reviewer, before making his Report to the Board to communicate his findings in the Preliminary Report to PU.</li> <li>* 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.</li> <li>* PU in 15 days after date of receipt of findings makes submissions or representations, in writing to Reviewer.</li> </ul>	<p><b>(a) At end of on-site Review if Reviewer satisfied with reply received from PU:</b> -</p> <ul style="list-style-type: none"> <li>* Submit a Peer Review Report to the Board along + IRR: -</li> <li>- Initial findings - Response by PU &amp; Manner in which Responses have been dealt with. (Copy of report forwarded to PU)</li> </ul> <p><b>(b) If Reviewer find response by PU not satisfactory:</b> -</p> <ul style="list-style-type: none"> <li>* Submit modified Report to Board + reasons for it</li> <li>* Submit IRR (Copy of report forwarded to PU)</li> </ul> <p><b>(c) In case of a modified report:</b> -</p> <ul style="list-style-type: none"> <li>* Board to order a "Follow On" Review after a period of 1 year from date of issue of report as in (b) above.</li> <li>* If Board so decides, period of 1 year above may be reduced but shall not be less than 6 months.</li> </ul>

<b>Eligibility for Peer Reviewers</b>	<ul style="list-style-type: none"> <li>Not guilty of misconduct under CA ACT, 1949</li> <li>Obtained prescribed training organised by Peer Review Board.</li> <li>Signed declaration of Confidentiality as prescribed.</li> <li>7 years of experience of Peer Review of Level 1 PUs.</li> <li>No disciplinary action pending against him or convicted by Court.</li> <li>Not to accept professional assignment from PU for 2 years from date of appointment.</li> <li>Continuous 10 years in Practise</li> <li>Not having any conflict of interest.</li> </ul>
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# INVESTIGATION

<u>Basis of Differ</u>	<u>INVESTIGATION</u>	<u>AUDIT</u>
↓	↓	↓
<b>Objective</b>	Aims to establish a fact or happening or at assessing a particular situation.	To verify whether FS display True & fair view of State of affairs & working results.
<b>Scope</b>	Scope of investigation may be governed by Statute or it may be non- statutory.	Scope of audit is wide & in case of statutory audit it is determined by relevant law.
<b>Periodicity</b>	Work is not limited by rigid time frame& may cover several yrs, as outcome of it is not certain.	Carried Quarterly, Half-yearly or Yearly.
<b>Nature</b>	Detailed study & examination of facts and figures.	Tests checking or sample technique to draw evidences to form judgment & opinion.
<b>Limitations</b>	No inherent limits due to nature of engagement.	Audit suffers from inherent limitation.
<b>Evidence</b>	It seeks Conclusive evidence.	Prima- facie or Persuasive evidence.
<b>Observance of Account Principles</b>	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.
<b>Reporting</b>	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 like Members of Co.

<b>TYPES OF INVESTIGATION</b>	<b>Non Stat.</b>	<ul style="list-style-type: none"> <li>* For Valuation of shares in private companies</li> <li>* In connection with review of profit/ financial forecast</li> <li>* On behalf of individual or a firm proposing to buy a business</li> <li>* On behalf of a bank proposing to advance loan to a company</li> </ul>
	<b>Statutory (by Inspector)</b>	<p><b>Sec. 210 of Co Act 2013 = Investigation into affairs of company: -</b></p> <ul style="list-style-type: none"> <li>• <u>CG may Order an investigation into affairs of company: -</u></li> <li>- On receipt of a report of Registrar/Inspector u/s 208      OR      - In Public Interest.      OR</li> <li>- On intimation of a Special resolution passed by company in this regard</li> <li>• CG to Order Investigation in affairs of company where order passed by Court/ Tribunal in this regard</li> <li>• CG may Appoint 1 or more persons as inspectors who report to CG in manner as directed by CG.</li> </ul> <p><b>Sec. 212 = Investigation into affairs of company by SFIO (Serious Fraud Investigation Office): -</b></p> <ul style="list-style-type: none"> <li>• <u>CG may, by order assign investigation into affairs of a company to SFIO: -</u></li> <li>- On receipt of a report of Registrar/Inspector u/s 208      OR</li> <li>- On intimation of a Special resolution passed by company in this regard      OR</li> <li>- In public interest      OR      - On request from any Department of CG/SG.</li> <li>• Director, SFIO may designate such number of inspectors as he considers necessary for investigation.</li> <li>• SFIO conducts Investigation in prescribed manner&amp; submits report to CG in period given in order.</li> </ul> <p><b>Sec 216 = Investigation into Ownership of Co: -</b></p> <ul style="list-style-type: none"> <li>• <u>CG may appoint 1 or more Inspectors to investigate &amp; report for Determining True persons: -</u></li> <li>- Who are or have been financially interested in the success or failure of the company      OR</li> <li>- Who are or have been able to control or materially influence the policy of the company.</li> <li>• CG may define the scope of investigation on matters / period/ particular shares or debentures</li> </ul>

**Reporting of Findings**

- Report not to contain anything not relevant highlighting nature of investigation or final outcome
- Every Word or expression used = properly considered as interpretation differences minimized.
- Relevant facts and conclusions should be properly linked.
- Bases and assumptions made = explicitly stated.
- Report clearly tell nature & objective of assignment accepted its Scope and limitation.
- Report should be made in paragraph form with headings for the paragraphs.
- Any detailed data & figures supporting finding may be given in Annexure.
- State restrictions or limitations imposed on instructions given by the client.
- Opinion of investigator = appear in final paragraph of report.

**POWERS & REPORT OF INSPECTOR ON INVESTIGATION**

**(Sec 217) Procedures & Powers of Inspector**

**Production of Docs**

- \* Officers, Employees & agents = produce all book & papers & provide assistance.
- \* With previous approval of CG, inspector may require info of any other body corporate.
- \* Inspector may detain the books for 180 days.

**Examine an Oath**

- \* Inspectors may examine Officers, employees & agents of co. or related co(s) on oath.
- \* Previous approval is required to examine any other person.

**/Powers of Civil Court**

- \* Discovery & production of books & other documents at such place & time as specified
- \* Summoning and enforcing attendance of person and examine them on oath
- \* Inspection of any books, registers & other documents at any place

**(Sec 219) Investigation in affairs of related co.**

- With prior approval of CG, Inspector may Investigate following affairs: -
- Body corporate which is/ was subsidiary or holding or another subsidiary of same holding of company under investigation. OR
  - Body corporate which is/ was managed by any person as MD or Manager who is MD or Mgr of company under investigation. OR
  - Body corporate whose BODs comprises nominees of Co. under investigation.
  - MD, Manager or Employee of Co. under investigation.

**(Sec 220) Seizure of docs**

- If Inspector has reasonable grounds that books & papers of Company / other body corporate/MD/ Manager are likely to destroyed: -
- Inspector may enter into places where these books are kept with required assistance. &
- Seize the books and papers after allowing the company to take copies of such books.
- Such books and papers kept by inspector for such period not later than conclusion of investigation.

**(Sec 223) Inspector Report**

- Inspector: - - May/ shall Submit Interim Report to CG when required.
- - Shall Submit Final Report to CG on conclusion of Investigation.
- Report shall be in writing or printed as CG may direct.
- Report may be obtained by making an application to CG.
- Report authenticated by Seal of Co. whose affairs is Investigated or by Certificate of Public officer.

**Steps in Investigation**

- Determination of objectives & establish scope
- Formulate Investigation program
- Examination & Study records by reference to appropriate evidence
- Analysis, processing & interpretation of findings
- Preparation of report & draw Conclusions

**DUE DILIGENCE**

**Meaning**

- Comprehensive appraisal of a business undertaken by a prospective buyer/ investor, specifically to establish its assets and liabilities and ascertain its commercial potentiality.
- It is a term in relation to corporate restructuring.
- Corporate restructuring normally includes internal reconstruction, amalgamations etc.
- Also performed in cases of venture capital financing, lending, disinvestment etc.

**PURPOSE: -**

- Assist purchaser/ investor in finding about business he is acquiring or investing (Success factors, strength & weakness)
- Expose potential problems in price negotiations or by dealing suitable clauses in contractual documentation

**CLASSIFICATION/ AREAS in which DD takes place**

<b>Commercial / Operational DD</b>	To evaluate whether proposed Merger would create Operational Synergies.
<b>Financial Due Diligence</b>	To analyze BOA & other info pertaining to Financial matters of entity.
<b>Tax Due Diligence</b>	To determine the tax effect of merger or acquisition.
<b>Information System DD</b>	To ascertain whether info systems is providing reliable info timely.
<b>Legal Due Diligence</b>	To review legal aspects on functions of entity & compliance with laws.
<b>Environmental Due Diligence</b>	To study entity's environment, its flexibility to acquirer entity.
<b>Personal Due Diligence</b>	To ascertain entity's personnel policies = appropriate & suit requirements of restructuring.

**Financial Due Diligence**

- Commences after a price has been agreed for the business.
- Initial price & other decisions are taken on basis of net worth & trend of profitability of target co
- To look behind initial info by co & to assess benefits & costs of proposed acquisition/ merger by inquiring in all relevant aspects of the past, present and future of the business to be acquired/merged with.

**MATTERS IN SCOPE/ STEPS in a Full-fledged Financial DD**

Studying Business History	Financial Projection	Cash Flow
Management and Employees	Significant Accounting Policies	Taxation
Statutory Compliance	Review of Financial Statements	Others (Below)

**In addition, below points also to be duly considered: -**

- Reason for sale of business and the effect on turnover and profits due to exist of present proprietor.
- The length of the lease under which business has been operating.
- The unexpired period of patents if any held by the vendors.
- The age of managerial staff and prospects of their continuing in service in the new environment.
- If bulk sales are to a few limited customers, the profitability should be discounted greatly, because any substantial withdrawal of customers might cause business crashes.
- Valuation of goodwill if any should be on reasonable basis having regards to all factors mentioned above.

**Increasing Turnover but declining Net Profit in 5 yrs**

- Other Items Included in Sales (like freight, excise duty, sales-tax, etc)
- High Administrative and Selling Expenses
- Competitive Price
- Negative Impact of Financial Leverage
- Additions to Fixed Assets
- Unfavourable Sales mix
- Cost-Price Relationship

**APPROACH/ STEPS FOR INVESTIGATION U/S 210 & 213**

Clarity of Terms of Reference	Scope of Investigation	Period for investigation
Framing of Programme	Using the work of Experts	Legal requirements & Investigation Report

<p><b>Enquiries on History of target's Products, Mkt., Supplier, Expenses, operations</b></p>	<ul style="list-style-type: none"> <li>• Info systems &amp; Important expense Categories</li> <li>• Nature of business (for ex manufacture, wholesaler)</li> <li>• Employment (by location, supply, wage levels etc.)</li> <li>• Product or services and markets (for example, major customers and contracts, profit margins)</li> <li>• History of business with important suppliers (Ex: LT contracts, imports, terms of payment)</li> </ul>	<ul style="list-style-type: none"> <li>• Research and Development</li> <li>• Inventories (locations, quantities)</li> <li>• Plant, warehouses, offices location</li> </ul>
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<p><b>Investigation to aid sanctioning Term Loan by Bank</b></p>	<ul style="list-style-type: none"> <li>• Repayment Schedule of the Borrower</li> <li>• Is Company authorised to borrow money</li> <li>• Economic position of Co</li> <li>• Financial standing of Co &amp; integrity &amp; reputation of Directors</li> </ul>	<ul style="list-style-type: none"> <li>• Purpose of Loan</li> <li>• Past profitability of Co</li> <li>• Ratio Analysis</li> <li>• Verification of A/ L</li> </ul>
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<p><b>Hidden Liabilities (Areas of Investigation)</b></p>	<ul style="list-style-type: none"> <li>• Agreement to buy back shares sold at a stated price</li> <li>• Environmental problems/ Claims/ 3<sup>rd</sup> party claims.</li> <li>• Liability claims; warranty liabilities, product returns/ discounts; liquidated damages for late deliveries</li> <li>• Pending final assessments of customs duty where provisional assessment only has been completed.</li> <li>• Unfunded gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.</li> <li>• Huge labour claims under negotiation when the labour wage agreement has already expired.</li> <li>• Tax liabilities under direct and indirect taxes.</li> </ul>	<ul style="list-style-type: none"> <li>• Future lease liabilities.</li> <li>• Long pending sales tax assessments.</li> </ul>
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<p><b>Over Valued Assets (Areas of Investigation)</b></p>	<ul style="list-style-type: none"> <li>• Uncollected/uncollectable receivables</li> <li>• Intangibles of no value.</li> <li>• Group Company balances under reconciliation etc.</li> <li>• Litigated assets and property.</li> <li>• Obsolete, slow non-moving inventories or inventories valued above NRV.</li> <li>• Huge inventories of packing materials etc. with name of company.</li> <li>• Underused or obsolete Plant and Machinery and their spares</li> <li>• Asset values which have been impaired due to sudden fall in market value etc.</li> <li>• Investments carried at cost though realizable value is much lower.</li> <li>• Investments carrying a very low rate of income / return.</li> </ul>
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**OBJECTIVES FOR INDIVIDUAL AREAS OF VERIFICATION THAT DD TO INCLUDE**

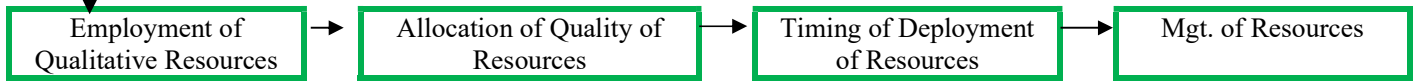
Brief Description of history of business	Background of promoters.
Accounting policies and practices	Management information systems
Details of management structure	Trading results both past and recent past
Assets and liabilities as per latest balance sheet	Cash flows patterns
Projection of future profitability	Current status of Tax assessments including appeals pending against tax liabilities assessed by tax authority

<p><b>Factors to Assess/ Value Future Maintainable Turnover</b></p>	<ul style="list-style-type: none"> <li>• <u>Trend</u> of sales (increasing consistently or fluctuating)</li> <li>• <u>Marketability</u> (possible to extend sales into new markets)</li> <li>• <u>Political &amp; economic considerations</u> (Govt. policy to promote extension of Mkt. to other countries)</li> <li>• <u>Competition</u> (Effect on business if other manufacturers enter same field or sell in cheaper price)</li> </ul>
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**AUDIT STRATEGY, PLANNING & PROGRAMMING**

(Also Refer - SA 300)

**Process of Establishing Overall audit strategy on Team Resources OR Benefits of Overall Audit Strategy**



<b>Auditing Techniques for Statutory Audit</b>	<ul style="list-style-type: none"> <li>Identifying RMM through understanding of Entity and its environment as per SA 315</li> <li>Design Response to Assessed Risks as per SA 330</li> <li>Obtain SAAE (SA 200 + SA 500)</li> <li>Perform compliance procedures to determine NTE of substantive procedures</li> <li>Test checking(SA 530) &amp; Verification and Valuation of Assets &amp; Liabilities.</li> </ul>
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**AUDIT PLAN TO LOCATE ABNORMAL WASTAGE OF RM**

General Requirements	Specific Considerations
<ul style="list-style-type: none"> <li>Obtain reports of Preventive Maintenance of machinery</li> <li>Procure list of RM</li> <li>Assess whether personnel employed trained &amp; efficient.</li> <li>Obtain Standard consumption figures</li> <li>See Quality Control techniques are consistent or changed.</li> <li>Examine inventory plans and procedures.</li> <li>Examine whether basis adopted for calculating waste is same for all months.</li> </ul>	<ul style="list-style-type: none"> <li>Examine possibilities of theft, fire losses etc.</li> <li>Examine Standard input output ratio</li> <li>Examine lab reports &amp; inspection reports if RM purchased of poor/ sub-standard quality</li> <li>Machine breakdown &amp; power failure may also result in loss of materials in process</li> <li>Examine inspection reports of inspections carried out</li> </ul>

<b>Identify Inherent Risk at different level in MNCs OR Factors to be Evaluated/ Influencing to assess Inherent Risk</b>	<b>At Level of Financial Statements</b>	<ul style="list-style-type: none"> <li>Unusual pressures on mgt.</li> <li>Nature of entity's business.</li> <li>Factors affecting industry in which entity operates.</li> <li>Integrity of Mgt.</li> <li>Mgt. Experience &amp; knowledge &amp; changes in Mgt. during period</li> </ul>
	<b>At level of A/c Balances &amp; Class of Transactions</b>	<ul style="list-style-type: none"> <li>Quality of A/c system</li> <li>Susceptibility of FS to misstatement</li> <li>Assets suspected to loss/ misappropriation</li> <li>Degree of judgment to determine A/c balance</li> <li>Complexity of underlying transactions &amp; events requiring work of Expert</li> <li>Completion of unusual and complex transactions, particularly at or near period end.</li> </ul>

<b>Audit Program for Revenue &amp; Expenditure of Fun of Fun Cinemas (Not Assets)</b>	<ul style="list-style-type: none"> <li>Ensure if incomes are correctly accounted</li> <li>Verify payments of maintenance of buildings</li> <li>Verify ICS on sale of online &amp; offline tickets</li> <li>Statutory requirements complied of wages &amp; salaries</li> </ul>	<ul style="list-style-type: none"> <li>Check MOA &amp; AOA</li> <li>Verify ICS to parking fees</li> <li>Verify ICS on income from canteens</li> <li>Object clause permitting this business</li> </ul>
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**General Matters/  
Factors Auditor  
see in taking up  
Engagement**

- General Economic factors = Government policies & Seasonal activities
- Conditions effecting business = Business risk & Mkt. & Competition
- Entity (Internal + External) = Owners, Mgt., Nature, Financial performance & Reporting

**Walk Through  
Tests**

- Procedure in which Auditor traces transaction from its initiation through company's Info systems to point when it is reflected in Financial Reports. (Origin to End)
- Auditor to perform 1 Walk through at minimum for each major class of transactions.
- Provides evidence to confirm that Auditor understands: -
  - Process flow of transactions.
  - Design of controls for internal control components including those preventing & detecting fraud.
  - Whether all points in process identified at which misstatements related to FS assertion could occur.
- Provide evidence to evaluate effectiveness of controls' design & confirm of controls placed is in operation.

**Major Sources of Obtaining Info about Client's business**

• Consider State of economy & its effects on Client's business	• Discussions with Client
• Previous year's audit working papers	• Other Relevant Files
• Visits to Client's premises & Plant facilities to mgt.	• Policy & procedures manual of Client
• Minutes of meetings of GM, BODS & important committees	• Client's annual Reports to shareholders
• Internal financial Mgt. report for current & previous periods including budgets	
• ICAI, other professional bodies & Industry Publications, Trade Journals, Magazines, Newspapers	

**Cut-off  
Procedure**

- Procedure exist to ensure separation of transactions at end of 1 yr from those in commencement of next year
- Principal areas of application of cut-off procedures involve sales, purchases & stock.
- Auditor should satisfy himself by examination and test check that these procedures adequately ensure that: -
  - Goods purchased for which property has passed to client have in fact been included in Inventories & that liability has been provided for & Goods sold excluded from inventories and credit been taken for sales.

**AUDIT PROGRAM TO  
VERIFY IF RECORDS TO  
IDENTIFY & VALUE P&M,  
TOOLS & DIES IS PROPER**

Check  
maintenance of  
Register

- Asset Register
- Code Register
- Spare Part Register
- Movement Register
- Asset Disposal Register

Review ICS

- Maintenance & R&D
- Obsolescence (Experts opinion)

Others

- Authorization for selling Fixed Asset.
- Record of assets & disposals
- Periodic inspection of assets is done or not.
- Review of insurance cover.

**Factors to  
Evaluate  
Inherent Risk**

- Integrity of mgt.
- Experience & knowledge of mgt.
- Turnover of KMP
- Nature of business prone to rapid tech. obsolescence
- Dealing with lots of related party
- Circumstances motivating mgt. to misstate FS when its financial performance is not satisfactory.

**RISK ASSESSMENT & INTERNAL CONTROL**

Considerations for effectiveness/  
Aspects in Framing of System of  
Internal check  
(CID Updating JAIL Controls)

- \* **C** = Custody & Records Distribution i.e. Persons having physical custody of assets not be permitted to have access to books of accounts.
- \* **I** = Independent Controls i.e. No person with Independent control over Important aspect of business.
- \* **D** = Distribution of powers i.e. Financial and administrative powers should be subdivided.
- \* **Updating** = Update of Controls.
- \* **J** = Job Rotation i.e. Duties/work of members of staff should be changed from time to time
- \* **A** = Accounting Control i.e. There should be an accounting controls for each important class of assets & be periodically reviewed.
- \* **I** = Introduction of system of Budgetary control.
- \* **L** = Leave i.e. Staff should be encouraged to go to leave from time to time without previous notice.
- \* **Controls** = Controls over Cash.

ICS for Entertainment  
Centres Collecting Cash

- \* Printing of Tickets
- \* Ticket Sales
- \* Daily Cash Reconciliation
- \* Daily Banking
- \* Entrance ticket
- \* Advance booking
- \* Discounts & free pass
- \* Surprise checks

Narrative Records

Complete & exhaustive description of system as found in operation by auditor

Flow Chart

- Graphic presentation of I.C. of various sections in form of a diagram full with lines & Symbols
- Flow chart is normally horizontal one in which docs & activities shown
- Provide most concise and comprehensive way to review I.C.
- Provide a neat visual picture of various activities involving flow of documents through various stages
- Auditor be able to visually correlate functions & related controls & assess Adequacy & effectiveness by
  - At what point a document is raised internally or received from external sources.
  - Number of copies in which a document is raised or received.
  - Intermediate stages set sequentially by which document & activity pass.
  - Distribution of the documents to various sections, department or operations.
  - Checking authorisation and matching at relevant stages.
  - Filing of the documents.
  - Final disposal by sending out or destruction.

Check List

Series of instructions and/or questions which a member of auditing staff must follow.

Internal Control Questionnaire

Set of Questions designed to provide a thorough view of state of ICS

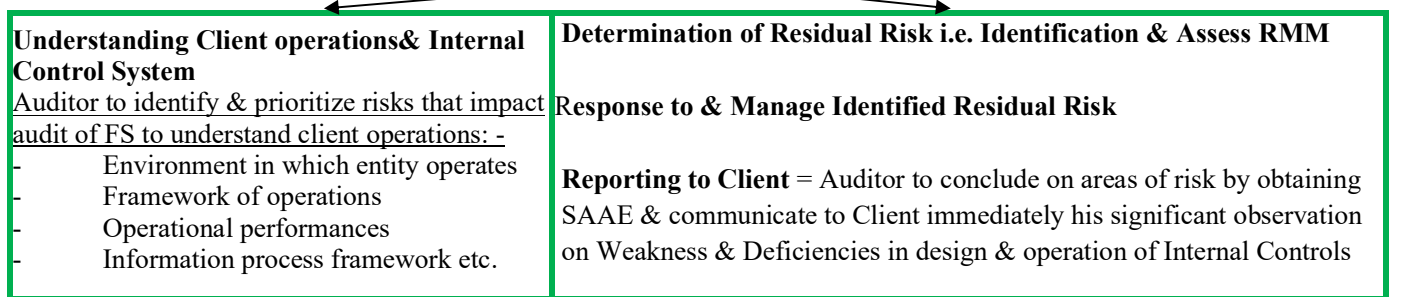
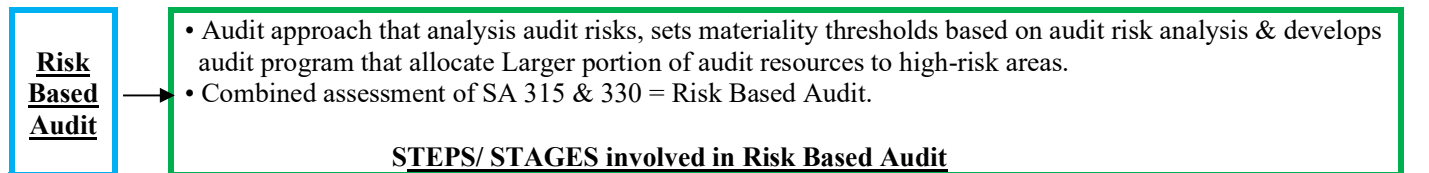
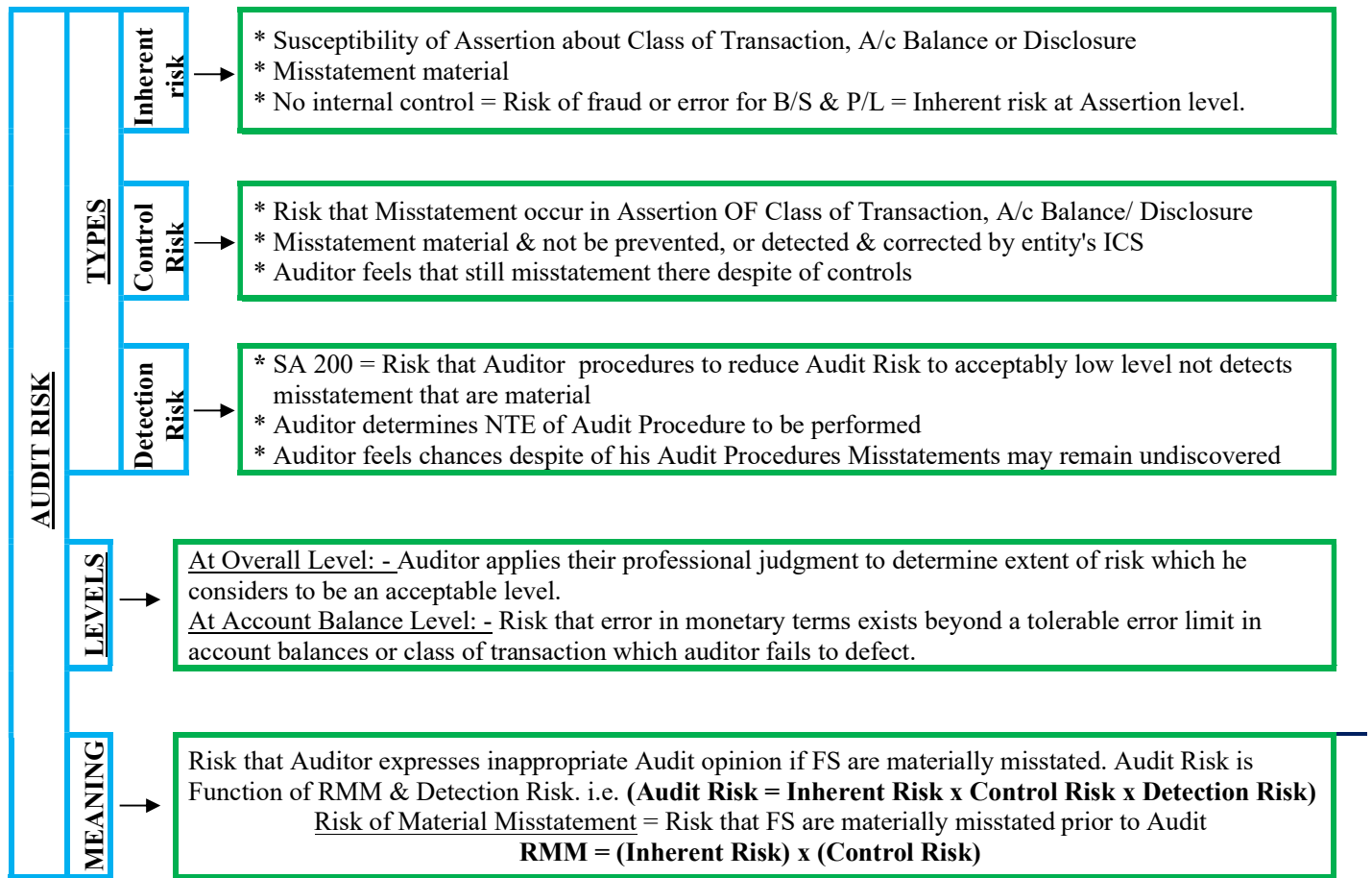
Letter of weakness

- SA 265 = Auditor includes in written communication i.e. Letter of weakness of deficiencies in ICS: -
- A description of the deficiencies and an explanation of their potential effects.
  - Sufficient info to enable TCWG & Mgt to understand the context of communication.
  - Auditor communicates material weaknesses in ICS as required by SA 260
  - Lists down the area of weaknesses in ICS and recommends suggestions for improvement.
  - Clearly indicate that this letter covers only weaknesses which have come to the attention of auditor
  - Clearly indicate his examination of internal control not designed to determine Adequacy of ICS for mgt.
  - Letter serves as means for mgt & governing body for improving system & its strict implementation.
  - Letter may also serve to minimize legal liability on major loss resulting from weakness in ICS.

Surprise check

- Useful method to determine whether errors exist and where they exist
- ICAI Recommendation = Surprise checks should form part of normal audit.
- Surprise check should be made at least once in the course of an audit.

METHODS OF COLLECTING INFO TO REVIEW ICS



**For Revisionary Voice Clips & PENDRIVE Classes: -**  
**Contact Author at 7838061193**

**[www.APNAMENTOR.com](http://www.APNAMENTOR.com)**

**AUDIT REPORT & CARO 2016**

**Applicability of CARO**

**CARO 2016 apply to all companies including Foreign companies except following: -**

- (a) Banking Company
- (b) Insurance Company
- (c) Company licensed to operate u/s 8
- (d) One Person Company
- (e) Small Company
- (f) Private limited Company (not being a subsidiary or holding of public co) with: -
  - Paid up capital + Reserves & Surplus  $\leq$  1Cr. (as on Balance Sheet Date) +
  - Total borrowings from Bank & F.I.  $\leq$  1Cr. (at any point of time during the FY) +
  - Total revenue as disclosed in Schedule III  $\leq$  10 Cr. (for the FY)

• **2(64) = Paid Up Capital** = Aggregate amount credited as paid-up is equivalent to amount received as paid up in respect of Shares issued. It also includes any amount credited as paid up in respect of shares.

• **Guidance Notes:** - Paid up s/c means that part of Subscribed Share Capital for which consideration in Cash or otherwise received. This includes Bonus Shares allotted by Corporate Enterprises.

• **In respect of co other than finance co, Revenue from operations consist of revenue from: -**

- (a) Sale of products
- (b) sale of services
- (c) other operating revenues, as reduced by excise duty

• **In respect of finance company, Revenue from operations consist of revenue from: -**

- (a) Interest
- (b) Other financial services.

• **Other income shall consist of followings: -**

- Dividend Income
- Net gain/loss on sale of investments
- Interest income (in case co other than finance co)
- Other non-operating income (net of expenses directly attributable to such incomes)

**CERTIFICATE for Special Purpose**

- \* Used where Auditor verifies accuracy of facts
- \* Written confirmation of accuracy of facts stated & not involve any estimate or opinion
- \* Certify circulation figures of a newspaper or value of imports or exports of company
- \* Represents that verified certain figures & is in position to vouch safe their accuracy
- \* After issues certificate = responsible for actual accuracy of what is stated therein.

**REPORT**

- \* Formal statement made after Enquiry, examination or review of specified matters including opinion.
- \* After issue report = responsible for ensuring that report is based on factual data
- \* Involves expression of opinion differing from one professional to another.
- \* No question of exactitude in report as info based on estimates & involves judgment too.

**Features of Qualified Audit Report**

- Clarity
- Explanation
- Placement
- Except for
- Quantification
- Nature of qualification
- Violation of law
- Notes – Report Relationship
- Draft Report

**MATTERS TO BE REPORTED UNDER CARO 2016 (Para 3)**

Para 3	Reporting Area	Reporting Requirements
(i)	Fixed Assets	<ul style="list-style-type: none"> <li>Whether company is maintaining proper records with full particulars including quantitative details &amp; situation.</li> <li>Whether Fixed Assets physically verified by mgt at reasonable intervals.</li> <li>Whether Material discrepancies were noticed on such verification.</li> <li>Whether such discrepancies have been properly dealt with in BOA.</li> <li>Whether Title deeds of immovable properties held in name of co &amp; if not provide details thereof.</li> </ul>
(ii)	Stock	<ul style="list-style-type: none"> <li>Whether physical verification conducted at reasonable intervals by Mgt.</li> <li>Whether material discrepancies noticed &amp; if so whether dealt properly in books.</li> </ul>
(iii)	Loans & Advances	<ul style="list-style-type: none"> <li>Whether loans granted to companies, firms, LLP covered u/s 189. If so: -                             <ul style="list-style-type: none"> <li>T &amp; C are not prejudicial to the co interest</li> <li>Schedule of repayment of principal &amp; payment of interest stipulated</li> <li>State amount overdue for &gt; 90days &amp; whether reasonable steps taken to recover Principal &amp; interest by company.</li> </ul> </li> </ul>
(iv)	Comply Sec 185 & 186	<ul style="list-style-type: none"> <li>In respect of loans, investments, guarantees &amp; security.</li> <li>If not, provide details thereof.</li> </ul>
(v)	Public Deposits	<ul style="list-style-type: none"> <li>RBI Directions &amp; Sec. 73 – 76 complied &amp; if not then Nature of contravention</li> <li>Order passed by CLB/ RBI/ Court/ Tribunal = Whether complied with or not.</li> </ul>
(vi)	Cost Records	<ul style="list-style-type: none"> <li>Whether as per Specified u/s 148(1)</li> <li>Whether accounts &amp; records made &amp; maintained.</li> </ul>
(vii)	Statutory Dues	<ul style="list-style-type: none"> <li>Undisputed PF, ESI, IT, ST, Custom, VAT, Excise, CESS, etc paid regularly</li> <li>If Not outstanding &gt; 6 months as on Balance Sheet Date.</li> <li>State Amount involved thereon &amp; forum of it.</li> </ul>
(viii)	Repay Dues	<ul style="list-style-type: none"> <li>Whether co. default in repayment of dues – F.I., Bank, Govt., Debenture holders</li> <li>If Yes – Nature &amp; Amount of Default.</li> </ul>
(ix)	Money raised by Public Issue & Loans	<ul style="list-style-type: none"> <li>Whether money rose by IPO/ FPO/ Term Loans = applied for stated purpose</li> <li>If Not = details along with delay &amp; subsequent ratification be reported.</li> </ul>
(x)	Fraud	<ul style="list-style-type: none"> <li>Whether fraud by company or by its officers/ employees noticed or reported.</li> <li>If Yes – Nature and amount to be stated.</li> </ul>
(xi)	Mgr Remuneration	<ul style="list-style-type: none"> <li>Whether managerial remuneration paid with requisite approvals u/s 197.</li> <li>If Not, state amount involved and steps taken for securing refund to be reported.</li> <li>Details to be reported are: -                             <ul style="list-style-type: none"> <li>To whom - Amount due for Recovery as at BS date</li> <li>Amt paid/ promised - Steps taken to secure recovery of amt</li> </ul> </li> </ul>
(xii)	NIDHI Co.	<ul style="list-style-type: none"> <li>Whether Net Owned Funds to Deposits Ratio = 1:20.</li> <li>Whether 10% unencumbered term deposits maintained.</li> </ul>
(xiii)	Transaction with Related Parties	<ul style="list-style-type: none"> <li>Whether transactions with related parties are in compliance with Sec. 177 &amp; 188.</li> <li>Whether details disclosed in F.S. as required by applicable AS.</li> </ul>
(xiv)	Preferential Allotment	<ul style="list-style-type: none"> <li>Whether any preferential allotment of Shares/ FCD/ PCD made.</li> <li>If so, whether Sec. 42 complied with &amp; amount raised used for stated purpose.</li> <li>If Not – provide details of amount involved &amp; nature of noncompliance.</li> </ul>
(xv)	Non Cash Transactions with Directors	<ul style="list-style-type: none"> <li>Whether co. has entered into non cash transactions with Directors.</li> <li>If so. Whether Sec. 192 has been complied with.</li> </ul>
(xvi)	Registration with RBI	<ul style="list-style-type: none"> <li>Whether registration required u/s 45IA of RBI Act, 1934 &amp; if so if it is got.</li> </ul>

# AUDIT COMMITTEE & CORPORATE GOVERNANCE

**Corporate Governance**

System by which companies are directed & governed by mgt. in best interests of Stakeholders & others ensuring Better Mgt., Greater Transparency & Timely FR. Responsibility to ensure it rests with BOD.

**Issues Addressed/Involved in Corporate Governance – Chapter IV of SEBI LODR (Listing Obligations & Disclosure Requirements) Regulations, 2015**

- \* Disclosures on important issues regarding Related party Transaction, accounting treatment etc.
- \* Provisions on set up & role of Nomination and Remuneration Committee.
- \* Provisions on composition & function of Audit Committee (Reg. 18).
- \* BODs & its composition, Independent, non-executive director etc.
- \* Obligations on Independent Ds & senior mgt.
- \* Code of Conduct & Vigil mechanism
- \* Provisions on set up & role of Stakeholder Relationship Committee
- \* Provisions on set up & role of Risk Mgt. Committee.
- \* Disclosure of Mgt. Discussion & Analysis.
- \* CEO/CFO Certification.
- \* Mgt. of Subsidiaries.
- \* Compliance Certificate
- \* Info to shareholders.

**COMPARISON = AUDIT COMMITTEE as per SEBI (LODR) REGULATIONS & Section 177**

Comparison Basis	Reg. 18 of SEBI (LODR) 2015	Section 177 of Companies Act, 2013
<b>Applicability</b>	For entities seeking listing for the first time.	Every listed company & *All public companies with a paid up capital ≥ ₹10 Cr. *All public companies having turnover ≥ ₹100 Cr. *All public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits ≥ 50 Cr.
<b>Member Composition</b>	Minimum 3 Ds = Members & 2/3rd of members of AC be IDs.	AC of Minimum of 3 Ds + IDs forming a majority.
<b>Knowledge of Members</b>	All member financially literate	Majority of members of AC including its Chairperson s to be persons with ability to read & understand FS.
<b>Interaction by Stat. Auditor</b>	Representative of External auditor be present for AC meeting	Auditors right to be heard in meetings of AC when it considers auditor’s report but not have right to vote.
<b>Secretary</b>	CS will work as Secretary of AC	No Such reference.
<b>U/s 177 Additional Requirements BUT Silent in SEBI (LODR)</b>	<ul style="list-style-type: none"> <li>• Every AC shall act as per terms of reference to be specified in writing by Board.</li> <li>• Board’s report u/s 134(3) to disclose Composition of AC &amp; where Board had not accepted any recommendation of AC, same shall be disclosed in Report along with reasons therefore.</li> <li>• Auditors of company &amp; KMP have right to be heard in meetings of the AC when it considers Auditor’s report but shall not have right to vote.</li> </ul>	
<b>Regulation 18 of SEBI (LODR) Regulations 2015 Additional Requirements BUT Silent in Sec. 177</b>	<ul style="list-style-type: none"> <li>• AC may invite such of executives, as it considers appropriate (&amp; particularly head of finance function) to be present at meeting of committee, but on occasions it may also meet without presence of any executives of company.</li> <li>• CS shall act as secretary to the committee.</li> <li>• AC shall meet at least 4 times in year &amp; gap in 2 meetings not be more than 4 months.</li> <li>• Quorum of AC shall be 2 members or 1/3 of members of AC (whichever higher) &amp; minimum of 2 Independent directors be present.</li> </ul>	

<b>SECTION 177 AUDIT COMMITTEE (AC)</b>	<b>177(1) Requirement</b>	<p>Every listed company &amp; following public companies shall constitute AC: -</p> <ul style="list-style-type: none"> <li>* All public co with paid up capital of <math>\geq</math> ₹10 Cr.      * All public co with turnover of <math>\geq</math> ₹100 Cr.</li> <li>* All public co with aggregate, outstanding loans/ borrowings/ debentures/ deposits <math>\geq</math> ₹50 Cr.</li> </ul> <p>(All above limits = existing on date of last audited FS be taken into a/c for purposes of this rule)</p>
	<b>177(2) Composition</b>	<ul style="list-style-type: none"> <li>* AC to consist of minimum of 3 directors with Independent Directors forming a majority</li> <li>* Majority of members including Chairperson = be with ability to read &amp; understand FS</li> </ul>
	<b>177(4) Functions</b>	<p>Every Audit Committee to act as per terms of reference specified in writing by Board including: -</p> <ul style="list-style-type: none"> <li>• Recommendation for appointment, remuneration and terms of appointment of auditors.</li> <li>• Review &amp; monitor auditor's independence, performance &amp; effectiveness of audit process.</li> <li>• Examination of FS &amp; auditors' report thereon.</li> <li>• Approval or subsequent modification of transactions of company with related parties.</li> <li>• Scrutiny of inter-corporate loans &amp; investments.</li> <li>• Valuation of undertakings or assets of company, wherever it is necessary.</li> <li>• Evaluation of Internal financial controls &amp; Risk Mgt. Systems.</li> <li>• Monitoring end use of funds raised by public offers &amp; related matters.</li> </ul> <p>→ <u>Proviso to Sec. 177(4)</u> AC may make omnibus approval for related party transactions proposed to be entered in by company subject to such conditions as prescribed.</p> <p>If transactions other than transactions in sec 188 of Co Act 2013 &amp; where Audit Committee not approve transaction = It shall make its recommendations to Board. Transaction not &gt; Rupees 1 Crore is entered by a director or officer of company without approval of Audit Committee and it is not ratified by Audit Committee in 3 months from date of Transaction, such transaction = voidable at the option of Audit Committee and if the transaction is with Related party to any director or is authorized by any other director, director concerned shall indemnify company against any loss incurred by it. These provisions N/ A to a transaction, other than a transaction referred to in sec 188, between a holding company and its wholly owned subsidiary company.</p>
	<b>177(5) Discretionary Powers</b>	<p><u>Audit Committee may: -</u></p> <ul style="list-style-type: none"> <li>• Call for comments of Auditors on ICS, Scope of audit &amp; observations of Auditors</li> <li>• Review of FS before their submission to Board</li> <li>• Discuss any related issues with Internal &amp; Statutory auditors &amp; mgt. of company</li> </ul>
	<b>177(6) Authority to Investigate</b>	<ul style="list-style-type: none"> <li>* AC has authority to investigate in matter in relation to items specified in Sec. 177(4) or referred to it by BODs.</li> <li>* AC for this purpose empowered to obtain professional advice from external sources &amp; full access to info in records</li> </ul>
	<b>177(7) Auditor's right to be heard</b>	<p>→ Auditors &amp; KMP right to be heard in meetings of AC when it considers Auditor's report but not to Vote.</p>
	<b>177(8) Disclosures in Board Report</b>	<p>→ Board's report u/s 134(3) to disclose composition of AC &amp; where Board not accepts Recommendation of AC, same to be disclosed in report + reasons</p>
	<b>177(9) &amp; 177(10) Vigil Mechanism</b>	<p>→ (i) Every listed company &amp; companies belonging to following class = shall establish Vigil mechanism for their directors &amp; employees to report their genuine concerns or grievances: -</p> <ul style="list-style-type: none"> <li>• Companies which accept deposits from the public</li> <li>• Companies which have borrowed money from banks &amp; PFI in excess of ₹50 Cr.</li> </ul> <p>(ii) <u>Vigil mechanism to provide for adequate safeguards against victimization of persons using such mechanism &amp; make provision for direct access to Chairperson of AC in appropriate/ exceptional cases.</u></p> <p>(iii) Details of establishment of mechanism disclosed by company on its website &amp; in Board's report.</p>

AUDIT COMMITTEE REGULATION 18 OF SEBI (LODR) REGULATIONS 2015

**Meetings of AC**

- AC should meet at least 4 times in a year & not more than 120 days to lapse in 2 meetings.
- Quorum either 2 or 1/3 of members of AC (whichever greater) but min 2 Independent members to be present.

**Verification on Composition of BODs**

Auditor should ascertain whether, throughout reporting period = BODs comprises optimum combination of executive and non-executive directors, with at least 1 woman director & not less than 50% of BODs comprising non-executive directors. BODs of top 500 listed entities shall have at least 1 independent woman director by April 1, 2019 & of top 1000 listed entities shall have at least 1 independent woman director by April 1, 2020. The top 500 and 1000 entities determined on basis of market cap, as at end of immediate previous financial year.

Auditor should also ensure that no listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of 75 years unless a special resolution is passed to that effect, in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such a person.

The directors of listed entities shall comply with following conditions w.r.t. maximum number of directorships, including any alternate directorships that can be held by them at any point of time:

- A person shall not be a director in more than eight listed entities with effect from April 1, 2019 and in not more than seven listed entities with effect from April 1, 2020 (A person shall not serve as an independent director in more than seven listed entities)
- Notwithstanding the above, any person who is serving as a whole time director / managing director in any listed entity shall serve as an independent director in not more than three listed entities. For the purpose of this abovementioned provision, the count for the number of listed entities on which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange.”  
Minutes of the Board of Directors’ meetings should be verified to ascertain whether a director is an executive director or a non-executive director.

The auditor should ensure that the board of directors of the top 1000 listed entities (from April 1, 2019) and the top 2000 listed entities (from April 1, 2020) shall comprise of not < 6 directors.

With effect from 1st April 2019, the statutory auditor of a listed entity shall undertake a limited review of the audit of all the entities/companies whose accounts are to be consolidated with the listed entity as per AS / IND-AS in accordance with guidelines issued by SEBI on this matter”: -

- All listed entities whose eq. shares and convertible securities listed on recognized stock x
  - Statutory auditors of such entities
  - All entities whose accounts are to be consolidated with the listed entity
  - Statutory auditors of entities whose accounts are to be consolidated with the listed entity
- = shall comply with the prescribed procedure.

**Requirement of Qualified & Independent**

- 2/3 of members of AC shall be Independent directors
- Least 1 member have a/c or related financial mgt. expertise.
- Chairperson to be Independent director & Chairperson to answer shareholder queries at AGM.
- AC at its discretion invite finance director or head of finance function, head of internal audit
- Representative of Statutory Auditor & other executives to be present at meetings of committee.
- CS to act as Secretary to committee.
- All members financially literate
- AC with min 3 Ds as members

**Powers of AC**

- Investigate activity in its terms of reference
- Obtain outside legal or professional advice
- Seek info from any employee
- Secure attendance of relevant expertise outsiders

**Role of AC**

- Reviewing with mgt., Annual FS before submission to Board, focusing primarily on: -
- \* Matters in Director’s Responsibility Statement & Board’s report u/s 134(3)(c).
  - \* Changes in accounting policies & practices & reasons for same.
  - \* Major accounting entries & estimates based on Exercise of Judgment by mgt.
  - \* Significant adjustments made in FS arising out of audit findings.
  - \* Compliance with listing & other legal requirements of FS.
  - \* Disclosure of any related party transactions.
  - \* Qualifications in the draft audit report.

**Areas of Mandatory Review of Info by AC**

- AC mandatorily review following info as per Part C (B) of Schedule II: -
- Mgt. discussion & analysis of financial condition & results of operations.
  - Statement of significant RP Transactions (as defined by AC) submitted by mgt.
  - Mgt. letters/ letters of ICS weaknesses by Statutory auditors. • Internal audit reports relating to ICS weak
  - A appointment, Removal, terms & remuneration of Chief Internal Auditor subject to AC Review.
  - Statement of deviations: -
    - Quarterly Statement of deviations including report of monitoring agency (if applicable) &
    - Annual Statement of funds used for purposes not stated in Offer Docs/ Prospectus/ Notice.

**ROLE of Nomination and Remuneration Committee {NRC} [Regulation 19 & Part D of Schedule II]**

- Board of every listed public company shall constitute it comprising least 3 directors, all of whom shall be non-executive directors & least half independent. However, in case of a listed entity having outstanding SR equity shares, two thirds shall comprise of independent directors. Chairperson to be an independent director.**
- \* Formulation of criteria for determining qualifications, positive attributes & independence of director
  - \* Recommend to BODs a policy, relating to remuneration of Directors, KMP & other employees
  - \* Formulation of criteria for evaluation of independent directors and the Board of Directors
  - \* Devising a policy on Board diversity
  - \* Identifying persons who are qualified to become directors & who may be appointed in senior mgt. as per criteria laid down, and recommend to the Board their appointment and removal
  - \* Whether to extend or continue term of appointment of Independent director, on basis of report of performance evaluation of independent directors

**Circumstances/ Examples of Adverse or Qualified Statement**

- Depending on the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of Corporate Governance. Examples are: -
- (a) The number of non-executive directors is less than 50% of the strength of Board of directors.
  - (b) Qualified and independent audit committee is not set up.
  - (c) Chairman of the audit committee is not an independent director.
  - (d) AC does not meet four times a year.
  - (e) Necessary powers in terms of Clause 49 of Listing Agreement not vesting by Board in the AC.
  - (f) The time gap between two Board meetings is more than four months.
  - (g) A director is a member of more than ten committees across all companies in which he is Director
  - (h) Info of quarterly results is neither put on the company's website nor sent in form so as to enable the Stock Exchange on which entity's securities are listed to enable Stock Exchange to put it on its own website.
  - (i) Power of share transfer is not delegated to Officer or Committee or to Registrar & share transfer agents.

**SEBI (LODR) Reg. 2015 = Independent Director**

- SEBI (LODR) Regulations, 2015, ID = Non-executive director other than Nominee director of listed entity: -
- In Opinion of Board = person of integrity and possesses relevant expertise and experience.
  - Is/ was not Promoter of the listed entity or its holding, subsidiary or associate company.
  - Who is not less than 21 years of age • Is not related to promoters or directors in CASH.
  - Apart from receiving director's remuneration, has or had no material pecuniary relationship with CASH or their promoters, or directors in 2 immediately preceding FYs or in current FY.
  - None of whose relatives has or had pecuniary relationship or transaction with CASH or their promoters, or directors, amounting to 2% or more of its Gross turnover or Total income or ₹50 Lac or higher amount as may be prescribed (whichever Lower) in 2 immediately preceding FYs or during current FY
  - Who, neither himself nor any of his relatives: -
    - Holds or has held the position of KMP or is or has been employee of CASH in any of 3 FYs immediately preceding FY in which he is proposed to be appointed.
    - Holds together with his relatives 2% or more of Total voting power of Listed Entity.
    - Is CE or director by whatever name called of any NPO that receives 25% or more of its receipts from listed entity, its promoters, directors or ASH or holds 2% or more of Total voting power of listed entity.
    - Is material supplier, service provider or customer or a Lessor or lessee of the listed entity
    - Is or has been Employee or Proprietor or Partner in any of 3 FYs immediately preceding FY in which he is proposed to be appointed of: -
      - \* A firm of auditors or CSs in practice or CWAs of CASH.
      - \* Any legal or a consulting firm that has or had any transaction with CASH of 10% or more of Gross Turnover of such firm.

**Features of Qualified & Independent AC set up SEBI (LODR) Reg. 2015**

- AC shall have minimum 3 directors as members. 2/3 of members of AC to be independent directors. **However, in case of a listed entity having outstanding SR (Superior Rights) equity shares, the audit committee shall only comprise of independent directors**
- Members of AC financially literate & least 1 member to have a/c or related financial Mgt. expertise. (“Financially literate” = Ability to read & understand basic FS i.e. B/S, P/L & Statement of cash flows)
- Chairperson of AC shall be Independent director.
- Chairperson of AC shall be present at AGM to answer shareholder queries.
- AC at its discretion to invite finance director or head of finance function, head of internal audit & representative of Statutory Auditor & other such executives to be present at Meetings of Committee; provided that occasionally, AC may meet without presence of any executives of Listed entity.
- CS shall act as Secretary to AC

**Disclosures - Mgt Discussion & Analysis [Schedule V]**

- Mgt. Discussion & Analysis report to form part of Annual Report on following matters in limits set:**
- \* Industry structure & developments \* Opportunities & Threats \* Segment or product-wise performance
  - \* Discussion on financial performance with respect to operational performance \* Risks and concerns
  - \* Material developments in HR / Industrial Relations front including no. of people employed. \* Outlook
  - \* Information to Shareholders [Regulation 36] \* Internal control systems & their adequacy
- = If Appointment of new director/ re-appointment of Director, Shareholders provided with info: -**
- A brief resume of the director.
  - Nature of expertise in specific functional areas.
  - Disclosure of relationships between directors inter-se
  - Shareholding of non-executive directors.
  - Names of listed entities in which person holds directorship & membership of Committees of Board

**Role of Auditor & Certification of Corporate Governance**

- |                           |  |
|---------------------------|--|
| <b>Auditor Role in AC</b> | <ul style="list-style-type: none"> <li>• Ensure he communicates frequently with AC on key a/c or auditing issues giving rise to RMM of FS.</li> <li>• Ensure that he addresses any questions or concerns voiced by AC.</li> <li>• Assist &amp; advise AC on improving corporate governance, oversight of FR process, implementation of a/c policies &amp; practices, compliance with AS, strengthening of ICS in regard to FR &amp; reporting process.</li> <li>• Assist Mgt. &amp; AC to enable them to discharge their functions effectively</li> <li>• Auditor role is not to drive corporate governance directly (Its Mgt. Role)</li> <li>• Auditor may play significant role in assisting Mgt. to ensure Better Standards of corporate governance.</li> </ul> |
| <b>Auditor Role</b>       | <ul style="list-style-type: none"> <li>• In certifying compliance with Corporate governance responsibility relates to verification &amp; certification of factual implementation of requirements of Corporate Governance as in SEBI (LODR) Reg. 2015</li> <li>• Such verification &amp; certification is neither Audit nor Expression of opinion.</li> <li>• Certificate from Auditor as regards compliance with requirements of Corporate Governance is not Assurance as to Future viability of company &amp; also not efficiency or effectiveness with which Mgt. conducted affairs of co.</li> </ul>  |
| <b>Audit Procedure</b>    | <ul style="list-style-type: none"> <li>• Auditor to conduct verification of compliance with requirements of Corporate governance as in LODR Reg., in accordance with Guidance Note on Certification of Corporate Governance issued by ICAI.</li> <li>• SAs would be applicable in performance of certification with requirements of corporate governance by Auditor, to extent relevant.</li> <li>• SA 230-Auditor to document matters important to give evidence to support Certificate of factual findings</li> <li>• Auditor should consider obtaining Mgt. representations as per SA 580, “Written Representations”.</li> </ul>  |

**Applicability of LODR Regulations [Regulation 3]**

- These regulations shall apply to Listed entity who has listed any of following designated securities on recognized stock exchange(s): -
- \* Specified securities listed on main board or SME Exchange or institutional trading platform
  - \* Non-convertible debt securities, non-convertible redeemable preference shares, perpetual debt instrument, perpetual non- cumulative preference shares
  - \* Indian depository receipt
  - \* Security receipts (added from September 06,2018)
  - \* Securitized debt instruments
  - \* Any other securities as may be specified by the Board
  - \* Units issued by mutual funds

**Interlink of Co. Act with SEBI (LODR)**

As per 140(2) of Co Act 2013, auditor shall within a period of 30 days from date of resignation, intimate about such resignation to Company & Registrar = Sub-clause (7A) inserted under Clause A in Part A of Schedule III under Regulation 30(2) of SEBI LODR Regulations requires detailed reasons to be disclosed by listed entities to the stock exchanges in case of resignation of the auditor of a listed entity as soon as possible but not later than twenty-four hours of receipt of such reasons from the auditor.

**Compliance Certificate | Part B of Schedule III** →

**CEO/CFO or any other person heading the finance function shall certify to the Board that: -**

- They have reviewed FS & cash flow statement for year & that to the best of their knowledge & belief: -
- These statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading. & These statements together present a true and fair view of company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.
- There are no transactions entered that are Fraudulent, Illegal and Violate company's code of conduct.
- They accept responsibility for establishing and maintaining ICFR
- They have indicated to the auditors and the audit committee: -
  - Significant changes in ICS in yr.
  - Significant changes in a/c policies in yr.
  - Instances of significant fraud.

**RM Committee [Reg. 21]** →

- Majority of members = members of BODs (If listed entity having outstanding Superior rights equity shares, then at least 2/3 of Risk Management Committee shall comprise of independent director)
- Senior Executives of listed entity can be members too. • Chairperson = member of BODs
- BODs Defines Role & responsibility of RM Committee & may delegate monitoring & reviewing of Risk Mgt. plan to committee and such other functions as it may deem fit including cyber security
- BODs shall constitute Risk Mgt.(RM) Committee who shall meet least once a year. This Reg. applies to top 100 listed entities, determined on basis of market capitalization, as at end of Immediate Previous FY.

**REMUNERATION OF**

**In this context, role of Auditor** →

- Ascertain from minutes of Board of Directors' meetings, shareholders' meetings, relevant agenda papers, notices, explanatory statements etc., whether remuneration of non- executive directors has been decided by Board after receiving prior approval of shareholders in the general meeting
- Refer to the Articles of Association of the company, wherever applicable
- Examine Report of Board on corporate governance to be included in annual report of company and ascertain whether same contains disclosures on remuneration of directors and compensation to non-executive director. Auditor to correlate this data with that contained in financial statements.

**W.e.f. 1<sup>st</sup> April, 2019 APPROVAL require** →

W.e.f. 1.4.19, approval of shareholders by special resolution obtained every yr. if annual remuneration to a single non- executive director > 50% of total annual remuneration to all non - executive.

Fees or compensation payable to executive directors who are promoters or members of the promoter group, shall be subject to the approval of the shareholders by special resolution in general meeting, if: -

- \* Annual remuneration payable to such executive director > 5 Crore OR 2.5% of net profits of listed entity, whichever is higher OR
- \* Where there is more than one such director, aggregate annual remuneration to such directors > 5% of net profits of listed entity.

Approval of shareholders under this provision shall be valid only till expiry of term of such director. For purposes of this clause, net profits be calculated as per section 198 of Companies Act, 2013.

**Disclosures in relation to the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redress) Act, 2013. (Schedule V)** →

**Amongst other matters, following should be disclosed in the section on Corporate Governance of the Annual Report: -**

- a. number of complaints filed during the financial year
- b. number of complaints disposed of during the financial year
- c. number of complaints pending as on end of the financial year"

**Subsidiary of Listed Entity (Reg. 24)** →

At least one independent director on the board of directors of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, whether incorporated in India or not. "Material subsidiary" = subsidiary, whose income or net worth is > 10% of consolidated income or net worth respectively, of listed entity & its subsidiaries in immediately preceding accounting year. *{This is wrongly mentioned in RTP. It should have been 20%}.*

A listed entity shall not dispose of shares in its material subsidiary resulting in reduction of its shareholding to less than 50 percent or cease the exercise of control over the subsidiary without passing Special Resolution in its General Meeting except in cases where divestment is being made under a scheme of arrangement duly approved by a Court/Tribunal or under a resolution plan duly approved under section 31 of the Insolvency Code and such an event is disclosed to the recognized stock exchanges within one day of the resolution plan being approved

Selling , disposing and leasing of assets amounting to more than 20 percent of the assets of the material subsidiary on an aggregate basis during a financial year shall require prior approval of shareholders by way of Special Resolution in its General Meeting unless the sale/disposal/lease is being made under a scheme of arrangement duly approved by a Court/Tribunal or under a resolution plan duly approved under section 31 of the Insolvency Code and such an event is disclosed to the recognized stock exchanges within one day of the resolution plan being approved".

**Related Party Disclosure [Regulations 27, 46 and Schedule V]**

- The listed entity shall disclose the transactions with any person or entity belonging to the promoter/ promoter group which hold(s) 10% or more shareholding in the listed entity, in the format prescribed in the relevant accounting standards for annual results
- The listed entity shall submit within 30 days from the date of publication of its standalone and consolidated financial results for the half year, disclosures of related party transactions on a consolidated basis, in the format specified in the relevant accounting standards for annual results to the stock exchanges and publish the same on its website

**STAKEHOLDERS RELATIONSHIP COMMITTEE [REGULATION 20]**

**INTRO**

- The listed entity shall constitute a Stakeholders Relationship Committee to specifically look into the - various aspects of interest of shareholders, debenture holders and other security holders.
- At least 3 directors, with at least 1 independent director to be members of Committee. (In case of a listed entity having outstanding Superior rights equity shares, at least 2/3 of Committee to be independent directors). Chairperson of this Committee shall be a non-executive director.
- Chairperson of the Stakeholders Relationship Committee shall be present at the annual general meetings to answer queries of the security holders. This committee shall meet at least once in a year.

**ROLE**

- Resolving the grievances of the security holders of listed entity including complaints related to transfer/transmission of shares, non- receipt of annual report, non-receipt of declared dividends, issue of new/duplicate certificates, general meetings etc.
- Review of measures taken for effective exercise of voting rights by shareholders.
- Review of adherence to the service standards adopted by the listed entity in respect of various services being rendered by the Registrar & Share Transfer Agent.
- Review of the various measures and initiatives taken by the listed entity for reducing the quantum of unclaimed dividends and ensuring timely receipt of dividend warrants/annual reports/statutory notices by the shareholders of the company.

**Additional Role of Audit Committee**

Reviewing the utilization of loans and/ or advances from/investment by holding company in the subsidiary exceeding rupees 100 crore or 10% of the asset size of the subsidiary, whichever is lower including existing loans / advances / investments as on April 01, 2019.

**Conditions & obligations auditor to comply on resignation as statutory auditor of listed entity/ material subsidiary w.r.t. limited review / audit report as per SEBI LODR Regulations**

**All listed entities/ material subsidiaries while appointing/ re-appointing auditor: -**

- If the auditor resigns within 45 days from the end of a quarter of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for such quarter
- If auditor resigns after 45 days from end of a quarter of a financial year, then auditor before such resignation, issue limited review/ audit report for such quarter as well as next quarter.
- If auditor has signed limited review/ audit report for the first three quarters of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for the last quarter of such financial year as well as the audit report for such financial year.

**Reporting of concerns w.r.t. Listed entity/its material subsidiary**

- In case of any concern with the management of the listed entity/material subsidiary such as non-availability of information, non-cooperation by the management which may hamper the audit process, the auditor shall approach the Chairman of the Audit Committee of the listed entity and the Audit Committee shall receive such concern directly and immediately without specifically waiting for the quarterly Audit Committee meetings.
- In case the auditor proposes to resign, all concerns with respect to the proposed resignation, along with relevant documents shall be brought to the notice of the Audit Committee. In cases where the proposed resignation is due to non-receipt of information/ explanation from the company, the auditor shall inform the Audit Committee of the details of information explanation sought and not provided by the management, as applicable
- On receipt of such information from the auditor relating to the proposal to resign as mentioned above, the Audit Committee or board of directors shall deliberate on the matter and communicate its views to the management and the auditor.

**Disclaimer in case of non-receipt of info**

In case listed entity/ its material subsidiary does not provide info required by auditor, to that extent, the auditor shall provide an appropriate disclaimer in audit report, which may be in accordance with the Standards of Auditing as specified by ICAI/ NFRA.

# AUDIT OF CONSOLIDATED FINANCIAL STATEMENTS (CFS)

**(Statutory requirement – Sec. 129(3) of Co Act, 2013 – CO. AUDIT)**

<p style="text-align: center;"><b>Parent Co. Mgt. Responsibility of Holding &amp; company for Preparation &amp; presentation of CFS</b></p>	<ul style="list-style-type: none"> <li>• Identify components &amp; including financial info of components to be included in CFS.</li> <li>• Where appropriate, identifying reportable segments for segmental reporting.</li> <li>• Identifying related parties and related party transactions for reporting.</li> <li>• Obtaining accurate and complete financial info from components.</li> <li>• Making appropriate consolidation adjustments.</li> <li>• Harmonize accounting policies &amp; framework &amp; GAAP conversion, where applicable.</li> </ul> <p>= Apart from above, Parent ordinarily issues instructions to Mgt. of Component specifying parent's requirements relating to financial info of components to be included in CFS.</p> <p>= Instructions ordinarily cover accounting policies to be applied, statutory &amp; other disclosure requirements applicable to Parent, including identification of and reporting on reportable segments &amp; RP &amp; RP transactions &amp; reporting timetable.</p>
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<p style="text-align: center;"><b>Auditor's Procedures in Auditing CFS</b></p>	<ul style="list-style-type: none"> <li>• Obtain a list of subsidiaries, associates &amp; joint ventures included in CFS.</li> <li>• Review info provided by mgt. of Parent identifying Subsidiaries, Associates &amp; Joint ventures.</li> <li>• Verify that all subsidiaries, associates and joint venture have been included in CFS.</li> <li>• Identify changes in the shareholding that might have taken place since the last audit.</li> <li>• Check compliance of AS-21, 23, 27.</li> <li>• Check compliance of Section 129 of Co Act 2013.</li> <li>• Using the work of another auditor &amp; Auditor's expert</li> <li>• Verify adjustments as per AS made when required &amp; properly authorized by Mgt. of parent as preparation of CFS gives rise to Permanent &amp; Current Period Consolidation Adjustments.</li> <li>• <u>In respect of completeness of this info, Auditor should perform the following procedures: -</u> <ul style="list-style-type: none"> <li>- Review his working papers for prior yr. for known subsidiaries, associates &amp; joint ventures.</li> <li>- Review parent's procedures for identification of subsidiaries and joint ventures.</li> <li>- Review investments to determine the shareholding in other entities.</li> <li>- Review Joint venture and other relevant agreements entered into by parent.</li> <li>- Review statutory records maintained by Parent (Register u/s 186 of Co Act, 2013)</li> </ul> </li> </ul>
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<u>CURRENT PERIOD CONSOLIDATED ADJ.</u>	<u>PERMANENT CONSOLIDATED ADJUSTMENT</u>
<p style="text-align: center;"><b>Adjustments made in accounting period for which Consolidation is done.</b></p> <ul style="list-style-type: none"> <li>• Eliminate Intra Group transactions.</li> <li>• Eliminate Unrealized profits.</li> <li>• Eliminate Intra-group indebtedness.</li> <li>• Adjustment for harmonizing a/c policies.</li> <li>• Adjustment for impairment loss.</li> <li>• Treatment of minority interest.</li> </ul>	<p style="text-align: center;"><b>Adjustments on 1<sup>st</sup> occasion of Preparation &amp; Presentation of CFS.</b></p> <ul style="list-style-type: none"> <li>• Determine goodwill or capital reserve.</li> <li>• Determine goodwill or capital reserve arising on application of equity method to a/c for investments in associates in CFS.</li> <li>• Determine amount of equity attributable to minorities at date on which investment in subsidiary is made.</li> </ul>

<p style="text-align: center;"><b>Auditor Responsibility for CFS</b></p>	<p>Auditor of the CFS is responsible for expressing opinion on whether CFS are prepared in all material respects, as per FRF under which Parent prepares CFS.</p> <p><b>Auditor's objectives in Audit of CFS are: -</b></p> <ul style="list-style-type: none"> <li>• Satisfy himself that CFS been prepared as per requirements of applicable FRF.</li> <li>• Enable himself to express opinion on True and fair view presented by CFS.</li> <li>• Enquire in matters as specified in section 143(1) of Co Act, 2013.</li> <li>• Report on matters in Clauses (a) to (i) of 143(3) of Co Act, 2013 &amp; 143(3) (j) + Rule 11</li> </ul>
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<b>AUDIT REPORT FOR A MULTI BUSINESS UNIT MNC</b>	<b>If Parent Auditor = Auditor of all its Components</b>	<p><u>Issue Audit report expressing opinion: -</u></p> <ul style="list-style-type: none"> <li>* Whether CFS give True &amp; Fair view of state of affairs of Group as on B/S Date</li> <li>* Whether Consolidated P/L statement gives True &amp; Fair view of results of consolidated P/L of Group for period under audit.</li> <li>* On True &amp; Fair view of Cash flows presented by Consolidated cash flow statements.</li> </ul> <p>Auditor of Parent to report whether principles &amp; procedures for preparation and presentation of CFS as laid in relevant AS(s) is followed. (Deviation = Auditor to disclose in Audit report to aware users)</p>
	<b>If Parent's Auditor not Auditor of all components</b>	<ul style="list-style-type: none"> <li>* Auditor of CFS to consider requirement of SA 600.</li> <li>* If Parent's auditor decides that he will make reference to Audit of other auditors in Report, he should disclose clearly portion of FS audited by Other auditor(s).</li> <li>* Reference in Report of auditor of CFS not to be construed as a qualification of opinion but rather as Indication of divided responsibility in Auditors of parent and its subsidiaries.</li> </ul>
	<b>If Component(s) Auditor Reports on FS under <u>Accounting</u> Framework differ than that of Parent</b>	<ul style="list-style-type: none"> <li>* Parent's Mgt. performs conversion of components' audited F.S. from framework used by component to framework under which CFS are prepared.</li> <li>* Conversion adjustments are audited by Principal auditor to ensure financial info suitable &amp; appropriate for purposes of consolidation.</li> <li>* Alternatively, component may prepare FS on basis of Parent's accounting policies.</li> <li>* Local component auditor can then audit &amp; issue Audit report on components FS prepared as per "Group accounting policies".</li> </ul>
	<b>If Component(s) Auditor Reports under <u>Auditing</u> Framework Different than that of Parent</b>	<ul style="list-style-type: none"> <li>* Audits of F.S., including CFS are performed under AS generally accepted in India.</li> <li>* To maintain consistency of Auditing framework and to enable parent auditor to rely &amp; refer to other auditor's Audit report in their audit report on CFS, components' FS be audited under framework that corresponds to Ind.- AS</li> </ul>
	<b>If FS of 1 or more components not audited</b>	<ul style="list-style-type: none"> <li>* Auditor reporting on CFS to consider unaudited components in evaluating a possible modification to his report on CFS</li> <li>* Evaluation necessary as Auditor not able to Obtain SAE on such Consolidated amt./ balances</li> <li>* Auditor to evaluate qualitative &amp; quantitative factors on possible effect of amt. remaining unaudited when reporting on CFS using Guidance provided in SA 705.</li> </ul>

## AUDIT OF BANKS

### PRINCIPAL ENACTMENTS GOVERNING BANK AUDIT

• Banking Regulation Act, 1949	• RBI Act, 1934 & SBI Act, 1955.
• Banking Co (Acquisition & Transfer of Undertakings) Act, 1970.	• SBI (Subsidiary Banks) Act, 1959.
• Prevention of Money Laundering Act, 2002.	• Regional Rural Banks Act, 1976.
• Payment & Settlement systems Act, 2007.	• Cooperative Societies Act, 1912.
• Credit Information Companies Regulation Act, 2005.	• Companies Act, 2013.
• Info Technology Act, 2000.	• SARFAESI Act, 2002.

<b><u>Audit Procedures on Balances in A/C Of Banks Situated in Foreign Country</u></b>	<ul style="list-style-type: none"> <li>• Ensure compliance with AS 11.</li> <li>• Verify ledger balance every year at year end with reference to reconciliation statement.</li> <li>• Examine large transactions in Inter Bank A/c in year end to ensure no window dressing.</li> <li>• Check deposit receipts and confirmation certificates from bank in respect of O/S deposits.</li> </ul>
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**Verify Bills Purchased**

- Verify that all documents of title are properly assigned to the bank.
- Sufficient margin should be kept while purchasing or discounting of a bill.
- Irregular outstanding accounts should be periodically reported to the head office.
- Proportionate income should be recognized between the periods

**REQUIREMENTS OF RISK MGT SYSTEM**

<b>Involvement of TCWG</b>	Risk Mgt. policies to be approved by TCWG on bank's business Objectives & Strategies, Capital strength, Mgt. Expertise, Regulatory requirements & types of risks.
<b>Identify, Measure &amp; Monitor Risks</b>	Risks that may significantly affect the achievement of bank's goals and objectives should be identified, measured and monitored.
<b>Control Activities</b>	<b>Banks must have controls including following: -</b> - Verification and approval of transactions                      - Effective segregation of duties. - Reporting and approval of exception.                                      - Setting of limits.
<b>Monitoring Activities</b>	Risk Mgt. models, methodologies and assumptions used to measure and manage risk need to be evaluated by Independent Risk Mgt. Unit
<b>Reliable Info System</b>	Must exist so as to provide adequate financial, operational and compliance info on a timely & consistent basis to management and TCWG.

**VERIFICATION OF INVESTMENTS = Audit Procedure**

<b>Internal control evaluation</b>	<ul style="list-style-type: none"> <li>• To ensure they are in accordance with RBI Guidelines.</li> <li>• Investment policy must confirm to RBI Guidelines.</li> </ul>
<b>Separation of Investment Fn.</b>	• Own investment account need to be separated from PMS client accounts.
<b>Examination of Documents</b>	• To ensure Investments made in authority & supported by documentation.
<b>Physical verification</b>	<ul style="list-style-type: none"> <li>• Should be carried out on balance Sheet date,</li> <li>• Carry out physical verification as near B/S date as possible in some cases</li> </ul>
<b>Examination of Valuation</b>	<ul style="list-style-type: none"> <li>• Method of accounting including yearend valuation is appropriate.</li> <li>• If inappropriate, consider effect of adoption of such policy on FS</li> </ul>
<b>Securities deal on Others behalf</b>	• Income from such activities to be recorded fairly.
<b>Examination of Classification and Shifting &amp; Examination of Reconciliation</b>	

**Verify Advances against Good**

- Sanction** = Examine Sanction Letter, Letter of hypothecation & note important T & C
- Stock statements** = Verify quantity & value of goods & Test check warehouse Register
- Inspection** = Ascertain if premises of borrowers periodically visited by bank officials to verify qty.
- Stock Audit** = See whether bank has got a system of Obtaining stock & receivables audit report
- Hypothecation/ Pledge** = Examine letter of hypothecation & Certificate of Registration of charge
- Insurance** = Examine Insurance policies for their validity, adequacy etc. & see policies in favour of bank.
- Documents of Title** = Inspect docs of Title to goods like Bill of lading, Dock warrant
- 3rd Party Certificate** = Where hypothecated goods are in Possession of 3<sup>rd</sup> parties

**Income Recognition Norms**

<b>Performing Investments</b>	• Accrual basis provided interest rate is predetermined.
<b>NPI</b>	• Realization Basis
<b>Govt. Guarantee</b>	• Accrual basis, provided interest is serviced regularly.
<b>Dividend</b>	• Accrual basis, if right to receive dividend is established.
<b>Discount on discounted instruments</b>	• Accrual basis over the remaining period of maturity.
<b>Units of Mutual Funds</b>	• Cash Basis
<b>Sale of Investments</b>	• Profit or loss to be shown in Profit & Loss Account.

<b>AUDIT PROCEDURE ON CONCURRENT AUDIT</b>	<b>Mean</b>	<ul style="list-style-type: none"> <li>• Examination which is contemporaneous with the occurrence of transactions.</li> <li>• It attempts to shorten Interval in a transaction &amp; its examination by an independent person not involved in its documentation.</li> <li>• Emphasize substantive checking rather than test checking.</li> </ul>
	<b>Coverage</b>	<ul style="list-style-type: none"> <li>* Branches whose total credit aggregate to not less than 50% of total credit of bank</li> <li>* Branches whose aggregate deposits cover not less than 50% of aggregate deposits of Bank.</li> <li>* Exceptionally large, very large and large branches</li> <li>* Special branches handling foreign exchange business</li> <li>* Branches rated as poor/very poor</li> <li>* Head Office dept. dealing with treasury/ funds Mgt. &amp; handling investment portfolio</li> </ul>
	<b>Scope</b>	<ul style="list-style-type: none"> <li>* Daily cash transactions with reference to abnormal receipts &amp; payments</li> <li>* Revenue leakage.</li> <li>* Verify of procedure &amp; docs to open new current, savings, term deposit accounts, etc.</li> <li>* Verify advances, OD, CC, term loans, bills purchase, LC etc. Procedure for sanction &amp; docs to be verified.</li> <li>* Verification of ledgers, inter branch reconciliation &amp; verification of interest, discount, commission.</li> <li>* Procedure for safe custody of security forms with branch.</li> <li>* Verification of high value transactions.</li> <li>* Ensure adequacy of procedures for TDS.</li> <li>* Verification of Foreign exchange transactions.</li> <li>* Verification of returns, statements, calculation of CAR &amp; compliance with RBI Guidelines.</li> <li>* Study of RBI and Internal Inspection reports, statutory auditor's report and compliance thereto.</li> </ul>

**Classification of Investments as per Prudential Norms**

1	<u>Held to Maturity (HTM)</u>	• Securities acquired by bank with the intention to hold till maturity.
2	<u>Held for Trading (HFT)</u>	• Securities acquired by bank for trading, i.e. to be sold in 90 days.
3	<u>Available for Sale (AFS)</u>	• Securities which do not qualify for being classified as HTM or HFT.
<b>Category of investment decided at time of acquisition and recorded on investment proposal.</b>		

<b>VERIFICATION OF CONTINGENT LIABILITIES</b>	<b>Disclosure requirement</b>	<p><u>3<sup>rd</sup> Schedule requires disclosure of Contingent Liabilities as footnote in B/S with: -</u></p> <ul style="list-style-type: none"> <li>• Claims against the bank not acknowledged as debts.</li> <li>• Liability for partly paid investments.</li> <li>• Liability on account of outstanding forward exchange contracts.</li> <li>• Guarantees given on behalf of constituents- In India &amp; Outside India.</li> <li>• Acceptances, endorsements and other obligations.</li> <li>• Other items for which Bank contingently liable.</li> </ul>
	<b>Verification</b>	<ul style="list-style-type: none"> <li>• Ascertain existence of Adequate ICS to ensure Contingent Liabilities executed only by authorised person</li> <li>• Ascertain if accounting system of bank provides for maintenance of adequate records on obligations.</li> <li>• Perform substantive audit tests to establish the completeness of the recorded obligations.</li> <li>• Obtain representation from the management that all contingent liabilities have been disclosed.</li> <li>• Ensure Compliance of AS 29, "Provisions, contingent liabilities and contingent assets".</li> </ul>
	<b>Claims against the bank not acknowledged as debt</b>	<ul style="list-style-type: none"> <li>• Examine relevant evidence like correspondence with lawyers, claimants, workers/officers etc.</li> <li>• Review Minutes of meeting of BODs, contracts, agreements, pending legal cases &amp; correspondence relating to Taxes etc., to identify claims against the bank.</li> <li>• Ascertain from Mgt. Status of claims outstanding as at the end of previous yr.</li> <li>• Review subsequent events to obtain evidence about completeness and valuation of claims.</li> </ul>
	<b>Acceptances, Endorsements &amp; other obligations</b>	<p><u>Letters of credit: -</u></p> <ul style="list-style-type: none"> <li>* Evaluate adequacy of ICS over LC Forms e.g. custody, records, reconciliation etc.</li> <li>* Verify the balance of LC from the Register maintained by the bank.</li> <li>* Examine the guarantees of the customers, copies of the LC issued &amp; security obtained.</li> </ul> <p><u>Other acceptances &amp; endorsements: -</u></p> <ul style="list-style-type: none"> <li>* Examine arrangements made by bank with customers.</li> <li>* Test check amounts of bills with the register.</li> <li>* Verify whether bills are marked off in register on payment at maturity.</li> </ul>

<b>VERIFICATION OF ADVANCES</b>	<b>Classified as NPA if</b>	<ul style="list-style-type: none"> <li>* It ceases to generate income for bank.</li> <li>* Interest &amp;/ or installment of principal remained <u>Overdue</u> or <u>out of order</u> for specified time</li> <li>* No credits continuously for 90 days as on B/S date or credits not enough to cover Interest debited in period.</li> <li>- <b>Overdue:</b> - Amount not paid on the due date fixed by Bank.</li> <li>- <b>Out of Order:</b> - O/s balance continuously in excess of sanctioned limit/ drawing power.</li> </ul>
	<b>Classification in Special Cases</b>	<ul style="list-style-type: none"> <li>* Account regularized near B/S date = Classify as NPA if account has inherent weaknesses.</li> <li>* Account classify borrower wise = All facilities granted to same borrower treated as NPA</li> <li>* Advances under Consortium = Based on Recovery of Individual member ban</li> <li>* Moratorium Period = A/c not Treated overdue if Date of debit of interest in moratorium period.</li> <li>* Temporary Deficiencies = Ensure DP arrived on basis of stock statement (not older than 3 month)</li> </ul>
	<b>Exceptions to NPA General Classification Norms</b>	<ul style="list-style-type: none"> <li>* Temporary Deficiencies = Non submission of stock statement, non-renewal of limits.</li> <li>* Natural Calamities = ST Agricultural loan converted to ST loans treated current dues.</li> <li>* Facilities backed by CG Guarantee = Overdue A/c classified as NPA only when CG repudiates its guarantee.</li> </ul>
	<b>NPA Classification Criteria of Specified Advances</b>	<ul style="list-style-type: none"> <li>* Term Loans = Interest / Installment remain overdue &gt; 90 days</li> <li>* Cash Credit / Overdraft = Account remained overdue &gt; 90 days.</li> <li>* Bills Payable/ Bills Discounted = Bills remained overdue &gt; 90days</li> <li>* Agricultural Advances = Interest/ Installment remain overdue: -                             <ul style="list-style-type: none"> <li>- &gt; 2 crop seasons (short duration crops) OR</li> <li>- &gt; 1 crop season (long duration crops)</li> </ul> </li> <li>* Credit Card Accounts = Min. amount due not paid in 90days from next statement due.</li> <li>* Other Accounts = Amount overdue &gt; 90 days.</li> </ul>
	<b>Income Recognition of NPA</b>	<ul style="list-style-type: none"> <li>* General Rule = Accrual basis if reasonable to expect ultimate collection</li> <li>* NPAs = Cash Basis</li> <li>* Advanced against LIC/ KVP/ NSC/ FDs = Accrual basis provided adequate margin is available.</li> <li>* Fees/ Commission on Rescheduled advance = Accrual basis over period covered by rescheduled extended credit period.</li> <li>* Govt. Guaranteed advances = If overdue, income to be realized on cash basis.</li> </ul>
	<b>Reversal of Income</b>	<ul style="list-style-type: none"> <li>* First Time NPAs = Interest credited but not realized to be reversed.</li> <li>* NPAs Commission/ Other Income = Recognized on accrual basis &amp; not received yet to reverse</li> <li>* Finance Charge of Leased Asset = Recognize Income on accrual but not yet realize be reversed</li> </ul>
	<b>Verify Security against Advance</b>	<ul style="list-style-type: none"> <li>• Execution of documents.</li> <li>• Evidences as to Market Value.</li> <li>• Registration of charge with ROC.</li> <li>• Whether security legally enforceable.</li> <li>• If Security in banks effective control.</li> <li>• Limitation period.</li> <li>• Evidences to ownership of assets.</li> <li>• Regular submit info by borrower.</li> <li>• Extent Value of security covers loan.</li> </ul>
	<b>Non Performing Investments</b>	<p>Those investments where Interest/ principal is due &amp; remains unpaid for &gt; 90 days and includes: -</p> <ul style="list-style-type: none"> <li>• Preference Shares where dividend is not paid</li> <li>• Securities issued by a person who has been given credit facility which is a NPA.</li> <li>• Equity, debentures etc. received as a result of conversion of NPA.</li> <li>• Unquoted equity shares value @1.</li> </ul>
	<b>Special Purpose Certificate</b>	<p>RBI Circular = Central Auditors are required to issue following certificates</p> <ul style="list-style-type: none"> <li>• Certificate on Reconciliation of securities by bank both on its own investment account &amp; Client's a/c</li> <li>• Certificate on compliance by bank in key areas of prudential &amp; other guidelines relating to transactions issued by RBI.</li> </ul>

**AUDIT OF GENERAL INSURANCE CO. (GIC)**

<b>AUDITORS' REPORT</b>	<b>Report to specify</b>	<ul style="list-style-type: none"> <li>• That they have obtained all Info &amp; explanations which, to best of their knowledge &amp; belief, were necessary for purposes of their audit &amp; whether they have found them satisfactory.</li> <li>• Whether proper BOA maintained by insurer as appears from examination of those books.</li> <li>• Whether proper returns, audited or unaudited, from branches and other offices have been received &amp; whether they were adequate for the purpose of their audit.</li> <li>• Whether B/S, Revenue Accounts &amp; P/L dealt with by report &amp; Receipt &amp; Payments Account are in agreement with BOA &amp; returns.</li> <li>• Whether Actuarial valuation of liabilities is duly certified by appointed actuary issued by authority.</li> </ul>
	<b>Express Opinion on</b>	<ul style="list-style-type: none"> <li>• Whether Balance Sheet gives a true and fair view of the insurer's affairs as at the end of the FY/ period.</li> <li>• Whether Revenue Account gives a true and fair view of the surplus or the deficit for the FY/ period.</li> <li>• Whether Profit and Loss Account gives a true and fair view of the profit or loss for the FY/ period.</li> <li>• Whether Receipts and Payments Account gives a true and fair view of receipts &amp; payments for FY/ period.</li> <li>• FS are prepared as per requirements of Insurance Act, 1938, IRDA Act, 1999 &amp; Co Act, 2013.</li> <li>• Investments have been valued in accordance with the provisions of the Act and the Regulations.</li> <li>• Accounting Policies selected by the insurer are appropriate and are in compliance with applicable AS</li> <li>• Principles as prescribed in these Regulations or any order or direction issued by the Authority in this behalf</li> </ul>
	<b>Certify that</b>	<ul style="list-style-type: none"> <li>• They Reviewed Mgt report &amp; that there is no apparent mistake or material inconsistencies with FS</li> <li>• Insurer has complied with the terms and conditions of the registration stipulated by the Authority.</li> </ul>

<b>Certificate</b>	<p><u>A certificate signed by the auditors (which are in addition to any other certificate or report which is required by law to be given with respect to the balance sheet) certifying that: -</u></p> <ul style="list-style-type: none"> <li>• Verified cash balances &amp; securities relating to the insurer's loans, reversions &amp; life interests</li> <li>• Extent to which they verified Investments &amp; transactions w.r.t. trusts undertaken by insurer as trustee.</li> <li>• No part of the assets of the policyholders' funds has been directly or indirectly applied in contravention of provisions of the Insurance Act, 1938 relating to the application and investments of the policyholders' funds."</li> </ul>
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<b>AUDIT PROCEDURES TO VERIFY CLAIMS</b>	<b>Prepared Registers &amp; Records</b>	<ul style="list-style-type: none"> <li>• Claims Intimation Register</li> <li>• Claims Paid Register</li> <li>• Claims Disbursement Bank Book</li> <li>• Claims Dockets</li> <li>• Salvage register</li> <li>• Report of quality assurance team</li> <li>• Claim intimation, claim form, particulars of policy, survey report, police report</li> <li>• Claim settlement note, claim satisfaction note, salvage report, etc.</li> </ul> <p>(Claim Account is debited with all payments including repair charges, fire fighting expenses, police report fees, survey fees, amount decreed by the Courts, travel expenses, photograph charges, etc.)</p>
	<b>Claim Outstanding at Year End</b>	<ul style="list-style-type: none"> <li>• <u>Provision made for only such claims for which co legally liable, considering particularly: -</u></li> <li>- That risk was covered by policy</li> <li>- That claim not arose during period company wasn't supposed to cover risk.</li> <li>- Claims arose during currency of policy</li> <li>• Provision made is normally not in excess of the amount insured</li> <li>• In Determining amount of provision, events after B/S date been considered</li> <li>• In determining amount of provision, 'Average clause' applied if under-insurance by parties.</li> <li>• No contingent liability carried in respect of any claim intimated for policies issued.</li> <li>• Claims are provided for net of estimated salvage, wherever applicable.</li> </ul>
	<b>Claims Paid</b>	<ul style="list-style-type: none"> <li>• In co-insurance arrangements, claims paid booked only for company's share &amp; balance debited to other insurance co.</li> <li>• If claims paid on basis of advices from other insurance companies &amp; if share of premium received</li> <li>• Claims communicated after yr-end for losses which occurred prior to yr-end must be accounted for in year of audit.</li> <li>• Claims payments duly sanctioned by Authority concerned</li> <li>• Salvage recovered duly accounted by company &amp; letter of subrogation obtained as per procedure.</li> <li>• Payment made against claims partially settled is duly vouched &amp; sanctioning authority is same</li> </ul>

**AUDIT PROCEDURES ON**

**ITEMS RELATING TO BALANCE SHEET**

**Outstanding Premium & Agents' Balances**

- Scrutinize 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 co rules.
- Enquire into the reasons for retaining the old balances.
- Verify old debit balances requiring provision or adjustment.
- Check age-wise, sector-wise analysis of outstanding premium.
- Verify whether outstanding premiums have since been collected.
- Check availability of adequate bank guarantee or premium deposit for outstanding premium.

**Investments**

- Auditor's objective in audit of investments is to satisfy himself as to their existence & valuation.
- Verify investment Scrip physically at the close of business on Balance sheet date.
- Where physical verification on B/S date not possible = auditor to do it on near date to it as possible
- Take into consideration any adjustments for subsequent transactions of purchase, sale, etc.
- Investments should not normally be held by any other person.
- Examine appropriateness of accounting policies followed by insurance company.
- Examine whether income from investments is properly accounted for.
- See if a proper system for recording & maintenance of TDS certificates received by Insurance Co.

**Cash & Bank**

- Physically verify cash balance collection & chest for meeting day to day expenditures.
- Obtain a certificate from Mgt. for the above mentioned balances as at the balance sheet date.
- Apply test check on the bank transactions.
- Check Bank Reconciliation statement and long outstanding entries therein.
- Obtain confirmation of Bank Balances for all operative and inoperative accounts.
- Verify deposits & withdrawals transactions at random & check if A/c is operated by authorized person
- In case of funds-in-transit, he should verify same are properly reflected as part of bank balance.

**Provision for Tax**

- Assess past trend of Income Tax Dpt., decision of High & Supreme Court for computation made.
- See whether deductions under Chapter VIA of the Income Tax Act, 1961 is properly taken into a/c
- Seen whether exemption provision relating to TDS from certain income as exempted properly availed.
- Check grossing up of TDS relating to Income properly done for computation of Taxable income.
- Check liability under VAT & whether provision for adequate amt. made in books or not.
- Verify adequate provision made for additional liability for earlier yr. for which demands received now

**Disclosure requirements of Contingent liabilities in notes to B/S of GIC**

- Underwriting Commitments outstanding.
- Guarantees given by or on behalf of the Company.
- Statutory demands/Liabilities in dispute not provided for.
- Claims other than those under policies not acknowledged as debts.
- Reinsurance obligations to the extent not provided for in the accounts.
- Partly paid up investments.
- Others (to be specified)

**PREMIUM**

- \* Auditor should look in ICS & compliance as laid for collection & recording of premiums.
- \* Ascertain Proper cover notes relating to the risks assumed have been serially numbered.
- \* Ascertain there is an adequate internal check on the issue of cover notes, policy documents, stamps, etc.
- \* Ascertain whether advance of last year is accounted this year as income.
- \* Ensure & Check Premium recorded originally at Gross figure without providing for unexpired risks
- \* Ensure & Check whether agency commission paid on such premium has been recovered.
- \* Ensure & Check whether service tax charged from insured at Rates in force, on the total premium

**Commission to Agent**

- Vouch disbursement entries & disbursement vouchers with copies of commission bills
- Check whether vouchers are authorized & TDS deducted as applicable
- Test check correctness of amounts of commission allowed
- Scrutinize agents' ledger & balances examine accounts with Dr. balances & obtain info on same
- Check whether commission outgo for period under audit been duly accounted

**Reserve For Unexpired Risks**

IRDA (General Insurance-Claim Reserving) Regulations, 2013 requires creation of a minimum amt. of Unexpired Risks reserve at a specified percentage of Net Premium as Not all risk expire as on B/S date.  
 Risk will be there in succeeding year for premium received in this year, thus provide for: -

- For marine hull insurance = 100% of Net Premium
- For fire, marine cargo and miscellaneous business = 50% of Net Premium.

Sec. 64V of Insurance Act, 1938 also specifies these percentages.  
 ( Provision of Income Tax Act 1961 & Income Tax Rules 1962 permit deduction of above reserves)

**Regulatory Requirements of Insurance Act 1938  
Framework on Solvency Margin**

\* Requirement of solvency margin = Every insurer and re-insurer shall at all times maintain an excess of value of assets over the amount of liabilities of, not less than 50% of the amount of minimum capital.

<u>Type of Insurance Business</u>	<u>Minimum paid up share capital required u/s 6 (excludes Preliminary Exp)</u>	<u>Sufficiency of Assets/Solvency Margin</u>
Life/ General Insurance	100 Cr	50 Cr
Health Insurance (exclusive)	100 Cr	50 Cr
Re-Insurer (exclusive)	200 Cr	100 Cr

\* Non-compliance of solvency margin = Insurer or re-insurer, who does not comply with requirement of solvency margin deemed to be insolvent & may be wound-up by court on application made by IRDA.

\* Submission of Financial Plan = If, at any time, insurer or re-insurer does not maintain required control level of solvency margin, he shall, in accordance with directions issued by IRDA, submit a financial plan, indicating a plan of action to correct the deficiency within a specified period not exceeding 6 months.

\* Modifications to Financial Plan = If the authority considers the financial plan inadequate, it shall propose modifications to the plan and shall give directions, including direction in regard to transacting any new business, or, appointment of administrator or both.

\* Non submission of financial plan = An Insurer or re-insurer who does not submit financial plan shall be deemed to have made default in complying with the requirements of this section

**Valuation of Investment**

\* Real Estate (Investment property) = Historical cost (-) Acc. Dep. (-) Impairment loss (No Residual value)

\* Debt Securities – as ‘held to maturity’ – Historical cost.

\* Equity / Derivative Active Market (Listed Company) – F.V. at B/S date. Impairment as expenses. Changes in F.V. in “Fair Value change A/c.” If debit balance, to be reduced from free reserves while declaring dividend (Any credit balance will not be able for distribution as dividend)

\* Unlisted and other – at Historical Cost. Provision shall be made for diminution in value. such provision may be reversed but increased carrying amount not to exceed its historical cost.

**Co-INSURANCE**

\* Large business risks are shared between more than one Insurer

\* Leading insurer issues the documents, collects premiums and settles claims and renders statements of Accountants to the co-insurers.

\* Ex: - A Insurance Company receives a insurance business (100%) with high risk. Shares 50 % business with B and 30 % with C. For B and C this is incoming coinsurance and for A it is outgoing coinsurance

**AUDIT PROCEDURE**

<b>Incoming Coinsurance</b>	<b>Outgoing Coinsurance(Leader)</b>
<ul style="list-style-type: none"> <li>* Auditor should check that premium a/c is credited on basis of statements received from leading insurer.</li> <li>* If statement is not received, whether premium has been accounted on the basis of advices received.</li> <li>* Obtain WR from the management that premium received from the leader has been accounted for.</li> <li>* Verify provision for claims made &amp; paid.</li> <li>* Ensure claim paid only for its share in co-insurance.</li> </ul>	<ul style="list-style-type: none"> <li>* For outgoing co-insurance auditor should scrutinize transactions relating to outgoing business; i.e. where company is leader.</li> <li>* Examine relevant documents.</li> <li>* At the time of settlement of claims, auditor will ensure whether the leader has received the respective share of claims from co-insurer.</li> <li>* <i>Jitna share of claim co-insurer ka banta hai, correspondingly unke hisse main debit liya hai ya nai.</i></li> </ul>

**Maintenance of Deposit with RI u/s 7**

- 3 % of Total Gross Premium written in India in any F.Y.
- Maximum limit of deposit is 10 Cr. (Reinsurance- 20 Cr)
- Deposit can be made either in cash or investment in approved securities.(M.V of securities on date of deposit is to be seen.

(NOTE: - Requirements pertaining to deposits has been omitted under Insurance Amendment Act)

**Reinsurance**

- An agreement between a ‘ceding company’ and a ‘reinsurer’ whereby former agrees to ‘cede’ & latter agrees to accept a certain specified share of Risk or liability upon terms as set out in agreement.
- A ‘ceding company’ is Original insurance company which has accepted Risk & agreed to ‘cede’ or pass on that Risk to another insurance company or the reinsurance company.
- If loss, insured’s claim for full amt. is against original insurer only. Original insurer lodges claim with Reinsurer

**TYPES OF REINSURANCE CONTRACTS**

**FACULTATIVE REINSURANCE**

- \* It is that type of reinsurance whereby contract relates to 1 particular risk & expressed in reinsurance policy.
- \* Oldest method of reinsurance and it necessitates consideration of each risk separately.
- \* Each transaction under facultative reinsurance has to be negotiated individually.
- \* Each party to transaction has a free choice, i.e., for ceding company to offer & reinsurer to accept.
- \* Drawbacks of this type of insurance are Volume of work involved & time taken to cover Risk.
- \* Still used even today, mainly when: -
  - Automatic covers have already been exhausted.
  - Risk is excluded from the Treaties.
  - Insurer does not want his reinsurance treaties overburdened with heavy & abnormal risks.
  - Insurer has no automatic cover at his disposal.

**TREATY REINSURANCE**

- Entered in ceding company & reinsurer(s) where reinsurances in limits of treaty
- Obligatory for Reinsurer to accept all risks within the scope this treaty
- Obligatory for ceding company to cede risks in accordance with terms of treaty
- Insurer generally prepares Statement of treaty reinsurances accounts on quarterly basis or on half yearly basis
- Reinsurer, in such cases, treats the amount paid to insurer as ‘advance against claim.

**NON-PROPORTIONAL TREATY**

- Distribution of liability in ceding company & reinsurer on basis of losses rather than sum insured
- Premium not calculated each time ceded but on whole portfolio of ceding company.
- Premium rate is predetermined.
- Cost of reinsurance vary substantially each year & depending on premium income
- Normally no commission is paid.

**PROPORTIONAL TREATY**

Based on Pro-rata apportionment of sum insured, premium & losses as per pre-determined percentage/ ratio

**EXCESS OF LOSS (XL) TREATY**

- \* Reinsurer’s liability arises only when claim > predetermined figure relating to specific branch of ceding company’s business or to its entire business.
- \* (Provides protection to insurer against numerous losses caused by cyclone, earthquake, etc. This cover is also known as ‘Catastrophic Cover’)

**STOP LOSS TREATY**

- ‘Excess of Loss Ration Cover’ as it protects co. from losing more than specified amount
- Amount fixed for ceding co annual premium income for class of business as %.
- Reinsurer liable for losses which exceed agreed % of loss ratio, until the limit of liability is reached which is expressed in form of loss ratio.

**Verification of Reinsurance Inwards/Outward or Ceded**

- Reinsurance agreement should be as per the norms and guidelines prescribed in the Insurance Act, 1938 IRDA Regulations as well as the company’s approved program
- The auditor should verify the reinsurance transactions are as per the arrangements with re-insurers
- The auditor should examine the accounting policy of the company in regard to reinsurance business received/ceded, premium received/paid and payment/receipt of commission
- Auditor should obtain evidence about the system of control over the reinsurance inward program
- Examine foreign currency transactions & ensure that they comply with AS 11
- Check whether cession is as per agreement entered.
- Check whether commission on cession is as per agreement.
- Check whether cession has been made as per stipulation applicable to various categories of risk.

**AUDIT OF NBFC**

**NON BANKING & FINANCE COMPANIES (NBFC)**

**Meaning** → Section 45 I(f) of RBI (Amendment) Act, 1997 defines NBFC as: -

- Financial institution which is a company.
- Non-banking institution also being a Co. with principal business of receiving of deposits or lending.
- Other non-banking institution or class of such institutions, as RBI with previous approval of CG may specify by notification in Official Gazette.

(RBI Directions on Acceptance of Public Deposits = state NBFC means only non-banking institution which is a Loan co, Investment co, Hire purchase finance co, Equipment leasing co & Mutual benefit financial co)

**Types of NBFCs registered with RBI** →

- Asset Finance Company (AFC)
- NBFC - Micro Finance Institution (NBFC-MFI)
- Core Investment Company (CIC)
- Investment Company (IC)
- Infra Finance Company (IFC)
- Infra Debt Fund- NBFC (IDF-NBFC)

**Classification of frauds by NBFC.**  
{Commissioner & CM's Fraud In FOREX}

- Cheating & forgery.
- Cash shortages & Negligence
- Misappropriation and criminal breach of trust.
- Fraudulent by forged Instruments, manipulation of BOA or by fictitious a/c & conversion of property.
- Irregularities in FOREX Transactions.
- Unauthorized credit facilities extended for reward or for illegal gratification.
- Other type of fraud not coming under specific heads above.

→ = Cases of 'Negligence and cash shortages' & 'Irregularities in foreign exchange transactions' referred in above items "Negligence and cash shortages OR Cheating and forgery" to be reported as fraud if the intention to cheat/ defraud is suspected/ proved.

= Cases where fraudulent intention not suspected/ proved at time of detection = treated fraud & reported:-

- Cases of cash shortages more than ₹10,000
- Cases of cash shortages more than ₹5000 if detected by management/ auditor/ inspecting officer & 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 RBI as per prescribed format and procedures.

**Audit of NBFC of Investment Co** →

- \* Physical Verification
- \* Verify that credit facilities extended & investments by concerned NBFC are as per prescribed ceiling.
- \* Verify whether the NBFC has not advanced any loans against the security of its own shares.
- \* Verify that Dividend income declared is duly received & interest due accounted for.
- \* Check if adequate provision for fall in Value
- \* Verify charges received or paid in respect of securities lent/borrowed.
- \* Obtain confirmation from Approved intermediary on securities deposited with/ borrowed from it as at yr end

\* Compliance with Prudential Norms

**Verification Procedures in Audit of Hire-Purchase Finance Co** →

- \* Credit Appraisal System
- \* Verification of Endorsement
- \* Recognition of Finance Charges
- \* Verification of Payments
- \* Regularity of HP Instalments
- \* Insurance of Asset
- \* Physical Verification

**Compliance of Public Deposits Directions by NBFC** →

- \* Credit Rating = Obtain a copy of the credit rating assigned to NBFC and check whether the public deposits accepted/held by it are in accordance with the level of credit rating assigned to it.
- \* Interest and Brokerage Payments = Test checks interest calculations & interest not in excess of specified.
- \* Written Application = NBFC accepted or renewed PD only after a written application from depositor
- \* Deposit Register = Verify it & test check the particulars entered for depositors with supporting receipts
- \* Repayment of Deposits = NBFC is regularly paying its deposits on due dates.
- \* Filling of Annual Returns = Filed its annual return in specified time i.e. before 30th June.
- \* Board Resolution passed if non-acceptance of public deposits

**MATTERS TO BE INCLUDED IN AUDITORS REPORT IN CASE OF NBFC**

In addition to Report made by Auditor u/s 143 of Co Act, 2013, auditor shall also make Separate report to BODs of Company on matters specified in Para 3 & 4 of NBFCs Auditor' s Report (Reserve Bank) Directions, 2016

**In case of All NBFCs (Para 3)**

- Whether company is **engaged in business of NBFC**
- Examine whether company **obtained Certificate of Registration (COR) from Bank** (Activity without a Valid COR granted by Bank = offence under RBI Act, 1934)
- If company holding COR issued by Bank, whether company is **entitled to continue to hold such COR in terms of its Principal Business Criteria** (Financial asset/ Income pattern) as on March 31
- Whether NBFC is **meeting required Net owned fund requirement** as laid in Non- Systemically Important & Non Deposit taking Company (Reserve Bank) Directions, 2016 **AND** Systemically Important Non-Deposit taking Company and Deposit taking Company (RBI) Directions, 2016. (Every NBFC to submit **Certificate from its Statutory Auditor** that it is engaged in business of NBFC requiring it to hold a COR u/s 45-IA of RBI Act and is eligible to hold it = for this a Certificate from Statutory Auditor on position of company at 31<sup>st</sup> March FY end may be submitted to Regional Office of Department of Non-Banking Supervision under whose jurisdiction NBFC is registered in 1 month from Date of finalization of B/S & in any case not later than December 30<sup>th</sup>)

**NBFCs Accepting/ Holding PD (Para 3)**

- Whether public deposits accepted by NBFC & other borrowings are in limits admissible to co as per provisions of NBFCs Acceptance of Public Deposits (Reserve Bank) Directions, 2016.
- Whether PD held by co in excess of such deposits permissible to it under NBFCs Accept of (PD) Public Deposits (RBI) Directions, 2016 are regularised in manner given in it.
- Whether NBFC is accepting "public deposit" without minimum Investment Grade Credit Rating from Approved credit rating agency as per NBFC Acceptance of PD (RBI) Directions, 2016.
- Whether Capital Adequacy Ratio as disclosed in return submitted to Bank has been correctly determined & whether such ratio is in compliance with Minimum CRAR prescribed therein.
- Whether company has defaulted in paying to its depositors Interest & /or principal amount of deposits after such Interest and/ or principal became due.
- Whether company has complied with Prudential Norms on Income Recognition, AS, Asset classification, provisioning for bad and doubtful debts, and concentration of Credit/ Investments.
- Whether co complied with Liquid Assets requirement as prescribed by Bank.
- Whether co furnished to Bank in Stipulated period the return on deposits.
- Whether co furnished to Bank in Stipulated period Quarterly return on Prudential Norms.

**If NBFCs Not Accepting PD (Para 3)**

- Whether BODs has passed Resolution for Non- acceptance of any public deposits.
- Whether company accepted any public deposits in relevant period/ yr.
- Whether company complied with Prudential norms relating to Income recognition, AS, Asset classification & provisioning for bad and doubtful debts as applicable to it.
- Whether NBFC has been correctly classified as NBFC Micro Finance Institutions (MFI)
- For Systemically Important Non-deposit taking NBFCs: -
  - Whether CAR as disclosed in return submitted to Bank has been correctly arrived at.
  - Whether company has furnished to Bank, Annual Statement of Capital funds, Risk assets/ Exposures & Risk asset ratio in stipulated period.

**Reasons to Unfavourable or Qualified statements (Para 4)**

- Where in Auditor's report, Statement regarding any of the items referred to in Para 3 above is unfavourable or qualified, Auditor's report shall also state reasons for such unfavourable or qualified statement.
- Where Auditor is unable to express any opinion on any of the items referred to in Para 3 above, his report shall indicate such fact together with reasons therefore.

**If a company in business of Non-Banking Financial Institution not required to hold CoR wrt certain conditions**

Apart from matters enumerated above where company has obtained a specific advice from Bank that it is not required to hold COR from Bank = auditor shall include statement that Company is complying with conditions stipulated as advised by Bank.

**Applicability of Indian Accounting Standards (Ind- AS) on NBFCs –**

- NBFCs to comply with IND- AS, as.:-**
- \* Accounting periods beginning 1 April 2018 = Listed and unlisted NBFCs having a net worth of 500 crore or more and holding, subsidiary, joint venture or associate companies of such NBFCs
  - \* Accounting periods beginning 1 April 2019 = All other listed NBFCs, unlisted NBFCs having a net worth of 250 crore or more but less than 500 crore and holding, subsidiary, joint venture or associate companies of such NBFCs.

**Difference in Division II (IND- AS- other than NBFCs) & Division III (IND- AS- NBFCs) of Schedule III**

- \* NBFCs allowed to present items of B/S in order of their liquidity which is not allowed to companies required to follow Division II. Additionally, NBFCs required to classify items of the balance sheet in financial & non-financial whereas other companies to classify items in current/ non-current.
- \* NBFC to separately disclose by note any item of 'other income' or 'other expenditure' > 1 % of Total income. Division II, on other hand, requires disclosure for any item of income or expenditure which exceeds 1% of revenue from operations or 10 lakhs, whichever is higher.
- \* NBFCs to separately disclose under 'receivables', the debts due from any LLP in which its director is a partner or member.

**Format for preparation of financial statements by NBFCs under IND- AS**

MCA vide notification dated October 11, 2018 introduced Division III under Schedule III of the Companies Act, 2013, wherein a format for preparation of financial statements by NBFCs complying with IND- AS has been prescribed = Every NBFC required to comply with IND - AS shall prepare its financial statements as per it

**Obligations of auditor to Submit Exception Reports to RBI in case of NBFCs (Para 5)**

= Where in case of NBFC, statement regarding any of the items referred to in Para 3 is Unfavourable or qualified, or in the opinion of the auditor the company has not complied with: -  
 (a) Provisions of Chapter III B of RBI Act OR (b) NBFC Acceptance of Public Deposits (RBI) Directions, 2016 OR (c) NBFC Non Systemically Important Non Deposit taking Company (Reserve Bank) Directions, 2016 AND NBFC Systemically Important Non-Deposit taking Co. & Deposit taking Company (RBI) Directions, 2016.  
 = It shall be obligation of Auditor to make a report containing details of such unfavourable or qualified statements and/ or about the non-compliance, as the case may be in respect of co to concerned Regional Office of Dept. of Non- Banking Supervision of the Bank under whose jurisdiction the registered office of the co is located.

**Audit of Equipment Leasing finance co**

- \* Credit Appraisal System
- \* Physical Verify
- \* Comply to AS-19
- \* Verification of Lease Agreement
- \* Maintenance of Asset

**COMPLIANCE OF PRUDENTIAL NORMS DIRECTIONS**

**Prudential Norms**

**Auditor has to verify compliance of prudential norms relating to: -**

- \* Norms for concentration of credit etc.
- \* Income recognition.
- \* Capital adequacy norm.
- \* Income from investments.
- \* Provision for bad & doubtful debts.
- \* Asset classification.
- \* Prohibition of granting loans against its own shares.
- \* Prohibition on loans and investments for failure to repay public deposits.

**Demand Loans Policy**

Ensure Board NBFC frame policy for granting demand/call loans & implement it

**Advances Classified**

Verify the classification of advances and loans as standard/ substandard/doubtful/loss and that proper provision has been made in accordance with the directions.

**NPA Income**

Ensure unrealized income from non-performing assets has not been taken to P/ L Statement

**Recovery in NPA Accounts**

Check all NPAs of the previous years to verify whether during the current year any payments received or still they continue to be NPA during the current year also.

**INVESTMENT AND CREDIT COMPANY (NBFC-ICC)**

**Meaning**

Investment and Credit Company (NBFC- ICC) means any company which is a financial institution carrying on as its principal business - asset finance, the providing of finance whether by making loans or advances or otherwise for any activity other than its own and the acquisition of securities and is not any other category of NBFC as defined by the RBI in any of its Master Directions. (Circular 25/21.06.001/2018-19 Dt. 22.2.19)

**Emergence**

As per circular RBI/2018-19/130 DNBR (PD) CC.No.097/03.10.001/2018-19 dated February 22, 2019, in order to provide NBFCs with greater operational flexibility, it has been decided that harmonization of different categories of NBFCs into fewer ones shall be carried out based on the principle of regulation by activity rather than regulation by entity. Accordingly, it has been decided to merge the three categories of NBFCs viz. Asset Finance Companies (AFC), Loan Companies (LCs) and Investment Companies (ICs) into a new category called NBFC - Investment and Credit Company (NBFC-ICC).

**Audit of NBFC – ICC**

- Physically verify all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.
- Verify whether the NBFC has not advanced any loans against the security of its own shares.
- Verify that dividend income wherever declared by a company, has been duly received by an NBFC and interest wherever due [except in case of NPAs] has been duly accounted for.
- Test check bills/contract notes received from brokers with reference to the prices vis - à-vis the stock market quotations on the respective dates
- Verify Board Minutes for purchase & sale of investments. Ascertain from Board resolution or obtain mgt. certificate to the effect that investments so acquired are current investments or Long Term Investments.
- Check whether investments have been valued in accordance with NBFC Prudential Norms Directions & adequate provision for fall in market value of securities made there against, as required by the Directions.
- Obtain a list of subsidiary/group companies from mgt. & verify investments made in subsidiary/group companies during yr. Ascertain basis for arriving at the price paid for the acquisition of such shares.
- Check whether investments in unquoted debentures/bonds have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.
- Auditor will have to ascertain whether the requirements of AS 13 “Accounting for Investments” or other accounting standard, as applicable, (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.
- In respect of shares/securities held through a depository, obtain a confirmation from depository regarding the shares/securities held by it on behalf of the NBFC.
- Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon).
- Verify charges received or paid in respect of securities lend/borrowed.
- Obtain a confirmation from the approved intermediary regarding securities deposited with/borrowed from it as at the year end.
- Auditor should examine whether each loan or advance been properly sanctioned. He should verify the conditions attached to sanction of each loan or advance i.e. limit on borrowings, nature of security, interest, terms of repayment, etc.
- Auditor should verify the security obtained and the agreements entered into, if any, with the concerned parties in respect of the advances given.
- Obtain balance confirmations from the concerned parties
- As regards bill discounting, verify that proper records/documents have been maintained for every bill discounted/rediscounted by the NBFC. Test check some transactions with reference to the documents maintained.
- Check whether the NBFC has not lent/invested in excess of the specified limits to any single borrower or group of borrowers as per NBFC Prudential Norms Directions.
- An auditor should verify whether the NBFC has an adequate system of proper appraisal and follow up of loans and advances. In addition, he may analyze the trend of its recovery performance to ascertain that the NBFC does not have an unduly high level of NPA
- Check the classification of loans and advances (including bills purchased and discounted) made by a NBFC into Standard Assets, Sub-Standard Assets, Doubtful Assets and Loss Assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms Directions.

# AUDIT OF PSUs

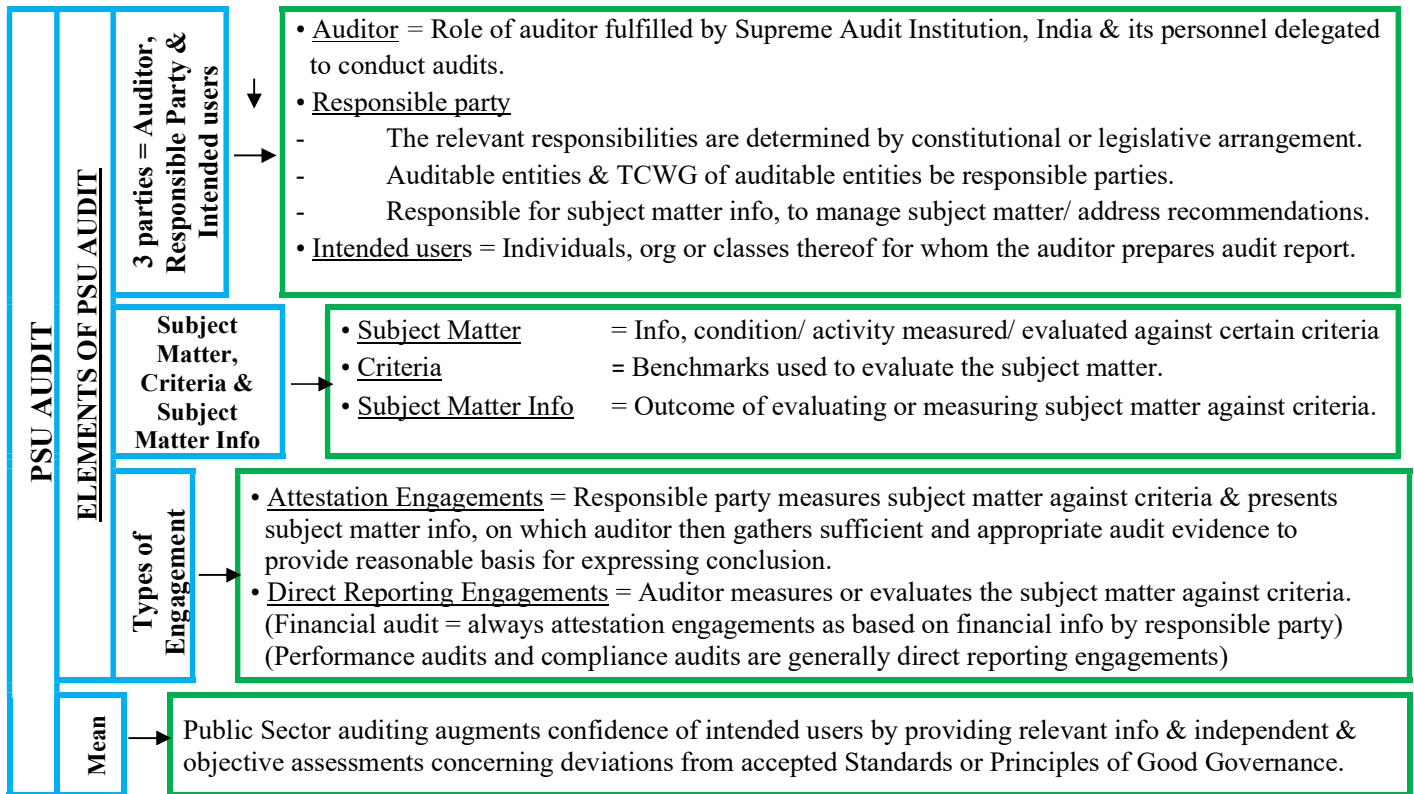
## COMPREHENSIVE AUDIT OF PSU

Audit of PSUs in India covers financial and compliance audit Plus 3 E's- Economy, Efficiency and Effectiveness.

**Areas covered**

*(CM IS CM as he manage Sales & plans Purchase economically)*

- C = Capacity utilisation/Cost Control Measures.
- I = Investment Decision.
- S = System of project formulation/ R & M
- C = Compare actual cost of capital with planned.
- Sales = Sales and Credit Control.
- Purchase = Adequate Purchase Policies.
- M = Management of Material/Labour.
- M = Management of Equipment.
- Plan = Planned rate of return.
- Economically = Economical Procedures.



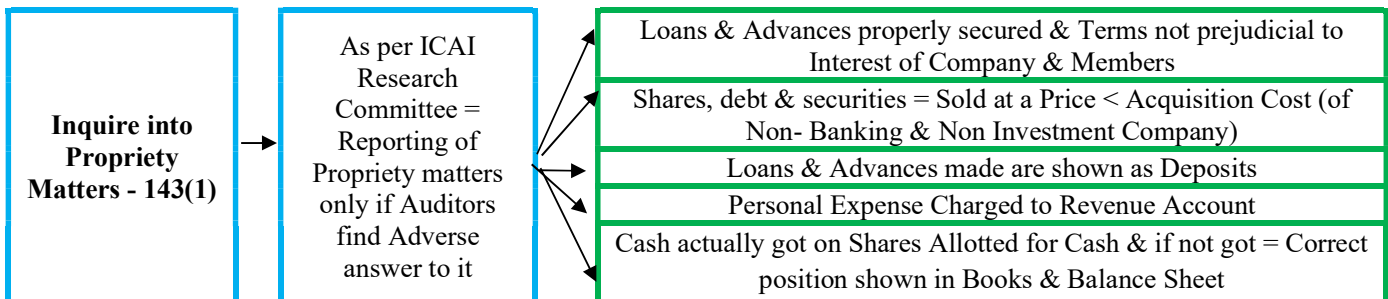
**Principles of PSU Audit** = General Principles + Principles related to Audit Process

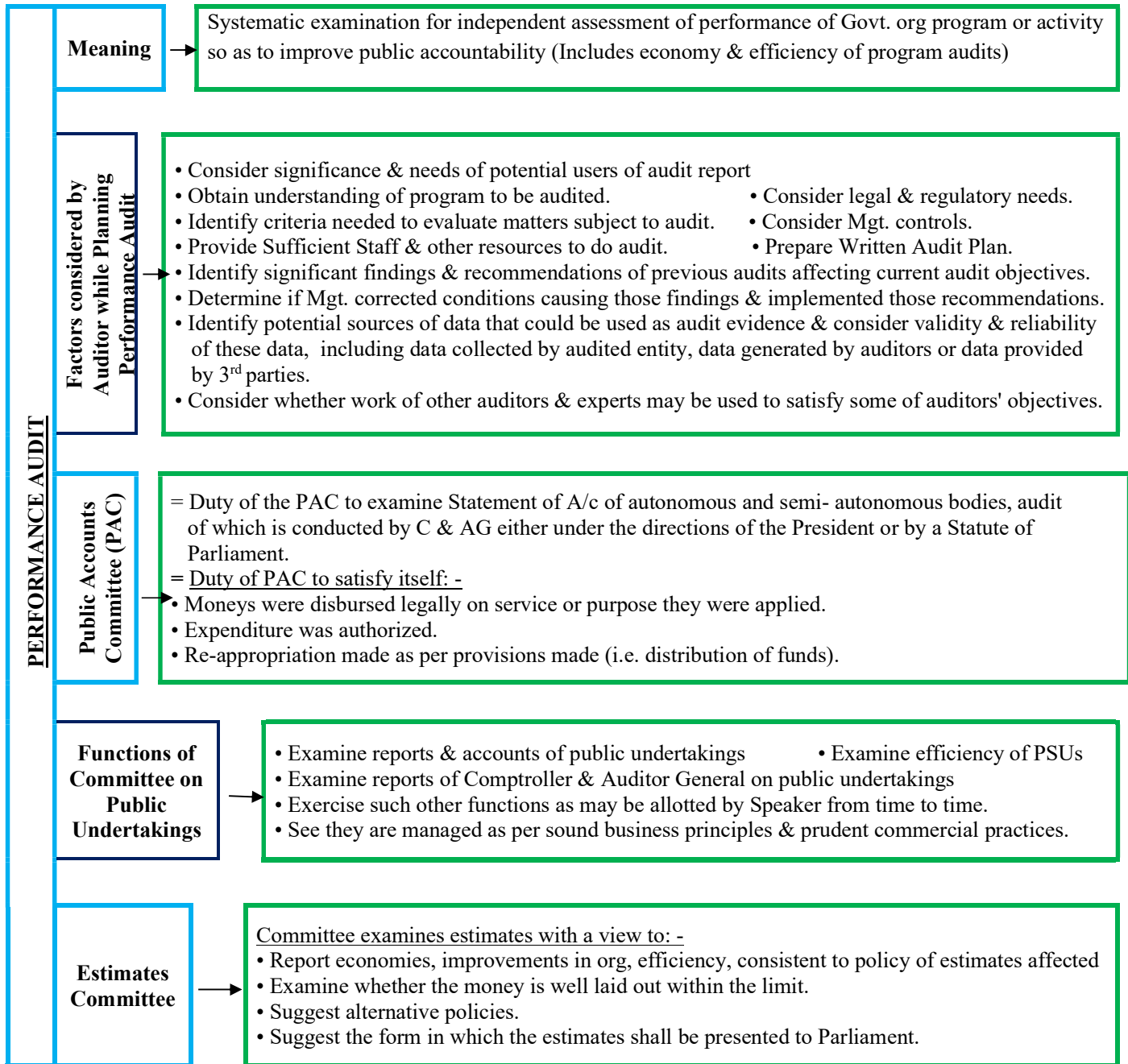
General Principles	Principles Related to Audit Process		
	Planning the Audit	Conducting the Audit	Reporting & Follow Up
• Ethics & Independence	Establish terms of Audit	Perform the planned procedure to obtain audit evidence.	Prepare a Report based on the Conclusions Reached
• Professional Judgement	Obtain Understanding of the Entity		
• Quality Control	Conduct Risk Assessment of Problem Analysis		
• Audit Team Mgt. & Skill	Identify Risks of Fraud		
• Audit Risk	Develop Audit Plan	Evaluate the audit evidence and draw conclusions.	Follow-Up on Reported Matters as relevant
• Materiality			
• Audit Risk			
• Materiality			
• Documentation			
• Communication			

<b>PROPRIETY AUDIT</b>	<b>Meaning</b>	<ul style="list-style-type: none"> <li>• Verify transactions on the test of public interest, commonly accepted customs &amp; standards of conduct.</li> <li>• These tests refers to 3 E's = Economy, Efficiency and Effectiveness.</li> <li>• It shifts the emphasis to substance of transaction.</li> <li>• Sec 143(6) and 143(7) of Co. Act 2013 empowers CAG to conduct supplementary or test audit.</li> <li>• <u>It requires transactions (mainly expenses) to conform to certain General principles</u></li> </ul>
	<b>Principles in Propriety audit of PSUs</b>	<ul style="list-style-type: none"> <li>* Expense is not prima facie more than the occasion demands and same degree of vigilance is exercised as exercised in respect of his own money.</li> <li>* Authority exercises power to sanction expenses to pass order which not accrue to its own advantage.</li> <li>* Funds not utilized for benefit of a particular person/ group.</li> <li>* Apart from agreed remuneration, no other avenue to benefit Mgt. personnel, employees &amp; others</li> </ul>
	<b>Propriety Elements/ Areas of Propriety Audit in Co Act, 2013</b>	<ul style="list-style-type: none"> <li>• Section 148 relating to Cost Records and Audit</li> <li>• Sec 143(6) &amp; 143(7) of Co Act 2013 empowers CAG to conduct supplementary or test audit</li> <li>• Section 143(1) requiring enquiry into Certain Specified Matters [Propriety Elements in CARO, 2016 = PARA 3(iii) (vii) (viii) (ix) (x) (xi) &amp; (xv)]</li> </ul>

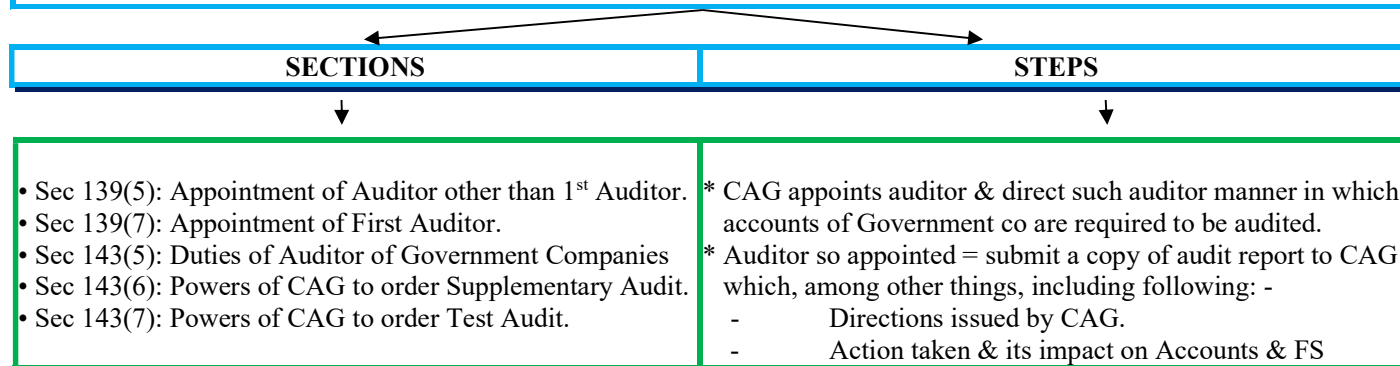
<u>Financial Audit</u>	<u>Compliance Audit</u>
<p><u>Financial audit is primarily concerned to: -</u></p> <ul style="list-style-type: none"> <li>• Express Audit opinion on FS</li> <li>• Enhance Degree of confidence of intended users in FS.</li> </ul> <p><u>C&amp;AG to express opinion whether FS prepared, in all material respects as per applicable FRF.</u></p>	<p>Compliance audit is Independent assessment of whether a given subject matter is in compliance with applicable authorities identified in criteria.</p> <p><u>Compliance audit is concerned with: -</u></p> <ul style="list-style-type: none"> <li>• <b>Regularity</b> = adherence to laws, regulations &amp; agreements applicable to entity.</li> <li>• <b>Propriety</b> = observations of General principles governing sound financial Mgt. &amp; ethical conduct of public officials.</li> </ul> <p><u>Perspective of compliance audit: -</u> Compliance Auditing is conducted either: -</p> <ul style="list-style-type: none"> <li>• In relation with audit of financial statements OR</li> <li>• Separately as individual compliance audits OR</li> <li>• In combination with performance auditing.</li> </ul>

<b>Objectives &amp; Scope of PSU Audit</b>	<ul style="list-style-type: none"> <li>• Fiscal Accountability = Includes audit of provision of funds, sanctions, compliances &amp; propriety.</li> <li>• Managerial Accountability = Includes audit of efficiency, economy and effectiveness.</li> </ul> <p>= Also to help the Government &amp; enterprise Mgt. improve their efficiency and effectiveness.</p> <p>= Bringing out financial &amp; operational deficiencies, inadequacies or ineffectiveness of systems, shortfalls in performance, etc. and by analysing the causes of shortfall from acceptable standards of performance.</p>
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**STEPS & SECTIONS IN AUDIT OF GOVERNMENT COMPANY**



**INTERNAL, MGT & OPERATIONAL AUDIT**

**PART- I: - INTERNAL AUDIT**

**Internal Audit** →

- Independent Mgt. function involving continuous & critical appraisal of functioning of entity with view to suggest improvements thereto and add value to and strengthen overall governance mechanism of entity, including entity’s strategic Risk Mgt. & ICS.
- Internal auditing need not be confined to financial transactions & its scope may be extended to task of reviewing whether resource utilization of enterprise is efficient & economical.
- Internal Auditor to review & report but not expected to take upon himself functions of operational managers.

**Internal Auditor = SECTION 138 read with Rule 13**  
 Following class of companies required to appoint an internal auditor or a firm of internal auditors.  
Every Listed Co & Private & Unlisted Public co meeting "any" of criteria below: -

<u>Criteria</u>	<u>Unlisted Public</u>	<u>Private</u>
<b>Turnover</b>	200 Cr or more in preceding FY	
<b>Outstanding Loans/ Borrowings from Banks/ PFI</b>	Exceeding ₹100 Cr or more anytime in Preceding FY.	
<b>Paid up Share Capital</b>	50 Cr or more in preceding FY	No such criteria
<b>Outstanding deposits</b>	25 Cr or more anytime in preceding FY	No such criteria

Internal Auditor to be: - • CA (whether or not he is engaged in practice) OR • Cost accountant OR  
 • Other Professional decided by BODs. (Principle of **EJUDEM GENERIS** = professional can’t include Doctor / Lawyer)

**Mgt. Functions & Scope of Internal Auditing** →

SCOPE of Internal Auditor’s work includes review of: -

- Accomplishment of goals & Objectives.
- System regarding custodianship & safeguarding of assets = monetary & non- monetary of enterprise.
- Compliance by various segments with Policies, plans & procedures of Co. & regulations and laws.
- System of collecting data = ensure info given to Mgt. & to external agencies is relevant & reliable.
- Org structure of the enterprise and its congruence with its objectives.
- Efficient & economical use of available resources tangible as well as intangible.

On basis of such review, Internal auditor highlights weaknesses & suggests for Improvement in Report

**Qualifications of Internal Auditor** →

- \* Special expertise necessary for evaluating Mgt. control systems, especially financial & accounting controls.
- \* Accounting and finance functions provide basic data for management control of an enterprise.
- \* Internal auditor must have accounting and financial expertise to be able to discharge his duties.
- \* Evaluate operational performance and non-monetary, operational controls.
- \* Basic knowledge of the technology and commercial practices of the enterprise.
- \* Basic knowledge of Commerce, Laws, Tax, Cost, economics, quantitative methods & EDP systems.
- \* CA/ CWA/ Other Professional as decided by BODs (not Doctor/ lawyer)
- \* Understanding of Mgt. principles & techniques is another essential qualification of Internal auditor
- \* Provide an assurance to the management that confidentiality of such information would be maintained.

**“Factors of Review of Internal audit function by Statutory Auditor”** →

- Scope of work and related audit programme are adequate for the external auditor’s purpose.
- Work is properly planned & work of assistants is properly supervised, reviewed, and documented.
- SAAE is obtained to afford a reasonable basis for conclusions reached.
- Conclusions reached appropriate in circumstances & reports consistent with results of work performed.
- Any exceptions or unusual matters are disclosed by the internal auditor’s procedures.
- External auditor should document his conclusions in respect of the specific work which he reviewed

**Review of Internal Control System (ICS) & Procedures**

- Review custodianship & safeguarding of assets
- Review goals & objects
- Review comply to policies, plans, procedures & regulations
- Review use of resources
- Review relevance and reliability of information
- Review org structure

**General Rules/ Features of Good Quality Internal Audit Report**

- **Objectivity** = Maintain credibility of internal audit function; comments & opinions expressed in the report should be as objective and unbiased as possible.
- **Clarity** = Language used should be simple and straight-forward.
- **Accuracy** = Information contained in the report, whether quantified or otherwise be accurate.
- **Conciseness** = Important information should not be omitted.
- **Constructive** = Destructive criticism should carefully be avoided in the report.
- **Readability** = Reader's interest be captured & retained by using Appropriate Para heading
- **Timeliness** = Submitted promptly as if time lag in event & its reporting is considerable, opportunity for taking action lost or a wrong decision taken in absence of Info.
- **Views** = Client views about audit conclusions or recommendations included in Audit report in appropriate circumstances.
- **Summary** = Of Conclusions & recommendations at end (particularly useful in long reports)

**Internal audit plan specifying Coverage of area**

- Identify benchmarks against which actual results of activities, time spent, cost incurred be measured
- NTE of reports or other communication & audit evidence to be obtained
- Setting the time budget for each of the activities & Involvement of experts
- Effect of new accounting or auditing pronouncements on the audit
- Degree of reliance he expects to be able to place on accounting system and internal control
- Terms of engagement & statutory responsibilities
- A/c policies adopted by client & changes in them
- Applicable legal or statutory requirements
- Identification of significant audit areas
- Determining NTE of procedures to be performed
- Setting of materiality levels for audit purposes
- Establishing and coordinating staffing requirements
- Method to physically verify cash & investment

**PART- II: - MANAGEMENT AUDIT**

**BRIEF BEHAVIOURAL ASPECTS ENCOUNTERED IN MGT AUDIT & WAYS TO SOLVE THEM**

- Behavioural Aspects Encountered in Mgt. Audit**
- Staff / Line conflict**
- Control**
- Possible Solutions to overcome these problems**
- Solution to behavioural problems**

- Financial auditors deal mainly with figures.
- Mgt auditors deal mainly with people.
- Many causes for behavioural problems arising in review function of mgt audit.
- Nature & causes of behavioural problems that mgt auditor is likely to face in discharge of review function that is expected of him

- \* Mgt auditors are staff people while members of other departments are line people.
- \* They to discount difficulties line staff may face, if called on to act on ideas of mgt auditor
- \* They are specialists in their field & may think their approach & solutions is only answer

- \* Mgt auditor is expected to evaluate effectiveness of controls there is instinctive reaction from client that report of auditor may affect them.
- \* Fear that action taken based on mgt audit report will affect line people. Causes are: -
  - Fear of criticism as a result of adverse audit findings
  - Fear of change in working habits as changes due to audit recommendations
  - Insensitive audit practices
  - Hostile audit style

- \* Demonstrate that audit is part of overall programme of review for protective benefit
- \* Demonstrate objective of review is to provide max service in all managerial dimensions.
- \* Demonstrate Review will be with minimum interference with regular operation.
- \* Responsible officers involved in process of review of findings & recommendations before audit report is formally released.
- \* Create an atmosphere of trust and friendliness.

<b>MANAGEMENT AUDIT</b>	<b>SCOPE</b>	<b>Objective</b> → Evaluation of functions of top mgt which: - <ul style="list-style-type: none"> <li>• Lays down objectives and policies.</li> <li>• Provide means &amp; procedures to implement, control &amp; engage in direction &amp; control on continuous basis.</li> </ul>															
		<b>Effectiveness &amp; Efficiency</b> → <u>Effectiveness</u> : - Evaluation of relevance & effectiveness of aims, duties & decisions of mgt at various levels. <u>Efficiency</u> : - Review of efficiency in mgt decisions & functions and to judge whether: - <ul style="list-style-type: none"> <li>• Management is doing the correct things</li> <li>• Management is doing those things correctly.</li> </ul>															
		<b>Aspects Covered</b> → <table border="0" style="width: 100%;"> <tr> <td>• Financial Managements.</td> <td>• Installed capacity.</td> <td></td> </tr> <tr> <td>• Purposes of organization.</td> <td>• Mgt Structure.</td> <td>• Internal controls.</td> </tr> <tr> <td>• Reports required by mgt.</td> <td>• Nature of production of Business.</td> <td>• Production planning.</td> </tr> <tr> <td>• Personnel policy.</td> <td>• Factory layout &amp; design</td> <td>• Material management.</td> </tr> <tr> <td>• Sales management.</td> <td>• Decision making process.</td> <td>• Books and Records.</td> </tr> </table>	• Financial Managements.	• Installed capacity.		• Purposes of organization.	• Mgt Structure.	• Internal controls.	• Reports required by mgt.	• Nature of production of Business.	• Production planning.	• Personnel policy.	• Factory layout & design	• Material management.	• Sales management.	• Decision making process.	• Books and Records.
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	<b>Desirability</b> → <ul style="list-style-type: none"> <li>• For Detecting &amp; overcoming current managerial deficiencies in ongoing operations</li> <li>• Managerial problems &amp; related operational difficulties can be spotted before fact</li> <li>• Mgt tool to assist the organization in accomplishing desired objectives.</li> <li>• Helpful in case of ailing industries, to isolate problems and account for their ailments.</li> <li>• Important if such industries are either to be taken over by government or to be heavily financed by financial institutions with a view to bring back vigour in them.</li> </ul>																
<b>STPES</b>	<b>Develop Mgt Audit Program</b> → <table border="0" style="width: 100%;"> <tr> <td>* Devising Statement of policy</td> <td>* Location of audit function in org</td> <td>* Allocate personnel</td> </tr> <tr> <td>* Staff training programme</td> <td>* Time and other aspects</td> <td>* Frequency</td> </tr> </table>	* Devising Statement of policy	* Location of audit function in org	* Allocate personnel	* Staff training programme	* Time and other aspects	* Frequency										
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<b>Conduct Mgt Audit</b> → <ul style="list-style-type: none"> <li>• Getting the facts through interviews</li> <li>• Once top mgt has decided on scope, staffing &amp; frequency of mgt audit, next phase is undertaking of actual audit.</li> <li>• This involves investigating &amp; analyzing present facts through interviews as well as completing mgt questionnaire so as to determine problems confronting org.</li> </ul>																	
	<b>Conclude Mgt Audit</b> → <ul style="list-style-type: none"> <li>• Prepare Mgt audit report that covers details of mgt auditor's findings &amp; recommendations</li> <li>• To assist in preparation of final report mgt auditors normally meet with mgt &amp; other concerned personnel for discussing freely aspect or finding of audit.</li> <li>• Assists independent 3<sup>rd</sup> party in bringing together important elements of audit as well as determining appropriate recommendations.</li> <li>• Comprehensive investigation involves report that is very broad in scope, while a smaller-scale investigation of 1 or 2 functional areas will result in a less comprehensive report.</li> </ul>																
<b>MGT AUDIT QUESTIONNAIRES</b>	<b>Meaning</b> → <ul style="list-style-type: none"> <li>* Important tool for conducting mgt audit</li> <li>* Auditors Inquires important facts by measuring current performance by these</li> </ul>																
	<b>Objectives</b> → <ul style="list-style-type: none"> <li>• Comprehensive and constructive examination of org mgt &amp; assigned tasks</li> <li>• Appraisal of mgt actions in accomplishing organization's objectives</li> <li>• Highlight weaknesses &amp; deficiencies of organization</li> <li>• Review of mgt functions of planning, organizing, directing &amp; controlling</li> </ul>																
	<b>Working</b> → <ul style="list-style-type: none"> <li>• 3 possible answers to mgt audit questions: "Yes", "No" and "N.A."</li> <li>• Mgt audit questionnaire does not give answers, but simply asks questions.</li> <li>• If all questions are answered with 'yes', operations are proceeding as desired.</li> <li>• If &gt; 1 'no' answers, difficulties experienced &amp; must be explained in writing.</li> <li>• If question does not apply, N.A. (not applicable) column is checked.</li> </ul>																
	<b>Importance</b> → Serves as mgt tool to analyze current situation & enables mgt auditors to identify those elements that are causing org. difficulties and deficiencies.																

<b>MANAGEMENT AUDIT REPORTS</b>	<b>Meaning</b>	<ul style="list-style-type: none"> <li>• Written report is the medium by which the comments, criticisms and recommendations of mgt audit department are conveyed to the Board, to functional directors and to mgt in general.</li> <li>• Mgt audit reports will inevitably cover a wide variety of subjects, reflecting the many and ever increasing ramifications of mgt audit departments.</li> </ul>
	<b>Categories</b>	<ul style="list-style-type: none"> <li>* Reports prepared by mgt audit staff after their visits to a unit</li> <li>* Periodical reports prepared by senior members of mgt audit department which summarize main audit findings &amp; recommendations for the period under consideration and which afford a concise review of department's activities for that period.</li> <li>* Reports on the results of special investigations and inquiries.      * Annual audit report.</li> </ul>
	<b>Oral reports</b>	<ul style="list-style-type: none"> <li>* In many situations, reporting of results will be on oral basis &amp; required a result of emergency needs.</li> <li>* It has a major limitation that there is no permanent record.</li> <li>* As a result there are more likely to be later misunderstandings.</li> <li>* This type of reporting be used carefully for specially matters covered by emergency oral reporting &amp; to be followed up immediately by written report giving reference to oral Reporting.</li> </ul>
	<b>Interim written reports</b>	<ul style="list-style-type: none"> <li>* When deemed advisable to inform mgt of significant developments during audit or at least preceding release of regular report.</li> <li>* Pertain to especially problems where need for early consideration or report may be of progress nature.</li> </ul>
	<b>Regular written reports</b>	<ul style="list-style-type: none"> <li>* Particular audit assignment includes preparation of a formal written report.</li> <li>* Form and content of such written reports will vary widely, both as between individual audit assignments &amp; individual companies.</li> <li>* They may be short or long.</li> </ul>

**TYPES**

**Summary written reports**

- \* Referred to as 'flash' reports.
- \* Practice in some companies is developed of issuing an annual report summarizing various individual reports issued describing range of their content.
- \* Primarily for audit committees of BODs, but in other cases for higher level mgt.
- \* Useful to top level mgrs who not actively review individual reports. .

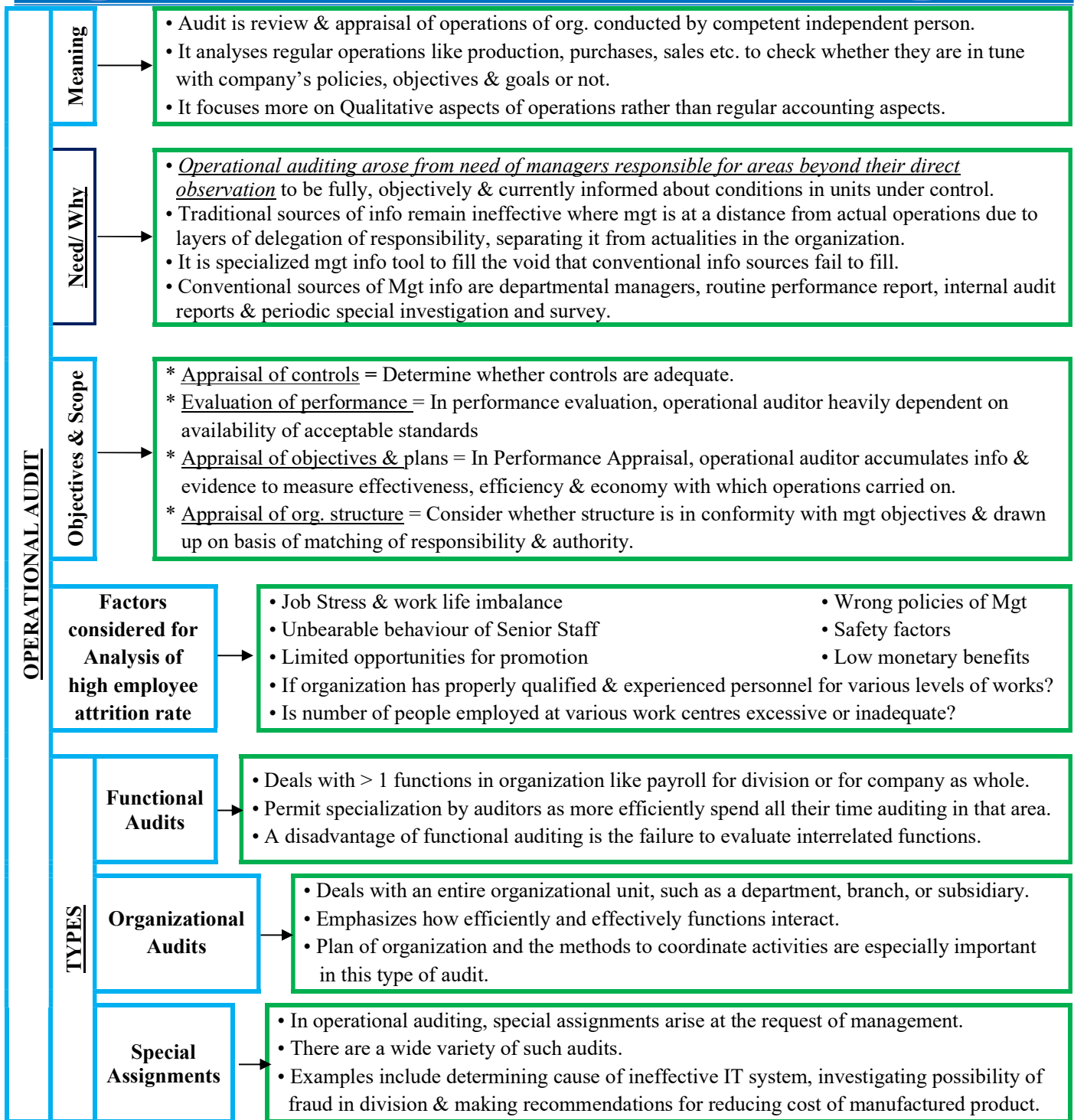
<b>Summary Written Report/ Organization of Mgt Audit reports (MAR)</b>			
* Title	* Objectives	* Scope	* Findings, conclusions & opinions
* Recommendations	* Client views	* Summary	

**PART- III: - OPERATIONAL AUDIT**

**Difference in Internal Auditing & Operational Auditing**

Over a period of time, the scope of internal auditing has been widened so as to all operations besides accounting and financial operations. So in present time, there is no difference between the two above.

OPERATIONAL AUDITING	INTERNAL AUDITING
Concerned with review & appraisal of operations of organization carried on by competent independent person.	Concerned with Determining whether other internal controls are well designed and in place.
Not part of Internal Control System (ICS)	Part of internal control system.
Constructive function (provide suggestions for improvement)	Protective function (safeguard assets of enterprise)
Analyzes all aspects of operations whether they are in tune with mgt policies, objectives & Goals.	Focuses more on Quantitative aspects.



Basis	FINANCIAL AUDITING	OPERATIONAL AUDITING
Purpose	Concerned with opinion that whether historical info recorded is correct or not	Emphasizes on effectiveness & efficiency of operations for future performance.
Area	Restricted to matters directly affecting appropriateness of presented FS	Covers all activities related to efficiency & effectiveness of Co. operations.
Reporting	Report is sent to all stock holders, bankers & other persons having interest in organization.	Report is primarily for mgt.
End Task	It reports findings to person as its end objectives.	It is not limited to reporting but includes suggestions for improvements.

**AUDIT OF DIVIDEND**

**Steps to ensure Dividend Paid only out of profit** →

Check if dividend declared out of profits after depreciation u/s 123(2) of Act & whether: -

- \* Depreciation provided as per Schedule II to Act
- \* Board resolution recommending dividend passed.
- \* Dividend was declared only in AGM.
- \* Register of members was closed u/s 91 of Act.
- \* Dividend declared in GM not > amt recommended by Board.
- \* Amount paid/ credited as paid on Share in advance of calls = not treated as paid on share.
- \* Dividend paid in prescribed manner in 30 days of time u/s 123(5).
- \* Dividend deposited in Separate Bank A/c in 5 days from Date of declaration of dividend.
- \* Intimation sent to Stock Exchange in case of listed company.
- \* If corrective action taken on complaints of non-payment/ delayed payment of dividend?

**123 (1) Source of Dividend** →

Dividend declared/ paid for FY only: -

- Out of profits for that year arrived after providing for depreciation OR
- Out of profits for any previous FY after depreciation & remains undistributed OR
- Out of money provided by CG/ SG for payment of dividend (Guarantee given by Govt.)

1<sup>st</sup> Proviso = Transfer to reserves = A co. may before Declaration of dividend in FY: -

- T/f % profits for that FY as considers appropriate to Reserves of company.
- Such transfer not mandatory & % transferred to reserves decided at Discretion of co.

2<sup>nd</sup> Proviso = N/A to Govt. Co in which entire paid up s/c held by CG/ SG(s) or both

**(SEC 123) DECLARATION OF DIVIDEND**

**Declare dividend out of acc profits = Rule 3 of Co. (Declaration & Payment of Dividend) Rules, 2014** →

If inadequacy/ absence of profits in any year, a co may declare dividend out of free reserves if: -

- \* Rate of dividend declared not > Average of rates of dividend declared by it in 3 years immediately preceding that yr. (This N/A if co not declared dividend in each of 3 PFYs)
- \* Total amount to draw from accumulated profits not > One-Tenth (10%) of paid-up s/c & free Reserves as appearing in latest Audited FS
- \* Amount drawn 1<sup>st</sup> be used to set off loss in FY in which dividend is declared before dividend on equity shares is declared.
- \* Balance reserves after withdrawal not to fall below 15% of paid up s/c as in latest Audited FS.

**123(3) Interim Dividend** →

- **BODs may declare Interim Dividend during any FY till holding AGM out of Surplus in P/L or out of profits of FY for which such Interim dividend is sought to be declared OR out of profits of FY till end of quarter immediately preceding date of declaration of Interim dividend**
- If company incurred loss in Current FY up to end of quarter immediately preceding date of declaration of Interim dividend, such interim dividend not declared at Rate > Average dividends declared by company in immediately preceding 3 FYs.

**123(4) Depositing Dividend** →

Dividend (including interim dividend) = to be deposited in Scheduled bank in Separate a/c in 5 days from Date of declaration (N/A to Govt. Co where entire paid up s/c held by CG/ SG(s) or both)

**123(5) Payment of dividend** →

- Dividends paid in Cash/ CHEQUE/ Warrant/ E- Mode to Registered shareholder/ his banker
- 123(5) not prohibits capitalization of profits/ reserves for issuing fully paid-up bonus shares
- This sub-section N/A to NIDHI Company. But any dividend payable in cash may be paid by Crediting same to account of member, if dividend not claimed in 30 days from date of declaration

**123(6) Contravention** →

Prohibition on Declaration of Dividend = Company failing to comply with: -

- \* Sec 73 (Prohibition on acceptance of deposits from public) &
- \* Sec 74 (Repayment of deposits accepted before commencement of Act)

= As long as failure continues, not to declare Dividend on Equity Shares.

<b>SECTION 124 (UNPAID DIVIDEND ACCOUNT)</b>	<b>124 (1) = T/f to Unpaid Dividend A/c</b>	<ul style="list-style-type: none"> <li>* Declared dividend not paid/ claimed in 30 days from Declaration</li> <li>* T/f dividend remaining unpaid/ unclaimed to Special A/c (to be opened by company in that behalf in scheduled bank as "Unpaid Dividend A/c" ) in 7 days from expiry of said 30 days.</li> </ul>
	<b>124 (2) = Statement of Particulars</b>	<p>Company in 90 days of making any transfer of amt u/s 124(1): -</p> <ul style="list-style-type: none"> <li>• Prepare Statement of Names, last known addresses &amp; unpaid dividend payable to each person &amp;</li> <li>• Place it on web-site of company (if any) &amp;</li> <li>• Also on any other web-site approved by CG for this purpose in manner &amp; particulars prescribed.</li> </ul>
	<b>124(3) Default in T/f</b>	<ul style="list-style-type: none"> <li>• If default in transferring Total amount/ part thereof to Unpaid Dividend A/c = Pay from Date of default = Interest on it @ 12% p.a. &amp;</li> <li>• Interest on it to benefit Members of company in proportion to amt remains unpaid to them.</li> </ul>
	<b>124(4) Apply for Claim</b>	Person claiming entitlement to money transferred u/s 124(1) = may apply to company for payment
	<b>124(5) T/f to IEPF</b>	<ul style="list-style-type: none"> <li>* Any money transferred to Unpaid Dividend A/c remaining unpaid or unclaimed for 7 yrs from Date of such transfer</li> <li>* Transferred to <u>Investor Education &amp; Protection Fund (IEPF)</u> with interest to Fund u/s 125(1)</li> <li>* Company to send Statement of details of transfer to authority which administers said Fund</li> <li>* That authority to issue Receipt to company as evidence of T/f.</li> </ul>
	<b>124(6) Transfer of shares to IEPF</b>	<ul style="list-style-type: none"> <li>* All shares on which dividend not paid/ claimed for 7 consecutive years or more = transferred in name of IEPF with Statement of details.</li> <li>* Any claimant of shares transferred above = entitled to claim shares from IEPF by procedure on submission of docs prescribed.</li> </ul>
	<b>124(7) Contravention</b>	<p><u>Prohibition on Declaration of Dividend</u> = <b>Company failing to comply with:</b> -</p> <ul style="list-style-type: none"> <li>* Sec 73 (Prohibition on acceptance of deposits from public) &amp;</li> <li>* Sec 74 (Repayment of deposits accepted before commencement of Act)</li> </ul> <p>= <b>As long as failure continues, not to declare Dividend on Equity Shares.</b></p>

**Prohibition on Sec 8 Co.** → Co. having license u/s 8 (Formation of Company with Charitable objects) of Act are prohibited from paying any dividend to members (their profits to be applied only for promoting objects of company)

**Steps to Verify/ Audit Dividend** →

- Examine MOA & AOA to ascertain dividend rights of different classes of shares
- Confirm dividend is made out of distributable profits u/s Sec. 123.
- If dividend made out of reserves, examine compliance of conditions as set out in rules.
- Inspect shareholders' Minute Book to verify dividend declared.
- Examine if dividend payable is deposited in Separate bank a/c in 5 days of declaration of dividend.
- Check particulars of members as entered in Dividend List by reference to Register of Members.
- Check amount of dividend paid with dividend warrants surrendered.
- Verify if dividend unclaimed or unpaid in 30 days of declaration = transferred to "Unpaid Dividend A/c" in 7 days from date of expiry of 30 days.
- Verify if Unpaid or unclaimed dividend amt. after 7 years from date of transfer = transferred to IEPF.

**Section 126 (Right Of Dividend, Rights Shares & Bonus Shares Held In Abeyance Pending Registration of Transfer of Shares)** →

- \* Where instrument of Transfer of shares delivered to company for registration & Transfer of shares not Registered by company, company shall: -
- T/f dividend on such shares to Unpaid Dividend A/c unless co. authorized by Registered holder in writing to pay such dividend to Transferee specified in such instrument of transfer
- Keep in abeyance on such shares = offer of rights shares & issue of fully paid-up bonus shares
- \* Final Dividend once declared in AGM cannot be revoked by BOD.
- \* Before declaration of dividend in AGM = dividend recommended by BOD may be revoked for just & proper reasons

<b>SECTION 125 (INVESTOR EDUCATION AND PROTECTION FUND (IEPF))</b>	<b>125(1) Authority</b> →	Establishment of Fund by CG
	<b>125(2) Credit to fund</b> →	<ul style="list-style-type: none"> <li>• Amount given by CG as grants after appropriation by Parliament by law.</li> <li>• Donations by CG, SG, Companies or other institution for Fund.</li> <li>• Unpaid Dividend A/c companies transfer to Fund u/s 124(5). • IEPF lying u/s 205C of Co. Act 1956.</li> <li>• General revenue a/c of CG transferred to account u/s 205 remaining unpaid/ unclaimed on commencement of Act.                             <ul style="list-style-type: none"> <li>• Amount received on disgorgement or disposal of securities.</li> </ul> </li> <li>• Income from investments as Interest or other income on investments of Fund.</li> <li>• Application money got for allotment of securities &amp; due for refund + Interest accrued</li> <li>• Matured deposits with companies other than banks + Interest accrued</li> <li>• Matured debentures with companies + Interest accrued</li> <li>• Amount of sale proceeds of fractional shares of bonus shares, merger &amp; amalgamation for 7 or more yrs.</li> <li>• Redemption amount of preference shares remaining unpaid/ unclaimed for 7 or more years.</li> </ul>
	<b>125(3) Use of Fund</b> →	<ul style="list-style-type: none"> <li>• Refund of unclaimed dividends, matured deposits &amp; debentures, application money refund &amp; interest.</li> <li>• Promotion of investors' education, awareness and protection.</li> <li>• Distribution of amount to eligible &amp; identifiable applicants for shares/ debt holders/ depositors who suffered losses due to wrong actions by person as per orders by Court.</li> <li>• Reimburse legal expenses on suits by members, debt-holders or depositors as sanctioned by Tribunal.</li> <li>• Other purpose incidental thereto as per rules as prescribed.</li> </ul>
	<b>125(4) Claim Apply</b> →	Person claiming amt. u/s 124(2) = may apply to Authority u/s 125(5) for payment of it
	<b>125(5) Authority for admin of fund</b> →	CG constitutes by notification = Authority for admin of IEPF consisting of Chairperson & other members not > 7 & CEO as CG may appoint.
	<b>125(6) Handling Fund</b> →	Manner of admin of Fund, appointment of chairperson, members & CEO and holding of meetings of authority = as per rules prescribed under IEPF Authority Rules, 2016.
	<b>125(7) CG Provides Resources to Administer fund</b> →	CG may provide to authority such offices, officers, employees & other resources as per IEPF Authority (Appointment of Chairperson & Members, holding of meetings & provision for offices & officers) Rules, 2016.
	<b>125(8) C&amp;AG consultation</b> →	Authority to administer Fund & maintain separate a/c & relevant records in relation to Fund in form as prescribed after consultation with C& AG.
	<b>125(9) Right of Authority to spend</b> →	Competent for authority constituted u/s 125(5) to spend money out of Fund to carry objects.
	<b>125(10) Audit of Fund</b> →	Accounts of Fund = audited by CAG of India at intervals as specified & Audited a/c + Audit Report = forwarded annually by authority to CG
	<b>125(11) Annual Report</b> →	Authority to prepare in form & at time for each FY its annual report giving full account of activities in FY & forward copy to CG & SG & to be laid before each House of Parliament

**SECTION 127 (PUNISHMENT FOR FAILURE TO DISTRIBUTE DIVIDENDS)**

Where Dividend declared = not paid or warrant not posted in 30 days from Date of declaration	<u>Exceptions i.e. no offence if</u>	This section N/A
<ul style="list-style-type: none"> <li>* Every Director of company if knowingly a party to default = punishable with imprisonment up to 2 years &amp; Fine ≥ ₹1,000 for every day default continues</li> <li>* Company to pay Simple interest @ 18% p.a. for time default continues.</li> </ul>	<ul style="list-style-type: none"> <li>* Dividend not paid by operation of law.</li> <li>* Shareholder directions to co. on payment of dividend &amp; those directions can't be complied &amp; same is communicated to him.</li> <li>* Dispute on Right to receive dividend.</li> <li>* Dividend lawfully adjusted by company against any sum due to it from Shareholder</li> <li>* For other reason failure to pay dividend or to post warrant wasn't due to default of co.</li> </ul>	To NIDHI company where dividend payable to member is ≤ ₹100 & sufficient compliance of provisions of section, if declaration of dividend announced in local language in 1 Local newspaper of wide circulation & displayed on Notice board of NIDHIS for at least 3 months.

# LIABILITIES OF AUDITOR

Sec. 147 – Punishment for Contravention

**Over the Co & Officer in default – 147(1)**  
{Violation of Sec. 139 - 146}

Company = Fine from 25,000 to 5 Lac  
Officer in Default = Imprisonment to 1 year **OR**  
Fine 10,000 - 1 Lac or Both

**Over the Auditor – 147(2)**  
{Violate Sec 139, 143, 144, 145}

Fine 25,000 to 5 Lakh **OR**  
4 Times Auditor Remuneration (Whichever less)  
Willful default = Imprisonment up to 1 year **AND** Fine 50,000 - 25 Lac  
**OR**  
8 Times the Remuneration of Auditor (Whichever less)

If auditor convicted u/s 147(2) = Liable to Refund Remuneration received by him to company & Pay for damages to company, statutory bodies or authorities or to members or creditors of Company for loss arising out of incorrect or misleading statements of particulars made in his audit report.

Measures for prompt payment of Damages 147(4): -

- \* CG by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to company.
- \* Such body, authority or officer shall pay damages to such company or persons.
- \* File report with CG on making such damages in manner specified in notification.

**147(5)** = If criminal liability of audit firm, in respect of liability other than fine = concerned partner or partners, who acted in a fraudulent manner or abetted or colluded in any fraud shall only be liable.

CIVIL LIABILITIES UNDER CO ACT, 13

## Sec 35: Civil liability for Misstatements in Prospectus

Person subscribed for securities acting on statement included or inclusion or omission of matter, in Prospectus which is misleading & sustained loss or damage as consequence, Company & person who: -

- Is Director of company at Time of issue of Prospectus.
  - Is Promoter of Company
  - Has Authorized him named & is named in Prospectus as director or agreed to become such director, either immediately or after an interval of time.
  - Authorized Issue of Prospectus & is Expert.
- = Liable to pay compensation to every person who sustained such loss or damage.

NO PERSON LIABLE ABOVE, if he proves: -

- \* Consented to be director = BUT withdrew consent before issue of prospectus & was issued without his authority or consent OR
- \* Prospectus issued without his knowledge or consent & on becoming aware of its issue, he gave reasonable public notice that it was issued without his knowledge or consent.
- \* *That, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that the said person had given the consent required by sub-section (5) of section 26 to the issue of the prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or, to the defendant's knowledge, before allotment thereunder.*

Notwithstanding anything ABOVE, where it is proved that prospectus issued to defraud applicants, other person or for any fraudulent purpose = Every person referred ABOVE: -

- \* Personally responsible without any limitation of liability, for all or any of the losses or damages incurred by any person who subscribed to the securities on the basis of such prospectus.
- \* Expert in 2(38) of Co Act, 2013 includes Engineer, VALUER, CA, CS, Cost accountant & other person who has power or authority to issue certificate in pursuance of any law for time being in force.

(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)



**“AUDIT OF AUTOMATED ENVIRONMENT”**

**Automated Environment**

- Ecosystem combining people, processes & technology in overall business environment
- Driven by computer based systems known as Info technology (IT) Systems/ Info systems (IS)
- Several applications exist in business depending on Nature, Size & Location of business, etc

Category of Business Applications	Example of Category
Packaged software (Off-shelf apps) used by micro & small business	Tally, QuickBooks.
Small ERPs used in small to medium business	Tally ERP, SAP Business One
ERP applications used in medium to large companies	SAP R/3, Oracle R12 Enterprise Business Suite.

**Key Concepts of Auditing in Real-Time Environment**

**Real-Time environment** = automated environment in which business operations & transactions initiated, processed & recorded immediately as they happen without delay.

- Example: - In bank using CBS Customer A/c balance instantly updated if withdraws cash from ATM.
- Real-time environment has several critical IT component enabling anytime & anywhere transaction i.e.:
  - (A) Applications = ERP, SAP, Oracle R 12, Core Banking Applications.
  - (B) Middleware = ATM Switches.
  - (C) Networks = Wide Area Network, Internet hosting.
  - (D) Hardware = Data Centre, Backup and storage devices, Power supply.

**Understand & Document Automated Environment**

**Auditor to document understanding of a company’s automated environment as per SA 230.**

It is Required as per SA 315 & auditor’s understanding of Automated environment to include: -

- \* Applications used by company.
- \* Organization structure & governance.
- \* IT risks & controls.
- \* Details of IT infra components for each app.
- \* Policies, procedures & processes followed.

**Consideration of Automated Environment Relevant at Each Phase of Audit Cycle**

- \* During Risk Assessment, auditor to consider risk arising from use of IT systems at company.
- \* When obtaining understanding of business process
- \* While assessing entity level controls for IT governance
- \* Pervasive controls, segregation of duties, general IT controls & apps considered and reviewed.
- \* During testing phase, results of general IT controls would impact NTE of testing.
- \* When testing of reports & info produced by entity (IPE) generated by IT systems & apps.
- \* At completion stage, evaluation of control deficiencies requires use of data analytics & CAATs.

**Risk Assessment Procedure**

- \* Identify events that affect achievement of business objectives
- \* Defines business goals & objectives
- \* Assess likelihood and impact
- \* Respond & mitigate risks
- \* Assess residual risk.

**How Auditor Understand & Evaluate Whistle-Blower policy**

- Does company have a whistle-blower policy?
- Is this policy documented & approved?
- How company deals with deviations & non-compliance?
- Is policy communicated to all employees?
- Does company monitor effectiveness of policy from time-to-time?
- Are employees aware of this policy & understand its purpose & their obligations?
- Has company taken measures (training) to make employees understand contents & purpose of policy?

**Standards, Guidelines & Procedures = Framework & Best Practices**

- SAs
- **Sec 143 of Co Act** = Requires statutory auditors to provide Independent Opinion on Design & Operating Effectiveness of Internal Financial Controls over Financial Reporting (IFC-FR) of company as at B/S date. (For this purpose GN on Audit of IFC-FR issued by ICAI provides framework, guidelines & procedures)
- **Sarbanes Oxley Act 2002 = SOX** (Sec 404 of this act require Public listed co. to implement, assess & ensure effectiveness of IC-FR & auditors independent opinion on design, operating effectiveness of IC-FR.
- **ISO 27001: 2013** is Info Security Mgt System (ISMS) = covers password security, application security, physical security, backup & recovery, that are relevant when auditing in Automated environment.
- **ITIL (Information Technology Infrastructure Library)** = best practices processes for IT service mgt
- **Control Objectives for Info & Related Technologies (COBIT).** • **Cyber Security Framework (CSF)**

# “FORENSIC AUDIT”

**Meaning**

- From Latin word forensic = of or before forum (Means suitable for use in court of law)
- Apply financial skills & investigative mentality to unresolved issues conducted with rules of evidence.
- Emerging discipline encompassing financial expertise, fraud knowledge & sound knowledge, understanding of business reality & working of legal system.
- **Objective** = Detect frauds in companies that suspected fraudulent transactions c

**NEED: -**

- Number of fraudulent activities & ambiguous financial activities accelerating all over world.
- Businesses exposed to risks of fraudulent activities. Recent frauds in India like Satyam & high profile corporate frauds like Enron and WorldCom has emphasised on the need of forensic audit.
- To combat corruption, financial crimes & frauds by investigations & resolving allegations of fraud & embezzlement

Basis of Difference	FORENSIC AUDIT	FINANCIAL AUDIT/ OTHER AUDIT
Applicability	Financial Investigation in response to Event.	Financial Audit is mandatory.
Objective	Detection of frauds.	Auditor is to give reasonable assurance that financial statement reflect True & fair view.
Difference in mindset	Investigative mentality	Professional skepticism
Nature of evidence	Conclusive evidence	Persuasive evidence
Techniques	Investigative, substantive or in depth check	Substantive and Compliance (Sample based)
Period	No period defined.	Quarterly, periodically or quarterly.
Verification of Stock, Estimated NRV of assets, provisions & liability	Independent verification of Suspected/ selected items where misappropriation suspected.	Relies on mgt certificate/ Management Representation.
Off balance sheet items (like contracts)	Regulatory & propriety of these transactions/contracts are examined.	Used to vouch the arithmetic accuracy & compliance with procedures.
Adverse findings (if any)	Legal determination of fraud impact & identify perpetrators depending on Scope.	Negative opinion or qualified opinion expressed with/ without quantification.

## SERVICES RENDERED BY FORENSIC AUDITORS

• Crafting questions to be posed	• Identify & preserve key evidence
• Conducting research relevant to facts of case	• Provide questions & cross examine fact & expert witnesses
• Identify individuals most knowledgeable of facts	• Identify alternative means to obtain key facts & info
• Responding to questions posed	• Evaluating produced docs & info for completeness
• Identify docs to be requested &/or subpoenaed	• Analysing produced records & other info for facts

## PROCESS OF FORENSIC AUDIT



## AREAS OF FORENSIC AUDIT

Fraud detection	Computer Forensic Audit	Fraud Prevention	Providing Expert Testimony
Investigate & analyze financial evidence, detect financial frauds & trace misappropriated funds	Develop computerized applications to assist in Recovery, Analysis & Presentation of financial evidence.	Review internal to verify their adequacy or provide consultation to develop & implement Internal control framework aligned to organization risk profile	Assisting in legal proceeding including testifying in court as an expert witness & preparing visual aids to support trial evidence.

**Importance of Forensic Auditors**

- They can resolve matters by combining accounting knowledge & experience with respect to: -
- Fraud Prevent & Detect
  - Internal Controls Review
  - Evidence Collection & Analysis
  - Investigative methodologies
  - Compliance & Regulatory Functions
  - Assignments with regulatory agencies like SEBI, RBI, EOW etc.
  - Risk Mgt
  - Other Critical areas

**AREAS IN WHICH SERVICES OF FORENSIC ACCOUNTANTS ARE IN GREAT DEMAND**

Criminal Investigation	Fraud Investigation/ Risk Control Reviews
Cases of Professional negligence	Settlement of Insurance Claims
Arbitration service	Dispute Settlement

**CHARACTERISTICS FORENSIC AUDITOR TO HAVE**

Inquisitiveness Creativity	Strong Visualization	Out of the Box Thinking
Sound professional judgment	Confidence	Imagination Curiosity
Persistence Detail oriented	Discretion Skepticism	Etc.

**FORENSIC AUDIT TECHNIQUES**

<b>Analytical Steps</b>	• Catalog possible fraud symptoms	• Understand Business.	• Identify possible frauds.
<b>Technology Steps</b>	• Use tech to gather data on symptoms	• Analyze results.	• Auto Detect procedures
<b>Investigate</b>	• Investigate Symptoms & Follow up.		

**SKILLS FORENSIC AUDITOR TO POSSESS**

SAs, Procedures & Related methodologies	Data Analytics Criminology Legal Framework
Litigation Investigative Techniques for Evidence gathering	A/c & Business reporting systems Info Tech
Network of professional contacts in related fields' viz. enforcement, regulatory bodies, law, industry, peers, etc.	

**FORENSIC AUDIT REPORT: - Points to be kept in mind while reporting**

<b>Clear Thinking</b>	• To whom the report is directed	• Purpose and aim
	• Cool and calm thinking to have logical and coherent presentation	• Pattern of presentation
<b>Keep reader in Mind</b>	• Translate technical matters to layman's language.	• To visualize the reader's viewpoint.
<b>Unbiased approach</b>	• To Mention the view of Client.	
<b>Impact of report</b>	• To remember the universal saying - "don't jump to conclusions"	
<b>Proper Sequence</b>	• Facts & figures to be in proper sequences.	

**POPULAR FORENSIC AUDIT TECHNIQUES USED BY AUDITOR**

General Audit Techniques	Generalized Audit Software
Stats & Math	Common Software Tool
Tech based/ Digital Forensic Technique	Data mining
CAAT	Lab Analysis of Physical & E - Evidences

**Factors for Presentation of Written Report**

- Nature of business of organization.
- Nature of subject
- For Whom Report is intended.
- Mgt altitude, directives & needs.
- Purpose of report
- Forensic auditor's approach & calibre

**SAMPLE TABLE OF CONTENTS OF FORENSIC AUDIT REPORT**

<b>Executive Summary</b>	• Background	• Origin of Audit	• Audit objective
	• Proposed Audit outputs	• Audit implementation approach	
<b>Risk Analysis</b>	• Internal & External Environment Risk		
<b>Audit Process</b>	• Preliminary understanding of scope	• Collect evidence	• Conduct Interviews
	• Validate Inferences and conclusions	• Conduct Interview	• Analyze findings
<b>Evidence of Risk Events</b>	• Conflicts of interest	• Bribery	• Extortion
	• Fraudulent transactions	• Inventory frauds	• Theft
<b>Audit Recommendations</b>	• Logical Framework Approach		• Pre Conditions & Risks.
<b>Governance</b>	• Stakeholder	• Budget Considerations	

**“QUALITY REVIEW”**

**Objects**

- \* Directed to evaluate audit quality & adherence to statutory & other regulatory requirements.
- \* Designed to identify & address weaknesses & deficiencies related to how audits performed by Audit firms.
- \* Achieve review of certain aspects of selected statutory audits performed by firm & other matters related
- \* Review not understood to provide assurance that firm’s audits or clients FS or reporting free of deficiencies.

**Essentials of Good Quality Control System**

- Standard on Quality Control (SQC) 1 requires that every firm’s system of quality control should include policies & procedures addressing each of following elements: -
- Leadership responsibilities for quality within the firm
  - Ethical requirements
  - Acceptance & continuance of client relationships & specific engagements
  - Engagement performance
  - Human resources

**Quality Review Board (QRB) Composition = 1 Chairperson + 10 Members**

Appointed from amongst person eminence having experience in field of law, economics, business, finance or accountancy

- FUNCTION: -**
- Guide members to improve quality of services & adhere to statutory & other regulatory requirements.
  - Review quality of services provided by members.
  - Recommend council for quality of services by members.

**Tech. Standards as per Quality Review Board**

- |  |   |
|--|---|
| • Statements on Auditing issued by ICAI                | • AS u/s 133 of Co Act 2013                         |
| • Guidance Notes on accounting & auditing matters.     | • AS issued by ICAI                                 |
| • Notifications/ Directions /Guidelines issued by ICAI | • Framework to Prepare & Present FS issued by ICAI. |
| • Code of Ethics issued by ICAI.                       | • Applicable Quality Control & Engagement Standards |

**OBJECTS of Technical Review**

- To ensure that firm has proper procedures and implementation for ensuring: -
- Consideration of SA 240
  - Comply applicable tech & other professional & ethical standards & relevant laws & regulations.
  - Implement System of quality control with reference to Applicable quality control standards.
  - Whether there is no MM of Assets & liabilities as at Reporting date of Company/ entity audited.

**Reporting responsibilities of Technical reviewer while carrying Quality review assignment**

- \* Technical Reviewers expresses opinion on SQC for attestation services of firm under review designed to carry professional attestation services assignments in manner ensuring compliance with applicable Technical standards & maintain quality of attestation service work they perform.
- \* Technical Reviewer’s review = not necessarily disclose all weaknesses/ all instances of lack of compliance Inherent limitations in effectiveness of SQC, departure from system may occur and not be detected.
- \* Projection of evaluation of SQC to future periods is subject to risk that SQC may become inadequate because of changes in conditions or degree of compliance with policies & procedures may deteriorate.
- \* Technical Reviewers also identify what they considered as deficiencies & defects or criticisms of firm’s SQC.

**Independence & Qualification of Technical Reviewer**

- There should not be conflict of interest.
- They should sign deed of confidentiality.
- Refer case to Director (Discipline) of Institute for necessary action under CA Act, 1949
- Informing details of non-compliances to regulatory bodies relevant to enterprise
- Intimating concerned auditor as to findings of the Report as well as action initiated.
- Consider matter completely & inform audit firm/ auditor accordingly.
- Member with no disciplinary proceeding in CA Act, 1949/ Penal action in other law against him in last 3 yrs.
- Member or his/ her firm or any of network firms or any of partners of firm or that of network firms not been Statutory Auditor of company or have rendered any other service to said company/ entity during last 3 FYs
- Member or his/ her firm or any of network firms or any of partners of firm or that of network firms not to have had any association with specified statutory audit firm, during the last 3 FYs.
- Member to comply with all eligibility conditions for appointment as auditor in 141(3) of Co Act 2013.

**Situations when Reviewer may Qualify Report**

- Non-compliance with tech standards
- Non-compliance with relevant laws & regulations.
- Quality control system design deficiency.
- Non-compliance with quality control policies
- Non-existence of adequate training program for staff.

**STAGES INVOLVED IN QUALITY REVIEW ASSIGNMENTS**

- Selection of Audit Firm & Technical Reviewer
- Technical Reviewer to convey his acceptance of Letter of Engagement
- Intimation to Audit Firm about the proposed Quality Review & acceptance
- Technical Reviewer to send specified Quality Review Program General Questionnaire
- Technical Reviewer to carry Quality Review by visiting office
- Technical Reviewer to send preliminary report to Audit firm.
- Audit firm to submit representation on preliminary report to Technical Reviewer.
- Technical Reviewer to submit final report with copy of Annual report to Board on Individual letter head duly signed & dated in 45 days from date of acceptance of assignment.
- Technical Reviewer to send copy of their final report to Statutory Auditor/ Audit firm, requesting firm to send their submissions thereon to Board in 7 days of receipt of final report with copy to Technical Reviewer.  
(On receipt Reviewer = submit in next 7 days a summary of their findings, reply & final comments)
- Quality Review Group to consider the report of Technical Reviewer & responses of Audit firm & recommend to QRB
- QRB to consider Report of Quality Review Group & decide final course of action.

**“AUDIT OF LLP”**

