CA FINAL - P3 – SMART NOTES

ADVANCED AUDITING, ASSURANCE AND PROFESSIONAL ETHICS

Let's play a game before you start learning from this book,

Original Text: "the matter of time, difficulty, cost involved in itself is not a valid basis for an auditor to omit an audit procedure for which there is no alternative or to be satisfied with an evidence that is less than persuasive" [Source: SA 200]

If you are Not able to understand the above para then here is an alternative way to express the above para,

Simplified Text: "the auditor shall obtain sufficient and appropriate evidence irrespective of time, cost and difficulty involved"

Tell me what you learned in the above? Don't worry, I will answer.

When you read the "simplified text" you felt in your mind that "yea.........Correct only", Right?

Now tell me have you felt the same when you read the "Original Text"?

NO Way [99% I am sure you didn't understand original text when you read even twice or thrice]

What is tested in exams, be it MCQs or Descriptive Questions, is of Original text standard and How you learned or wanted to learn is in Simplified text format.

As a teacher, I strongly believe that I shall bring the student level of understanding to original text with perfect clarity rather making the book simple and keeping their level of understanding at low.

Remember I am a Tutor and not an Author! My objective is Igniting minds and Not selling Books.

Disclaimer: This is NOT a Short Notes or Chart Book. Do NOT believe in shortcuts. Generally, the easiest way to succeed is following the RIGHT process, and we ourselves make things complicated by choosing shortcuts.

1. FUNDAMENTALS OF AUDITING

DEFINITION OF AUDIT

An audit is an **independent examination** of financial information of any entity, **whether or not profit oriented** and **irrespective of its size or legal form**, when such an examination is conducted **with a view to express an opinion thereon.**

OBJECTIVE OF THE AUDIT/AUDITOR

To **express opinion** (Audit Report) on financial statements whether:

- The **financial statements** are **free from MMS** and
- They are **prepared as per AFRFW**.

AUDITOR

"Auditor" is used to refer to the **person or persons conducting the audit**, usually the **engagement partner or other members** of the engagement team, or the firm.

ENGAGEMENT TEAM:

a. **Engagement Partner**
b. **Audit Manager**
c. **Paid assistant**
d. **Senior article assistant**
e. **Junior article assistant**
f. **Any other designation**

BOOKS OF ACCOUNTS

As per companies act, 2013 "books of account" includes:

a. all sums of **money received and expended** and matters in relation there to.
b. all **sales and purchases** of goods and services.
c. the **assets and liabilities** and
d. The **items of cost.**

APPLICABLE FINANCIAL REPORTING FRAMEWORK [AFRFW]

In view of the **nature of the entity** and the **objective of the financial statements**, the **framework adopted by management** for **preparation and presentation** of the financial statements.

E.g.: For a company the AFRFW is SCH-III and Accounting standards.

GENERAL PURPOSE FINANCIAL STATEMENTS (GPFS)

1. If the **F/S are prepared** as per **General Purpose Framework (GPFW)** then they are called as GPFS.

   GENERAL PURPOSE FRAMEWORK:
   A financial reporting framework **designed to meet the common financial information needs** of a **wide range of users**. (Framework may be understood as Rules and Regulations)

2. Further this framework may be a **Compliance Framework** (or) a **Fair Presentation Framework.**

   a. **COMPLIANCE FRAMEWORK (CFW):** It refers to a framework where **F/S are prepared and presented EXACTLY as per the requirements of framework WITHOUT ANY DEVIATION.**

   b. **FAIR PRESENTATION FRAMEWORK:** It refers to a framework where **F/S are prepared and presented as per the requirements of such framework** (CFW) **AND**
      I. **Contains disclosures beyond the requirements** or
      II. **May deviate from the requirement** of the framework
      III. **To Achieve Fair Presentation**.

MISSTATEMENT

DIFFERENCE BETWEEN

REPORTED F/S ITEM: Amount, Classification, Presentation, Or Disclosure.

AND

AFRFW: Amount, Classification, Presentation, Or Disclosure.

2. AUDIT REPORTING

[(COVERING SA 700, 701, 705, 706, 710, 720, 299, 600, 610, 620, 570 & 260 AND REPORTING REQUIREMENTS U/S 143 OF COMPANIES ACT 2013 INCLUDING CARO, 2020)]

PART – I (REPORTING STANDARDS)

SA 700 – FORMING OF AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

A. OBJECTIVES OF THE AUDITOR UNDER SA- 700:

The objectives of the auditor are:

a. To **form an opinion** on the financial statements and
b. To **express an opinion** on the financial statements.

Note: Applicable in the context of audit of **complete set of GPFS**.

B. FORMING AN OPINION ON THE FINANCIAL STATEMENTS:

When the financial statements are prepared in accordance with a **fair presentation framework**, the **auditor shall also evaluate**:

a. The **overall presentation**, **structure and content** of the F/S and
b. Whether the **related notes**, **represent the underlying transactions and events** in a manner **that achieves fair presentation**.

C. DEFINITIONS:

1. UNMODIFIED OPINION:

When the **auditor concludes that** the **financial statements are free from material misstatements** (i.e., give a true and fair view) and are also **prepared in accordance with the applicable financial reporting framework**, then he **shall express an unmodified opinion** which is also known as **Unqualified Opinion** or **Clean Opinion**.

2. WHEN IS A MODIFIED OPINION ISSUED:

a. If the auditor **concludes that based on the Sufficient and appropriate audit evidence** obtained, the **financial statements** as a whole are **NOT free from material misstatement** **or**
b. Is **unable to obtain sufficient appropriate audit evidence** to conclude that the financial statements as a whole are free from material misstatement.

D. EVALUATIONS TO BE MADE BY AUDITOR:

3. QUALITATIVE ASPECTS OF ENTITIES ACCOUNTING PRACTICES:

a. Management makes **a number of judgments**.
b. The **auditor may find** existence of **management bias** and **lack of neutrality** over accounting practices.
c. This **may cast significant doubt** on **reliability of financial statements**.
d. The **indicators of management bias or lack of neutrality**:
   I. **Selective correction of misstatements** brought to the notice of management by auditor.
   II. Possible **management bias over** selecting appropriate **accounting estimates**.
   III. **Frequent changes in accounting policies** without a proper reason.

4. SPECIFIC EVALUATIONS ABOUT FINANCIAL STATEMENTS:

c. Whether the **accounting policies selected and are applied consistently** and are they in **accordance with AFRFW**.
d. Whether the **F/S adequately disclose** the significant **accounting policies**.
e. Whether the **accounting estimates are reasonable**.
f. Whether the **information presented** in the F/S is **relevant, reliable, comparable, and understandable and not misleading**.
g. Whether the **terminology used** in the F/S, including **the title of each assertion** in financial statements, **are appropriate**.

E. CONTENTS OF THE AUDITOR'S REPORT:

1. **Title**
2. **Addressee (GPFS - Members and in case of SPFS - BOD)**
3. **Opinion Para [Refer F 1]**
4. **Basis for Opinion [Refer F 2]**
5. **Material Uncertainty related to Going Concern (SA 570)**
6. **Key Audit Matters (SA 701)**
7. **Emphasis of Matter Paragraph (SA 706)**
8. **Other Matter Paragraph (SA 706)**
9. **Other Information (SA 720)**

Applicable as per the relevant standard (items 5 to 9)

10. **Responsibilities of Management for the Financial Statements [Covered in SA 210] [Refer F 3]**
11. **Auditor's Responsibilities for the Audit of the Financial Statements [Refer F 4]**
12. ***Report on Other Legal and regulatory requirements (E.g., CARO, 2020) [Refer F 5]**

13. **Signature of the Auditor [Refer F 6]**
14. **Place of Signature [Ordinarily the city where the audit report is signed]**
15. **Date of the Auditor's Report [Refer F 7]**
16. **UDIN (Unique Document Identification Number w.e.f.1st July 2019) [The requirement to mention UDIN is applicable both for manually and digitally signed reports/certificates including certificates uploaded online.]**

F. DETAILED EXPLANATION TO FEW CONTENTS OF AUDIT REPORT:

1. **OPINION PARAGRAPH / AUDITOR'S OPINION:** The opinion section shall mention the following:
   a. **Identify the entity**.
   b. **State that the F/S have been audited** (Not in case of Disclaimer of Opinion)
   c. **Identify the title of each statement** comprising the financial statements.
   d. **Refer to the notes**, including the summary of significant accounting policies and
   e. **Specify the date of, or period covered by,** each financial statement comprising **the financial statements**.

2. **BASIS FOR OPINION PARAGRAPH:**
   a. **States that** the audit was conducted **as per standards on auditing**.
   b. **Refers to the section** of the auditor's report that **describes the auditor's responsibilities under the SAs**.
   c. Includes a **statement that the auditor is independent of the entity** in accordance with the **relevant ethical requirements** relating to the audit and **has fulfilled the auditor's other ethical responsibilities**. The statement **shall refer to the Code of Ethics**.
   d. **Statement** as to whether the auditor has **obtained sufficient appropriate audit evidence** for the opinion expressed by him.

3. **RESPONSIBILITIES FOR FINANCIAL STATEMENTS:**
   Refer to "Preconditions to audit" under SA 210.

4. **AUDITORS RESPONSIBILITIES FOR AUDIT OF FINANCIAL STATEMENTS:**

LOCATION OF DESCRIPTION OF AUDITORS RESPONSIBILITES

(a) Within the body of the auditor's report

(b) Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix or

(c) By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or the auditing standards expressly permit the auditor to do so.

5. OTHER REPORTING RESPONSIBILITIES: [NOT REQUIRED FROM EXAM VIEWPOINT]

6. SIGNATURE OF THE AUDITOR:

a. **Quote PERSONAL NAME**
b. **Quote FIRM NAME**
c. **Quote MRN**
d. **Quote FRN**

7. DATE OF THE AUDITOR'S REPORT:

The auditor's report date shall be **only on or after obtaining sufficient and appropriate evidence and on or after Approval of F/s** by competent authority.

G. SUPPLEMENTARY INFORMATION ALONG WITH FINANCIAL STATEMENTS:

a. INTEGRAL PART: The supplementary information shall be **covered by the auditor's opinion**.

b. NOT AN INTEGRAL PART:

i. Evaluate **whether such supplementary information** is presented in a way that **clearly differentiates it from the audited F/S**.
ii. **If not**, then the auditor **shall ask management to change**.
iii. **If management refuses to do** so, the auditor **shall identify the unaudited supplementary information** and **explain in the auditor's report** that such **supplementary information has not been audited**. **[SIMILAR TO SA 720 REPORTING]**

SA 701 – COMMUNICATING KEY AUDIT MATTERS IN THE INDEPENDENT AUDITOR'S REPORT

A. DEFINITION OF KEY AUDIT MATTER:

The **matters which in auditor's Judgment** are of **most significant** in the **audit of the F/S** of the **current period** and these are **selected from the matters communicated with those charged with governance**.

B. PURPOSE OF KEY AUDIT MATTER (OBJECTIVE):

1. **To enhance the communicative value** of auditor's report by providing **greater transparency about the audit**.
2. **Provides additional information** to the users of the F/S for **understanding the entity** and **areas of significant matters** in the **professional judgment of auditor**.
3. **Communicating key audit matters in the auditor's report is:**
   a. **NOT a substitute for disclosures in the financial statements.**
   b. **NOT a substitute for the auditor expressing a modified opinion.**
   c. **NOT a separate opinion on individual matters.**
   d. **NOT a substitute for reporting in accordance with SA 570.**

C. APPLICABILITY AND PROHIBITION ON KEY AUDIT MATTERS (KAM):

1. This SA applies to **audits of complete sets of GPFS of**:
   a. **Listed entities** and
   b. **Circumstances when the auditor decides to communicate key audit matters** in the auditor's report and
   c. **Required by law or regulation**

2. **DESCLAIMER OF OPINION: SA 705 prohibits** the auditor from **communicating key audit matters** when the **auditor disclaims an opinion on F/S.**

D. FACTORS FOR DETERMINING KEY AUDIT MATTERS:

The auditor shall take into account the following factors while determining the Key Audit Matters:

1. Areas of **higher assessed risk of material misstatement** or **significant risks**.
2. Areas in the financial statements that **involved significant management judgment**, including accounting estimates that have

been **identified as having high estimation uncertainty**.

3. **Significant events or transactions** that occurred during the period under audit.

Examples: (Inclusive list)

a. Assessment of Impairment.
b. Provision for losses and contingencies.
c. Valuation of financial instruments.
d. Matters relating to Revenue recognition
e. Taxation matters (multiple tax jurisdictions, uncertain tax position, deferred tax assets)

E. CERTAIN MATTERS NOT TO BE COMMUNICATED AS "KAM" [RESTRICTIONS ON KAM]:

In the following specific issues, the auditor **shall not be communicated as KAM**:

a. **Law or regulation prohibits** such disclosure about the matter or
b. The **auditor determines that** the matter should not be communicated in the auditor's report **because of the possible adverse consequences**.
c. The **matter is highly confidential** or **sensitive** at the interest of the company.

SA 705 – MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

A. OBJECTIVE OF THE AUDITOR / CIRCUMSTANCES WHEN A MODIFICATION TO THE AUDITOR'S OPINION IS REQUIRED:

The objective of the auditor is **to express clearly an appropriately modified opinion** on the F/S when:

a. The **auditor concludes** that, **based on the audit evidence obtained**, the financial statements **as a whole are not free from material misstatement** or
b. The auditor is **unable to obtain sufficient appropriate audit evidence** to conclude that the financial statements as a whole are free from material misstatement.

B. DIFFERENT TYPES OF MODIFIED OPINIONS:

The decision regarding which type of opinion is appropriate depends upon:

a. The Nature of the matter giving rise to the modification:

1. **Whether the** misstatements are material.
2. **Inability to obtain audit evidence for material items of financial statements.**

b. Auditor's judgment about pervasiveness **of** effects **or** *possible effects* **of matters related to financial statements.**

1. QUALIFIED OPINION:

The auditor shall express a qualified opinion when:

a. The auditor, **having obtained sufficient appropriate audit evidence**, **concludes that misstatements**, individually or in the aggregate, **are material, BUT NOT pervasive**, to the financial statements or **[But Not replace with AND it becomes A.O]**

b. The auditor is **unable to obtain sufficient appropriate audit evidence** on which to base the opinion, but the auditor **concludes that the possible effects** on the financial statements of **undetected misstatements**, if any, could **be material BUT NOT pervasive**.

[But Not replace with AND it becomes D.O.O]

2. ADVERSE OPINION:

The auditor, **having obtained sufficient appropriate audit evidence**, **concludes that misstatements**, individually or in the aggregate, are **BOTH material AND pervasive**, to the financial statements

3. DISCLAIMER OF OPINION:

The auditor is **unable to obtain sufficient appropriate audit evidence** on which to base the opinion, but the auditor **concludes that the possible effects** on the financial statements of **undetected misstatements**, if any, could be **BOTH material AND pervasive**.

C. MEANING OF PERVASIVE EFFECTS:

Pervasive effects on the F/S are those that, in the auditor's judgment:

a. **Are not confined (limited) to specific elements**, accounts or items of the financial statements or

b. **If so confined**, **represent** or could represent **a substantial proportion** of the financial statements or

c. In **relation to disclosures, are fundamental to user's** understanding of the financial statements.

BELOW TABLE SHOWS DIFFERENT TYPES OF OPINIONS BASED IN DIFFERENT SITUATIONS

SITUATION	CASE	MMS EXIST?	PERVASIVE?	OPINION
Sufficient and appropriate evidence OBTAINED	**A**	No	NA	**Unqualified Opinion**
	B	Yes	No	**Qualified Opinion**
	C	Yes	Yes	**Adverse Opinion**
SITUATION	**CASE**	**IS IT MATERIAL?**	**IS THE POSSIBLE EFFECT PERVASIVE?**	**OPINION**
Sufficient and appropriate evidence NOT OBTAINED	**A**	No	NA	**Unqualified Opinion**
	B	Yes	No	**Qualified Opinion**
	C	Yes	Yes	**Disclaimer of Opinion**

D. CLARIFICATION ON EMPHASIS OF MATTER PARA IN CASE OF ADVERSE OPINION / DISCLAMER OF OPINION:

When the auditor **expresses an adverse opinion** or **disclaim an opinion** on the financial statements as a whole, **the auditor's report shall not also include an unmodified opinion with respect to** the same financial reporting framework on a single financial statement or **one or more specific elements**, **accounts** or **items** of a financial statement.

If Included then it **would contradict the auditor's adverse opinion** or disclaimer of opinion on the financial statements as a whole.

[**NOT TO USE EMPHASIS OF MATTER IN THE AUDITORS REPORT in case of A.O and D.O.O**]

E. CONSEQUENCE OF AN INABILITY TO OBTAIN SUFFICIENT APPROPRIATE AUDIT EVIDENCE DUE TO A MANAGEMENT-IMPOSED LIMITATION AFTER THE AUDITOR HAS ACCEPTED THE ENGAGEMENT:

1. **Request the Management to remove the limitation** in order to avoid Modified Opinion.
2. If **Management refuses to remove limitations**, the auditor shall **perform alternative procedures** to obtain S & A Audit Evidence
3. **REPORTING:** If the **auditor is unable to obtain sufficient appropriate** audit evidence:
    a. Concludes that the **possible effects on the financial statements of undetected misstatements**, if any, could be **material but not pervasive**, the auditor shall **qualify the opinion** or
    b. If the auditor concludes that the **possible effects on the financial statements of undetected misstatements**, if any, could be **both material and pervasive** the auditor shall:
        i. **Withdraw from the audit**, where practicable and possible under applicable law or regulation or
        ii. If **withdrawal from the audit before issuing the auditor's report is not practicable or possible**, **disclaim an opinion on the financial statements**.

SA 706 – EMPHASIS OF MATTER PARAGRAPH AND OTHER MATTER PARAGRAPH IN THE INDEPENDENT AUDITOR'S REPORT

A. DEFINITIONS:

1. **EMPHASIS OF MATTER PARAGRAPH: A paragraph included in the auditor's report that** refers to a matter **appropriately presented or disclosed in the financial statements that,** in the auditor's judgment**, is of such importance that it is fundamental to users' understanding of the financial statements.**

2. **OTHER MATTER PARAGRAPH: A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that in auditors' judgment, is relevant for users understanding of the audit, auditors' responsibilities or the auditor's report.**

B. WHEN TO USE EMPHASIS OF MATTER PARAGRAPH:

1. **CONDITIONS:** The auditor **shall include an Emphasis of Matter** paragraph in the auditor's report **provided**:
   a. The auditor would **not be required to modify the opinion** in accordance with SA 705 (Revised) as a result of the matter and
   b. When SA 701 applies, **the matter has not been determined to be a key audit matter**.

2. **MANNER OF PRESENTATION OF EMPHASIS OF MATTER:**

   a. Include the paragraph **within a separate section** of the auditor's report with an **appropriate heading** that includes the term **"Emphasis of Matter":**
      I. Shall **express the matter being emphasized** (highlighted) and **give the reference to such matter** in the financial statements and
      II. Also **state that** the auditor's **opinion is not modified** in respect of the matter emphasized.
   b. An Emphasis of Matter Para is **NOT A SUBSTITUTE** for
      I. A **modified Opinion** in accordance with SA 705
      II. **Disclosures in Financial statements** as per AFRFW.
      III. **Reporting in accordance with SA 570** when a material uncertainty exists relating to entities ability to continue as a going concern.

C. WHEN TO ISSUE OTHER MATTER PARAGRAPH IN THE AUDITOR'S REPORT:

1. The auditor shall include **an Other Matter paragraph** in the auditor's report, provided:
   a. This is **not prohibited by law or regulation** and
   b. When SA 701 applies, **the matter has not been determined to be a key audit matter**.

2. **MANNER OF PRESENTATION:** When the auditor includes an Other Matter paragraph in the auditor's report, the auditor shall **include the paragraph within a separate section** with the heading **"Other Matter,"** or other appropriate heading.

D. COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE:

If the **auditor expects to include an Emphasis of Matter or an Other Matter paragraph** in the auditor's report, the auditor **shall** communicate with those charged with governance regarding their expectation and the wording of this Para.

SA 299 – JOINT AUDIT OF FINANCIAL STATEMENTS

A. MEANING:

The process of **appointing two or more individuals or firms or combination of individuals and firms** is known as joint audit. (SA 299 – Joint Audit of Financial Statements)

B. RESPONSIBILITY OF JOINT AUDITOR:

1. **Individual / Separate Responsibilities:** Where **work is divided among** the joint auditors **on a suitable basis** then **each joint auditor is responsible only for the work performed by them:**
   a. **Items of Assets or liabilities**
   b. **Income or Expenditure**
   c. **Geographical areas**
   d. **Identified units**
   e. **Period of Financial statements**

2. **Joint / Combined Responsibility:** In the **following areas all the joint auditors will have indivisible or combined** responsibility.
   a. In respect of **audit work not divided.**
   b. In respect of **decisions taken by all the joint auditors.**
   c. In respect of **matters brought to the notice of all** joint auditors.
   d. For **verifying disclosure requirements** of financial statements and
   e. For **ensuring that the audit report complies with relevant statute**.

Note: Each joint auditor is **entitled to rely on the work performed by another joint auditor** and need not review the work performed by others.

C. AUDIT REPORTING IN CASE OF JOINT AUDIT:

a. Generally, all the **joint auditors arrive common conclusions** and **express common opinion** through a single audit report.
b. However, **NO joint auditor is bound by majority's** opinion.
c. **If there is a difference of opinion** among joint auditors, then such **disagreeing auditor can express his own opinion** by a separate report. In such a **case each joint auditor shall refer about other joint auditor's report in their audit report**.

D. SPECIAL CONSIDERATIONS AS PER SA – 299:

1. The **Engagement partner and Key engagement Team** from each of the Joint auditors **shall be involved in planning the audit**.
2. All **joint auditors should establish jointly the overall audit strategy.**
3. All Joint auditors **shall discuss and develop a Joint audit plan**.
4. **Each of the Joint auditors** shall **assess the risk of Material Misstatement and communicate to other Joint auditors**.
5. The Joint auditors should **discuss and document the nature, timing and extent of audit procedures** for **Common areas and Specific areas of audit to be performed**.
6. Joint auditors **shall issue common engagement letter** and **obtain common management representation letter.**
7. The **Work allocation between joint auditors shall be documented** and signed by all the joint auditors which shall **also be communicated to those charged with governance**.

SA 600 - USING THE WORK OF OTHER AUDITORS

A. DIVISION OF RESPONSIBILITY:

1. **principal auditor** would **NOT BE RESPONSIBLE** in respect of the work entrusted to the other auditors.
2. **MENTION THE FACT:** The principal auditor should **STATE CLEARLY THE DIVISION OF RESPONSIBILITY** for the financial information of the entity by indicating **the extent to which the financial information of components audited by the other auditors** have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors.

B. DEFINITIONS:

PRINICIPAL AUDITOR: "Principal auditor" means **the auditor with responsibility for reporting on the financial information of an ENTITY** when **that** financial information **includes** the **financial information of one or more components audited by another auditor**.

a. **OTHER AUDITOR:** "Other auditor" means an auditor, **other than the principal auditor**, with responsibility **for reporting on the financial information of a component which is included** in the **financial information audited by the principal auditor**. (AKA Component auditor)

b. **COMPONENT:** "Component" means **a division, branch, *subsidiary, joint venture, associated enterprises or other entity* whose financial information is included in** the **financial information audited by the principal auditor**.

C. ACCEPTANCE OF PRINCIPAL AUDITOR:

The auditor **should consider** the following:

1. The **materiality of the portion of the financial information** which the principal auditor audits.
2. The principal auditor's **degree of knowledge regarding the business** of the components.
3. The **risk of material misstatements** in the financial information **of the components audited by the other auditor** and
4. The **performance of additional procedures** as set out in this SA **regarding the components audited by other auditor resulting in the principal auditor having significant participation**.

D. PRINCIPAL AUDITOR's PROCEDURES:

1. The principal auditor should perform procedures **to obtain sufficient appropriate audit evidence**, **that the work of the other auditor is adequate** for the principal auditor's purposes:

    a. **AT PLANNING STAGE:** Advise the other auditor of **the use that is to be made of the other auditor's work** and report and **make sufficient arrangements for co-ordination** of their efforts AT THE PLANNING STAGE of the audit.

    b. **SPECIAL CONSIDERATIONS:** The principal auditor would **inform the other auditor** of matters such as **areas requiring special consideration, procedures for the identification of inter-component transactions** that may require disclosure **and the timetable for completion of audit** and

    c. **REPORTING REQUIREMENTS:** **Advise the other auditor** of the **significant accounting, auditing and reporting requirements** and obtain representation as to compliance with them.

2. The principal auditor **might discuss with the other auditor** the **audit procedures applied or review a written summary** of the other auditor's procedures and findings which may be in the form of a completed questionnaire or checklist.
3. The principal auditor **may also wish to visit the other auditor**

4. The **nature, timing and extent of these procedures** depends on:
    a. The **circumstances of the engagement and**
    b. The principal auditor's **knowledge of the professional competence of the other auditor**.

E. COORDINATION BETWEEN PRINCIPAL AUDITOR AND OTHER AUDITOR:

1. The principal auditor **may find it necessary to issue written communication(s)** to the other auditor.
2. The **other auditor**, **knowing the context in which his work** is to be used by the principal auditor, **should co-ordinate with the principal auditor**. For example:
    a. By **bringing to the principal auditor's immediate attention** any significant **findings requiring to be dealt with at entity level**,
    b. **adhering to the timetable for audit** of the component, etc.
    c. He should **ensure compliance with the relevant statutory** requirements.
3. Similarly, the principal auditor should **advise the other auditor of any matters that come to his attention** that he thinks **may have an important bearing on the other auditor's** work
4. When considered necessary by him, the principal auditor **may require the other auditor to answer a detailed questionnaire regarding matters on which the principal auditor requires information for discharging his duties**. The other auditor should respond to such questionnaire on a timely basis.

F. SIGNIFICANT FINDINGS BY OTHER AUDITORS:

1. **DISCUSSIONS:** The principal auditor may consider it appropriate to **discuss with the other auditor and the management** of the component, the **audit findings or other matters affecting the financial information of the components**.
2. **SUPPLEMENT TEST:** He may also decide that **supplemental tests of the records** or the financial statements **of the component** are necessary. Such **tests may be performed by the principal auditor** or the **other auditor**.
3. **DOCUMENTATION:** The principal auditor should document:
    a. The **components audited by other auditors**.
    b. **Their significance to the financial information of the entity as a whole**.

c. The **names of the other auditors** and

d. Any **conclusions reached that individual component are not material**.

e. **The procedures performed and the conclusions reached by Principal auditor**.

   E.g., The auditor would document the results of discussions with the other auditor and review of the written summary of the other auditor's procedures.

G. REPORTING REQUIREMENTS FOR PRINCIPAL AUDITOR'S:

1. **OTHER AUDITOR EXPRESSED MODIFIED OPINION:**

   a. The **principal auditor should consider whether the subject of the modification** is of such **nature and significance**, in relation to the financial information of the entity on which the principal auditor is reporting **that it requires a modification of the principal auditor's report.**

   b. **DOCUMENT how he has dealt with the qualifications or adverse remarks contained** in the other auditor's report in framing his own report. [Requirement u/s 143(3)(c) of Companies Act, 2013]

2. **OTHER AUDITORS WORK CANNOT BE USED:** If the work of the other auditor **cannot be used and the principal auditor** has not been able to perform sufficient additional procedures regarding the financial information of the component audited by the other auditor, the **principal auditor should express a qualified opinion or disclaimer of opinion** because there is a limitation on the scope of audit.

SA 570 – GOING CONCERN

A. OBJECTIVE:

The objectives of the auditor are:

a. To **obtain sufficient appropriate audit evidence** regarding the **appropriateness** of management's **use of the going concern basis** of accounting **in the preparation of the financial statements**.

b. To **conclude**, based on the audit evidence obtained, **whether a material uncertainty exists** and

c. To **report in accordance with this SA**.

B. PRELIMINARY ASSESSMENT REGARDING USE OF GOING CONCERN ASSUMPTION BY MANAGEMENT:

1. **DISCUSS WITH MANAGEMENT REGARDING THEIR PRELIMINARY ASSESSMENT OF GOING CONCERN:**
    a. The **nature and condition of its business**.
    b. **Effects of external events or conditions** such as change in law or regulatory.
    c. The information pertaining to **operational forecast of foreseeable future**.
    d. **Significant events or transactions** that are occurred during the period under review. E.g., fire accident or catastrophe etc.,

2. If **such an assessment has not yet been performed**, the auditor shall **discuss with management the basis** for the intended use of the **going concern basis of accounting**.

C. PERIOD COVERED FOR ASSESSMENT OF ENTITY'S ABILITY TO CONTINUE AS A GOING CONCERN:

1. If the **management assessment of going concern is less than 12 MONTHS**, then the auditor **shall request management to extend** its assessment period to **at least 12 months**.

2. **In some cases, estimation more than 12 months** is also justified and in such a case the assessment **shall be made for such extended period**.

3. **MODIFIED OPINION:** If **management is unwilling to make or extend** its assessment, the **auditor shall consider the implications** for the auditor's report.

D. AUDIT PROCEDURE WHEN EVENTS OR CONDITIONS ARE IDENTIFIED:

If the **auditor identifies** any **circumstances** that cast **significant doubt on entity's going concern**, Perform the following:

1. **Whether there is a policy of assessment of risk related to going concern by management.** If not, request management to make an assessment.
2. **Evaluating management's plans for future actions** in relation to its going concern assessment.
3. **Whether the entity has prepared a cash flow forecast** based on a reliable data:
   a. **Evaluating the reliability of the underlying data.**
   b. whether there is **adequate support for the assumptions underlying** the forecast.
4. **Requesting written representations from management** regarding their plans for future actions and the **feasibility of these plans**.

SIGNIFICANT DELAY IN APPROVAL OF F/S: If there is **significant delay in the approval of the financial statements** by management or those charged with governance **after the date of the financial statements**, the auditor shall **inquire as to the reasons** for the delay. If the auditor **believes that the delay could be related to events** or conditions relating **to the going concern** assessment, the **auditor shall perform the above additional audit procedures** necessary and consider the effect on the auditor's conclusion regarding the existence of a material uncertainty.

E. ADEQUACY OF DISCLOSURES IN FINANCIAL STATEMENTS WHEN EVENTS OR CONDITIONS HAVE BEEN IDENTIFIED:

WHEN MATERIAL UNCERTAINTY EXIST: The auditor shall **verify whether the financial statements**:

a. **MANAGEMENT PLAN EXISTS: Adequately disclose the principal events or conditions** that may **cast significant doubt** on the entity's ability to continue as a **going concern** and **management's plans to deal with** these events or conditions and
b. **NO ALTERNATIVE PLANS TO MITIGATE: Disclose clearly that** there is a **material uncertainty related to events** or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, **that it may be unable to realize its assets and discharge** its liabilities in the normal course of business. [ILFS Audit report 2017 – 2018]

F. REPORTING IF "GOING CONCERN ASSUMPTION IS APPROPRIATE BUT MATERIAL UNCERTAINTY EXIST":

1. **F/S "ADEQUATELY" DISCLOSES THE FACT:** If the auditor concludes that the **financial statements adequately disclose the material uncertainty** that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events and
   a. The audit report shall **include a separate section** under the heading **"Material uncertainty related to going concern"** and **draw the attention of the readers** to **the specific note point** presented or disclosed adequately by management regarding the material uncertainty.
   b. The auditor will express an **UNQUALIFIED OPINION** in this regard as the entity has adequately disclosed about the material uncertainty.

2. **F/S "DO NOT ADEQUATELY" DISCLOSES THE FACT:**

   If the auditor concludes that the **financial statements are not adequately reflecting the material uncertainty** regarding going concern, then the auditor shall:
   a. Express a **QUALIFIED/ADVERSE OPINION** and
   b. In the **Basis for Qualified (Adverse) Opinion** section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and **that the financial statements DO NOT adequately disclose this matter.**

G. REPORTING IF "GOING CONCERN ASSUMPTION IS INAPPROPRIATE":

If the **financial statements have been prepared** using the **going concern basis of accounting but,** in the auditor's judgment, management's use of the **going concern basis** of accounting for the preparation of F/S **is inappropriate** the auditor **shall express an ADVERSE OPINION**.

H. INDICATORS THAT CAST DOUBT ON GOING CONCERN:

Refer Our Main Material for List of Indicators

SA 720 - AUDITORS RESPONSIBILITY IN RELATION TO OTHER INFORMATION

A. OBJECTIVE OF SA – 720:

The objectives of the auditor, having read the other information, are:

1. To **consider whether there is a material inconsistency between** the **other information** and **the financial statements**.
2. To consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit.
3. To **respond appropriately when the auditor identifies** that such **material inconsistencies.**
4. To report in accordance with this SA.

IMPORTANT NOTE:

1. The auditor's responsibilities under this SA **DO NOT constitute an assurance engagement on other information** or **DO NOT impose an obligation on the auditor to obtain assurance** about the other information.
2. This **SA does not apply** to:
    a. **Preliminary announcements** of financial information or
    b. **Securities offering documents**, including prospectuses.

B. DEFINITIONS:

OTHER INFORMATION: Financial or non-financial information **(other than financial statements and the auditor's report thereon) included in an entity's annual report.**
NOTE: Other Matter Paragraph as per SA 706 is Completely different from the above.

ANNUAL REPORT: A document, or combination of documents, prepared typically on an annual basis by management or those charged with governance in accordance with law, regulation or custom, the purpose of which is to provide owners (or similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements. An annual report contains or accompanies the financial statements and the auditor's report thereon and usually includes information about the entity's developments, its future outlook and risks and uncertainties, a statement by the entity's governing body, and reports covering governance matters.

MISSTATEMENT OF THE OTHER INFORMATION: A misstatement of the other information exists when the **other information is incorrectly stated or otherwise misleading** (including because it omits or obscures information necessary for a proper understanding of a matter disclosed in the other information).

C. AUDIT PROCEDURE FOR OTHER INFORMATION:

1. **OBTAIN OTHER INFORMATION:** The auditor shall **obtain other information:**
    a. Determine, through **discussion with management**, which document(s) comprises **the annual report**, and the entity's **planned manner and timing** of the issuance of such document(s).
    b. To **obtain final version of other information** in a timely manner and, if possible, **PRIOR TO THE DATE OF THE AUDITOR'S REPORT** and
    c. **NOT AVAILABLE PRIOR AUDIT REPORT DATE: Request management to provide a written representation** that the **final version of the document(s) will be provided** to the auditor when available, and **prior to its issuance by the entity**, **such that the auditor can complete** the procedures required by this SA.

2. **VERIFY THE OTHER INFORMATION:** The auditor **shall read the other information** and check:
    a. **Whether there is a material inconsistency** between the other information and the financial statements.
    b. To consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit.
    c. Further he **shall remain alert for indications** that the **other information not related to the financial statements** or the auditor's knowledge obtained in the audit **appears to be materially misstated**.

D. RESPONDING WHEN A MATERIAL INCONSISTENCY APPEARS TO EXIST OR OTHER INFORMATION APPEARS TO BE MATERIALLY MISSTATED:

If the auditor **identifies that a material inconsistency** appears to exist, the auditor shall **discuss the matter with management** and **conclude whether**:

a. A **material misstatement of the other information exists**.
b. A **material misstatement of the financial statements exists** or

E. IF MATERIAL MISSTATEMENT EXISTS IN OTHER INFORMATION:

1. **REQUEST MANAGEMENT TO CORRECT IT:** If management:
   a. **Agrees to make the correction**, the auditor shall **determine** that the **correction has been made** or
   b. **Refuses to make the correction**, the auditor shall **communicate the matter with those charged with governance**.

2. **MMS IN OTHER INFORMATION IDENTIFIED BEFORE DATE OF AUDITOR'S REPORT:** The other information is **NOT CORRECTED** after communicating with those charged with governance, the auditor shall **take appropriate action**:
   a. **Communicating with those charged with governance about how the auditor plans** to address the material misstatement **in the auditor's report**. *[Report in Other Info Para of the Report]*
   b. **Withdrawing from the engagement**, where withdrawal is possible under applicable law or regulation.

3. **MMS IN OTHER INFORMATION IDENTIFIED AFTER THE DATE OF THE AUDITOR'S REPORT:** The auditor shall:
   a. If the **other information is corrected**, **perform the procedures necessary** in the circumstances or
   b. If the **other information is NOT CORRECTED** after communicating with those charged with governance, **take appropriate action considering the auditor's legal rights** and obligations, **to seek to have the uncorrected material misstatement appropriately brought to the attention of users** for whom the auditor's report is prepared. [Follow the procedure outlined in SA 560]

F. IF MATERIAL MISSTATEMENT EXISTS IN FINANCIAL STATEMENTS:

If the auditor concludes that a material misstatement in the financial statements exists or the auditor's understanding of the entity and its environment needs to be updated, the **auditor shall respond appropriately.**

G. AUDITOR'S REPORTING REQUIREMENTS:

Read our Main material

SUMMARY OF REPORTING:

MMS in Other Information	MMS in FInancial Statements
•UMO and Report in Other Info para about such MMS in Other Info.	•Modified Opinion and Reasons in Basis for M.O para of the report.

SA 710 - COMPARAT INFORMATION – CORRESPONDING FIGURES AND COMPARATIVE FINANCIAL STATEMENTS

A. DEFINITIONS:

COMPARATIVE INFORMATION:

The **amounts and disclosures included in the financial statements in respect of one or more prior periods** in accordance with the applicable financial reporting framework.

CORRESPONDING FIGURES:

Comparative information where **amounts and other disclosures for the prior period** are included **as an integral part of the current period** financial statements and **are intended to be read only** in relation to amounts and other disclosures **relating to the current period** (current period figures).

COMPARATIVE FINANCIAL STATEMENTS: [NOT RELEVANT FOR EXAMS]

Comparative information where amounts and other disclosures for the prior period are included for comparision with financial statements of the current period but, if audited, are referred in the auditors opinion. The level of Information included in those comparative financial statements is comparable with that of the financial statements of the current period.

B. OPINION OF AUDITORS ON COMPARATIVE INFORMATION:

The audit reporting **differs between the approaches are**:

1. For **corresponding figures**, **the auditor's opinion** on the financial statements **refers to the current period only**, whereas
2. For **comparative financial statements**, the **auditor's opinion refers to each period** for which financial statements are presented.

C. AUDIT PROCEDURES FOR COMPARATIVE INFORMATION:

1. PERFORM SPECIFIC AUDIT PROCEDURE:

a. Ensure that **comparative information agrees with the amount and other disclosure** presented in **the prior period**. (E.g., Compare CY Balance Sheet with LY Balance Sheet)

b. The **accounting policies applied are consistent** with those applied in current period.

c. Any **changes in the accounting policies** than they are properly **disclosed and presented**.

2. **EVALUATING THE IMPACT ON FINANCIAL STATEMENT:** If the auditor **identifies / aware of any possible misstatement** in the comparative information, then:
   a. He should **perform the necessary audit procedures** to obtain sufficient audit evidence.
   b. If the auditor had **audited the prior period's financial statement** than he should follow the relevant requirements of SA 560.

3. **WRITTEN REPRESENTATION:** As required by SA 580, the auditor **should also request written representation**. He should also obtain a **specific written representation regarding any prior period item** that is disclosed in current year's financial statement.

D. AUDIT REPORTING:

1. **W.R.T. CORRESPONDING FIGURES:** When corresponding figures are presented, the **auditor's opinion shall not** refer to the corresponding figures **EXCEPT**:
   a. If the **auditor's report of the previous period** contains **Modified Opinion**.
   b. **A MMS EXIST in the financial statement of prior period**, which was **not addressed earlier**.
   c. If the **prior period financial statement is not audited**, then he should **obtain sufficient audit evidence** that **the opening balance does not contain any material misstatement**.

2. **W.R.T. COMPARATIVE FINANCIAL STATEMENT:**

REFER MAIN MATERIAL. [NOT IMP FOR EXAMS]

3. **COMMON REPORTING TREATMENT FOR BOTH THE APPROACHES: (TO BE MENTIONED IN "OMP")**
   a. **PP F/S AUDITED BY PREDECESSOR AUDITOR:** The **auditor** shall **state in his audit report:**
      i. That the **financial statements of the prior period** were **audited by a predecessor auditor**.

ii. The **type of the opinion expressed by the predecessor auditor**.
iii. The **date of that audit report**.

b. **PP F/S NOT AUDITED:** He **shall report the same in other matter paragraph** in his audit report that the **corresponding / comparative figures are unaudited**.

However, **the disclosure does not relieve** him from his **responsibility of obtaining sufficient appropriate audit** evidence **that the opening balances do not contain misstatements**. [SA 510 REQUIREMENT]

SA 260 - COMMUNICATION TO THOSE CHARGED WITH GOVERNANCE [TCWG]

A. OBJECTIVE:

1. To **communicate clearly with TCWG**:
   a. The **auditor is responsible for forming and expressing an opinion** on the financial statements that have been prepared by management with the oversight of those charged with governance and
   b. The **audit of the financial statements does not relieve management** or **TCWG** of **their responsibilities**.
2. **To obtain from TCWG information relevant to the audit.**
3. **To provide TVWG** with **timely observations arising from the audit that are significant and relevant** and
4. To **promote effective two-way communication** between the auditor and TCWG.

B. MATTERS TO BE COMMUNICATED TO TCWG:

1. **RESPONSIBILITIES OF THE AUDITOR. [WRITE POINT A (1) OF ABOVE].**
2. **PLANNED SCOPE AND TIMING OF AUDIT:** The **planned scope and timing of the audit**, which includes communicating about the **significant risks identified by the auditor**.

3. **SIGNIFICANT FINDINGS FROM THE AUDIT:**
   a. The **auditor's views about significant qualitative aspects of the entity's accounting practices**.
   b. **Significant difficulties,** if any, **encountered during the audit**. **[Refer Pronouncements for more discussion]**

c. **Circumstances** that **affect the form and content of the auditor's report**
d. **Any other significant matters** in the **auditor's professional judgment**, are relevant.
e. **Written representations** the auditor is requesting.

SA 610 - USING THE WORK OF AN INTERNAL AUDITOR

A. DEFINITIONS:

1. **Internal audit function:** It is a function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.

2. **Direct assistance:** Direct assistance means the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

B. USING THE WORK PERFORMED BY INTERNAL AUDITOR (Type 1):

1. EVALUATION PROCESS:

The **external auditor shall evaluate** the following before using the work performed by IAF:

a. **Independence and Objectivity of IAF** in the overall organization.
b. The **level of competence** of the internal audit function and
c. Whether they follow **a systematic and disciplined approach**, including quality control.

2. PROHIBITION ON TYPE 1 WORK:

The **external auditor shall not use the work:**

a. The function is **lacking Independence and objectivity**.
b. The function **lacks sufficient competence** or
c. The function **does not apply a systematic and disciplined approach**, including quality control.

3. NATURE AND EXTENT OF WORK OF INTERNAL AUDIT FUNCTION THAT CAN BE USED:

a. **AREAS OF WORK:** The external auditor can use IAF work in the following:
   i. Testing of the **operating effectiveness of controls**.
   ii. **Substantive procedures** involving **limited judgment**.
   iii. Observations of **inventory counts**.

iv. **Testing of compliance** with **regulatory requirements**.

v. Audits or **reviews of the financial information** of **subsidiaries** that are **not significant** components to the group.

b. **NO UNDUE USE OF IAF:** The **external auditor shall make all significant judgments** and **Further to prevent undue use**, shall plan to **use less of the work of the function** and **perform more of the work directly**.

c. **Check the external auditor is being sufficiently involved** in the audit in spite of using IAF work as planned.

d. **Communicate to TCWG** how the external auditor has **planned to use the work of the IAF**.

4. **MANNER OF USING THE WORK:**

a. **Discussion and Coordination with the Internal Audit Function.**

b. **Read the reports of the IAF** to obtain an understanding of the **nature and extent of audit procedures they performed and the related findings**.

c. **Evaluating whether:**

i. **IAF properly planned, performed, supervised, reviewed and documented the work**.

ii. They **obtained S & A A/E to draw reasonable conclusions** and

iii. **Conclusions reached are appropriate in the circumstances** and

iv. **The reports prepared by** them are **consistent with the results of the work performed**.

C. USING INTERNAL AUDIT FUNCTION TO PROVIDE DIRECT ASSISTANCE (Type 2):

1. **EVALUATION PROCESS:**

The external auditor **shall evaluate** the following **before taking Direct assistance** from IAF:

a. Whether the **internal auditors possess objectivity and independence**. [For Detailed Content – Refer Main material]

b. Whether the internal auditors are **having necessary skill and competence**.

2. PROHIBITION ON TYPE 2:

The external auditor **shall not use an internal auditor** to provide direct assistance if:

a. **significant threats to the objectivity** of the internal auditor; or
b. The internal auditor **lacks sufficient competence** to perform the proposed work.

3. AREAS WHERE IAF CANNOT BE USED FOR DIRECT ASSISTANCE:

The external auditor **shall not use internal auditors to provide direct assistance in the following areas**:

a. **Areas involve making of significant judgment**s in the audit.
b. **Areas relate to higher assessed risks** of material misstatement.
c. **Areas relate to work** with which **the internal auditors have been already involved.**

SA 620 – USING THE WORK AN AUDITOR'S EXPERT

A. IMPORTANT DEFINITION'S:

AUDITOR'S EXPERT:

1. An individual or organisation **possessing expertise in a field other than accounting or auditing**, whose work in that field is **used by the auditor** to assist the auditor **in obtaining sufficient appropriate audit evidence**.
2. An auditor's expert **may be either an auditor's internal expert** or **an auditor's external expert**.

MANAGEMENT'S EXPERT:

An individual or organisation **possessing expertise in a field other than accounting or auditing**, whose work in that field **is used by the entity to assist the entity in preparing the financial statements.**

B. SOLE RESPONSIBILITY – AUDITORS ONLY:

The **AUDITOR HAS sole responsibility for the audit opinion expressed**, and that responsibility is **not reduced by the auditor's use of the work of an auditor's expert**.

C. FACTORS FOR DETERMINING THE NEED OF AN EXPERT AE or ME:

1. AN AUDITOR'S EXPERT MAY BE NEEDED IN **ONE OR MORE OF THE FOLLOWING:**

a. **While obtaining an understanding of the entity and its environment**, including its internal control.
b. While **Identifying and assessing the risks of material misstatement**.
c. Determining and implementing **overall responses to assessed risks at the financial statement level**.
d. Designing and **performing further audit procedures to respond to assessed risks.**
e. **Evaluating the sufficiency and appropriateness of audit evidence obtained**.

2. AUDITOR UNDERSTANDING OF OTHER FIELD:

An auditor **who is not an expert in a relevant field** other than accounting or auditing. This **understanding may be obtained through**:

a. **Experience in auditing entities that require such expertise** in the preparation of their financial statements.
b. **Education or professional development in the particular field**. This may include:
   i. **Formal courses**, or
   ii. **Discussion with individuals possessing expertise**.
c. **Discussion with other auditors who have performed similar engagements.**

D. CONSIDERATIONS WHEN DECIDING WHETHER TO USE AN AUDITOR'S EXPERT:

The following **considerations will be taken into account** in deciding **whether to use an auditor's expert**:

1. The **nature and significance of the matter**.
2. The **risks of material misstatement** in the matter.
3. The expected nature of procedures to respond to identified risks, including the **auditor's knowledge of and experience with the work of experts in relation to such matters** and
4. The **availability of alternative sources of audit evidence**.
5. **If management has used a management's expert** 1st Point in main material**:**
   The **following additional factors** shall also be considered:
   a. The **nature, scope and objectives of the management's expert's** work.
   b. Whether the management's expert is:
      i. **employed by the entity**, or

ii. is **a 3rd party engaged by it to provide relevant services**.

c. Management's **Control or influence over the work of the management's expert**.
d. The management's expert's **competence and capabilities**.
e. Whether the **management's expert is subject to technical performance standards or other professional** or industry requirements.

E. NTE OF AUDIT PROCEDURES INFLUENCED BY AUDITORS EXPERT'S WORK:

1. In determining the **NTE of audit procedures**, the **auditor shall consider**:
   a. The **nature of the matter** to which that **expert's work relates**.
   b. The **risks of material misstatement in the matter** to which that expert's work relates.
   c. The **significance of that expert's work** in the context of the audit.
   d. The **auditor's knowledge of and experience with** previous work performed by **that expert** and
   e. **Whether that expert is subject to the auditor's firm's quality control policies and procedures**.

2. In the following cases generally **more extensive audit procedures** would require:
   a. The **work of the auditor's expert relates to a significant matter that involves subjective and complex judgments.**
   b. The **auditor has not previously used the work of the auditor's expert**, and has **no prior knowledge of that expert's competence, capabilities and objectivity**.
   c. The **auditor's expert is performing procedures that are integral to the audit**.
   d. The **expert is an auditor's external expert** and is **not subject to the firm's quality control policies and procedures**.

F. EVALUATE – COMPETENCE, CAPABILITY AND OBJECTIVITY OF AUDITOR's EXPERT:

1. Evaluate **whether the auditor's expert** has the **necessary competence, capabilities and objectivity** for the auditor's purposes.
2. **EXTERNAL EXPERT OBJECTIVITY: In the case of an auditor's external expert**, the evaluation of objectivity **shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity**. The **following evaluations shall be made:**
   a. **Inquire of the entity about any known interests or relationships with the auditor's external expert.**

b. **If relationship exist, discuss with that expert any applicable safeguards to reduce the threat** *see point in main material* **to acceptable level** and
c. **REPRESENTATION FROM EXPERT** about **any interests or relationships with the entity** of which that expert is aware.
3. **Whether the expert's work is subject to technical performance standards or other professional** or industry requirements, ethical standards and **other membership requirements.**
4. The **Evaluation of Experts competence is a continuous process.**

G. ENTER INTO AGREEMENT WITH THE AUDITOR'S EXPERT:

The **auditor shall agree, in writing** on the following matters with the auditor's expert:

1. The **nature, scope and objectives of that expert's work**.
2. The **respective roles and responsibilities** of the auditor and that expert.
3. The **nature, timing and extent of communication** and
4. The need for the **auditor's expert to observe confidentiality requirements**.

H. EVALUATING THE ADEQUACY OF THE AUDITOR'S EXPERT WORK:

The auditor shall **evaluate the adequacy of the auditor's expert's work for the auditor's purposes**, including:

1. The **relevance and reasonableness of that expert's findings or conclusions,** and **their consistency with another audit evidence.**
   a. **Inquiries** of the auditor's expert.
   b. **Reviewing the auditor's expert's working papers** and reports.
   c. **Corroborative procedures. [Refer Main Material for detailed explanation] [E.g., Observation, 3rd party confirmations]**
2. **The relevance and reasonableness of Significant assumptions and methods** in the circumstances and
3. **The relevance, completeness, and accuracy of that source data**.

I. WHEN THE WORK OF AUDITORS EXPERT IS *NOT ADEQUATE*:

1. If the **auditor determines that the work of the auditor's expert** is **not adequate for the auditor's purposes**, the auditor shall:
   a. **REQUEST FOR FURTHER WORK:** Agree with that expert on the nature and extent of **further work** to be performed by that expert; or

b. **Perform further audit procedures.**

2. **NO EVIDENCE – MODIFIED OPINION:** If the **auditor cannot resolve the matter through the additional audit procedures**, which may involve further work being performed by both the expert and the auditor, or include employing or engaging another expert, **it may be necessary to express a modified opinion because the auditor has not obtained sufficient appropriate audit evidence.**

J. REPORTING REFERENCE IN AUDITORS REPORT [ABOUT AUDITORS EXPERT]:

1. **UMO – No Reference:** The auditor **shall not refer** to the work of an auditor's expert in an auditor's report containing an unmodified opinion ***unless required by law or regulation to do so***. If such reference is required by law or regulation, the auditor **shall indicate** in the auditor's report that the ***reference does not reduce the auditor's responsibility*** for the audit opinion.

2. **MO – Refer, if necessary for better understanding:** If the auditor may refer to the work of an auditor's expert in the auditor's report **because such reference is relevant to an understanding** nature of a modification to the auditor's opinion. Further the auditor shall indicate in the auditor's report that such ***reference does not reduce the auditor's responsibility*** for that opinion.

PART – II LEGAL AND OTHER REGULATORY REQUIREMENTS

A. DUTY OF AUDITOR TO INQUIRE ON CERTAIN MATTERS u/s 143(1):

It is the duty of auditor to inquire into the following matters:

1. Whether **loans and advances made by the company on the basis of security:**
   a. Have been **properly secured** and
   b. **Whether the terms on which they have been made** are **prejudicial to the interests** of the company or its members.
2. Whether **transactions of the company** which are **represented merely by book entries** are prejudicial to the interests of the company.
3. Whether **any Shares or Securities held by the company are sold at a price less than purchase price. However, this point shall not apply to banking and investment companies**.
4. Whether **loans and advances made by the company** have been **shown as deposits**.
5. Whether **personal expenses have been charged to revenue account.**
6. Where **it is stated in the books** and documents of the company **that any shares have been allotted for cash**:
   a. **Whether cash has actually been received** in respect of such allotment and
   b. If **no cash has actually been received**, the **position as stated** in the account books and the **balance sheet is correct**, regular and not misleading.

Reporting Requirements: If the auditor got a positive response he can ignore above matters. However, if there are any negative or adverse comments observed then he shall state them in his report along with reasons.

In the audit report these matters should be included under the section "reporting on legal and other regulatory requirements".

B. DUTY OF AUDITOR TO REPORT ON CERTAIN MATTERS u/s 143(3):

The auditor's report **shall also state:**

a. Whether he has **sought and obtained all the information** and explanations which to the best of his knowledge and belief were

necessary for the purpose of his audit.

b. Whether, **in his opinion, proper books of account** as required by law have been **kept by the company so far as appears** from his examination of those books and **proper returns adequate for the purposes of his audit** have been **received from branches not visited by him.**

c. Whether the **report on the accounts of any branch office** of the company **audited by a person other than the company's auditors** (Branch auditor) has **been sent to him** and **How he has dealt** with it in preparing his report.

d. Whether the **company's balance sheet and profit and loss** account (Financial Statements) dealt with in the report **are in agreement with the books of account** and returns.

e. Whether, in his opinion, the **financial statements comply with the accounting standards.**

f. The **observations or comments of the auditors** on **financial transactions or matters which have any adverse effect** on the functioning of the company.

g. Whether **any director is disqualified from being appointed** as a director under sub- section (2) of the section 164.

h. Any **qualification, reservation or adverse remark relating to the maintenance of accounts** and other matters connected therewith.

i. Whether the **company has adequate internal financial controls w.r.t financial statements** in place and the operating effectiveness of such controls **(Ref - Note 1)**

j. **Such other matters as may be prescribed:** The following matters prescribed under Rule 11 of Company Audit and auditors rules, namely:

   I. Whether the **company has disclosed the impact of pending litigations** on its financial position in its financial statement.

   II. Whether the **company has made provision, as required under any law or accounting standards**, for material foreseeable losses, if any, on long term contracts including derivative contracts.

   III. Whether there has been **any delay in transferring amounts,** required to be transferred, **to the Investor Education and Protection Fund by the company**.

   IV. **NEWLY ADDED IN 2021:**

      i. Whether the **management has represented** that, to the best of it's knowledge and belief, **other than as disclosed in the notes to the accounts**, **no funds have been *advanced or loaned or invested*** (either from borrowed funds or share premium or any other sources or kind of funds) **by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"),** with the understanding, whether recorded in writing or otherwise, **that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified** in any manner whatsoever **by or on behalf of the company ("Ultimate Beneficiaries**") or **provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries.**

ii. Whether the **management has represented**, that, to the best of its knowledge and belief, **other than as disclosed in the notes to the accounts**, **no funds have been *received* by the company** from **any person(s) or entity(ies), including foreign entities ("Funding Parties"),** with the understanding, whether recorded in writing or otherwise, **that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified** in any manner whatsoever **by or on behalf of the Funding Party** ("Ultimate Beneficiaries") or **provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries.**

iii. Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, **nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) and (ii) contain any material misstatement**.

V. Whether the **dividend declared or paid during the year** by the company is in compliance with section 123 of the Companies Act, 2013.

VI. [Whether the company, in respect of financial years commencing on or after the 1st April, 2022] has used such accounting software for maintaining its books of account which has a **feature of recording audit trail (edit log) facility and the same has been** operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.]

AUDIT TRAIL MEANS, *a step-by-step sequential record which provides evidence of the documented history of financial*

transactions to its source. An auditor can trace every step of the financial data of a particular transaction right from the general ledger to its source document with the help of the audit trail.

NOTE 1: The provisions of **internal financial controls shall not apply** for the following private limited companies:

1. **One Person company**.
2. **Small company**.
3. A **Private company** satisfying the **following conditions**-
    a. **Turnover** as per latest financial statements **shall not exceed Rs. 50 Crore** and
    b. **Loans and Borrowings** from banks and financial institutions **shall not exceed Rs. 25 Crore**.

NOTE 2: "The auditor of the company shall, in his report under section 143, make a statement as to **whether the remuneration paid by the company to its directors is in accordance with the provisions of this section**, whether remuneration paid to any director is in excess of the limit laid down under this section and give such other details as may be prescribed". [**This provision is applicable only for PUBLIC COMPANIES**]

Audit Reporting requirements:

a. The auditor shall report on the above matters irrespective of positive or negative remarks observed by him.
b. Further he shall state these matters under the section "reporting on legal and other regulatory requirements".

C. DUTY TO REPORT AS PER CARO 2020:

Applicability Provisions – Please Read from Main Material

21 CLAUSES TO BE REPORTED

[These clauses shall be reported as part of Auditors Report as referred under SA 700 under the para / section "REPORTING ON OTHER LEGAL AND REGULATORY REQUIREMENTS]

1. FIXED ASSETS: (MODIFIED IN CARO 2020)

a. **FIXED ASSET REGISTER:** Whether the company **is maintaining proper records** showing full particulars including
   I. **Quantitative details of PPE** and Intangible Assets (Fixed Assets) and
   II. **Situation of PPE**.

b. **PHYSICAL VERIFICATION**:
   i. Whether these fixed assets **have been physically verified** by the management **at reasonable intervals**.
   ii. Whether **any material discrepancies were noticed** on such verification and if so, whether the **same have been properly dealt with in the books** of accounts.

c. **IMMOVABLE PROPERTY:** Whether the **title of immovable properties** is held **in the name of the company**. **If not**, **provide the details** of the same:
   I. Description of the Property
   II. Gross Carrying Value
   III. Held in Name of (I.e., Promoter or director or employees)
   IV. Reason for Not being held in name of Company.

d. **REVALUATION (NEWLY ADDED IN 2020):**
   Whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so:
   i. **Whether the revaluation is based on the valuation by a Registered Valuer.**
   ii. **Specify the amount of change**, **if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets.**

e. **DISCLOSURE OF BENAMI TRANSACTIONS (NEWLY ADDED IN 2020):**
   Whether **any proceedings have been initiated or are pending against the company** for holding any benami property **under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules** made there under, if so, whether the company has appropriately disclosed the details in its financial statements.

2. INVENTORIES: (MODIFIED IN CARO 2020)

a. **PHYSICAL VERIFICATION:**

I. Whether **physical verification of inventory has been conducted at reasonable intervals** by the management.

II. Whether **any discrepancies of 10% or more in the aggregate for each class of inventory** were noticed and if so, whether **they have been properly dealt with in the books** of account.

b. **WORKING CAPITAL LOANS (NEWLY ADDED IN 2020):**

I. Whether during any point of time of the year, the company has been **sanctioned working capital limits in excess of 5 crore rupees**, **in aggregate, from banks or financial institutions on the basis of security of current assets.**

II. Whether the **quarterly returns or statements** filed by the company with such banks or financial institutions **are in agreement with the books of account** of the Company, if not, give details.

3. INVESTMENTS, GUARANTEE, SECURITY, LOANS OR ADVANCES (MODIFIED IN 2020):

a. APPLICABILITY: Whether during the year the company **has provided loans or provided advances in the nature of loans**, or **stood guarantee**, or **provided security to any other entity** [not applicable to companies whose principal business is to give loans], **if so, indicate**:

I. **TO RELATED PARTIES:** The **aggregate amount during the year**, and **balance outstanding** at the balance sheet date with respect to such loans or advances and guarantees or **security to subsidiaries, joint ventures and associates.**

II. **TO UNRELATED PARTIES:** The **aggregate amount during the year,** and **balance outstanding** at the balance sheet date with respect to such loans or advances and guarantees or security **to parties OTHER THAN subsidiaries, joint ventures and associates.**

b. TERMS AND CONDITIONS:

Whether the investments made, guarantees provided, security given and the **terms and conditions** of the grant of all loans and advances in the nature of loans and guarantees provided **are not prejudicial to the company's interest.**

c. REPAYMENT REGULARITY:

In respect of loans and advances in the nature of loans, whether the schedule of **repayment of principal and payment of interest** has been stipulated and whether the repayments or receipts are **regular**.

d. OVERDUE > 90 DAYS:

If the amount is overdue, **state the total amount overdue for more than 90 days,** and whether **reasonable steps have been taken** by the company for recovery of the principal and interest.

e. RESCHEDULING OR EXTENTION OF OVERDUE LOANS (NEWLY ADDED IN 2020):

Whether any loan or advance in the nature of loan granted which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, if so,

I. **Specify the aggregate amount** of such **dues renewed or extended or settled by fresh loans** and
II. The **percentage of the aggregate to the total loans or advances** in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans].

f. DEMAND LOANS WITHOUT REPAYMENT PERIOD:

Whether the company **has granted any loans or advances** in the nature of loans either **repayable on demand or without specifying any terms or period of repayment,** if so,

I. **Specify the aggregate amount**, **percentage thereof to the total loans granted,**
II. **Aggregate amount of loans granted to Promoters, related parties** as defined in clause (76) of section 2 of the Companies Act, 2013

4. OTHER LOANS, INVESTMENTS, GUARANTEES MADE BY COMPANY: (SAME AS CARO 2016)

In respect of loans, Investments, Guarantees, and securities provided by company, whether provisions of section 185 & 186 have been complied with? If not, provide the details thereof.

5. DEPOSITS: (SAME AS CARO 2016)

In case the company has accepted deposits from the public,

a. **Verify the compliance** with the following:
   I. the provisions of **Sections 73 to 76** of the Co.'s Act, 2013 or
   II. whether the **directives issued by the RBI** and
   III. An **order passed by CLB or any court or any other Tribunal**, if any.

b. If there is **any Non-compliance, the nature of contraventions should be stated.**

6. COST RECORDS: (SAME AS CARO 2016)

a. **Whether maintenance of cost records has been prescribed** by the Central Government under sub section (1) of section 148 of the Co.'s Act, 2013 is applicable.
b. **If applicable, whether such accounts and records have made and maintained.**

7. STATUTORY DUES: (SAME AS CARO 2016)

a. UNDISPUTED DUES:

I. **Is the company regular in depositing undisputed statutory dues** e.g., provident fund, ESI, Income Tax, service tax and any other statutory dues **with the appropriate authorities**, and
II. **if not**, the **extent of the arrears of outstanding statutory** dues as at the last day of the financial year concerned **for a period of more than 6 months from the date**, they became payable, **shall be indicated by the auditor**. (Only Information and not opinion)

b. DISPUTED DUES:

In case **dues have not been deposited on account of any dispute**, the auditor shall indicate

I. The **amounts involved in dispute** and
II. The **forum where dispute is pending**.

8. DISCOVERY OF UNDISCLOSED INCOME (NEWLY ADDED IN 2020):

Whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year. (Author Note: May Be treated as prior period items in the accounting records)

9. DEFAULT IN REPAYMENT OF DUES:

a. LENDER WISE DEFAULT:

I. Whether the company has **defaulted in repayment of borrowings of loans to a financial institution, Bank, Debenture holders or Governments**.
II. **If so**, the **period and amount of default to be reported** each lender

wise in the following Format:

- Nature of Borrowing
- Name of the lender
- Amount Not Paid on Due Date
- Whether Principal or Interest or both
- Delay in Days
- Remarks, if any.

b. **WILFUL DEFAULTER (NEWLY ADDED IN 2020):**
Whether the **company is a declared willful defaulter** by any bank or financial institution or other lender.

c. **PURPOSE OF TERM LOANS:**
Whether **term loans were applied for the purpose for which the loans were obtained**; if not, the amount of loan so diverted and the purpose for which it is used may be reported.

d. **ST LOAN FOR LT PURPOSE (NEWLY ADDED IN 2020):**
Whether funds raised on short term basis have been utilized for long term purposes, if yes, the nature and amount to be indicated.

e. **LOANS TAKEN TO MEET SUBSIDIARY COMPANY NEEDS (NEWLY ADDED IN 2020):**
Whether the **company has taken any funds from any entity or person** on account of or **to meet the obligations of its subsidiaries, associates or joint ventures**, if so, details thereof with nature of such transactions and the amount in each case.

f. **LOAN AGAINST PLEDGE OF SECURITES OF SUBSIDIARIES:**

I. Whether **the company has raised any loans** during the year **"ON PLEDGE OF SECURITIES HELD IN SUBSIDIARY/ASSOCIATE/JOINT VENTURE** and if So, Give details thereof

II. Also report **whether the company has defaulted in repayment of such loans**.

10. END USE OF FUNDS RAISED:

a. **IPO / FPO:**

I. Whether the **money raised by way of initial or further public offer** (including debt instruments) were **utilized for the purposes for which those are raised**.

II. If not, the details along with the defaults, delays & subsequent rectifications, if any, to be reported.

b. PREFERENTIAL ALLOTMENT:

I. Whether the company **has made any preferential allotment or private placement** of shares or fully or partly convertible debentures during the year under review &

II. If so, verify the following:

- **Compliance with section 42** of the act. and
- The **amount raised have been used for the purpose** for which they are raised.

III. If not provide the details in respect of the amount involved & nature of non-compliance

11. REPORTING OF FRAUDS:

a. NOTICED OR REPORTED:

I. Whether **any fraud by the company** or whether **any frauds on** the company has been **noticed or reported during the year**.

II. If yes, the nature and the amount involved is to be indicated.

b. SEC. 143(12) – FRAUD (NEWLY ADDED IN 2020):

Whether **any report under sub-section (12) of section 143** of the Companies Act has been **filed by the auditors in Form ADT-4** as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government.

c. WHISTLE BLOWER COMPLAINTS (NEWLY ADDED IN 2020):

Whether the auditor has considered whistle-blower complaints, if any, received during the year by the company.

12. NIDHI COMPANY: (SAME AS CARO 2016)

a. Whether Nidhi Company has **complied with the net owned funds (i.e., net worth) to deposits** in the ratio of **1:20** to meet out the liability.

   i.e., for every one rupee of net owned funds, Nidhi company cannot accept more than 20 rupees of deposits.

b. Whether **Nidhi Company is maintaining 10% Unencumbered term deposits** as specified in Nidhi Rules, 2014 to meet out the liability.

c. Whether **there has been any default in payment of interest on deposits or repayment thereof for any period** and if so, the details thereof.

13. RELATED PARTY TRANSACTION: (SAME AS CARO 2016)

Whether all transaction with related parties is

a. In **compliance with section 177 & 188** where applicable, &
b. Details have been **disclosed in the financial statements** etc., as **required by applicable accounting standards**.

14. INTERNAL AUDIT SYSTEM (NEWLY ADDED IN CARO 2020):

a. **Whether the company** has an internal audit system commensurate with the size and nature of its business.
b. **Whether the** reports of the Internal Auditors **for the period under audit** were considered by the statutory auditor.

15. NON-CASH TRANSACTION: (SAME AS CARO 2016)

Whether Company has entered into any Non-Cash Transactions **with** directors **& if so provisions of section 192 have been complied with.**

16. ON-BANKING FINANCIAL INSTITUTION (MODIFIED IN 2020):

a. **45IA OF RBI ACT:** Whether the **company is required to be registered under section 45-IA** of Reserve Bank of India Act 1934, and If so, whether the registration has been obtained.
b. **NBFC ACTIVITIES (NEW):** Whether the company has **conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR)** from the Reserve Bank of India as per the Reserve Bank of India Act, 1934.
c. **CORE INVESTMENT COMPANY (NEW):**
   I. Whether **the company is a Core Investment Company** (CIC) as defined in the regulations made by the Reserve Bank of India, if so,
   II. Whether **it continues to fulfil the criteria of a CIC**, and **in case the company is an exempted** or unregistered CIC, whether it **continues to fulfil such criteria**.
   III. Whether the **Group has more than one CIC** as part of the Group, if yes, **indicate the number of CICs** which are part of the Group.

17. CASH LOSSES (NEWLY ADDED IN 2020):

Whether the company has incurred cash losses in the financial year and in the immediately preceding financial year**, if so,** state the amount of cash losses.

18. RESIGNATION OF AUDITORS (NEWLY ADDED IN 2020):

a. **Whether there has been** any resignation of the statutory auditors during the year**, if so,**

b. **Whether the** auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors**.**

19. MATERIAL UNCERTAINITY (NEWLY ADDED IN 2020):

On the basis of the financial ratios, ageing and expected dates of realisation of financial assets and payment of financial liabilities, other information accompanying the financial statements, the auditor's knowledge of the Board of Directors and management plans, **Whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report that company is capable of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of 1 year from the balance sheet date.**

20. CORPORATE SOCIAL RESPONSIBILITY FUND (NEWLY ADDED IN 2020):

a. Whether, in respect of other than ongoing projects**, the company has transferred unspent amount to a Fund** specified in Schedule VII to the Companies Act **within a period of 6 months of the expiry of the financial year** in compliance with second proviso to sub-section (5) of section 135 of the said Act.

b. **Whether** any amount remaining unspent **under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project,** has been transferred to special account **in compliance with the provision of sub-section (6) of section 135.**

21. MODIFIED OPINION (CARO) IN OTHER GROUP COMPANIES (NEWLY ADDED IN 2020):

a. *Whether there have been* ***any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the consolidated financial statements,***

b. if yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.

AUDIT REPORTING:

a. The **reporting under the above matters is mandatory**. Means whether it is positive or negative the auditor must comment.

b. Where the **response obtained for the above matters is negative**, the **auditor shall give reasons thereof.**

Also, **where the auditor is unable to express any opinion** on any specified matter, his report **shall indicate such fact together with the reasons why it is not possible** for him to give his opinion on the same.

3. PROFESSIONAL ETHICS

FUNDAMENTAL PRINCIPLES THAT GOVERN A PROFESSIONAL ACCOUNTANT, SAY, AN AUDITOR

The fundamental principles as **discussed in Code of Ethics of ICAI are given below**:

A. INTEGRITY:

1. All professional accountants to be **straightforward and honest in both Professional and Business relationships**.
2. Professional Accountant **should not be associated with reports, returns, communications** or other information **that:**
    a. Contains a **materially false or misleading statement**.
    b. Contains statements or information **furnished recklessly**.
    c. **Omits or obscures (unclear) information** where such omission or obscurity **would be misleading**.
3. If the **professional accountant expresses a modified report** in respect of **above cases**, then he shall **not consider to be in breach**.

B. OBJECTIVITY:

1. All Professional Accountants **must not to compromise** their professional or business judgment **because of bias, conflict of interest or the undue influence** of others.
2. **Relationships** that **bias or unduly influence** the professional judgment of the professional accountant **should be avoided.**

C. PROFESSIONAL COMPETENCE AND DUE CARE:

1. The objective is:
    a. To **maintain professional knowledge and skill** at the level required.

b. To **act diligently in accordance with applicable** technical and professional **standards**.

2. Professional competence is divided into **2 parts:**
   a. **Attainment** of competence and
   b. **Maintenance** of competence.
3. **DELIGIENCE:** Diligence requires an accountant **to act carefully, thoroughly and on timely basis**. Professional accountant should take steps to **ensure that those working under** the professional accountant **have appropriate training and supervision**.

D. CONFIDENTIALITY:

1. A professional accountant shall comply with the principle of confidentiality, which **requires an accountant to respect the confidentiality of information acquired as a result of professional and employment relationships** which **may be present or prospective**.
2. **without proper and specific authority**, **UNLESS there is a legal or professional duty or right to disclose or**
3. **Even, shall maintain confidentiality even in a social environment**.
4. **Even after end of the relationship with client or employer** as required under legal and professional standards.
5. **CIRCUMSTANCES EXCEPTION TO CONFIDENTIALITY:** In the following cases the professional accountants **are permitted to disclose confidential information** to outsiders if:
   a. **Required by Law.**
   b. It is **permitted by law and authorized by client**. [E.g., Production of documents in the course of legal proceedings]
   c. **Professional Duty or right to disclose:**
      i. To **comply with Peer Review or Quality Reviews**.
      ii. To **respond to an inquiry in an investigation by regulatory.**
      iii. To **comply with technical and professional standards.**
6. **FACTORS FOR DISCLOSING:** Refer Main Material.

E. PROFESSIONAL BEHAVIOUR:

1. Professional accountant **shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation** of the profession.

2. In marketing and promoting themselves and their work, **professional accountants should not bring the profession into disrepute [Discredit]**. Professional accountants should be honest and truthful and **should not:**
   a. **Make exaggerated claims.**

b. **Make disparaging references** or unsubstantiated comparisons to the work of others. (E.g., Degrading fellow members)
c. **Any direct or indirect measures to advertise which are in violation of Advertisement Guidelines.**

CONFLICT ARISES ON FUNDAMENTAL PRINCIPLES:

1. A professional accountant **might face a situation in which complying with one fundamental principle**, **conflict with complying with one or more other fundamental principles**. In such a situation, the accountant might **consider consulting, with**:
   a. Others within the client or employing organisation.
   b. Those charged with Governance.
   c. **The Institute**.
   d. **Legal Counsel**.
2. He shall **exercise his professional judgment in resolving** the conflict or **dis-associate from the matter creating conflict**.

THE CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS AS PER IFAC IDENTIFIES DIFFERENT TYPES OF THREATS TO INDEPENDENCE OF AUDITORS

PART 1: IDENTIFICATION THE THREATS:

The Fundamental Principles are threatened by **range of threats which are broadly classified into the following types:** (As per International Federation of Accountants)

A. SELF INTREREST THREATS: The threat that **a financial or other interest** will **INAPPROPRIATELY influence a professional accountant's judgment** or behaviour.

Examples:
1. Having a **direct financial interest in a client**
2. **Undue dependence on total fees** from a client.
3. Having **a close business relationship** with a client.
4. **Concern about the possibility of losing a client**.
5. **Potential employment** with a client.
6. **Contingent fees** relating to an assurance engagement.

B. SELF REVIEW THREATS: The threat that a professional accountant will **not appropriately evaluate the results of a previous judgment made.**

Examples:

1. The discovery of a **significant error during a re-evaluation** of the work of the professional accountant in public practice.
2. Reporting on the operation of financial systems **after being involved in their design or implementation.**
3. Having prepared the original data used to generate records **that are the subject matter of the engagement.**
4. A member of the assurance team being, or having recently **been, a director or officer of that client**.

C. ADVOCACY THREATS: The threat that a professional accountant will **promote a client's or employing organization's position to the point that the accountant's objectivity is compromised.**

Examples:

1. Promoting shares in a listed entity when **that entity is a financial statement audit client.**
2. **Acting as an advocate on behalf of an assurance client** in litigation or disputes with third parties.
3. **lobbying in favour of legislation** on behalf of a client.

D. FAMILIARITY THREATS: The threat that **due to a long or close relationship with a client, or employing organization**, a professional accountant **will be too sympathetic to their interests** or too accepting of their work.

Examples:

1. A member of the engagement team having **a close or immediate family relationship with a director or officer** of the client.
2. **A former partner of the firm being a director or officer** of the client or an employee in a position to exert direct and significant influence over the subject matter of the engagement.
3. **Accepting gifts or preferential treatment from a client**, unless the value is clearly insignificant.
4. **Long association of senior personnel with the assurance client.**

E. INTIMIDATION THREATS: The threat that a professional **accountant will be deterred from acting objectively because of actual or perceived pressures**, including attempts to exercise undue influence over the accountant.

Examples:

1. Being **threatened with dismissal or replacement** in relation to a client engagement.
2. Being **threatened with litigation.**

3. Being **pressured to reduce inappropriately the extent of work performed in order to reduce fees.**
4. Being **informed that a planned promotion will not occur** unless the accountant agrees with an inappropriate accounting treatment.

PART 2 – EVALUATION OF THREATS:

1. **Acceptable level:** An acceptable level is a level **at which a professional accountant using the reasonable and informed** third party test **would likely conclude that the accountant complies with the fundamental principles.**
2. **Reasonable and Informed Third Party:** The **reasonable and informed third party test** is a consideration by the professional accountant about **whether the same conclusions would likely be reached by another party**. The reasonable and informed **third party does not need to be an accountant but would possess the relevant knowledge and experience to understand and evaluate the appropriateness** of the accountant's conclusions in an impartial manner.

PART 3 – ADDRESSING THREATS:

1. **ELIMINATE OR WITHDRAW:** If the professional accountant determines that **the identified threats are not at an acceptable level**, the accountant **shall address the threats by eliminating them or reducing them to an acceptable level**. The accountant shall do so by:
   a. **Eliminating the circumstances**, including interests or relationships, that are creating the threats. *[E.g., Will not acquire shares]*
   b. **Applying safeguards, where available and capable** of being applied, to reduce the threats to an acceptable level. *[E.g., Makes relatives not to acquire shares]* or
   c. **Declining or ending the specific professional activity**. *[E.g., Do Not accept audit if he or his relatives has shares in the company]*
2. **COMPULSORY WITHDRAWAL FROM ENGAGEMENT:** There are some situations in which **threats can only be addressed by declining or ending the specific professional activity**. This is because the circumstances that created the **threats cannot be eliminated**, and **safeguards are not capable of being applied** to reduce the threat to an acceptable level.

SAFEGUARDS TO REDUCE OR ELIMINATE VARIOUS THREATS

Safeguards are **actions individually or in combination that the accountant takes that effectively reduce threats to an acceptable level.** The following are various safeguards that can be applied to reduce threats to an acceptable low level:

1. **Leadership qualities of the firm w.r.t fundamental principles.**
2. **Policies and procedures to implement and monitor quality controls.**
3. **Using different partners and engagement teams with separate reporting lines** for the provision of non-assurance services to an assurance client.
4. **Involving another firm** to perform or re-perform **part of the engagement**.
5. **Rotating senior assurance team** personnel.
6. **Separating teams** when **dealing with matters of a confidential nature** might address a self-interest threat.

NON-COMPLIANCE WITH LAWS AND REGULATIONS

1. **NOCLAR MEANING:**
   - **a.** Non-compliance with laws and regulations ("non-compliance") **comprises of acts of omission or commission, intentional or unintentional**, which **are contrary to the prevailing laws or regulations committed by:**
     - i. **A client**/professional accountant's employing organisation.
     - ii. **Those charged with governance** of a client or employing organisation.
     - iii. **Management of a client**/ employing organisation or
     - iv. **Other individuals working for or under the direction of a client**/ employing organisation.

2. **DO NOT INCLUDE PERSONAL MIS CONDUCT:** However, NOCLAR under Revised Code of Ethics **does not address the personal misconduct unrelated to the business activities** of the client/ employing organisation and non-compliance by parties other than listed out in the definition of NOCLAR.

3. **EXAMPLES:** As per IESBA, following examples would be covered in NOCLAR:
   - **a. Fraud, corruption and Bribery**

b. Money laundering, terrorist financing and proceeds of crime
c. Securities markets and trading
d. Banking and other financial products and services
e. Data protection
f. Environmental protection
g. Public health and safety
h. Tax and pension liabilities and payments

4. **OBJECTIVE:** The objective of NOCLAR is that - **turning a blind eye to potential NOCLAR is not an appropriate response from professional accountants,** while placing renewed emphasis on the roles of management and those charged with governance in addressing the matter.

5. Some important facts about NOCLAR are given below:
    a. **During Course of Providing a Service:** NOCLAR will be applicable **if a professional accountant encounters, or is made aware of, non-compliance or suspected non-compliance** in the course of providing a professional service to a client. He is **not required to investigate, nor responsible for ensuring compete compliance**.
    b. **Expertise of Laws not Required:** A professional accountant is **expected to apply knowledge and expertise**, and exercise professional judgment. However, **he is not expected to have a level of knowledge of laws and regulations greater than that which is required to undertake the engagement**. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.
    c. **Certain Matters Expressly out of Purview:** Matters that **are clearly inconsequential or relating to personal misconduct** pertaining to business activities of the client **not covered**.
    d. **Disclosure, which is Contrary to Law not Required:** As per IESBA Code, **disclosure of the matter to an appropriate authority** would be **precluded if doing so would be contrary to law or regulation.**

6. **Applicability of NOCLAR in India:**
    a. **Responding to Non-Compliance with Laws and Regulations (NOCLAR) applicable to Professional Accountants in service (Section 260): Applicable to Senior Professional Accountants** in service, **being employees of listed entities.**
    Senior professional accountants in service ("senior professional accountants") are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the

acquisition, deployment and control of the employing organization's human, financial, technological, physical and intangible resources.
It is further explained that **the senior professional accountants refer to key managerial personnel**.

b. **Responding to Non-Compliance with Laws and Regulations (NOCLAR) applicable to Professional Accountants in public practice (Section 360): Applicable to Audit engagements of entities** the shares of **which are listed on recognized stock exchange(s)** in India **and have net worth of 250 crores of rupees or more**.

"For the purpose of Section-360 "Audit" or "Audit engagement" shall mean **a reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether financial statements** give a true and fair view in accordance with an applicable financial reporting framework".

7. **NOCLAR vs. SA 250:**
   a. SA 250 is applicable **only on Audit**, and not on other Assurance engagements. However, **NOCLAR is applicable on professional accountants in service, and in practice.** Among those in practice, it applies to Auditors, as well as professional services other than Audit.
   b. SA 250 talks of auditor's responsibilities for laws having direct effect on the determination of material amounts and disclosures in the financial statements (such as tax and labour laws); and other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business.
   c. **NOCLAR, while being alike to SA 250** till this point, is further ahead of it in that **it takes into account non-compliance that causes substantial harm resulting in serious consequences** in financial or non-financial terms.
   d. **SA 250 does not define stakeholders**. NOCLAR is related to affect of non-compliance on investors, creditors, employees as also the general public.
   e. As per NOCLAR, in exceptional circumstances, **the professional accountant might become aware of an imminent breach** of a law or regulation that would cause substantial harm to investors,

creditors, employees or the general public. Having first considered **whether it would be appropriate to discuss the matter with management or those charged with governance** of the company, the accountant **shall exercise professional judgment** and determine whether **to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences** of such imminent breach. If disclosure is made, that disclosure is permitted. This provision is not existent in SA 250.

8. STEPS FOR RESPONDING TO NOCLAR:

a. Obtaining an understanding of the matter
b. Addressing the matter
c. Seeking Advice
d. Determining whether further action is needed
e. Determining whether to disclose the matter to an Appropriate Authority
f. Imminent Breach
g. Documentation

9. PROVISIONS OF CONFIDENTIALITY UNDER CHARTERED ACCOUNTANTS ACT, 1949:

a. **For Members in practice - Clause (1) of Part -I of First schedule to The Chartered Accountants Act, 1949:** A chartered accountant in practice **shall be deemed to be guilty of professional misconduct**, if he **discloses information acquired in the course of his professional engagement** to any person **other than his client** so engaging him, without the consent of his client or otherwise than as required by any law for the time being in force.
b. **For Members in service - Clause (2) of Part-II to the Second Schedule of the Chartered Accountants Act, 1949:** A member of the Institute, whether in practice or not, **shall be deemed to be guilty** of professional misconduct, **if he being an employee** of any company, firm or person, **discloses confidential information acquired** in the course of his employment **except as and when required by any law** for the time being in force or except as permitted by the employer.

10. DOCUMENTATION REQUIREMENTS IN NOCLAR: Revised Code over and above **require the professional accountant to follow the additional documents requirements** as under:

a. How **management / those charged with governance have responded to the matter**.

b. The **course of action the accountant considered**, the judgments made and the decisions that were taken, having regard to the reasonable and informed third party test.
c. **How the accountant is satisfied** that the responsibility of public interest has been fulfilled.
d. **This documentation is in addition to complying with the documentation requirements under applicable auditing standards**. SAs, for example, require a professional accountant performing an audit of financial statements to:
e. **Prepare documentation sufficient to enable an understanding of significant matters arising during the audit**, the conclusions reached, and significant professional judgments made in reaching those conclusions.
f. **Document discussions of significant matters with management, those charged with governance**, and others, including the nature of the significant matters discussed and when and with whom the discussions took place; and
g. **Document identified or suspected non-compliance**, and **the results of discussion with management** and, where applicable, those charged with governance and other parties outside the entity.

MEMBERSHIP OF THE INSTITUTE

A. REGISTER OF MEMBERSHIP (SEC. 19): The register of members shall include the following details:

1. **Full Name, Date of Birth, Domicile, Residential and Professional Address.**
2. **Date of Entry of name in the register.**
3. Whether the **member hold COP or not.**
4. **Qualifications of the Member.**
5. Any other prescribed details.

B. DISABILITIES / DISQUALIFICATIONS FOR THE PURPOSE OF MEMBERSHIP (SEC.8):

A **person is debarred from** having his name entered in or borne on the **Register of Members of the Institute:**

1. If he has **not attained the age of 21 years at the time of his application** for the entry of his name in the Register.
2. If **he is of unsound mind**.
3. If he is **an undischarged insolvent.**

4. If he, **being a discharged insolvent**, has **not obtained from the court** a certificate stating that his insolvency **was caused by misfortune without any misconduct** on his part.
5. If he has been **convicted by a competent court**:
   a. Of an **offence involving moral turpitude** and **punishable with transportation or imprisonment** or
   b. Of an **offence**, not of a technical nature, committed by him in **his professional capacity.**
6. If he has been removed from membership of the Institute on being **found on inquiry to have been guilty of professional or other misconduct.**

Note: If a member **knowingly fails to disclose the fact that he suffers from above disabilities**, it **will amount to professional misconduct**. Accordingly, his name may be removed from permanently ROM by the council.

C. TYPES OF MEMBERSHIP OF INSTITUTE (SEC.5): The Members of the institute are divided into the following designations:

ASSOSIATE CHARTERED ACCOUNTANT:

Any person, **whose name has been entered in the Register**, shall be **deemed to have become an Associate** of the Institute and shall also be **entitled to use the letters A.C.A. after his name** to indicate that he is an Associate Member of the Institute.

FELLOW CHARTERED ACCOUNTANT:

1. An associate member **who has been in continuous practice in India for at least 5 years,**
2. A member who has been **an associate for a continuous period of not less than 5 years** and **who possess such qualifications** as may be prescribed by the Council with a view **to ensuring that he has experience equivalent to the experience normally acquired as a result of continuous practice for a period of 5 years** as a Chartered Accountant.
   (E.g., CA working under a practicing member or audit firm at least 5 years even though not in practice in individual capacity.)

The abovementioned **members shall be entitled to use the letters F.C.A. after his name** to indicate that he is a Fellow Member of the Institute.

D. REMOVAL OF NAME FROM THE REGISTER (SEC.20):

The council, on the following occasions, **may remove the name of any member from ROM:**

1. A member who is **dead**
2. **A request has been received for removal from such MEMBER.**
3. A member who **has not paid required fee.** (E.g., Renewal fee for COP)
4. A member who has been **affected with disabilities specified u/s. 8** of ICAI Act, 1949.

NOTE: If the name of any member has been **removed from the Register for non-payment of required fee**, then, on receipt of an application, his **name may be entered again** in the Register – **on payment of the arrears of annual fee and entrance fee** along **with such additional fee**, as may be determined by the Council.

E. RESTORATION OF MEMBERSHIP (REGL 19):

The **effective date in case of restoration of cancelled membership**, in different situations, shall be in the following manner:

1. APPLICATION FOR RESTORATION MADE IN THE SAME YEAR OF REMOVAL:

If **removal happened on account of non-payment** of required fee – **Restoration shall be with effect from the date on which it was removed from register**, **provided, the member pays required fee including entrance fee and any additional fee** as may be prescribed by council.
(In other words, **there will not be any break in service**.)

2. REMOVAL OF NAME IN A DISCIPLINARY ACTION*:

Restoration date **shall be in accordance with the order**.
*Board of Discipline, Disciplinary committee, Appellate authority or High court.

3. ANY OTHER CASE:

Restoration shall **be with effect from the date on which the application and fee are received**.

F. PENALTY FOR FALSELY CLAIMING TO BE A MEMBER (SEC.24):

Any person who

1. **Not being a member** of the Institute
    a. **Represents that he is a member** of the Institute.
    b. **Uses the designation as Chartered Accountant**.
2. **Being a member of the Institute**, but **not having a certificate of practice**, **represents that he is in practice or practices as a Chartered Accountant.**
3. Shall be leviable with a fine

a. **1ST TIME:** up to **Rs. 1,000/- on first conviction** and
b. **SEBSEQUENT TIME:** for subsequent convictions – **fine up to Rs. 5,000/- or imprisonment up to 6 months or with both.**

EXPLANATION ON CHARTERED ACCOUNTANT IN PRACTICE

A practicing Chartered Accountant is **a person who is a member of the Institute and is holding Certificate of Practice**; and **includes such members of the Institute who are deemed to be in Practice.**

A. SIGNIFICANCE OF COP:

1. **No member of the Institute shall be entitled to practice** whether in India or elsewhere **unless he has obtained from the Council a certificate of practice**.
2. **ANNUAL FEES: Every such member shall pay such annual fee** for his certificate
3. **A member of the Institute can have no other capacity in which he can take up such practice**, **separable from his capacity to practice as a member of the Institute. (I.e., a Member can practice only as a member of institute.)**
4. **If COP is cancelled or terminated, such person cannot undertake any other assignment which he is entitled to undertake only as a member of the institute.**

Example: If and when he appears before the Income-tax Tribunal as an Income-tax representative after having become a member of the Institute, he could so appear only in his capacity as a Chartered Accountant and a member of the Institute (Only with COP).
In other words, a member who is suspended from practice cannot undertake such assignments which he ordinarily undertakes in the capacity of member of institute.

B. CANCELLATION AND RESTORATION OF COP (REGL.10 & REGL.11):

CANCELLATION (REGL.10):
COP shall be **liable for cancellation** in the following cases:
1. The **name of the person is removed from ROM.**
2. Certificate was issued **on the basis of incorrect, misleading or false information, or by mistake or inadvertence** (accidental).
3. A member has **ceased to practice**.
4. A member has **not paid annual fee for certificate of practice till 30th day of September of the relevant year**.

RESTORATION (REGL.11):

The Council **may restore the COP with EFFECT FROM the date on which it was cancelled:**

1. To a member whose **certificate has been cancelled due to non-payment of the annual fee** for the COP **AND**
2. An application together with **the fee, is received by the Secretary before the expiry of the relevant year.**

C. DEEMED TO BE IN PRACTICE (SEC.2):

There are two classes of members, **those who are in practice** and **those who are otherwise occupied.**

In Section 2(2) of the Act, the **term deemed "to be in practice" has been defined as follows:**

1. **DEEMED TO BE IN PRACTICE:** A member of the Institute shall be deemed "to be in practice" when:
   a. **Individually** or
   b. **In partnership with Chartered Accountants in practice**, or
   c. **In partnership with members of such other recognized professions** as may be prescribed
   AND
   d. **Consideration of remuneration received or to be received for being:**
      1. Engages himself **in the practice of accountancy**.
      2. Offers to perform or **performs service involving the:**
         1. **Auditing or verification of financial transactions, books, accounts or records, or**
         2. **The preparation, verification or certification of financial accounting and related statements or**
         3. **Holds himself out to the public as an accountant.**
      3. **Renders professional services or assistance** –
         i. In or about matters of principle or
         ii. **Detail relating to accounting procedure** or
         iii. The **recording, presentation or certification of financial facts or data.**
      4. **Renders such other services as**, in the **opinion of the Council, are to be rendered by a Chartered Accountant in practice**.

   e. **A member shall be deemed to be in practice if he, in his professional capacity** and **neither in his personal capacity nor in his capacity as an employee**, **acts as:**

i. **A liquidator, trustee, executor, administrator, arbitrator, receiver, adviser or representative for costing, financial or taxation matters** or

ii. **Takes up an appointment made by the Central Government or a State Government or a court of law or any other legal authority or acts as a Secretary unless his employment is on a salary-cum-full-time basis.**

2. **FOR TRAINING ARTICLES:** An associate or a fellow of the Institute **who is a salaried employee of**
   a. Chartered Accountant in practice (individual) or
   b. A firm of such Chartered Accountants or
   c. Firm consisting of one or more chartered accountants and members of any other professional body having prescribed qualifications

   Shall be deemed to be in practice for the limited purpose of the training of Articled Assistants.

3. **A Chartered accountant in practice is permitted to render entire range of Management Consultancy and Other Services [MCOS].**

4. **MCOS EXCLUDES:** MCOS **shall not include the function** of (these are treated as Deemed to be in practice)
   a. **Statutory or periodical audit, tax (both direct taxes and indirect taxes) representation** or
   b. **Advice concerning tax matters** or
   c. **Acting as liquidator, trustee, executor, administrator, arbitrator or receiver**.

5. **MCOS INCLUDES:**
   i. **Financial management planning and financial policy determination***.
   ii. Capital structure planning and advice regarding raising finance*.
   iii. **Working capital management***.
   iv. **Preparing project reports and feasibility studies***.
   **[Consideration of "tax implications" while rendering the services at (i), (ii), (iii) and (iv) above will be considered as part of "Management Consultancy and other services"]*
   v. Preparing cash budget, cash flow statements, profitability statements, statements of sources and application of funds etc.
   vi. **Budgeting including capital budgets and revenue budgets**.
   vii. **Inventory management**, material handling and storage.
   viii. **Market research and demand studies**.

ix. Price-fixation and other management decision making.
x. Management accounting systems, cost control and value analysis.
xi. Control methods and management information and reporting.
xii. **Personnel recruitment and selection**.
xiii. Setting up executive incentive plans, wage incentive plans etc.
xiv. **Management and operational audits**.
xv. **Valuation of shares and business** and advice regarding amalgamation, merger and acquisition. Acting as Registered Valuer under the Companies Act, 2013 read with The Companies (Registered Valuers and Valuation) Rules, 2017. (incorporated pursuant to decision of Council at its 388th Meeting)
xvi. Business Policy, corporate planning, organisation development, growth and diversification.
xvii. Organisation structure and behaviour, development of human resources including design and conduct of training programmes, work study, job-description, job evaluation and evaluation of workloads.
xviii. **Systems analysis and design**, and computer related services including selection of hardware and development of software in all areas of services which can otherwise be rendered by a Chartered Accountant in practice and also to carry out any other professional services relating to EDP.
xix. **Acting as advisor or consultant to an issue**, including such matters as:
   a. **Drafting of prospectus** and memorandum containing salient futures of prospectus. Drafting and filing of listing agreement and completing formalities with Stock Exchanges, Registrar of Companies and SEBI.
   b. **Preparation of publicity budget**, advice regarding arrangements for selection of (i) ad-media, (ii) centres for holding conferences of brokers, investors, etc., (iii) bankers to issue, (iv) collection centres, (v) brokers to issue, (vi) **underwriters and the underwriting arrangement**, distribution of publicity and issue material including application form, prospectus and brochure and deciding on the quantum of issue material (In doing so, the relevant provisions of the Code of Ethics must be kept in mind).
   c. Advice regarding selection of various agencies connected with issue, namely Registrars to Issue, printers and advertising agencies.

d. **Advice on the post issue activities**, e.g., follow up steps which include listing of instruments and dispatch of certificates and refunds, with the various agencies connected with the work.

Explanation - For removal of doubts, it is hereby clarified that the activities of broking, underwriting and portfolio management are not permitted.

xx. Investment counselling in respect of securities [as defined in the Securities Contracts (Regulation) Act, 1956 and other financial instruments.] (In doing so, the relevant provisions of the Code of Ethics must be kept in mind).

xxi. Acting as registrar to an issue and for transfer of shares/other securities. (In doing so, the relevant provisions of the Code of Ethics must be kept in mind).

xxii. **Quality Audit.**

xxiii. **Environment Audit**.

xxiv. **Energy Audit.**

xxv. Acting as Recovery Consultant in the Banking Sector.

xxvi. Insurance Financial Advisory Services under the Insurance Regulatory & Development Authority Act, 1999, including Insurance Brokerage.

xxvii. Acting as Insolvency Professional in terms of Insolvency and Bankruptcy Code, 2016 (incorporated pursuant to decision of Council at its 362nd Meeting).

xxviii. **Administrative Services**. (incorporated pursuant to decision of Council at its 388th Meeting) Administrative services involve assisting clients with their routine or mechanical tasks within the normal course of operations. Such services require little to no professional judgment and are clerical in nature.

6. **INVITATION TO OFFER – DEEMED TO BE IN PRACTICE:** The act of **setting up of an establishment offering** to perform accounting services **would be tantamount to being in practice** even though no client has been served.

7. **COUNTED IN COP CALCULATION:** A member of the Institute is deemed to be in practice **during the period he renders 'service with armed forces'**

Note:

1. **MANAGEMENT SERVICES cannot be provided to a company** if the **member is appointed as a statutory auditor for the said company**. (Sec. 144 of Companies Act, 2013.)

2. A CA in full time employment is representing his employer in a tax assessment, it cannot be treated as deemed to be in practice. However, if he represents colleagues in tax assessments then It may be treated as Deemed to be in practice.
3. **Implications of a CA deemed to be in practice:**
    a. **Shall obtain COP [NOT APPLICABLE FOR EMPLOYEE CA IN FIRM].**
    b. **Pay annual fee.**
    c. **Obey council regulations, guidelines and professional standards.**

COMPANIES CANNOT PRACTICE AS CHARTERED ACCOUNTANTS

1. As per Sec. 25 of Chartered Accountants Act, 1949, **No Company shall practice as chartered accountants.**
2. **The term company includes LLP which has a partner – company.**
3. From reading the above two provisions it can be concluded that an LLP is eligible to act as an auditor **provided it should not have a partner which is a company**.

MEMBER IN PRACTICE IS PROHIBITED TO USE AN OTHER DISIGNATION OTHER THAN CA

1. Under **Section 7** of the Chartered Accountants Act, 1949 **a member in practice:**
    a. **Cannot use any designation other than that of a Chartered Accountant,**
    b. **Cannot use any other description**, whether in addition thereto or in substitution therefor.
2. Also, **a member in practice may use any other letters** or description **indicating membership of Accountancy Bodies** which have been **approved by the Council**, so long as, **such use does not imply:**
    a. **Adoption of a designation and/or**
    b. **Does not amount to advertisement or publicity.**
3. **MEMBERSHIP OF FOREIGN INSTITUTES:** The members are **PERMITTED** to mention membership of a foreign Institute of Accountancy, which has been recognized by the Council.
4. **Merchant Banker / Advisor to an issue:** In client Companies' offer documents and advertisements regarding capital issue, **name and address of the Chartered Accountant or firm of Chartered Accountants**

acting as Advisor or Consultant to the Issue could be indicated under the caption "Advisor/Consultant to the Issue".
However, they shall **NOT APPEAR PROMINENTLY.**

5. Members of the Institute in practice **who are otherwise eligible may also practice as Company Secretaries** and/or Cost Accountants. Such members shall, **however, not use designation/s of the aforesaid Institute/s simultaneously** with the designation "Chartered Accountant".
   E.g., Inavolu. Ram Harsha, Chartered Accountant, ~~Company Secretary, Cost Accountant~~
   Inavolu. Ram Harsha, CA, CS, CMA, DISA, B. Com – is permitted usage.
6. For example, though a member cannot designate himself as a Cost Accountant. However, he can use the letters C.M.A after his name, when he is a member of that Institute.
   E.g., Inavolu Ram Harsha, CA, DISA, CMA, CS, B.Com.
7. **NOT TO USE CERTAIN PHRASES:** It is **improper for a Chartered Accountant to state** on his professional documents that he is an **Income-tax Consultant, Cost Accountant, Company Secretary, Cost Consultant or a Management Consultant**. [For Specified Qualifications, Abbreviations can be used such as CS, CMA, DISA]
8. **NOT IN PRACTICE:** A member who is **not in practice AND** does not use the designation of a Chartered Accountant **may use any other description.**

PROVISIONS RELATED TO MAINTENANCE OF BRANCH OFFICES

A. SEPARATE INCHARGE FOR EVERY OFFICE:

1. If an audit firm has **more than one office in India**, **each one of such offices should be in the SEPARATE CHARGE OF A MEMBER**. Failure in this regard would constitute professional misconduct.
2. **182 DAYS:** The member **must actively associate with such office**:
   a. **RESIDES:** If the member resides in the place where the office is situated for a period of not less than 182 days in a year or
   b. **ATTENDS OFFICE:** if he attends the said office for a period of not less than 182 days in a year or
   c. In such other circumstances as, in the opinion of the Executive Committee, establish such active association.

B. MEMBER IN-CHARGE FOR MORE THAN ONE OFFICE: A Member can **open second office without a separate charge of a member** of institute in the following cases:

1. The **second office is located in the same premises.**
2. The **second office is located in the same city**.
3. The **second office is located within a distance of 50 km from the municipal limits of a city**, in which the first office is located.

C. EXEMPTION IN HILL AREAS: A member or firm **can open temporary office in hill area** subject to the following conditions:

1. **allowed to open temporary offices for a limited period not exceeding 3 months** in a year.
2. The **regular office need not be closed during this period** and all correspondence can continue to be made at the regular office.
3. The **name board of the firm in the temporary office should not be displayed at times other than the period such office is permitted** to function as above.
4. The **temporary office should not be mentioned in the letterheads, visiting cards or any other documents** as a place of business of the member/firm.
5. Before commencement of every winter, **it shall be obligatory on the member/firm to inform the Institute that he/it is opening the temporary office from a particular date and after the office is closed at the expiry of the period of permission**, an intimation to that effect should also be sent to the office of the Institute **by registered post.**

IMPORTANT NOTES / CLARIFICATIONS:

1. **NAME BOARD:** A member is allowed to put name board at his place of residence **provided it is a nameplate or a name-board of an individual member** and **not of the firm**.
2. **MAIN OFFICE:** When **more than one office is located in the same city**, the **member shall declare which office is main office**.
3. **MEMBER – PAID ASSISTANT – WTE:** The member **in charge of branch** office of the firm **shall be associated with the firm either as a partner or paid assistant**. **If he is paid assistant, then he must be in whole time employment [WTE] of the firm.**

MEANING OF CHARTERED ACCOUNTANT IN SERVICE

As per Code of Ethics, a Professional Accountant in Service or Chartered Accountant in Service **means a professional accountant employed or engaged** in **an executive or non-executive capacity** in such areas as commerce, industry, service, the public sector, education, the not-for-profit sector, regulatory bodies or professional bodies, or a professional accountant contracted by such entities.

TYPES OF MIS-CONDUCT [SEC.22]

A. PROFESSIONAL MIS-CONDUCT: (ARISES OUT OF PROFESSIONAL WORKS)

1. **Defined in Part – I, II and III of First Schedule & Part – I and II of Second Schedule.**
2. **If the member is found guilty of any of the acts or omissions stated in any of the respective parts of the Schedule, he/she shall be deemed to be guilty of professional misconduct.**

B. OTHER MIS-CONDUCT: (DOES NOT ARISE FROM PROFESSIONAL WORKS)

1. **Defined in Part – IV of First Schedule and Part – III of Second Schedule. These provisions empower the Council to inquire into any misconduct of a member even it does not arise out of his professional work.**
2. This is considered necessary because a chartered accountant is **expected to maintain the highest standards of integrity even in his personal affairs.**
3. Other misconduct would **also relate to conviction by a competent court for an offence involving moral turpitude punishable with transportation or imprisonment**.

SCHEDULES TO CA ACT, 1949

SCHEDULE [2]	PART [7]	DEALS WITH	NO. OF CLAUSES [34]
FIRST SCHEDULE	Part - I	**Professional misconduct** in relation to Chartered Accountants in **PRACTICE**	12 Clauses
	Part – II	**Professional misconduct** in relation to Members of the Institute in **SERVICE**	2 Clauses
	Part – III	**Professional misconduct** in relation to Members of the Institute **GENERALLY**	3 Clauses
	Part – IV	**Other misconduct** in relation to Members of the Institute **GENERALLY**.	2 Clauses

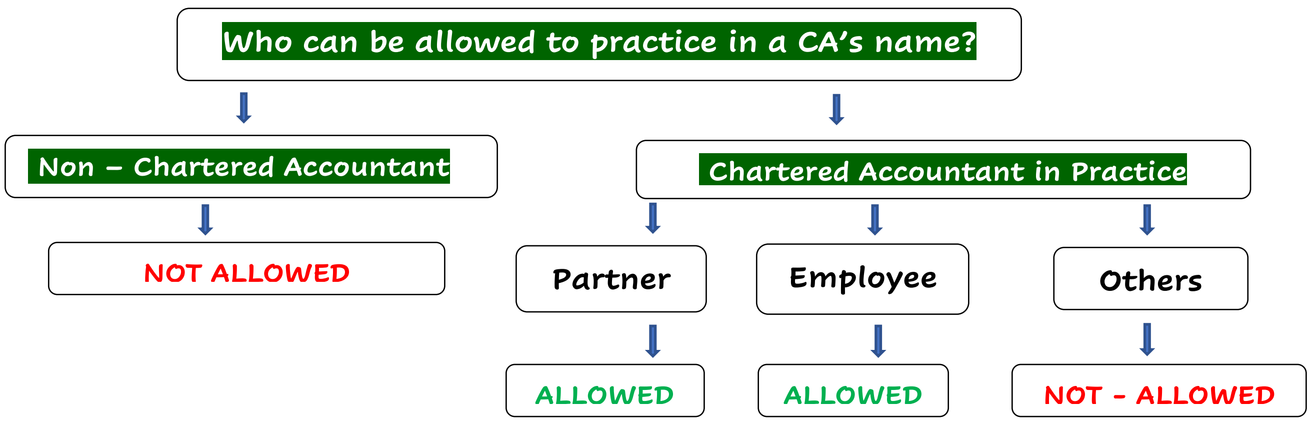
SECOND SCHEDULE	Part – I	**Professional misconduct** in relation to Chartered Accountants in **PRACTICE**	**10** Clauses
	Part – II	**Professional misconduct** in relation to Members of the Institute **GENERALLY**	**4** Clauses
	Part – III	**Other misconduct** in relation to Members of the Institute **GENERALLY**.	**1** Clause

PROFESSIONAL MIS-CONDUCT BY MEMBERS IN PRACTICE FIRST SCHEDULE – PART 1

A **Chartered Accountant in practice** is deemed to be guilty as per Part – I to First Schedule in the following cases:

CLAUSE – 1: ALLOWING NON – MEMBER AND OUTSIDERS TO PRACTICE IN THE NAME OF CAP:

1. **A Chartered Accountant in practice (CAP) is deemed to be guilty if he allows another person to practice in his name.**
2. **EXCEPTION:** This clause will **not apply If such other person is also a practicing CA** and is associated with the firm **as a partner or employee under the control and supervision of CAP**.



CLAUSE – 2: SHARE OF PROFITS TO NON – MEMBERS:

1. If CAP **pays or allows or agrees to pay or allow**, directly or indirectly, **any share, commission or brokerage in the fees or profits of his professional business**, **to any person,** it shall be **treated as guilty of professional mis – conduct.**
2. **EXCEPTION:** However, this clause **shall not apply** if the **fees is shared with:**
   a. **a member of the Institute or**
   b. **a partner or**
   c. **a retired partner or**
   d. **the legal representative of a deceased partner, or**
   e. **a member of any other professional body or**
   f. **a person having recognized qualifications, as permitted by the council.**
3. The **Professional bodies prescribed** by the council are: (Reg. 53A)
   a. **ICSI**
   b. **ICWAI**
   c. **Bar Council of India**
   d. **Indian Institute of Architects.**
   e. **Indian Institute of Actuaries.**
4. The **Professional qualifications prescribed by the council** are: (Reg. 53A)
   a. **CS.**
   b. **CMA.**
   c. **Actuary.**
   d. **B.E.**
   e. **B. Tech.**
   f. **Architect.**
   g. **LLB.**
   h. **MBA.**
5. **Look at the substance of the transaction and not the nomenclature of the transaction**. E.g., Whether the **fee being shared for any purpose such as office expenses, reference fees etc.**, from persons other than permitted, **will also be treated as the GUILTY**.
6. **If CAP is sharing fees in the form of deposit with State Government treasury, for the sake of administrative expenses incurred in the process of assignment of audit of cooperative societies, then it shall NOT BE TREATED AS GUILTY.**
7. **TREATMENT OF SHARE OF PROFIT / GOODWILL ON DEATH OF A PARTNER OR PROPRIETOR:**

a. **PARTNERSHIP FIRM – Can share to the legal representative of the deceased partner** provided such **A CLAUSE EXIST IN the partnership DEED.**

b. **PROPRIETORSHIP FIRM –**

SHARING OF FEES: Sharing of fees is strictly **PROHIBITED between legal representative of deceased CAP and BUYER of goodwill.**

SALE OF GOODWILL: PERMITTED subject to the following conditions.

CASE 1: DEATH OF PROPRIETOR ON OR AFTER 30.08.1998:

i. **PERMISSION:** The **Legal heir shall obtain permission of the council within ONE YEAR from the date of demise** of such proprietor.
ii. **SALE COMPLETE - ONE YEAR TIME LIMIT:** Also, **Goodwill of sole proprietor can be transferred** to another eligible member of the institute, after the death of proprietor. **Provided the sale is completed in all aspects within ONE year from the date of demise** of such Proprietor.
iii. **NON-REMOVAL OF NAME – ONE YEAR:** Further the **name of the firm shall not be removed for ONE year from death of proprietor** or
iv. **DISPUTE – LEGAL HEIR:** In case of Dispute regarding legal heir of the deceased proprietor and the institute received information of dispute within ONE YEAR of death of proprietor, **then the name of the concerned firm shall be kept in ABEYANCE until ONE YEAR from Date of settlement of dispute**
v. **The purchaser can use firm name.**

CASE 2: DEATH OF PROPRIETOR ON OR BEFORE 29.08.1998:
Sale/transfer is completed / effected AND the Institute's **permission to practice in the deceased's proprietary firm name is sought for by 28th August, 1999** and the firm name concerned is still available with the Institute.

NOTE: In case of a partnership firm when all the partners die at the same time, the above Council decision would also be applicable.

CLAUSE – 3: ACCEPTING SHARE OF PROFIT OR FEES FROM NON – MEMBER:

1. If CAP **accepts or agrees to accept, any part of profits of professional work of any person who is not a member of institute**, then it shall be **treated as guilty of professional mis – conduct**.
2. **EXCEPTION:** However, this clause **shall not apply** if the **fees is shared with:**
    a. **A member of the Institute or**
    b. **a partner or**
    c. **a retired partner or**
    d. **the legal representative of a deceased partner, or**
    e. **a member of any other professional body or**
    f. **a person having recognized qualifications, as permitted by the council.**
3. **REFERRAL FEES AMONGST MEMBERS - PERMITTED:** It is **not prohibited for a member in practice** to charge Referral Fees, being the fees obtained **by a member in practice from another member in practice** in relation to referring a client to him.

CLAUSE – 4: PROHIBITING A CAP TO ENTER PARTNERSHIP WITH NON – MEMBERS:

1. If a **CAP enters into partnership with any person other than CAP**, shall be **treated as guilty of professional mis – conduct.**
2. **EXCEPTION:** However, this clause **shall not apply if such CAP enters partnership with the following persons:**
    a. **Another CAP.**
    b. **A member of professional body as prescribed by the council.**
    c. **A person having recognized qualification as prescribed by the council.**
    d. **A person whose qualification recognized being equivalent to member of ICAI.**
3. **MULTI DISCIPLINARY - NOT PERMIRTED:** The members may however take note of **the fact that they cannot form Multi-Disciplinary partnerships till such time** that Regulators of such other professionals also permit partnership with chartered accountants, and guidelines in this regard are issued by the Council.
4. **COUNCIL DECISIONS / CASE LAWS:**

    ASSISTANT DIRECTOR OF INCOME TAX (INVESTMENT), CALICUT V. P SUBRAMANIAN: The Respondent had signed **2 sets of financial statements of the same AUDITEE, for the same financial year. The two financial statements showed different figures of contract receipts, net**

profits and balance sheet. He was grossly negligent in the conduct of his professional duties. The **Respondent admitted that he was the managing partner/partner in two partnership firms where there were other partners who were not Chartered Accountants.** Held, the respondent is **guilty under Clause (4) of Part I of First Schedule** and **under Clauses (5), (6) & (7) of Part I of Second Schedule.**

CLAUSE – 5: PROHIBITION ON SECURING PROFESSIONAL BUSINESS:

1. **If a CAP Secures –**
   a. **either through the services** of a person who is **not an employee** of such Chartered Accountant or
   b. who is **not his partner**, or
   c. **by means which are not open to a CAP [C6 & C7]**,

   Any professional business then he shall be treated as guilty of professional mis – conduct.

2. **EXCEPTION:** However, this clause **shall not apply** if he secures professional business **through the ways permitted under previous clauses.** (i.e., 2, 3 and 4).

3. **COUNCIL DECISIONS / CASE LAWS:**
   a. **JETHANAND SHARDA vs. DEEPAK MEHTA: TREATED AS GUILTY** – A Chartered Accountant wrote various letters to officers of different Army Canteens giving details about him and his experience, his partner & office and the norms for charging audit fees. (Council's decision dated 1st to 4th July, 1998)
   b. **QUOTE:** "A man must stand erect, and not to be kept erect by others", is a dictum by Marcus Aurelius.

CLAUSE – 6: PROHIBITION ON SOLICITATION OF CLIENTS OR PROFESSIONAL WORK:

1. If a CAP, **solicits clients or professional work** either directly or indirectly **by circular, advertisement, personal communication or interview or by <u>any other means</u>**, then he shall be treated as guilty of professional mis – conduct.
2. **EXCEPTION:** However, this clause **shall not apply if CAP solicits work from:**
    a. **Another CAP.**
    b. Securing work **as a consequence of response to a tender of various users of professional services** or organizations. [i.e., applying for a TENDERs]

COUNCIL/COURT DECISIONS / GUIDELINES:

3. **TENDERS – MIN FEE QUOTED – PERMITTED:** As per the council guidelines, **if a tender is placed for a professional work which can be exclusively reserved for CAP** [E.g., audit / attestation], **then the CAP SHALL NOT respond to such tenders.**
   Exceptions:
    a. **If the tender document contains MINIMUM FEES details,** then CAP can respond and secure such work. **(E.g., Audit and Attestation services)**
    b. **Also, if professional work is not exclusively reserved for CAP's.**
4. An **advertisement of Coaching /teaching activities** by a CAP **may amount to indirect solicitation**, as well as solicitation by any other means – **Treated as Guilty**.
   Exception: Members **may put, outside their Coaching/teaching premises, sign board** mentioning:
    a. The name of Coaching/teaching Institute,
    b. Contact details and
    c. Subjects taught therein only.
    d. As regards the size and type of sign board, the Council Guidelines as applicable to Firms of Chartered Accountants would apply.
5. **EDUCATIONAL VIDEOS:** While the videos of educational nature **may be uploaded on the internet by members**, **no reference should be made to the Chartered Accountants Firm** wherein the member is a partner/ proprietor. Further, **it should not contain any contact details or website address. [2021 NEWLY ADDED GUIDELINE]**

6. **Permitted – Advertisement relating to change of partnership, dissolution, change in address and contact details provided such advertisement is limited to bare statement of facts in newspapers and consideration given to the appropriateness of the area of distribution of the newspaper or magazine and number of insertions.**

7. **Permitted – Classified advertisement in the journal/ newsletter of the Institute intended to give information**:
   a. For **sharing professional work** on assignment basis or
   b. For **seeking partnership or salaried employment** of an accountancy nature,

   Provided it only contains the accountant's name, address or telephone number, fax number, e-mail address.

8. **Permitted –** Application for empanelment for allotment of audit and other professional work with various departments and authorities. **However, it would not be proper for the Chartered Accountant to make roving enquiries by applying to any such organization for having his name included in any such panel. It is permissible to quote fees on enquiries being received from such bodies, which maintain such panel.**

9. **Permitted – Entries in telephone/trade directories** subject to certain restrictions **[with NO special reference for CAP's contact details]**

10. **Permitted –** The designation **"Chartered Accountant" as well as the name of the firm may be used** in greeting cards, invitations.
    a. **For marriages and religious ceremonies** and
    b. Any invitation for **opening or inauguration of office** of the members,
    c. **Change in office premises and change in telephone numbers**, **provided that such greeting cards or invitations etc. are sent only to clients, relatives and close friends of the members concerned.**

11. **Sponsoring Activities:**
    a. A member in practice or a Firm of Chartered Accountants is **NOT permitted to sponsor an event**. However, such member or Firm **may sponsor an event conducted by a Programme Organizing Unit (PoU) of the ICAI**, provided such event has the prior approval of Continuing Professional Education (CPE) Directorate of the ICAI.
    b. Members sponsoring activities relating to Corporate Social Responsibility **may mention their individual name with the prefix "CA"**. However, **the mention of Firm name or CA Logo is NOT**

permitted. [E.g., Food Distribution During Lockdown without mentioning Firm Name]

12. **Right of Representation u/s. 140(4) –**
    a. The wording of his representation should be such that, **it does not tantamount directly or indirectly to canvassing or soliciting for his continuance as an auditor**.
    b. The letter should **merely set out in a dignified manner how he has been acting independently and conscientiously**.
    c. Also, it **may indicate his willingness to continue as auditor.**

13. **Sharing Firm Profile with prospective Client:** It is **not permitted to share Firm profile with a prospective Client UNLESS** it is **in response to a proposed client's specific query**, and otherwise not prohibited to be used by the client.

14. **Television or Movie Credits:** While sharing name of the member or Firm of Chartered Accountants for inclusion in Television or Movie Credits, it must be taken care of that exhibition of name is not made differently as compared to other entries in the credits. **[E.g., In Movies we would have come across special thanks to Andhra bank, special thanks to Ram & Co., Chartered Accountants – PERMITTED as these credits are uniform format for all.]**
15. **Permitted – Transfer of Original Work:** A member **should not accept the original professional work emanating from a client introduced to him by another member.** If any professional work of such client comes to him directly, it should be **his duty to ask the client that he should come through the other member** dealing generally with his original work. (I.e., Similar to Obtaining consent of Previous auditor). [Auditor shall not grab the client introduced to him by another auditor]

16. **Permitted – Website:**
    a. A CAP can use a website – **No restriction related to usage of colours or format.**
    b. Website **shall run on pull model** and **NOT to use push model** regarding:
        i. Nature of services rendered.
        ii. Past experience.
        iii. Expertise of partners / Employees.
        iv. Details of Employees/articles.
        v. Year of establishment.
    c. Website address **can be mentioned on letter heads, visiting cards and sign boards.**
    d. It **may contain:**

i. Name of the Firm/Member/Partners.
ii. Phone Numbers and Email ID's of H.O and Branches as well.
iii. Passport photos of Partners, Partners Qualification, Year of Qualification.
iv. Employees Name and their Qualifications.
v. Career Opportunities.
vi. Can contain external links such as - Website links of ICAI, Other Professional bodies, Government department sites, Regulatory authorities.
vii. News articles such as budget highlights and government policies.
viii. Common Logo prescribed by ICAI.
ix. Chat rooms for clients or other CAP's – May provide line advice in return for payment or free of cost.
x. Last date of updating the website.

e. Website shall NOT contain:
   i. Names of clients and fees charged – Unless it is required as per regulations.
   ii. No advertisement.
   iii. No other photographs other than passport size photos.
   iv. Rate card for services to be offered.
f. Intimation shall be given to ICAI about website while submitting annual membership forms.
g. The Website address should be as near as possible to the individual name/trade name, firm name of the Chartered Accountant in practice or firm of Chartered Accountants in practice.
h. A number of non-Chartered Accountants' firms, corporate including banks, finance Companies and newspapers have set up their own Websites providing advisory services on taxation and other areas where Chartered Accountants are rendering professional service.
   i. Some of such Websites may request Chartered Accountants or Chartered Accountants' firms to provide consultation and advice through their Websites.
   ii. This would be permitted subject to the condition **that on the** Website, contact address of the Chartered Accountant concerned is NOT provided NOR such Website will contain any material which advertises professional achievements or status of such Chartered Accountant except making a

statement that they are Chartered Accountants. **The name of Chartered Accountants' firm with suffix "Chartered Accountants" would not be permitted. (E.g., Clear-tax, Taxman)**

17. **Advertisements – Treated as Guilty –**
    a. **G.P. Agrawal (1982) –** An advertisement was published in a newspaper **containing the member's photograph wherein he was congratulated on the occasion of the opening ceremony** of his office – **Held as guilty** by the council and later the high court.
    b. **Anil K. Garg (1987) –** A member who got an advertisement **published in a newspaper offering his "services in matters of Accounts, Income Tax, Labour laws, Law matters and Management Services was found guilty** in terms of this clause as also under Clause (7)
    c. **Naresh C.Aggarwal (1992) –** Where a Chartered Accountant issued **a letter to a Bank requesting for empanelment of his firm as auditor along with the particulars of his firm** showing the past experience and other details of the firm; and **a Member of Parliament had also sent a letter to the Bank recommending** the name of the said Chartered Accountant's firm. **Held that the member was guilty.**

CLAUSE – 7: PROHIBITION ON ADVERTISING PROFESSIONAL ATTAINMENTS AND USING OTHER DESIGNATIONS:

1. A **CAP is deemed to be guilty of professional mis – conduct if he advertises:**
    a. **his professional attainments or**
    b. **services offered or**
    c. **uses any designation other than Chartered Accountant** on professional documents, visiting cards, letter heads and sign boards.
2. **EXCEPTION:** However, **a CAP can mention about a degree of**:
    a. A **university** established under a law (E.g., B.com, M.com)
    b. **Title indicating membership of ICAI** (E.g., ACA, FCA, DISA)
    c. **Any other institution that is recognized** by CG or the council (E.g., CS, CMA)
    d. **A member empanelled as Insolvency Professional or Registered Valuer can mention** "Insolvency Professional" or "Registered Valuer" respectively **on his visiting card and letter head.**

COUNCIL / COURT DECISIONS OR GUIDELINES:

1. **DATE OF SETTING UP PRACTICE – Not Permitted –** The **date of setting up the practice by a member or the date of establishment of the firm on the letterheads and other professional documents, etc. SHOULD NOT BE MENTIONED. However, in the Website, the year of establishment can be given on the specific "pull" request.** [A & Co., Since 1980 – Not Permitted]

2. **Permission to MENTION QUALIFICATIONS OF CERTAIN INSTITUTIONS:** The members are permitted to mention a title on their visiting cards to indicate membership of a foreign Institute of Accountancy, which has been recognised by the Council e.g., South African Institute of Chartered Accountants (**SAICA**), Institute of Certified Public Accountants (**CPA Ireland**) and Institute of Chartered Accountants in England and Wales (**ICAEW**).

3. **DIRECTORSHIP DETAILS – Permitted –** A member **may give information about directorship held and reasonable personal details** and may state his outside interests. He should **not give the names of any of his clients or details of the service offered by his firm.**

4. **PHOTO ON MAGZINE – Permitted –** There should be **no objection to the publication of photographs** and brief particulars of members in magazines provided no payment is made for such publication and there is **NO advertisement of professional attainments**.
5. **PHOTO ON VISITING CARD – Not Permitted.**

6. **QR CODE ON VISITING CARD – Permitted –** Allowed to print QR Code on Visiting cards (Quick Response) provided this code **shall not contain information other than that is permitted to be printed on visiting cards.**

7. **NEWSPAPER ADVERTISEMENT FOR RECRUITMENT – Permitted –** News Paper (Press) advertisement can be given with regard to the following guidelines:
    a. Advertisement for recruiting staff for own office is allowed.
    b. Advertisements on behalf of clients requiring staff or wishing to acquire or dispose of business or property is allowed.
    c. Advertisement for the sale of a business or property by a member acting in a professional capacity as trustee, liquidator or receiver is allowed.

8. **CONFERENCES – PERMITTED:** Members giving talks or lectures or attending conference may describe themselves as Chartered Accountants only when they are acting in their capacity as Chartered

Accountants. However, **reference to the professional firm of the member should not be given.**

9. **WRITING ARTICLES – Permitted –** Members writing articles or letters to the press on subjects connected with the profession **may give their names and use the description Chartered Accountants.**

10. **SIGN BOARDS – Permitted –** With regard to the size of signboard for his office that member can put up, it is matter in which the members should exercise their own discretion and good taste.

11. **GLOW SIGNS – Not Permitted** – Use of glow signs or lights on large-sized boards as is used by traders or shop-keepers would not be proper.

12. **DIRECTORSHIP IN A COMPANY:** As soon as he is appointed as a director of a Company, **he should specifically invite the attention of the management of the company to the aforesaid provisions** and **should request that before any such prospectus or public announcements or public communication mentioning** the name of the member concerned, is issued, the material pertaining to the member concerned should, as far as practicable be **got approved by him**. **The use of the expression 'Chartered Accountant' is permissible.**
    a. However, the **member must ensure that descriptions** about his **expertise, specialization and knowledge** in any particular field of other appellation or adjectives are **not published with his name.**
    b. **Particulars about directorships held by the member in other companies can be given.**

13. **COMMON CA LOGO:** To promote the brand of CA profession and responding to the long felt need to have a symbol of CA Profession in India, ICAI came up with a unique logo which could be used by all members, whether in practice or not. Encapsulating the current beliefs, attitudes and values of the profession, the CA Logo seeks to enhance the identity of the members**. The logo consists of the letters 'CA' with a tick mark (upside down)** inside a rounded rectangle with white background. **The letters 'CA' have been put in BLUE,** the corporate colour which not only stands out on any background but also denotes creativity, innovativeness, knowledge, integrity, trust, truth, stability and depth. The upside-down tick mark, typically used by the chartered accountants, has been included to symbolize the wisdom and value of the professional. **The GREEN COLOUR IN THE TICK MARK signifies growth, prosperity, harmony and freshness. Members are**

encouraged to use this logo. The Council has decided that use of CA logo in the stamp is permissible, subject to CA logo guidelines.

14. **RELATIONSHIPS WITH OTHERS – Not Permitted –** The usage of expression/words "In association with / Associates of / correspondents of...etc." are not permitted and treated as guilty.
15. **BULK SMS – Not Permitted:** Where a Chartered Accountant allegedly propagating his services subsequent to demonetization, an objective of Government of eradicating black money, through mass SMS along with his mobile number offering his services towards conversion of cash with minimum tax liability. Held guilty of Professional Misconduct falling within the meaning of Clause (6) & (7) of Part I and "Other Misconduct" falling within the meaning of Clause (2) of Part IV of First Schedule read with section 22 of the Chartered Accountants Act, 1949. (Kailash Shankarlal Mantry)

CLAUSE – 8: COMMUNICATION WITH PREVIOUS AUDITOR: (OBTAIN NOC)

1. **If a CAP Accepts any position as an auditor previously held by another member of institute**, **without first communicating him in writing then such CAP shall be treated as guilty of profession mis – conduct**. (Obtain NO OBJECTION CERTIFICATE)
2. **This sort of communication is required for all types of audits – statutory audit, tax audit, internal audit, concurrent audit or any other kind of audit.** However, **NOC is not required for special audits** as required under any law for the time being in force.
3. Further **NOC is not required for accepting assignments that are conducted by other professionals not being Chartered Accountants**. [It is healthy practice to communicate.]
4. **REASONS FOR COMMUINICATION:** Why CAP shall communicate with previous auditor:
    a. **Professional Courtesy**.
    b. **To know the reasons for the change** in auditor.
    c. **To be able to safeguard his own interest** and the legitimate interest of the public and
    d. **Protect the independence of the existing accountant.**

e. When **making the inquiry from the retiring auditor**, the proposed auditor **should primarily find out whether there are any professional or other reasons why he should not accept** the appointment.

5. **FEES NOT PAID:**
   a. The existence of a dispute as regards the **fees not having been paid often may be the root cause of an auditor being changed,** but this would **NOT CONSTITUTE VALID REASONS for rejecting proposed appointment.**
   b. In the case of an **undisputed audit fees** for carrying out the statutory audit under the Companies Act, 2013 or various other statutes having **not been paid,** the **incoming auditor should not accept the appointment unless such fees are paid.**
   c. **Incoming auditor should** in appropriate circumstances **use his influence in favour of his predecessor** to have the disputes as regards the fees settled.
   d. **Where the Previous Auditor is not available for accepting payment of undisputed audit fees,** and it **is not otherwise possible to transfer the payment to him electronically**, the Incoming Auditor **may advise the client to purchase Demand Draft** of the amount **equivalent to undisputed Audit Fees** of retiring auditor, and may **accept the Audit assignment after verifying the same.** It will be the **duty of the Incoming auditor to ensure the payment of undisputed Audit Fees of the retiring auditor at the earliest possibility.**

6. **What should be the correct procedure to adopt when a prospective client tells you that he wants to change his auditor and wants you to take up his work?**
   a. Inquire Full facts of the case such as **reasons for replacement**.
   b. Inquire **whether the client had informed the retiring auditor** of the intended change:
      i. **If Yes – Send a communication to retiring auditor.**
      ii. **If No – Inquire the client, why he did not make** a first move. If the client has no valid reason, it **would be inappropriate to accept such proposed audit** for the incoming auditor.
   c. **BANK / GOVERNMENT COMPANIES – TIME BOUND:** In case the **time schedule given for the assignment** is such that there is **no time to wait for the reply** from the outgoing auditor, the incoming auditor **may give a conditional acceptance of the appointment and commence the work** which needs to be

attended to immediately after he has sent the communication to the previous auditor in accordance with this clause. **In his acceptance letter, he should make clear to the client that his acceptance** of appointment **is subject to professional objections, if any**, from the previous auditors and **that he will decide about his final acceptance after taking into account the information** received from the previous auditor.

7. **Does Reply must from retiring auditor to incoming auditor:**
    a. **Reply Obtained –**
        i. **No Objection raised –** Incoming auditor **can accept** and continue the engagement.
        ii. **Objections raised –** Evaluate the **nature of objections** and decide accordingly:
            1. Objections **justified – Reject the Proposed appointment.**
            2. Objections **Not Justified – Accept the engagement**.
    b. **Reply Not Obtained –** The proposed auditor, **after waiting for a reasonable time for a reply**, **can accept and continue with the engagement.**

8. **Mode of Communication:**
    a. **Communication must be in writing** through a registered post. (After Corona – Emails also)
    b. There should be **positive evidence of the fact that the communication addressed to the outgoing auditor has reached his hands.**
    c. **Certificate of posting of a letter cannot**, in the circumstances, be **taken as a positive proof of its delivery to the addressee**. **(Rajasthan High Court in J.S. Bhati v.s. The Council of the ICAI)**
    d. Communication **must be through a "Registered Post Acknowledgment due (RPAD)"** or by hand against a written acknowledgment would provide such positive evidence. **(R.M. Singhai vs. R.V. Agarwal (1988))**
    e. **Acknowledgement of the communication from retiring auditor's vide email address registered with the Institute or his last known official email address,** or Unique Identification Number (UDIN) generated on UDIN portal (subject to separate guidelines to be issued by the Council in this regard)
    f. **Premises found Locked:** The communication received back by the Incoming Auditor with "Office found Locked" written on the

Acknowledgement Due **shall be deemed as having been delivered to the retiring auditor.**

g. **Firm not found at the given Registered address, the letter will be deemed to be delivered.**

9. **COUNCIL/HIGH COURT/BOD DECISIONS:**

CA. Manindra Chandra Poddar vs. CA. Manas Ghosh (2013) – The **onus to communicate with retiring auditor lies on Incoming auditor.**

10. **Reduced audit fee for incoming auditor (undercutting) –** Treated as guilty **unless there is a reasonable justification for such undercutting**. It will **not be treated as indirect way of promotion or solicitation**.

CLAUSE – 9: PROHIBITS TO ACCEPT THE AUDIT OF COMPANY WITHOUT COMPLYING WITH PROVISIONS OF COMPANIES ACT, 2013:

1. **A CAP is treated as guilty of professional mis conduct, if he accepts the audit of a company without ascertaining the compliance with Sec. 139, 140, 141 and 142 of companies act, 2013.**
2. The word "ascertain" means "to find out for certain". This would mean that **the incoming auditor should find out, whether the company has complied with the provisions of Section 139, 140 and 142 read with Section 141 of the Companies Act, 2013.**
3. The incoming auditor **shall verify the following aspects in this regard:**
   a. **Board Resolution for recommendation** of incoming auditor.
   b. **Minutes of General Meeting where incoming auditor is appointed.**
   c. Whether the **notice of general meeting has been sent as per the law.**
   d. **Approval of CG in case outgoing auditor is removed before expiry of term.**
   e. **Most importantly, Qualifications and Dis-Qualifications of the incoming auditor.**
   f. **Obtain a certificate from the management that they have complied with above sections.**
   g. **Communication with outgoing auditor as required under Clause - 8**
4. **If the incoming auditor is NOT allowed to verify above information and records, then such appointment shall not be accepted.**

NOTE: If Time permits – Give a single reading of content given in ICAI SM [Oct 2021 Edition] – pg. 18.66 to 18.68 [Not Imp from Exam Viewpoint]

CLAUSE – 10: PROHIBITED TO ACCEPT FEES AS A PERCENTAGE OF PROFITS OF COMPANY:

1. **A CAP is treated as guilty of professional mis – conduct if he:**
   a. **Charges or offers to charge,**

   b. **accepts or offers to accept**
   c. **in respect of any professional employment fees which are:**
      i. **based on a percentage of profits or**
      ii. **which are contingent upon the findings, or results of such employment.**
2. **EXCEPTION:** However, if the same is **permitted under any regulations made under this act** then it **shall not be treated as guilty**.
3. It is to be noted that, the **fees cannot be considered as contingent if it is fixed by court or any public authority**. (E.g., Disputed fees)
4. **ADDITIONAL EXCEPTIONS:** In the following cases **acceptance of fees as a percentage of profits is permitted**:
   a. In the case of **a receiver or a liquidator**, the fees may be based on a percentage of the realization or disbursement of the assets.
   b. In the case of **an auditor of a co-operative society**, the fees may be based on a percentage of the paid-up capital or the working capital or the gross or net income or profits.
   c. **In the case of a valuer for the purposes of direct taxes** and duties, the fees may be based on a percentage of the value of property valued.
   d. In the case of **certain management consultancy services** as may be decided by the resolution of the Council from time to time, the fees may be based on percentage basis which may be contingent upon the findings, or results of such work.
   e. In the **case of certain fund-raising services,** the fees may be based on a percentage of the fund raised. (E.g., Underwriting)
   f. In the **case of debt recovery services,** the fees may be based on a percentage of the debt recovered.
   g. In the **case of services related to cost-optimization**, the fees may be based on a percentage of the benefit derived.
   h. **Any other service** or audit as may be decided by the Council. **[Following activities have been decided by the Council under "h" above: (i) Acting as Insolvency Professional, (ii) Non-Assurance Services to Non-Audit Clients]**

CLAUSE – 11: PROHIBITED TO ENGAGE IN ANY OTHER OCCUPATION OR BUSINESS OTHER THAN A CA:

1. A CAP is treated as guilty of professional mis – conduct **if he engages in any business or occupation in addition to CAP.**
2. **EXCEPTIONS:**
    a. If such **business/occupation is permitted by council of ICAI**, then it shall not be treated as guilty. (Ref – Point 3)
    b. If such **CAP is a director of a company not being MD/WTD.** (audit relation with the company is prohibited).
    c. A **CAP may act as a liquidator, trustee, executor, administrator, arbitrator, receiver, adviser or representative** for costing, financial or taxation matter, or **may take up an appointment that may be made by the Central Government or a State Government** or a court of law or any other legal authority or may act as a Secretary in his professional capacity, provided his employment is **not on a salary-cum-full-time basis. (Reg. 191 read with 190A).**
3. **PERMITTED ADDITIONAL OCCUPATIONS BY COUNCIL:**
    a. **NO PERMISSION REQUIRED/GENERAL PERMISSIONS –**
        i. **Employment under Chartered Accountants in practice** or firms of such chartered accountants.
        ii. **Private tutorship**. (Teaching hours - Not exceeding 25 Hours a week)
        iii. **Authorship of books and articles**. (Not Retail Reports)
        iv. **Holding of Life Insurance Agency License for the limited purpose of getting renewal commission.**
        v. **Attending classes and appearing for any examination.**
        vi. **Holding of public elective offices such as M.P., M.L.A. and M.L.C.**
        vii. **Honorary office leadership of charitable-educational or other non-commercial organisations.**
        viii. **Acting as Notary Public, Justice of the Peace, Special Executive Magistrate and the like.**
        ix. **Part-time tutorship under the coaching organisation of the Institute.**
        x. **Valuation of papers, acting as paper-setter, head-examiner or a moderator, for any examination.**
        xi. **Editorship of professional journals.**
        xii. Acting as Surveyor and Loss Assessor under the Insurance Act, 1938 provided they are otherwise eligible.

xiii. **Acting as recovery consultant in the banking sector.**
xiv. **Owning agricultural land and carrying out agricultural activity.**

b. **REQUIREMENT FOR SPECIAL AND PRIOR PERMISSION:**

i. **Full-time or part-time employment in business concerns provided that the member and/or his relatives do not hold "substantial interest" in such concerns.** (Read with Point – iii)
ii. **Full-time or part-time employment in non-business concern.**
iii. **Office of managing director or a whole-time director of a body corporate** within the meaning of the Companies Act, 2013. (Read with Point – I)
iv. **INTEREST in family business concerns** (including such interest devolving on the members as a result of inheritance / succession / partition of the family business) or concerns in which **interest has been acquired as a result of relationships and in the management of which NO ACTIVE PART IS TAKEN. (Including Karta of HUF) [Read Point 7]**
v. **Interest in an educational institution.**
vi. **Part-time or full-time lectureship for courses OTHER THAN those relating to the Institute's examinations** conducted under the auspices of the Institute or the Regional councils or their branches. (E.g., GMCS trainer)
vii. **Part-time or full-time tutorship under any educational institution other than the coaching organization of the Institute.** (Teaching hours - Not exceeding 25 Hours a week)
viii. **Editorship of journals other than professional journals.**
ix. Any other business or occupation for which **the Executive Committee considers that permission may be granted.**

4. It is **open to the Council to refuse permission in individual cases** though covered under any of the above categories.
5. The term "relative", in relation to a member, means **the husband, wife, brother or sister or any lineal ascendant or descendant** of that member. (Same definition under Income tax)
6. **DIRECTORSHIP / PROMOTER OF A COMPANY:**
   a. A member in practice is permitted generally to be **a DIRECTOR SIMPLICITOR in any company** including a board-managed company and as such **he is not required to obtain any specific permission of the council** in this behalf **irrespective of whether he and / or his relatives hold substantial interest in that company.**

b. **"Director Simplicitor" means an ordinary / simple Director. (Will not involve in executive affairs of the company)**
c. The **auditor of a subsidiary company cannot accept appointment as a director in holding company** of such subsidiary company.
d. There is **NO BAR FOR A MEMBER TO BE A PROMOTER / signatory to the Memorandum and Articles of Association** of any company. No specific permission is required.
e. A member **can accept the office of a managing director or a whole- time director only after obtaining**, the **specific and prior approval of the Council.**

7. **Member in practice having interest in family business:**

"A member of the Institute **can acquire interest in family business** in any of the following manner:

(i) As a proprietary firm
(ii) As a partnership firm
(iii) In the name and style of Hindu Undivided Family as its Karta or a member.

It would be necessary for the members to provide evidence that interest in the family business concern devolved on him as a result of inheritance/succession/partition of the family business. It is also necessary for the member **to show that he was not actively engaged in carrying on the said business** and that the family business concern in question **was not created by himself**.

8. **Decisions of the council / BOD / High court:**

a. **Bombay High Court –** Clause – 4 does not have overriding effect on Clause – 11.
b. **A CAP can register himself as registering authority for obtaining DSC's for clients.**
c. **A CAP may be a research adviser but cannot publish retail reports**.
d. A CAP **cannot receive remuneration for Financial advisory role to a bank, financial institutions, mutual funds or insurance companies.**
e. **A CAP cannot take agency of GIC/UTI/NSDL.**
f. A CAP **Cannot hold customs brokers license** under Sec. 146 of Customs Act, 1962.
g. **Trading in stocks / commodity derivatives is also an additional occupation and hence special permission of the institute is required.**

CLAUSE – 12: PROHIBITING A NON-MEMBER / NON – PARTNER TO SIGN ON BEHALF OF THE FIRM:

1. **A CAP is treated as guilty of professional mis – conduct if he allows, the following, to sign on his behalf or on behalf of firm:**
    a. **a non-member of the institute or**
    b. **a member who is not in practice or**
    c. **a person who is not a partner of his firm.**
2. **EXCEPTION:** However, the above clause does not apply **with respect to reports NOT CONTAINING EXPRESSION OF OPINION.**
3. In the following cases **a CAP can allow others to sign on his behalf with regard to routine documents** where professional opinion or authentication is not involved:
    a. **Issue of audit queries** during the course of audit.
    b. **Asking for information or issue of questionnaire**.
    c. **Letter forwarding draft observations**/financial statements.
    d. Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.
    e. **Acknowledging and carrying on routine correspondence** with clients.
    f. **Issue of memorandum of cash verification** and **other physical verification or recording the results** thereof in the books of the clients.
    g. **Issuing acknowledgements for records produced**. Raising of bills and issuing acknowledgements for money receipts.
    h. **Attending to routine matters in tax practice**, subject to provisions of Section 288 of Income Tax Act.
    i. **Any other matter incidental to the office administration** and routine work involved in practice of accountancy.
4. Also, the Council has decided that:
    a. Where a Chartered Accountant **while signing a report or, a financial statement or any other document is statutorily required to disclose his name**, **the member should disclose his name while appending his signature on the report or document**.
    b. Where there is **no such statutory requirement**, the member may **sign in the name of the firm**. (Member Seal vs Firm Seal).

PROFESSIONAL MIS-CONDUCT BY MEMBERS IN SERVICE FIRST SCHEDULE – PART II

A member of the Institute (other than a member in practice) **(I.e., Member in Service - MIS)** shall be deemed to be guilty of professional misconduct, **if he is being an employee of any company, firm or person** – (MIS may be full time or part time employee with or without COP)

CLAUSE – 1: PROHIBITS TO PAY, SHARE OF HIS EMOLUMENTS OF EMPLOYMENT:

1. A member of the Institute in service (MIS) is deemed to be guilty of professional misconduct, **if he is an employee of any company, firm or person** and **during that course whatever emoluments he receives**, **if he:**
   a. **either pays or**
   b. **allows to pay or**
   c. **agree to pay any part or share thereof whether directly or indirectly.**
2. **EXCEPTION:** However, this clause **dose not restricts such sharing or commitments among relatives, dependents, friends etc.**, **if** there is no relationship in procuring or retaining the job and payment **is not a consideration for job procurement or retainership.**

CLAUSE – 2: PROHIBITS TO ACCEPT TIPS FROM EMPLOYER RELATED SERVICE PROVIDERS:

A MIS is treated as guilty of professional mis – conduct **if he accepts or agrees to accept any part of fee, profits or gains** from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person **by way of commission or gratification.**
(Simply he shall not get anything unauthorizedly from 3rd parties who are clients / customers to the company where the member is providing service.)

PROFESSIONAL MIS-CONDUCT BY MEMBERS IN PRACTICE FIRST SCHEDULE – PART III

A member of the Institute, **whether in practice or not**, shall be deemed to be guilty of professional misconduct, if he –

CLAUSE – 1: NOT BEING A FELLOW OF THE INSTITUTE, BUT ACTS AS FELLOW OF THE INSTITUTE. (LESS THAN 5 YEARS) [ACA acting as FCA]

CLAUSE – 2: FAILS TO SUPPLY INFORMATION CALLED FOR, OR DOES NOT COMPLY WITH REQUIREMENTS OF:

1. ICAI,
2. Council,
3. Any of its committee,
4. Director (Discipline),
5. Board of Discipline,
6. Disciplinary committee,
7. Quality review board or
8. the appellate authority.

COUNCIL DECISIONS:

a. **P.S. Rao (1992) –** Clause (11) of Part I and Clauses (1) and (3) of Part III where **a Chartered Accountant had not disclosed to the Institute at any time about his engagement as a proprietor of a non-chartered accountant's firm** while holding certificate of practice and **had not furnished particulars of his engagement as Director** of a company despite **various letters of the institute which remained un replied**. Held that **he was guilty under Clause (11) of Part I and Clauses (1) and (3) of Part III of the First Schedule.**

CLAUSE – 3: GIVING FALSE INFORMATION TO OTHERS:

1. A member of the institute is treated as guilty of professional mis – conduct, **if he provides knowingly any false information:**
    a. **While inviting work from another CA**
    b. **While responding to tenders** or enquiries.
    c. **While advertising through a writeup or anything** as provided in clause – 6&7 of Part – I of this Schedule.
2. This clause applies whether the **misrepresentation is made through documents or acts.**

PROFESSIONAL MIS-CONDUCT BY MEMBERS IN GENERAL FIRST SCHEDULE – PART IV

As per Part – IV of Schedule – I to CA Act, 1949, A member of the Institute, **whether in practice or not**, shall be deemed to be guilty of **other misconduct,** if he –

CLAUSE – 1: HELD GUILTY BY ANY CIVIL OR CRIMINAL COURT FOR AN OFFENCE WHICH IS PUNISHABLE WITH IMPRISONMENT FOR A TERM NOT EXCEEDING SIX MONTHS.

CLAUSE – 2: IN THE OPINION OF THE COUNCIL, BRINGS DISREPUTE TO THE PROFESSION OR THE INSTITUTE AS A RESULT OF HIS ACTION WHETHER OR NOT RELATED TO HIS PROFESSIONAL WORK.

JUDGMENTS:

1. **Deputy General Manager, Canara Bank vs. Prasanta Kumar Roy Burman:** Where a Chartered Accountant **had floated various Companies/Firms and availed huge limits from various Banks** in the name of the said Companies/Firms. The limits were availed fraudulently by him against factory, land & building, machineries and other fixed assets in his name and others were already mortgaged with a Bank. Furthermore, **besides holding full time COP he was also the Proprietor/Director** of Firms/Private Limited Company for which **he did not inform the Institute**. Held, guilty of 'Other Misconduct' falling under **Clause (2) of Part IV of First Schedule to the Chartered Accountants Act, 1949** with respect to the charge of being Proprietors of other Firms he was guilty of '**Professional Misconduct' falling under Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.**

2. **Kanchan Bhagchandani vs. Vaibhav Kumar Mehta:** The **accounts of the Complainant were maintained and audited** by a Chartered Accountant. Even after the full payment of fees **he refused to complete the work and to file the Income Tax Returns**. The Respondent Firm was in the possession of all the original accounts and refused to hand over the same. Further on seeking for the payments against the work done for the interior of the new office of the Firm, the Complainant was abused and threatened. The Password of Income Tax account was also changed by him without knowledge of the Complainant. The Respondent refused to accept the payment made by cheque. Held, guilty of **'Other Misconduct' falling within the meaning of Clause (2) of Part IV** of the First Schedule to the Chartered Accountants Acts, 1949 read with section 22 of the said Act.

PROFESSIONAL MIS-CONDUCT BY MEMBERS IN PRACTICE
SECOND SCHEDULE – PART I

CLAUSE – 1: PROHIBITION ON DISCLOSURE OF INFORMATION PERTAINING TO CLIENT:

1. A CAP Shall be deemed to be guilty of professional mis – conduct **if he discloses information relating to client**, **acquired in the course of professional work, to any third party.**
2. **EXCEPTION:** However, the above clause **does not apply:**
    a. Information is disclosed **with the consent of client.**
    b. Such **disclosure of information is required under law.**
3. The duty of **not to disclose such information continues even after completion of engagement.**
4. **Members duty in unlawful acts of client:**
    a. A CAP is **NOT DUTY BOUND TO DISCLOSE income tax authorities about taxation frauds committed by his clients** which came to know during the conduct of professional work.
    b. Sec. 126 of Indian Evidence act **-** **a barrister, attorney, pleader or *Vakil*** is barred from disclosing **except with the express consent of his client:**
        i. any communication **made to him in the course of and for the purpose of his employment** or
        ii. to **state the contents or conditions of any document with which he has become acquainted** in such course.
    c. The **proceedings before income tax authorities are judicial proceedings** and the CAP who represents on behalf of client be treated as attorney. **Accordingly, Sec. 126 protection applies to a CAP acting on behalf of client.**
    d. However, **if a CAP discovers any fraud or crime *committed after* commencement of his professional work** then sec. 126 protection will not apply. He would be **liable to disclose to legal authorities**. (Past frauds – can be hidden. New Frauds – Must be disclosed)

5. **Suppression of facts in Past IT Returns:**
    a. **Intentional Suppression – Discovered**: The CAP **can continue to support his client.**
    b. **Unintentional Suppression** – CAP **may disclose** such information to tax authorities.
    c. **Fraud relates to past accounts certified by such CAP –**
        i. The member **shall advise the client to make a complete disclosure.**
        ii. If **client refuses to disclose**:
            1. then member **can withdraw from engagement** and
            2. **inform concerned authorities that the past records examined and reported upon are unreliable.**
6. **Suppression related to current period:** Suppose if the suppression of fraud relates to current period accounts, then member shall advise the client to make a full disclosure. If client refuses then:
    a. member shall withdraw from engagement or
    b. should give a modified report.
7. Suppose **the employment of member is dispensed before** accounts are complete or reported upon, the **member has no further obligation regarding the same.**

CLAUSE – 2: PROHIBITS A CAP TO CERTIFY ACCOUNTS NOT VERIFIED BY HIM:

1. A CAP is deemed to be guilty of professional mis – conduct **if he certifies or reports** on financial statements which are **not examined by him or by his partner/employee or another CAP.** [**EXCEPTION: JOINT AUDIT**]
2. The **certification may be in his name or his firm's name.**

P.N. Vittal Dass, Addl. Collector of Customs, Mumbai vs. P.U. Patil: Where a Chartered Accountant **issued false certificates to several parties for past exports for monetary consideration without verifying any supporting records or documents**. On the strength of these false certificates, **certain unscrupulous importers were able to obtain import license, effect imports and clear these free of duty, perpetuating a fraud on Government revenue** and depriving the Government of its legitimate revenue to the tune of several Crores of Rupees. Held that the respondent was guilty of professional misconduct within the meaning of **clauses (2), (7) & (8) of Part I of the second schedule** of the Chartered Accountants Act, 1949 in terms of section 21 & 22 of the said Act.

CLAUSE – 3: PROHIBITS A CAP TO USE HIS NAME ON REPORTS RELATED TO EARNINGS ESTIMATE:

1. A CAP shall be deemed to be guilty of professional mis – conduct **if he allows or permits his name or firm name on a report that deals with earning estimate which depends on contingent future transactions.**
2. **EXCEPTION:** However, as per the opinion of the council, a CAP is **permitted to use his name on earnings estimate documents [including projections]** provided he:
   a. **Indicates clearly about the sources** of information.
   b. The **basis of Forecast and underlying assumptions** made.
   c. The **fact that he did not vouch for the accuracy** of forecast.

CLAUSE – 4: PROHIBITS EXPRESSION OF OPINION ON F/S OF ENTITY WHERE CAP HAS SUBSTANTIAL INTEREST:

1. A CAP is deemed to be guilty of professional mis – conduct **if he expresses opinion on financial statements of business or entities in which either he or his firm or his partner has a substantial interest.**
2. Further as per the guidelines of the council, **a CAP is prohibited to express opinion on financial statements of an entity if one or more of his relatives has a substantial interest.**
3. The above rules equally apply for all types of attest functions.
4. A Chartered Accountant **should not by himself or in his firm name:**
   a. Accept the **Auditor ship of a college, if he is working as a part-time lecturer** in the college.
   b. Accept the **Auditor ship of a Trust where his partner is either an employee or a trustee** of the Trust.
5. **COOLING OFF PERIOD AFTER COMPLETION OF TENURE AS DIRECTOR: A member shall not accept the assignment of audit of a Company for a period of 2 years from the date of completion of his tenure as Director, or resignation as Director of the said Company.**

CLAUSE – 5: FAILURE TO DISCLOSE A MATERIAL FACT KNOWN TO A CAP – GUILTY:

1. A CAP Shall be deemed to be guilty of professional mis – conduct **if he fails to disclose a material fact known to him which is not disclosed in financial statements in accordance with AFRFW.**
2. **EXCEPTION:** However, If the failure **is on the part of a member who is in employment** and that information is **not meant for any outside authorities then it shall not be treated as guilty.**

CASE LAWS:

Kishori Lal Dutta vs-P.K. Mukherjee (1968) – Where a Chartered Accountant had **not disclosed the fact that a large amount of loan have been given out of the funds of an Employees Provident Fund** to the Employer Company **in contravention of the Rules of the Provident Fund** and **had failed to report on the default in clearing the cheques** received in re-payment of the loan. **Held by the Supreme Court** on appeal that it was **no defence for the chartered accountant to say that he had disclosed the irregularities to the company as it was his duty to have made a disclosure thereof to the beneficiaries of the Provident Fund** in the statement of accounts signed by him **as the legal position of the auditor in the present case was similar to that of the auditor appointed under the Companies Act.** He was **therefore guilty of professional misconduct**.

CLAUSE – 6: FAILS TO REPORT A MMS - GUILTY:

1. A CAP shall be deemed to be guilty of professional mis – conduct **if he fails to report a MMS in the financial statements known to him**.

CLAUSE – 7: GUILTY IF DOES NOT EXERCISE DUE DILIGENCE:

1. A CAP shall be deemed to be guilty of professional mis – conduct **if he does not exercise due diligence or grossly negligent**, in conducting his professional work.
2. **Karnataka High court judgment (1977) –**
    a. It is the duty of an auditor **to perform the work with skill, care and caution**.
    b. If there exist **any matter that gives suspicion then he should probe it to the bottom**; but in the absence of anything of that kind he is only bound to be reasonably cautious and careful.
    c. **Negligence generally would not amount to gross negligence** in the case **of minor errors and lapses**, which do not constitute professional misconduct and which, therefore, **don't require a reference to the Disciplinary Committee**. **The Council would nevertheless bring the matter to the attention of its members so that greater care may be taken in the future in avoiding errors and lapses of a similar type.**

CLAUSE – 8: CAP SHALL OBTAIN SUFFICIENT AND APPROPRIATE EVIDENCE:

1. A CAP shall be deemed to be guilty of professional mis – conduct **if he fails to obtain sufficient and appropriate evidence which is necessary for expression of opinion.**

2. **EXCEPTION:** However, if he is unable to obtain sufficient and appropriate evidence, **he shall deny expression of opinion**. (i.e., Disclaimer of opinion)
3. This clause covers **both expression of opinion and certification of facts.**
4. If a member **fails with this clause it may be further treated as gross negligence.**

CLAUSE – 9: CAP SHALL FOLLOW AUDIT - GAAP:

1. A CAP shall be deemed to be guilty of professional mis – conduct **if he fails to comply with generally accepted audit procedures while performing professional works**.
2. **EXCEPTION:** However, **if he is unable to comply with GAAP** and **mentions the same in his report, then this clause shall not apply**.
3. **Audit of Listed Companies:** Pursuant to SEBI Notification, Statutory Audit of Listed Companies under the Companies Act, 2013 shall be done by **only those auditors who have subjected themselves to the Peer Review process** of the Institute, **and hold a valid certificate** issued by the Peer Review Board of the ICAI.
4. **Verification on behalf of Banks:** In the case of verification on behalf of banks, the rules or procedure for conducting such audit are different from the normal rules applicable to audits under the Companies Act. **Members are required to be very familiar with the special procedure required in these matters and act accordingly.**

CLAUSE – 10: CAP MUST KEEP CLIENTS MONEY IN A SEPARATE BANK ACCOUNT:

1. Any amount received from client **must be kept in a separate bank account and shall be utilized only for the purposes mentioned** by the client.

2. **EXCEPTIONS:** However, this **clause does not apply** for the following receipts:
   a. An **advance received** by a Chartered Accountant **against services to be rendered.**
   b. **Moneys received for expenses to be incurred**, for example, **payment of prescribed statutory fees, purchase of stamp paper** etc., which are **intended to be spent within a reasonably short**.

For example: N.S. Chenoy v.s. K.V. Subba Rao: Commonly many CA's are mentioning their bank account details for getting IT Refund of the client. This is treated as guilty of professional mis – conduct.

PROFESSIONAL MIS-CONDUCT BY MEMBERS IN GENERAL SECOND SCHEDULE – PART II

A member who **may be in practice or otherwise**, shall be deemed to be professional mis – conduct in the following cases:

CLAUSE – 1: MEMBERS TO COMPLY WITH CA ACT, REGULATIONS AND GUIDELINES:

1. A member is deemed to be guilty of professional mis – conduct **if he fails to comply with CA Act or any regulations made thereunder**.
2. Common violations of regulations, came to the notice of the council:
    a. Regulation 43 – Engagement of Articled Assistant.
    b. Regulation 46 – Registration of Articled Assistant.
    c. Regulation 47 – Premium from Articled Assistant.
    d. Regulation 48 – Stipend to Articled Assistant.
    e. Regulation 56 – Termination or assignment of Articles.
    f. Regulation 65 – Articled Assistant not to engage in any other occupation.
    g. Regulation 67 – Complaint against the employer (from Articled Assistant).
    h. Regulation 68 to 80 – Audit Assistant.
    i. Regulation 190 – Register of offices and firms
    j. Regulation 190A – Chartered Accountants not to engage in any other business or occupation.
    k. Regulation 191 – Part time employment's a Chartered Accountant may accept.
    l. Regulation 192 – Restriction on fees

CLAUSE – 2: PROHIBITION TO DISCLOSE INFORMATION RELATED TO EMPLOYER:

1. A member is deemed to be guilty of professional mis – conduct **if he disclosed any confidential information relating to his employer** company, firm or any other person.
2. **EXCEPTION:** However, this clause **does not apply if consent of employer is obtained for such disclosure.**

CLAUSE – 3: PROVIDING MIS – LEADING INFORMATION TO THE INSTITUTE:

A member shall be deemed to be guilty of professional mis – conduct if he furnishes **any returns, reports, statements or forms which contain any false information knowingly to the institute**, council or any of its committees, BOD, Director Discipline, Disciplinary committee, Quality review board, appellate authority.

CLAUSE – 4: DEFALCATION OF MONEY RECEIVED:

A member shall be deemed to be guilty of professional mis – conduct, if **he defalcates or embezzles any money received in professional capacity**. This act amounts to fraud.

OTHER MIS-CONDUCT BY MEMBERS IN GENERAL SECOND SCHEDULE – PART III ONLY 1 CLAUSE

A member of the Institute, **whether in practice or not**, shall be deemed to be guilty of other misconduct, **if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment** for a term **EXCEEDING 6 MONTHS.**

COUNCIL GUIDELINES, 2008

The council guidelines contain various chapters. Few relevant chapters are being discussed here under:

CHAPTER – I: These guidelines shall be applicable to **ALL the Members of the Institute whether in practice or not** wherever the context so requires.

CHAPTER – II: A member of the Institute who is **an employee shall exercise due diligence and shall not be grossly negligent** in the conduct of his duties.

CHAPTER – III: OMITTED

CHAPTER – IV: OMITTED

CHAPTER – V: MAINTENANCE OF BOOKS OF ACCOUNTS BY CAP:

1. A member of the Institute in practice or the firm of Chartered Accountants, **shall maintain and keep in respect of his / its professional practice, proper books of account** including the following-

a. A cashbook.
b. A ledger.

2. These books of accounts have to be maintained **irrespective of the fact that the member turnover is less than the limits specified u/s 44AA of income tax act, 1961.**

CHAPTER – VI: LIMIT OF NUMBER OF TAX AUDIT ASSIGNMENTS:

1. A member of the Institute in practice **shall not accept, in a financial year, more than the "60 tax audits"** under Section 44AB of the Income-tax Act, 1961.
2. In case of partnership firm / LLP, the above number is counted for "per partner in practice".
3. **Exclusion from the limit: Audit conducted u/s. 44AD, 44ADA and 44AE.**
4. The **audit signatures may be distributed between all of the partners as per the choice of the firm**.
5. A Chartered Accountant in practice **shall maintain a record of the tax audit assignments accepted by him IN EACH ASSESSMENT YEAR** in the format as may be prescribed by the Council.
6. The **audit of one or more branches of the same concern** by one Chartered Accountant in practice **shall be construed as ONLY ONE TAX AUDIT ASSIGNMENT.**

CHAPTER – VII: NON-PAYMENT OF UNDISPUTED AUDIT FEES:

1. A CAP **shall not accept the appointment as auditor** of an entity in case the **undisputed audit fee of another Chartered Accountant** for carrying out the statutory audit under the Companies Act, 2013 or various other statutes has not been paid.
2. However, this prohibition **shall not apply in case appointment is w.r.t sick units.**

Explanation 1: For this purpose, **the provision for audit fee in accounts** signed by both - the auditee and the auditor **along with other expenses, if any, incurred by the auditor in connection with the audit**, shall be considered as **"undisputed audit fees".**

Explanation 2: For this purpose, "sick unit" shall mean **a unit registered for not less than 5 years**, which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

CHAPTER – VIII: PROHIBITION ON AUDIT ASSIGNMENTS UNDER COMPANIES ACT 2013:

A member of the Institute in practice **shall not hold at any time appointment of more than the "specified Number of audit assignments"** of Companies under Section 139 of the Companies Act, 2013. [Similar to Ceiling Limit Concept u/s 141(3)(g) of Companies Act, 2013]

EXPLANATIONS AND CLARIFICATIONS:

1. **SPECIFIED NUMBER OF AUDIT ASSIGNMENTS:** For the above purpose, the "specified number of audit assignments" means –
   a. **PROPRIETOR:** In the case of a Chartered Accountant in practice or a proprietary firm of Chartered Accountant, **30 audit assignments** whether in respect of private Companies or other Companies, with the ***exception of one person Companies and dormant companies [W.E.F. FEB 2020]***.
   b. **PARTNERSHIP:** In the case of Chartered Accountants in practice, **30 audit assignments per partner** in the firm, whether in respect of private Companies or other Companies, with the ***exception of One person Companies and dormant companies [W.E.F. FEB 2020].***
2. The **number of partners of a firm on the date of acceptance of audit** assignment shall be taken into account.
3. All other rules prescribed under **Chapter – VI shall equally apply here**.

CHAPTER – IX: PROHIBITION IF OTHER FEES EXCEEDS STATUTORY AUDIT FEES:

1. In case of **public sector undertakings, government companies, listed companies and *other public companies having turnover Rs. 50 crore or more* –** The **audit of these companies shall not be accepted** by a CAP **if the audit fees is LESS THAN the aggregate fees received for other services rendered** to the same company.
2. The **above restrictions shall apply in respect of fees** for other works or services or assignments **payable to the statutory auditors and their associate concerns put together.**
3. The term **"other works" or "services" or "assignments" shall include Management Consultancy** and all other professional services permitted by the Council pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 but **SHALL NOT INCLUDE**:
   a. **Audit under any other statute**. (E.g., Tax audit and GST audit)
   b. **Certification work required to be done by the statutory auditors**.
   c. **Any representation before an authority**.

CHAPTER – X: INDEBTED MORE THAN RS.1,00,000/-:

1. **A CAP** or **a partner of a firm** in practice or **a firm** or **a relative of such member or partner** **shall not accept appointment as auditor of a concern while indebted to the concern** or **given any guarantee** or **provided any security in connection with the indebtedness** of any third person to the concern:
    a. For **limits fixed in the statute** and (E.g., company under companies act)
    b. In other cases, **for amount exceeding Rs. 1,00,000/-**
2. However, this restriction **does not apply if the CAP received fees on progressive basis.**

CHAPTER XI: DIRECTIONS IN CASE OF UNJUSTIFIED REMOVAL OF AUDITORS:

A member of the Institute in practice shall follow the direction given, by the Council or an appropriate Committee or on behalf of any of them, to him being **the incoming auditor(s) not to accept the appointment as auditor(s), in the case of unjustified removal of the earlier auditor(s).**

CHAPTER XIII – GUIDELINES ON TENDERS:

1. A member of the Institute in practice **shall not respond to any tender issued by an organization or user of professional services** in areas of services **which are exclusively reserved for chartered accountants,** such as audit and attestation services.
2. **EXCEPTION:** However, such restriction **shall not be applicable**:
    a. Where **minimum fee of the assignment is prescribed** in the tender document itself **or**
    b. Where the **areas are open to other professionals along with the Chartered Accountants.**

CHAPTER XIV – UNIQUE DOCUMENT IDENTIFICATION NUMBER (UDIN) GUIDELINES

A member of the Institute in practice **shall generate Unique Document Identification Number (UDIN) for all kinds of the certification, GST and Tax Audit Reports and other Audit, Assurance and Attestation functions undertaken/signed by him** which made mandatory from the following dates through announcements published on the website of the ICAI www.icai.org at the relevant time: -

1. **For all Certificates w.e.f. 1st February, 2019.**

2. **For all GST and Tax Audit Reports w.e.f. 1st April, 2019.**
3. **For all other Audit, Assurance and Attestation functions w.e.f. 1st July, 2019**.

CHAPTER XV – GUIDELINES FOR NETWORKING: [NEWLY ADDED]

A. PROFESSIONAL JUDGMENT: The judgment as to whether the larger structure is a network shall be made in light of whether a reasonable and informed third party would be likely to conclude, **weighing all the specific facts and circumstances,** that the entities are associated in such a way that a network exists. This judgment shall be applied consistently throughout the network.

1. **ONLY REFERRAL WORKS – *NOT A NETWORK*:** A larger structure may be aimed **only at facilitating the referral of work**, which in itself does not meet the criteria necessary to constitute a network.
2. **SHARE COMMON BRAND NAME / QC / RESOURCES – *NETWORK:*** a larger structure might be such that it is **aimed at co-operation and the firms share a common brand name, a common system of quality control**, or significant professional resources and **consequently is deemed to be a network.**
3. **PROFIT OR COST SHARING – *NETWORK*:** Where the larger structure is aimed at co-operation and **it is clearly aimed at profit or cost sharing** among the entities within the structure, it is deemed to be a network. However, **the sharing of immaterial costs does not in itself create a network.**
4. **COST SHARING ONLY FOR WORK METHODS – *NOT A NETWORK*:** In addition, if the **sharing of costs is limited only to those costs related to the development of audit methodologies**, manuals, or training courses, this would **not in itself create a network.**
5. **JOINT DEVELOPMENT OF PRODUCT – *NOT A NETWORK*:** Further, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product does not in itself create a network.
6. **COMMON CONTROL AND MANAGEMENT – *NETWORK:*** Where the **larger structure is aimed at cooperation and the entities within the structure share common ownership**, control or management, it is deemed to be a network. This could be achieved by contract or other means.
7. **COMMON QCP – *NETWORK:*** Where the larger structure is aimed at co-operation and the entities within **the structure share common quality control policies and procedures,** it is deemed to be a

network. For this purpose, common quality control policies and procedures are those designed, implemented and monitored across the larger structure.

8. **COMMON BUSINESS STRATEGY – *NETWORK:*** Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy, it is deemed to be a network. **Sharing a common business strategy involves** an agreement by the entities to achieve common strategic objectives.
9. **JOINT WORKS – NOT A NETWORK:** An entity is not deemed to be a network firm merely because it co- operates with another entity solely to respond jointly to a request for a proposal for the provision.
10. **SHARING SIGNIFICANT PROFESSIONAL RESOURCES - *NETWORK*:** Where the larger structure is aimed at **co-operation and the entities within the structure share a significant part of professional resources**, it is deemed to be a network. **Professional resources include:**
    a. **Common systems** that enable firms to exchange information such as client data, billing and time records.
    b. **Partners and staff**.
    c. **Technical departments** that consult on technical or industry specific issues, transactions or events for assurance engagements.
    d. **Audit methodology or audit manuals**; and
    e. **Training courses** and facilities.

MEANING OF SIGNIFICANT SHARING OF RESOURCES:

- **FACTS AND CIRCUMSTANCES:** The determination of whether the professional resources shared are significant, and therefore the firms are network firms, shall be made based on the relevant facts and circumstances.
- **COMMON AUDIT METHODOLOGY ONLY – NOT SIGNIFICANT:** Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources would be significant.
- **COMMON TRAINING ONLY – NOT SIGNIFICANT:** The same applies to a common training endeavour.
- **EXCHANGE OF PEOPLE – PERCEIVED AS SIGNIFICANT:** Where, however, the shared resources involve the exchange of people or information, such as where staff are drawn from a shared pool,

or a common technical department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant.

B. VARIOUS LEGAL FORMS OF THE NETWORK:

1. **MUTUAL ENTITY:** A network can be constituted as a mutual entity which will act as a facilitator for the constituents of the Network. In such a case the Network itself will not carry out any professional practice.
2. **PARTNERSHIP:** A network **can be constituted as a partnership firm** subject to the condition that the total number of partners does not exceed 20.
3. **LLP:** A network **can be constituted as a Limited Liability Partnership** subject to the provision of the Chartered Accountant Act and Rules and such other laws as may be applicable.
4. **COMPANY:** A network **can be constituted as company** subject to the guidelines prescribed by Institute for corporate form of practice and formation of management consultancy services company.
5. **PERMITTED CAP FIRMS TO BE MEMBERS:** Network Firms shall consist of sole Practitioner / proprietor, partnership or any such entity of professional accountants as may be permitted by the Act.
6. **A firm is allowed to join only one network.**
7. **Firms having common partners shall join only one Network**.

C. APPROVAL OF NAME OF NETWORK AMONGST FIRMS REGISTERED WITH INSTITUTE:

1. **AFFILIATES vs ASSOCIATES:** The Network may have distinct name which should be approved by the Institute. To distinguish a "Network" from a "firm" of Chartered Accountants, the words "& **Affiliates" shall be used after the name of the network and the words "& Co." / "& Associates" shall not be used.**
2. The prescribed format of application for approval of Name for Network is at Form 'A' (enclosed).
3. **UNDESIRABLE NAMES – NOT PERMITTED:** Provisions of Regulation 190 of the Chartered Accountants Regulations, 1988 shall be applicable to the name of Network. However, even if a name is approved and subsequently it is found that the same is **undesirable** then, the said name may be withdrawn at any time by the

Institute. The Institute shall reject any undesirable name and the provisions in respect of names of companies as prescribed in the Companies Act, 2013 shall be applicable in spirit.

4. **30 DAYS TIME LIMIT TO APPROVE:** The **Institute shall approve or reject the name of the Network within a period which shall not be later than 30 days from the date of receipt** of the said Form.
5. **DO NOT CARRY-ON PRACTICE:** Mere ***approval of the name*** of the Network shall not entitle the Network to carry on practice in its own name.

D. REGISTRATION OF NETWORK WITH ENTITIES IN INDIA:

1. **RESERVE NAME – 3 MONTHS:** After the name of a Network is approved as per provision under Guideline 5, **the Institute same shall reserve such name for a period of three (3) months** from the date of approval.
2. The **Network shall get itself registered with the Institute** by applying in **Form B within the period of 3 months**, failing which the name assigned shall stand cancelled on the expiry of the said period. Registration of **Network with Institute is mandatory**.
3. If **different Indian firms are networked with a common Multinational Accounting Firm**, they **shall be considered as a part of network.**

E. LISTING OF NETWORK ALONG WITH ENTITIES / FIRMS OUTSIDE INDIA:

Proprietary/individual members, partnership firms as well as members in LLP or any such other entity of members as may be permitted by the Act, **shall be permitted to join such network with entities outside India provided** that the proprietary/individual members, partnership firms as well as members in LLP or any such other entity of members **are allowed to join only one network** and **firms having common partners shall join only one such network.**

F. CHANGE IN CONSTITUTION OF REGISTERED NETWORK:

In case of change in the constitution of registered Network on account of any entry into or exit from the Network, the network shall communicate the same to the Institute by filing **Form 'C'** within a period of thirty (30) days from the date of change in the constitution.

G. ETHICAL COMPLIANCE AND RULES:

Once the relationship of network arises, it will be necessary for such a network to comply with all applicable ethical requirements prescribed by the Institute from time to time in general and the following requirements in particular:

1. **PROHIBITED SERVICES:** If **one firm of the network is the statutory auditor** of an entity **then the associate [including the networked firm(s)] or the said firm directly/indirectly shall not accept the internal audit or book-keeping or such other professional assignments which are prohibited for the statutory auditor firm**.
2. **CEILING ON NON-AUDIT FEES:** The guidelines of ceiling on Non-audit fees is applicable in relation to a Network as follows:
    a. **AUDITOR FIRM – OTHER SERVICES FEES NOT TO EXCEED STAT AUDIT FEES:** For a Network firm who is doing statutory audit (including its associate concern and/or firm(s) having common partnership), it shall be the same as mentioned in the said notification and
    b. **OTHER NETWORK FIRMS – NOT TO EXCEED 3 TIMES:** For **other firms of the same Network collectively, it shall be 3 times of the fee payable for carrying out the statutory audit of the same undertaking/ company.**
3. **ROTATION OF AUDITORS:** In those cases where rotation of firms is prescribed by any regulatory authority, **NO** member firm of the network can accept appointment as an auditor in place of any member firm of the network which is retiring.
4. The **Network may advertise the Network to the extent permitted by the Advertisement Guidelines** issued by Institute.
5. The firms constituting the network are permitted to use the words **"Network Firms" on their professional stationery**.
6. The constituent member firms of a Network and the Network shall comply with all the Ethical Standards prescribed by the Council from time to time.

H. CONSENT OF CLIENT:

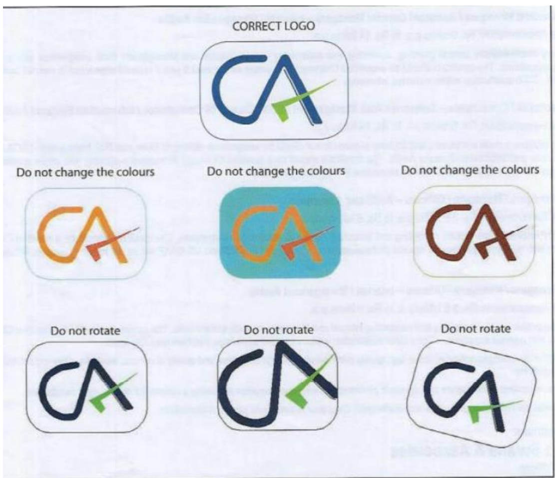
The effect of registration of network with Institute will be deemed to be a public notice of the network and therefore consent of client will be deemed to be obtained.

I. FRAMEWORK OF INTERNAL BYELAWS OF NETWORK:

To streamline the networking, a network **shall formulate operational bye-laws**. Bye-laws **may contain the following clauses** on which the affiliates of the network may enter into a written agreement among themselves [These clauses are illustrative]:

1. **Appointment** of a Managing Committee, from among the managing partners of the member firms of the network and the terms and conditions under which it should function.
2. The **minimum and maximum number** of **members of the Managing Committee** shall also be agreed upon.
3. **Administration** of the network
4. **Contribution of membership fees** to meet the cost of the administration of the network.
5. Identifying a partner of any of the member firms of the network to be responsible for the assignment (engagement partner).
6. **Dispute settlement procedures** through arbitration and conciliation
7. Development of **training materials** for members of the network
8. Issue of **News-letters** for staff and clients
9. **Development of software** for different types of assignments
10. Development and **maintenance of data bases relevant** for different types of assignments
11. **Library.**
12. Appointment of **a technical director** to whom references can be made
13. Determining the **methodology for drawing resources** from each member firm
14. Determining **compensation to member firms for resources** to be drawn from them
15. **Peer review** of the member firms

CHAPTER XVI – LOGO GUIDELINES: [already discussed previously]



CHAPTER XVII – GUIDANCE FOR CORPORATE FORM OF PRACTICE:

1. The Council decided to allow members in practice **to hold the office of Managing Director, Whole-time Director or Manager of a body corporate** within the meaning of the Companies Act **PROVIDED** that **the body corporate is engaged exclusively in rendering Management Consultancy and Other Services** permitted by the Council in pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 and **complies with the conditions(s) as specified by the Council** from time to time in this regard.
2. **MD / WTD IN The members can retain full time Certificate of Practice** besides being the Managing Director, Whole-time Director or Manager of such Management Consultancy Company.
3. There will be **no restriction on the quantum of the equity holding** of the members, either individually and/ or along with the relatives, in such Company.
4. **The name of the Management Consultancy Company is required to be approved by the Institute and such Company has to be registered with the Institute.**
5. On abundant caution, it may be clarified that **no audit practice can be done in Corporate Form.** The consultancy practice hitherto done in **Individual or Firm Status alone is now** intended to be permitted in Corporate Form also.

ETHICAL COMPLIANCE:

Once the Management Consultancy Company is Registered with the Institute as per the Guidelines, it will be necessary for such a Company to comply with the following requirements: -

1. **ASSOCIATE COMPANY – NOT TO ACCEPT PROHIBITED SERVICES:** If the individual practitioner/sole-proprietorship firm/partnership firm is the statutory auditor of an entity **then the Management Consultancy Company should not accept the internal audit or book-keeping or such other professional assignments, which are prohibited for the statutory auditor firm.**
2. **CEILING ON NON-AUDIT FEES:** Ceiling on Non-audit fees is **applicable in relation to a Management Consultancy Company.**
3. **COMPANY SHALL NOT DO SOLICITATION:** The Management Consultancy Company shall comply with clauses (6) & (7) of Part-I of the First Schedule to the Chartered Accountants Act, 1949 and such other directives as may be issued by the Institute from time to time.

4. **DECLARATION:** The Management Consultancy Company **shall give an undertaking that it shall comply with clauses (6) & (7) of Part-I of the First Schedule** to the Chartered Accountants Act, 1949 and such other directives as may be issued by the Institute from time to time.
5. **OBJECT OF MANAGEMENT CONSULTANCY COMPANY:** The Management Consultancy Company shall engage itself only in Management Consultancy & Other Services. The Management Consultancy Company shall give an undertaking that it shall render only Management Consultancy & Other Services prescribed by the Council pursuant to powers under section 2 (2)(iv) of the Chartered Accountants Act, 1949.

COUNCIL GUIDELINES FOR ADVERTISEMENT, 2008

WRITE UP:

The Members **may advertise through a write up** setting out their particulars or of their firms and services provided by them subject to the following Guidelines and **must be presented in such a manner as to maintain the profession's good reputation, dignity and its ability** to serve the public interest.

The Member(s)/Firm(s) should ensure that **the contents of the Write up are true to the best of their knowledge** and belief and **are in conformity with these Guidelines** and be aware that the Institute of Chartered Accountants of India will neither approve a propose write-up, nor owns any responsibility whatsoever for such contents or claims by the writer Member(s)/ Firm(s).

CONDITIONS:

1. It shall be **honest and truthful**.
2. There shall be **no exaggerated claims for the services** offered by the member or the Firm, or the qualifications or experience of the member or any of the partners or any other person associated with the Firm.
3. It **must not make any disparaging** [degrading others] references or unsubstantiated comparisons to the work of others.
4. It should **not be of a nature that may bring the profession into disrepute.**
5. It **should not contain testimonials or endorsements** concerning Member(s) or names of clients (both the past and present) or the fees charged.

6. It **should not contain any information about achievements /awards** (except the awards given by the Central or State Governments or Regulatory bodies) or any other position held, or accreditation(s) granted by any organisation.
7. **Monogram of any kind or use of any kind of catch words is not permissible**.
8. The **Membership No./FRN (as may be applicable) is mandatory** to be mentioned in the write-up.
9. It should not be of font size exceeding 14.
10. It must **not be violative of any provisions** of Chartered Accountants Act, 1949, Chartered Accountants Regulations, 1988, Code of Ethics, 2020 or any Guideline of the Council
11. The Institute of Chartered Accountants of India **may issue a reasoned directive for removal or withdrawal of the whole write-up** or of any part(s) thereof.

ADVERTISEMENT THROUGH WRITE-UP:

FOR DETAILED NOTES ON PERMISSABLE CONTENTS OF THE WRITE UP – PLEASE REFER PAGE. 18.129 IN STUDY MATERIAL – OCT 2021 EDITION. [NOT IMP FROM EXAM VIEWPOINT]

NOTE ON ONLINE THIRD-PARTY PLATFORMS

1. A Number of non-Chartered Accountants' firms, corporates including banks, finance Companies and newspapers **have set up their own Websites providing advisory services** on taxation and other areas **where Chartered Accountants are rendering professional service**. Some of such Websites **may request Chartered Accountants or Chartered Accountants' firms to provide consultation** and advice through their Websites.
2. **No other service**, besides consultancy and advice can be rendered through such websites.
3. This would be permitted **subject to the condition that on the Website, contact address of the Chartered Accountant concerned is not provided nor** such Website will contain any material which advertises professional achievements or status of such Chartered Accountant **except making a statement that they are Chartered Accountants.**
4. **The name of Chartered Accountants' firm with suffix "Chartered Accountants" would not be permitted.**

PUBLICATION OF NAME OR FIRM NAME BY CHARTERED ACCOUNTANTS IN THE TELEPHONE OR OTHER DIRECTORIES PUBLOISHED BY TELEPHONE AUTHORITIES OR PRIVATE BOIES AND AGGREGATORS AND SPECIALISED DIRECTORIES

A. TELEPHONE OR OTHER DIRECTORIES:

The Chartered Accountants and Chartered Accountants Firms may have entries made in a Telephone Directory (in printed and electronic form) either **by making a special request or by means of an additional payment.** The Council has also considered the question of permitting entries in respect of Chartered Accountants and their firms under specified groups in telephone/trade directories subject to the following additional restrictions:

1. The entry should **not appear in any other section/category except that of 'Chartered Accountants'.**
2. The member/firm **should belong to the town/city in respect of which the directory is being published.**
3. The order of the entries should **not be in any manner other than alphabetical.**
4. The entry **should not be made in a differential or prominent manner** giving the impression of publicity/advertisement.
5. The entries should not be restricted and **should be open to all the Chartered Accountants/firms of Chartered Accountants** in the particular city/town in respect whereof the directory is published.
6. The **members can also include their names in trade/ social directories.**

B. APPLICATION BASED SERVICE PROVIDER AGGREGATORS:

It is **not permissible for members to list themselves** with online Application based service provider Aggregators, wherein other categories like businessmen, technicians, maintenance workers, event organizers etc. are also listed. [E.g., JUSTDAIL.]

C. SPECIALISED DIRECTORIES FOR LIMITED CIRCULATION:

The name, description and address of member (or firm) **may appear in any directory or list of members of a particular body in which the names are listed alphabetically.** For a specialised directory or a publication such as a "Who's Who" (including those compiled on purely local basis), **a member should use his discretion in supplying information, bearing in mind the nature and purpose of the publications**.

In addition to his name, description and address and those of his firm, a member may give where appropriate, directorships held and reasonable personal details and may state his outside interests. **He should not, however, give the names of any of his clients.**

D. EXEMPTIONS FROM THE ABOVE:

1. A special exemption has been made as regards publication of the name and address of a member or that of his firm, with the description Chartered Accountant(s), **in an advertisement appearing in the press in the following circumstances**, provided that the **advertisement is not displayed more prominently than is usual for such advertisements or the name of the member or that of his firm with the designation Chartered Accountant(s) appears in type not bolder than the substance** of the advertisement:
   (a) **Advertisement for recruiting staff in the member's own office**.
   (b) Advertisement inserted **on behalf of clients requiring staff or wishing to acquire or dispose of business** or property.
   (c) Advertisement **for the sale of a business or property by a member acting in a professional capacity** as trustee, liquidator or receiver.
2. When advertising for staff, it is desirable that members should **avoid the expression such as "a well-known firm",** since this would savour of advertisement. Similar considerations apply to advertisements for articled assistants. The advertisements should not contain any promotional element nor should there be any suggestion that the services offered by the Chartered Accountant or his firm are superior to those offered by other accountants.

SELF REGULATORY MEASURES

These measures are **recommendatory** in nature:

A. BRANCH AUDITS:

1. The **branch audits of a company should not be conducted** by its statutory auditors **consisting of ten or more members** but **should be conducted by the local firms of auditors consisting of less than ten members.**

Note: This is not a restriction on the right of the statutory auditors to have access over branch accounts conferred under the Companies Act, 2013.

2. The above restriction **shall not apply in the following cases:**
    a. **Accounting records of branches are maintained at head office.**
    b. **Significant operations of the company are carried at branches.**

B. JOINT AUDITS:

In the case of large companies, the **practice of associating a practicing firm with less than 5 members as Joint auditors** should be encouraged. Where a client desires to appoint such a firm as joint auditor, the **senior firm should not object to the same**.

C. RATIO BETWEEN QUALIFIED AND UNQUALIFIED STAFF:

1. Every CAP engaged in audit work shall have **At Least 1 Qualified Member for every 5 Non-Qualified** members of the staff.
2. While counting Non-qualified member staff, the following shall be **excluded**:
    a. Article and audit Assistants.
    b. Typists.
    c. Peons.
    d. Other persons not engaged in professional works. (E.g., Maid, Servants, Janitor).

D. DISCLOSURE OF INTEREST BY AUDITORS IN OTHER FIRMS:

The Council has decided that as a good and healthy practice, auditors **should make a disclosure of the payments received by them for other services through the medium of a different firm** or firms in which the said auditor may be either a partner or proprietor.

E. RECOMMENDED MINIMUM SCALE OF FEES:

The Institute has issued revised Minimum scale of Fees for the professional assignments of the members of ICAI. The recommended scale of Fees is to be charged as per the work performed for various professional assignments. The Fees has been recommended separately for Class-A, B and C cities.

4A. AUDIT OF BANKS

CHARACTERISTICS OF BANKING INDUSTRYY AND SPECIAL ISSUES THAT ARISE IN AUDIT OF BANKS

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

1. Custody of **large volumes of monetary items, including cash and negotiable instruments, whose physical security has to be ensured**. This applies to storage and the transfer of monetary items, making banks vulnerable to misappropriation and fraud, necessitating establishment of formal **operating procedures, well-defined limits for individual discretion and rigorous systems of internal control**.
2. Engagement in a **large volume and variety of transactions in terms of number and value** which necessarily require complex accounting and **internal control systems and widespread use of Information Technology** (IT).
3. Operation through a **wide network of geographically dispersed branches and departments** necessitating a greater decentralization of authority and dispersal of accounting and control functions.
4. Assumption of **significant commitments without any transfer of funds**. These items, called **'off-balance sheet' items, may at times not involve accounting entries** and the failure to record such items may be difficult to detect.
5. Engagement in transactions that are **initiated at one location, recorded at a different location and managed at yet another location**.
6. **Direct Initiation and completion of transactions by the customer** without any intervention by the bank's employees. For example, over the Internet or mobile or through automatic teller machines (ATMs).
7. **Integration and linkages of national and international settlement systems** could pose a systemic risk to the countries in which they operate.
8. **Regulatory requirements by governmental authorities** often influence accounting and auditing practices in the banking sector.

SPECIAL AUDIT CONSIDERATIONS arise in the audit of banks because of:

1. The particular **nature of risks associated with the transactions undertaken**.

2. The **scale of banking operations and the resultant significant exposures** which can arise within short period of time.
3. The **extensive dependence on IT** to process transactions.
4. The effect of the **statutory and regulatory requirements**.
5. The **continuing development of new products and services** and banking practices which may **not be matched by the concurrent development of accounting principles** and auditing practices.
6. **Evolution of technology and providing services** through net banking and mobiles has exposed banks to huge operational and financial risk. It is imperative for branch auditors and SCAs (statutory central auditors) **to have detailed knowledge of the products offered** and risks associated with them, and **appropriately address them in their audit plan** to the extent they give rise to the risk of material misstatements in the financial statements.
7. In today's environment, the **banks use different applications to carry out different transactions** which may include data flow from one application to other application; the auditor while designing his **plans should also understand interface controls between the various applications**.

FORM & CONTENT OF FIN. STATEMENTS OF A BANK

1. Every banking company is required **to prepare a Balance Sheet and a Profit and Loss Account** in the forms set out in the **Third Schedule to the Act** or as near thereto as the circumstances admit
2. Every banking company **needs to comply with the disclosure requirements under the various Accounting Standards**, as specified under section 133 of the Companies Act, 2013, read with Rule 7 of the Companies (Accounts) Rules 2014, in so far as they apply to banking companies, or the Accounting Standards issued by the ICAI.
3. It may be noted that **implementation of Indian Accounting Standards (Ind AS) has been deferred by RBI for all scheduled commercial** banks presently.

Note:

1. It is pertinent to state that preparation of balance sheet of a bank usually involves **preparation of standalone financial statements and consolidated financial statements.**

2. Preparation of Standalone financial statements involve **consolidation of branch accounts and incorporation of various verticals / departments** of bank in case of a nationalized bank/public sector bank.
3. In case of private banks, the **processes of accounting are centralized and there is no concept of mandatory branch audit** in accordance with RBI guidelines.
4. Public sector banks and private banks are listed on recognized stock exchange and are required to **comply with SEBI regulations including LODR**.

APPOINTMENT OF AUDITORS OF A BANKING COMPANY

1. Banking Regulation Act requires that the balance sheet and profit and loss account of a banking company should be **audited by a person duly qualified under any law** for the time being in force to be an auditor of companies.

2. **JOINT AUDITS:** Most banks, especially those in nationalised banks or public sector, **appoint 4 or more (depending upon their size and Board decision, as per RBI guidelines) firms of chartered accountants** to act jointly as statutory central auditors (SCAs).

3. **STATUTORY CENTRAL AUDITOR's:** The appointment letter sent by banks in connection with the appointment of SCAs typically contains the following:
   a. **Period of appointment**.
   b. Particulars of **other central auditors**.
   c. Particulars of **previous auditors**.
   d. Procedural **requirements to be complied** with in accepting the assignment.
   e. A **statement of division of work and review and reporting responsibilities** amongst joint auditors in case of nationalised banks
   f. Scope of assignment which **includes any special reports or certificates to be given by the SCAs** in addition to the main report. The statutory Central auditors provides the following **additional reports or certificates**:

      i. Report on **adequacy and operating effectiveness of Internal Controls** over Financial Reporting in case of banks.
      ii. **Long form audit report**.

iii. Report on **compliance with SLR requirements**.
iv. Report on whether the **treasury operations** of the bank have been conducted in accordance with the instructions issued by the RBI from time to time.
v. Certificate on **reconciliation of securities** by the bank (both on its own investment account as well as PMS Banks' account).
vi. Certificate on **compliance by the bank in key areas of guidelines** relating to such transactions issued by the RBI.
vii. Report on whether the **income recognition, asset classification** and provisioning have been made as per the guidelines issued by the RBI from time to time.
viii. Report on whether **any serious irregularity was noticed in the working of the bank** which requires immediate attention (in accordance with sec 143(12) of the Companies Act, 2013.)
ix. Certificate in respect of **custody of unused Bank Receipt forms and their utilisation**.
x. Authentication of **capital adequacy ratio, including disclosure requirements** and other ratios reported in the notes to accounts.
xi. Report on status of the compliance by the bank with regard to the **implementation of recommendations of the Ghosh Committee** relating to frauds and malpractices and of the **recommendations of Jilani Committee** on internal control and inspection/credit system.
xii. Report on **instances of adverse credit-deposit ratio** in the rural areas.
xiii. **Asset liability management.**
xiv. Certificate on **Corporate Governance in case of banks listed on Stock Exchange**.
xv. Certification on **claim of various interest subsidies and interest subvention**.

g. In case of statutory branch auditors (SBAs), appointment letter is given on similar lines **except in regard to particulars of other auditors and statement of division of work**. It is to be noted that **statutory branch audit is carried out by a single firm of chartered accountants**.

AUTHORITY APPOINTING THE AUDITORS: As per the provisions of the relevant enactments, the **auditor of a banking company is to be**

appointed at the annual general meeting of the shareholders, whereas the auditor of **a nationalised bank is to be appointed by the concerned bank acting through its Board of Directors**. In either case, **approval of the Reserve Bank is required** before the appointment is made. The auditors of regional rural banks are to be appointed by the concerned bank with the approval of the Central Government.

Note: Students may refer Chapter 12 of CA Intermediate Auditing and Assurance Study Material for Eligibility, Qualifications, Disqualification, Appointment, Powers, Remuneration etc. of Auditor.

PROCESS OF CONDUCTING THE BANK AUDIT

STEP 1 – INITIAL CONSIDERATIONS:

1. **ACCEPTANCE & CONTINUANCE:** **The assessment of engagement risk is a critical part** of the audit process and **should be done prior to the acceptance of an audit engagement** since it affects the decision of accepting the engagement and in planning decisions if the audit is accepted.

2. **DECLARATION OF INDEBTEDNESS:** The RBI has advised that the banks, **before appointing their statutory central/circle/branch auditors, should obtain a declaration of indebtedness** i.e., a written confirmation that credit facilities, if any, availed from any other bank or financial institution **by auditor/firm/partners/staff/family members have not become non-performing assets**. This is in **addition the declaration regarding absence of disqualifications stipulated** in Section 141 of the Companies Act 2013 which includes borrowing above stipulated amount.

3. **INTERNAL ASSIGNMENTS IN BANKS BY STATUTORY AUDITORS:** The RBI decided that the **audit firms should not undertake statutory audit assignment** while they are associated **with internal assignments** in the bank during the same year.

4. **TERMS OF AUDIT ENGAGEMENTS:** SA 210, "Terms of Audit Engagements" requires that for each period to be audited, the **auditor should agree on the terms of the audit engagement with the bank before beginning significant portions of fieldwork**. It is imperative that the terms of the engagement are documented, to **prevent any confusion as to the terms that have been agreed** in relation to the audit and the respective responsibilities of the management and the

auditor, at the beginning of an audit relationship. This is **usually done in the form of engagement letter** which is written by the auditor and acknowledged by the bank.

5. **COMMUNICATION WITH PREVIOUS AUDITOR:** As per Clause (8) of the Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice **cannot accept position as auditor previously held by another chartered accountant** without first communicating with him/her in writing.

6. **PLANNING:** The **audit plan needs to be properly documented** with respect to timing, extent of checking, audit procedures to be followed at assertion level and should be flexible and updated or changed, as and when necessary.

7. **ESTABLISH THE ENGAGEMENT TEAM:** The **assignment of qualified and experienced professionals is an important component** of managing engagement risk. The size and composition of the engagement team would depend on the size, nature, and complexity of the bank's operations.

STEP 2 – UNDERSTANING:

1. **UNDERSTANDING THE BANK AND ITS ENVIRONMENT INCLUDING INTERNAL CONTROL:** An understanding of the bank and its environment, including its internal control, enables the auditor:
   a. To **identify and assess risk**.
   b. To develop an audit plan to **determine the operating effectiveness of the controls, and to address the specific risk**s.
2. **UNDERSTAND THE BANK'S ACCOUNTING PROCESS:** The accounting process produces **financial and operational information for management's use and it also contributes to the bank's internal control**. Thus, understanding of the accounting process is **necessary to identify and assess the risks of material misstatement** whether due to fraud or not, and to design and perform further audit procedures.
3. **UNDERSTANDING THE RISK MANAGEMENT PROCESS:** Management develops **controls and uses performance indicators to aid in managing key business and financial risks**. An effective risk management system in a bank generally requires the following:

STEP 3 – RISK ASSESSMENT:

1. **IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENTS:** SA 315 requires the auditor to **identify and assess the risks of material**

misstatement at the financial statement level and the assertion level for classes of transactions, account balances, and disclosures to **provide a basis for designing and performing further audit procedures**.

Oversight by those charged with Governance	Identification, Measuring & Monitoring of Risks	Control Activities	Monitoring Activities	Reliable Information Systems
Those charged with governance (BOD/CEO) should approve written risk management policies. **The policies should be consistent with the banks business objectives and strategies**, capital strength, management expertise regulatory requirements and the types and amount of risk it regards as acceptable	**Risk that significantly impact the achievement of Banks's goals** should be identified measured & monitored against pre-approved limits and criteria	A Bank should have appropriate **controls to manage its risks, including effective segregation of duties** (Between front & Back office) accurate measurement of reporting positions and results, setting of limits, reporting and approval of exceptions, Physical security & contingency planning.	Risk management models, methodologies and assumptions used to **measure and manage risks should be regularly assessed and updated**. This function may be conducted by the independent risk management unit.	Banks require reliable information systems that provide adequate financial, operation and compliance information on a timely and consistent basis. Those charged with governance and management require risk management information that is easily understood and that **enable them to access the changing nature of the banks risk profile**.

2. **ASSESS THE RISK OF FRAUD INCLUDING MONEY LAUNDERING:** As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor's objective is **to identify and assess the risks of material misstatement** in the financial statements due to fraud, to obtain sufficient appropriate audit evidence on those identified misstatements and to respond appropriately. **The attitude of professional scepticism should be maintained by the auditor** to recognise the possibility of misstatements due to fraud.
3. The RBI has from time to time issued guidelines ("Know Your Customer Guidelines – Anti Money Laundering Standards"), requiring

banks to establish policies, procedures and controls **to deter and to recognise and report money laundering activities**.

4. **ASSESS SPECIFIC RISKS:** The auditors should **identify and assess specific risks of material misstatement at the financial statement level** which refers to risks that relate to the banking industry and the use of IT therein.
5. **RISK ASSOCIATED WITH OUTSOURCING OF ACTIVITIES:** The modern-day banks make **extensive use of outsourcing as a means of both reducing costs as well as making use of services of an expert** not available internally. There are, however, certain risks associated with outsourcing of activities by banks and therefore, it is **quintessential for the banks to effectively manage** those risks.

STAGE 4 – EXECUTION:

1. **ENGAGEMENT TEAM DISCUSSIONS:** The engagement team should **hold discussions to gain better understanding of bank and its environment**, including internal control, and to assess the potential for material misstatements of the financial statements.

2. **RESPONSE TO THE ASSESSED RISKS**: SA 330 "The Auditor's Responses to Assessed Risks" requires the auditor **to design and implement overall responses to address the assessed risks** of material misstatement at the financial statement level. The auditor should design and perform **further audit procedures** whose nature, timing and extent are based on and **are responsive to the assessed risks** of material misstatement at the assertion level.

3. **ESTABLISH THE OVERALL AUDIT STRATEGY:** SA 300 "Planning an Audit of financial Statements'' states that the **objective of the auditor is to plan the audit so that it will be performed in an effective manner**. For this purpose, the audit engagement partner should:
   a. Establish the **overall audit strategy, prior to the commencement of an audit**; and
   b. **Involve key engagement team member**s and other appropriate specialists while **establishing the overall audit strategy**.

4. **AUDIT PLANNING MEMORANDUM**: The auditor should summarise the team's audit plan by preparing an audit planning memorandum in order to:
   a. Describe the **expected scope and extent of the audit procedures** to be performed by the auditor.

b. Highlight **all significant issues and risks identified during their planning and risk assessment activities**, as well as the decisions concerning reliance on controls.
c. Provide **evidence that they have planned the audit engagement appropriately and have responded** to engagement risk, pervasive risks, specific risks, and other matters affecting the audit engagement.

5. **DETERMINE AUDIT MATERIALITY:** The auditor should consider the **relationship between the audit materiality and audit risk** when conducting an audit. The determination of audit materiality is a matter of professional judgment and **depends upon the knowledge of the bank**, assessment of engagement risk, and the reporting requirements for the financial statements.

6. **CONSIDER GOING CONCERN:** In obtaining an understanding of the bank, the auditor should consider whether there are events and conditions which **may cast significant doubt on the bank's ability to continue as a going concern**.

STAGE 5 – REPORTING:

Students should refer to the reporting requirements explained in heading. Auditor's Report of this Chapter.

SPECIAL CONSIDERTIONS IN IT ENVIRONMENT

The technological developments have brought **new challenges for auditors as audit is required to be conducted through** the system. Considering the importance of IT systems in preparation and presentation of financial statements, it is imperative that **bank should share detailed information with auditors** like: -

1. Overall **IT policy, structure and environment** of Bank's IT system
2. **Data processing and data interface** under various systems
3. **Data integrity and data security**
4. **Business Continuity plans and disaster control plans**
5. **Accounting manual and critical accounting entries**, their processes and involvement of IT systems
6. **Controls over key aspects**, use of various account heads, expense booking, overdue identification etc.

7. Controls on **recording of various e-banking and internet banking** products and channels
8. **MIS reports** being generated and their periodicity
9. Major **exception reports** and process of generation including embedded logic
10. Process of **generating various information related to various disclosures** in financial statements and involvement of IT systems

Overall review of IT environment and computerized accounting system has to be taken at head office level. The branch auditors generally do not have access to IT policy and processes implemented by the bank. Hence, based upon **guidance and information received from Statutory central auditors**, branch auditors **need to ensure that data review and analysis through CBS is carried out and tests of controls and substantive checking** of sample transactions is carried out at branch level and results are shared with statutory central auditors.

It is responsibility of statutory central auditors to obtain understanding of IT environment and various **controls put in place by management and evaluate whether controls are operating effectively**. The methodology adopted by the bank in implementing and monitoring controls should be discussed with head of IT department and based on this understanding, audit procedures can be designed. **The key security control aspects that an auditor needs to address when undertaking audit in a computerised bank** include:

1. Ensure that **authorised, accurate and complete data is made available** for processing.
2. Ensure that in case of **interruption due to power**, mechanical or processing failures, the system **restarts without distorting the completion** of the entries and records.
3. Ensure that the **system prevents unauthorised amendments** to the programmes.
4. . It is important for the auditor to ensure **that access and authorisation rights given to employees are appropriate**.
5. Verify that segregation of duties is ensured while granting system **access to users and that the user activities are monitored by performing activities log** review.
6. Verify that **changes made in the parameters or user levels are authenticated**.

7. Verify that **charges calculated manually for accounts when function is not regulated** through parameters are properly accounted for and authorised.
8. Verify that **all modules in the software are implemented**.
9. Verify that **exceptional transaction reports are being authorised** and verified on a daily basis by the concerned officials. It is **important for auditor to understand the nature of exception** and its impact on financials.
10. Verify that the **account master and balance cannot be modified/amended/altered except by the authorised personnel**.
11. Verify that **all the general ledger accounts codes authorised by Head Office** are in existence in the system.
12. Verify that **balance in general ledger tallies with the balance in subsidiary book**.

INTERNAL AUDIT & INSPECTION OF BANKS

1. **Central audit and inspection department** in Banks is a combination of centralized function with some level of decentralization which is usually **headed by a Chief Audit Executive**. It is **responsible for undertaking risk-Based Internal Audit (RBIA)** as per the framework as stipulated by RBI.
2. The **primary function is to ensure that the audit function is handled smoothly, effectively & efficiently**.
3. Risk-based Internal audit is conducted based upon **the risk assessment of business and control risks of branches**. The risk assessment process includes:
    a. **Identification of inherent business risks** in various activities undertaken by branches (Business risk)
    b. Assessment of **effectiveness of control systems for monitoring** inherent risks of business activities of branch (Control risk)
    c. **Making an assessment** of level and **direction of various risk areas** and assess level and direction of overall business risk and control risk
    d. **Drawing up of risk matrix taking into account factors** viz. Risk of branch

STRESS TESTING & BASEL III FRAMEWORK OF BANKING COMPANIES

STRESS TESTING:

RBI has required that all commercial banks (excluding RRBs and LABs) **shall put in place a Board approved 'Stress Testing framework'** to suit their individual requirements which **would integrate into their risk management systems**. Stress tests are designed **to understand whether a bank has enough capital to survive plausible adverse economic conditions** and to maintain enough buffer to stay afloat under extreme scenarios.

BASEL III FRAMEWORK:

1. Basel III norms **relate to the Capital Adequacy requirement compliance** which the Bank has to achieve. Basel capital adequacy norms are **meant for the protection of depositors and shareholders** by prescriptive rules for measuring capital adequacy, thereby **evolving methods of determining regulatory capital and ensuring efficient use of capital**.
2. Basel III **accord strengthens the regulation, supervision and risk** management of the banking sector. It is **global regulatory standard on capital adequacy** of banks, stress testing as well as market liquidity risk.
3. The Basel III accord, aims at:
    a. Improving the **banking sector's ability to absorb shocks arising from financial and economic stress**, irrespective of reasons thereof.
    b. **Improving risk management and governance practices**; and
    c. Strengthening **banks' transparency and disclosure standards**.

AREAS OF INTERNAL CONTROL IN A BANKING COMPANIES

A. GENERAL CONTROLS:

1. The staff and officers of a bank should be **shifted from one position to another frequently** and without prior notice.
2. The **work of one person should always be checked by another person** (usually by an officer) in the normal course of business.
3. The **arithmetical accuracy of the books** should be proved independently every day.

4. **All bank forms** (e.g., Cheque books, demand draft/pay order books, travellers' cheques, foreign currency cards etc.) **should be kept in the possession of an officer, and another responsible officer should verify the issuance and stock** of such stationery.
5. The **mail should be opened by a responsible officer**. **Signatures on all the letters and advices** received from other branches of the bank or its correspondence should be **checked by an officer with the signature book**.
6. The **signature book and the telegraphic code book** should be kept with **responsible officers and access should be allowed only to authorised officers**.
7. The bank should take **out insurance policies against loss due to all the risks** such as fire, natural calamities, theft and employees' infidelity.
8. The **financial powers of officers of different grades should be clearly defined**.
9. There should be **surprise inspection of head office and branches at periodic interval** by the internal audit department. The irregularities pointed out in **the inspection reports should be promptly rectified**.

B. CASH:

1. Cash should be **kept in the joint custody of 2 responsible** officers.
2. Cash should be **test-checked daily and counted in full occasionally by a responsible officer other than those handling the cash**. Actual cash in hand should agree with the balance shown by the Day Book every day.
3. The **cashier should have no access to the customer's ledger accounts and the Day Book**. This is an important safeguard as the Bank managements are **often tempted to use cashiers because of their shorter working hours as ledger clerks** in the absence of regular staff etc.
4. The **counterfoil of cash receipt vouchers** (e.g., counterfeits of pay-in-slips lodged by the depositors) should be **signed by an officer in Cash Department,** in addition to the receiving cashier.
5. **Payments should be made only after the vouchers** (e.g., cheques, demand drafts etc.) have been **passed for payment by the authorised officer** and have been entered in the customer's account.
6. **High value cash receipts and payments should be verified by a higher officer/ branch manager** and **the excess cash balance should be**

remitted to currency chest according to branch's retention limit on daily basis.

7. Where the teller system is prevalent:
    a. A **limit should be placed on the powers of tellers** to make payment.
    b. All vouchers relating to the accounts of customers which the tellers handle should **first be sent to them and entered by them in the ledger**.
    c. **Total payment made by a teller should be reconciled with the cash columns of the Voucher Summary** Sheet of the ledger concerned every day.
    d. There should be **frequent rotation of tellers**.

C. CLEARINGS:

1. Under the **Cheque Truncation System (CTS)** implemented by RBI, an **electronic image of the cheque is transmitted to the paying branch** through the clearing house. This **effectively eliminates the associated cost** of movement of the physical cheques, reduces the time required for their collection.
2. As per RBI guidelines, the branch **is required to either call the customer or email him** for any cheque **received for the amount of Rs. 5 lakh and above in respect of inward clearings**.
3. The Auditor is to check whether **signature of the drawer of the cheque is being verified by the staff or not** as else there will be liability of the paying bank under all circumstances.
4. The **unpaid cheques received in outward clearing should be either sent to the customers** at their recorded address or the customers be informed to collect the same from bank branch.

D. BILLS FOR COLLECTION:

1. All the documents accompanying the **bills should be received and entered in the Register** by a responsible officer. At the time of dispatch, the **officer should also see that all the documents are sent along with the bills**.
2. The accounts of customers or principals should be **credited only after the bills have been collected or an advice to that effect received** from the bank branch or agent to which they were sent for collection.
3. It should be ensured that **bills sent by one branch for collection to another branch of the bank**, **are not taken in the bills for collection**

twice in the amalgamated balance sheet of the bank. For this purpose, the receiving branch should reverse the entries regarding such bills at the end of the year for closing purposes.

E. BILLS PURCHASED:

1. At the time of purchase of the bills, an officer **should verify that all the documents of title are properly assigned** to the bank.
2. Sufficient **margin should be kept while purchasing or discounting a bill to cover** any decline in the value of the security etc.
3. If the **bank is unable to collect a bill on the due date, immediate steps should be taken to recover** the amount from the drawer against the security provided.
4. All **irregular outstanding account/s should be reported to the Head Office**.
5. In the case of **bills purchased outstanding at the close of the year the discount received** thereon should be properly **apportioned between the 2 years**.

F. LOANS AND ADVANCES:

1. The bank should **make advances only after satisfying itself as to the creditworthiness** of the borrowers and after obtaining sanction from the proper authorities of the bank.
2. All the **necessary documents** (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) **should be executed** by the parties before advances are made.
3. Sufficient **margin should be kept against securities taken to cover any decline in the value** thereof and to comply with Reserve Bank directives. Such **margins should be determined by the proper authorities of the bank** as a general policy or after detailed scrutiny for specific accounts.
4. All the **securities should be received and returned by responsible officer.** They should be kept in the Joint custody of 2 of such officers.
5. All securities requiring registration **should be registered in the name of the bank or otherwise** accompanied by the documents **sufficient to give title of the bank**.
6. In the case of **goods in the possession of the bank**, contents of the packages should be test checked at the time of receipts. The godowns/warehouses should be **regularly and frequently inspected by a responsible officer** of the branch concerned, in addition to inspectors of the bank.

7. **Market value of goods should be checked by officers of the bank by personal enquiry** in addition to the invoice value given by the borrowers.
8. As soon as any **increase or decrease takes place in the value of securities proper entries** should be made in the **Drawing Power Book and Daily Balance Book.**
9. All accounts should be **kept within both the drawing power and the sanctioned limit** as per prescribed norms. Additional **temporary limit may be sanctioned, for a maximum of 20% of existing limit and 90 days maximum tenure**.
10. All the accounts which **exceed the sanctioned limit or drawing power or are against unapproved securities** or are otherwise irregular should be **brought to the notice of the Management/Head Office** regularly.
11. The operation (in each advance account) should be **reviewed at least once every year.**

G. DEMAND DRAFTS:

1. The **signatures on a demand draft should be checked** by an officer with the Signature Book.
2. All the D.Ds. sold/ issued by a branch should **be immediately confirmed by an advice to the paying branch**.
3. If the paying branch **does not receive proper confirmation** of any D.D. from the issuing branch or **does not receive credit** in its account with that branch, **it should take immediate steps to ascertain the reasons**.

H. INTER BRANCH ACCOUNTS:

1. The accounts should be **adjusted only on the basis of advice (and not on the strength of entries found in the statement of account) received from other branches**,
2. **Prompt action should be taken preferably by central authority**, if any entries (particularly debit entries) **are not responded** to by any branch within a reasonable time.

I. CREDIT CARD OPERATIONS:

1. There should be **effective screening of applications** with reasonably good credit assessments.
2. There should be strict **control over storage and issue of cards**.

3. There should be a system where a merchant confirms the status of **unutilised limit of a credit-card holder** from the bank before accepting the settlement, in case the amount to be **settled exceeds a specified percentage of the total limit of the card holder**.
4. There should be a **system of prompt reporting by the merchants of all settlements accepted** by them through credit cards.
5. **Reimbursement** to merchants should be made only after **verification of the validity of merchant's acceptance** of cards.
6. All the reimbursement (gross of commission) should be **immediately charged to the customer's account**.
7. There should be a system to **ensure that statements are sent regularly** and promptly to the customer.
8. There should be a **system to monitor and follow-up customers' payments**.
9. Payments **overdue beyond a reasonable period should be identified and attended**. For **defaulting customers, credit should be stopped** by informing the merchants, as early as possible, to avoid increased losses.
10. There should be a system of periodic review of credit card holders' accounts. On this basis, the **limits of customers may be revised, if necessary**. The review should also include determination of **doubtful amounts and the provisioning** in respect thereof.

COMPLIANCE WITH CRR AND SSLR RATIOS

CASH RESERVE RATIO (CRR):

CRR is a **specified minimum fraction of the total deposits of customers, which commercial banks have to hold as reserves either in cash or as deposits with the central bank**. The RBI, from time to time, reviews the evolving liquidity situation and accordingly decides the rate of CRR required to be maintained by scheduled commercial banks. Therefore, the auditor **needs to refer the master circular issued from time to time** in this regard to **ensure the compliance of CRR requirements**.

STATUTORY LIQUIDITY RATIO (SLR) REQUIREMENTS:

SLR is the requirement that **every scheduled commercial bank in India is required to maintain in the form of certain liquid assets such as gold, cash and government approved securities before providing credit to the customers.** The Reserve Bank of India requires statutory central auditors of banks to verify the **compliance with SLR requirements of 12 ODD DATES in different months** of a fiscal year **not being Fridays**. The objective of maintaining SLR **is to have an amount in the form of liquid assets** which can be used to handle a **sudden increase in demand for the amount** from the depositors.

The resultant report is to be **sent to the top management of the bank and to the Reserve Bank.**

1. Correctness of the **compilation of DTL** (Demand and Time Liabilities) position; and
2. **Maintenance of liquid assets** as prescribed u/s 24 of Banking Regulation Act.

AUDIT APPROACH TO VERIFY CRR AND SLR:

1. Obtain an **understanding of the relevant circulars/ instructions** of the RBI, particularly regarding composition of items of DTL.

2. Request the **branch auditors to send their weekly trial balance as on Friday** and these are consolidated at the head office. Based on this consolidation, the **DTL position is determined for every reporting Friday.** The statutory central auditor should **request the branch auditors to verify the correctness of the trial balances** relevant to the dates selected by him/her. The branch auditors **should also be specifically requested to examine the cash balance** at the branch on the selected dates.

3. Examine, on a test basis, **the consolidations regarding DTL position prepared by the bank** with reference to the related returns received from branches. The auditor **should examine whether the valuation of securities done by the bank** is in accordance with the guidelines prescribed by the RBI.

4. While **examining the computation of DTL**, specifically examine that the following items have been **excluded from liabilities, some of these are**:
   a. **Paid up capital**, reserve, any credit balance in profit & loss account of bank, **amount of loan taken from RBI** and amount of **refinance taken from EXIM bank, NHB, SIDBI and NABARD [NEWLY ADDED IN 2021 – APPLICABLE FROM MAY 2022 ONWARDS]**
   b. **Part amounts of recoveries** from the borrowers in respect of debts considered bad and doubtful of recovery.
   c. Amounts **received in Indian currency against import bills** and held in sundry deposits pending receipts of final rates.

   d. **Un-adjusted deposits/balances lying in link branches** for agency business like dividend warrants, interest warrants, refund of application money, etc., in respect of shares/debentures to the extent of payment made by other branches but not adjusted by the link branches.
   e. **Margins held and kept in sundry deposits** for funded facilities.

5. Similarly, specifically examine that the **following items have been included in liabilities, some of these are**:
   a. **Net credit balance in branch adjustment accounts** including these relating to foreign branches.
   b. Interest on deposit as at the end of the first half year reversed in the beginning of the next half-year. ***[REMOVED FROM 2021 – NOT APPLICABLE FOR MAY 2022 EXAM ONWARDS]***
   c. **Borrowings from abroad by banks in India** needs to be considered as 'liabilities to other' and **thus, needs to be considered at gross level unlike 'liabilities towards banking system in India'**, which are permitted to be netted off against 'assets towards banking system in India'. Thus, the **adverse balances in Nostro Mirror Account needs to be considered as 'Liabilities to other'**.
   d. The **reconciliation of Nostro accounts (with Nostro Mirror Accounts) needs to be scrutinized** carefully to analyse and ascertain if any **inwards remittances are received on behalf of the customers / constituents** of the bank and have **remained unaccounted and / or any other debit (inward) entries have remained unaccounted** and are pertaining to any liabilities for the bank.

6. Examine **whether the consolidations** prepared by the bank include the **relevant information in respect of all the branches**. It may be noted that, **even though interest accrues daily, it is recorded in the books only at periodic intervals**. Thus, examine whether such **interest accrued but not accounted for in books is included in the computation of DTL**.

7. The auditor at the central level should apply the audit procedures listed above to the overall consolidation prepared for the bank as a whole. Where **such procedure is followed, the central auditor should adequately describe** the same in the report.

8. While reporting on compliance with SLR requirements, the auditor should **specify the number of unaudited branches and state that he/she has relied on the returns received from the unaudited branches in forming an opinion**.

NOTE: Recently, there has been **introduction of Automated Data Flow (ADF) for CRR & SLR reporting** and the auditors should develop necessary audit procedures around this.

VERIFICATION OF ASSESTS OF A BANKING COMPANY

Discussed From ICAI SM [Directly]

VERIFIATION OF CAPITAL AND LIABILITIES

Discussed From ICAI SM [Directly]

ISSUANCE OF AUDITORS REPORT BY CENTRAL STATUTORY AUDITOR AND BRANCH AUDITORS OF BANKING COMPANIES

AUDITOR's REPORT:

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

FORMAT OF AUDITOR's REPORT:

1. **STANDARDS ON AUDITING:** The auditors, **central as well as branch, should also ensure that the audit report issued by them complies with the requirements of SA 700**, "Forming an Opinion and Reporting on

Financial Statements", **SA 705**, "Modifications to the Opinion in the Independent Auditor's Report", **SA 706**, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", **SA 710**, "Comparative Information-Corresponding Figures and Comparative Financial Statements" and **SA 720**, The Auditor's Responsibility Relating to Other Information in Documents Containing Audited Financial Statements.

2. **DISCLOSURES – UN AUDITED BRANCHES:** The auditor should ensure that not only the information relating to number of unaudited branches is given **but quantification of advances, deposits, interest income and interest expense** for such unaudited branches **has also been disclosed in the audit report**.

3. **ADDITIONAL REPORTING REQUIREMENTS UNDER COMPANIES ACT:**
   a. The auditor of a banking company is **also required to state in the report the matters covered by Section 143 of the Companies Act**, 2013. It is pertinent to mention that the reporting requirements relating to the **Companies (Auditor's Report) Order, 2020 is NOT APPLICABLE to a banking company** as defined in clause (c) of section 5 of the Banking Regulation Act, 1949.

   b. As per reporting requirements cast through Rule 11 of the Companies (Audit and Auditors) Rules, 2014 the **auditor's report shall also include their views and comments** on the following matters, namely: **[143(3)]**
      i. Whether the bank has **disclosed the impact, if any, of pending litigations** on its financial position in its financial statements.
      ii. Whether the bank **has made provision, as required under the law or accounting standards**, for material foreseeable losses, if any, on long term contracts including derivative contracts.
      iii. Whether there has been **any delay in transferring amounts, required to be transferred to the investor education and protection fund**.
      iv.
         1. Whether the management has represented that, to the best of it's knowledge and belief, other than as disclosed in the notes to the accounts, **no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies)**, including foreign entities

("Intermediaries"), with the understanding, whether recorded in writing or otherwise, **that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities** identified in any manner whatsoever by or on behalf of the **bank ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries**.

2. Whether the management has represented, that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, **no funds have been received by the bank from any person(s) or entity(ies)**, including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, **that the bank shall, whether, directly or indirectly, lend or invest in other persons or entities identified** in any manner whatsoever by or on behalf of the **Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or the like** on behalf of the Ultimate Beneficiaries.

3. Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, **nothing has come to their notice that has caused them to believe** that the representations under sub-clause (1) and (2) **contain any material misstatement**.

v. Whether the **dividend declared or paid during the year by the company is in compliance with section 123** of the Companies Act, 2013.

vi. Whether the company, **in respect of financial years commencing on or after the 1st April, 2022** has used such accounting **software for maintaining its books of account** which has a feature of **recording audit trail (edit log) facility and the same has been operated throughout the year** for all transactions recorded in the software and the audit trail feature has not been tampered with and **the audit trail has been preserved by the company** as per the statutory requirements for record retention.

AUDIT TRAIL MEANS, a step-by-step sequential record which provides evidence of the documented history of financial transactions to its source.

LONG FORM AUDITOR's REPORT:

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

OTHER REPORTING REQUIREMENTS: [REPORTING ABOUT FRAUD]

1. The RBI issued a Circular relating to implementation of recommendations of **Committee on Legal Aspects of Bank Frauds applicable to all scheduled commercial banks** (excluding Regional Rural Banks). The said circular **provides details regarding liability of accounting and auditing profession** including the professional conduct, non-disclosure of client information and need to report fraud.

2. Auditor should also consider the **compliance with provisions of Standards on Auditing.**
EXAMPLE: SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", explains that **the duty of confidentiality is over -ridden by statute, law or by courts**. Whereas an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error according to SA 240.

3. Further, **as per sub-section 12 of section 143 of the Companies Act, 2013,** if an auditor of a company, in the course of the performance of duties as auditor, has reason to **believe that an offence of fraud involving such amount or amounts** as may be prescribed, is being or

has been committed in the company by its officers or employees, the **auditor shall report the matter to the Central Government within such time** and in such manner as may be prescribed. Therefore, if the auditor while performing normal duties comes across any instance, he/she should **report the matter to the RBI in addition to Chairman/Managing Director/Chief Executive of the concerned bank**.

CONCURRENT AUDIT OF BANKS

INTRODUCTION:

1. Concurrent audit, **is an audit or verification** of transactions or activities of an organisation **concurrently as the transaction/activity takes place**. The concept in this audit is **to verify the authenticity of the transaction/activity within the shortest possible time** after the same takes place. It is **SIMILAR to internal audit** which is a concept recognised under the Companies Act.

2. It is recognised that **there must be a system of someone**, **other than the person involved in the operations, verifying the authenticity of the transaction/activity on a regular basis**, so that **any deviation from the laid down procedures can be noticed** in the shortest possible time and remedial action can be taken.

3. In some banks, **this task has been entrusted to the internal inspection staff who are not engaged in operational activities**. In other banks, this work is **allotted to outside professional firms of chartered accountants**. The Reserve Bank of India (RBI) has **issued certain guidelines for the conduct of this audit**.

SCOPE OF CONCURRENT AUDIT:

1. The **detailed scope of the concurrent audit should be clearly and uniformly determined** for the Bank as a whole by the Bank's Inspector and Audit Department in consultation with the **Bank's Audit Committee of the Board of Directors (ACB)**. In determining the scope, importance should be given to **checking high-risk transactions having large financial implications** as opposed to transactions involving lesser amounts. The **detailed scope of the concurrent audit may be determined and approved by the ACB**.

2. The **guidelines issued by the RBI cover all the key areas of activities of the branch** which is under concurrent audit. Most banks have **prepared an Audit Manual for this purpose**. Broadly stated, the following areas are covered by these guidelines:

SCOPE OF CONCURRENT AUDIT IN BANKS

1
- **Cash**
- **Deposits**

2
- **Advances**
- **Investments**

3
- **Foreign Exchange**
- **House Keeping & Other Items**

CONCURRENT AUDIT SYSTEM IN COMMERCIAL BANKS:

The concurrent audit system is to be **regarded as part of a bank's early-warning system to ensure timely detection** of irregularities and lapses which helps in **preventing fraudulent transactions at branches**. It is, necessary for the bank's management to give serious attention to the implementation of various aspects of the system such as selection of branches/coverage of business operations, appointment of auditors, appropriate reporting procedures, follow-up/rectification processes and utilisation of the feedback from the system for appropriate and quick management decisions.

The bank **should once in a year review the effectiveness of the system and take necessary measures** to correct the lacunae in the implementation of the programme.

COVERAGE OF BUSINESS/BRANCHES:

1. The **scope of work to be entrusted** to concurrent auditors, coverage of business/branches, etc. is left to the **discretion of the head of internal audit of banks** with the **due prior approval of the Audit Committee** of the Board of Directors (ACB).
2. Banks may, ensure that **risk sensitive areas identified by them** as per their specific business models **are covered under concurrent audit**.

3. The **broad areas of coverage under concurrent audit** shall be based on **the identified risk** of the unit and **must include random transaction testing of sufficiently large** sample of such transactions wherever required.

TYPES OF ACTIVITIES TO BE COVERED:

Discussed Directly in ICAI SM

APPOINTMENT OF CONCURRENT AUDITOR's AND ACCOUNTABILIY:

1. **BANKS DISCRETION:** The **option to consider whether concurrent audit should** be done by bank's own staff or external auditors is **left to the discretion of individual banks**.
2. **OWN STAFF:** In case **the bank has engaged its own officials, they should be experienced**, well trained and sufficiently senior. The staff engaged on concurrent audit **must be independent of the branch** where concurrent audit is to be conducted.
3. **MAXIMUM TENURE OF EXTERNAL CONCURRENT AUDITOR'S:** ACB of the bank shall **decide the maximum tenure of external concurrent auditors with the bank**. Generally, tenure of external concurrent auditors with a bank **shall not be more than 5 years on continuous basis**. However, **no concurrent auditor shall be allowed** to continue with a branch/business unit for a **period of more than 3 years**.
4. **LAPSES IN WORKINGS:** If external firms are appointed and **any serious acts of omissions or commissions are noticed** in their working their **appointments may be cancelled and the fact may be reported to RBI & ICAI**.

REMUNERATION OF CONCURRENT AUDITOR:

Terms of appointment of the external firms of Chartered Accountants for the concurrent audit and **their remuneration** may be **fixed by ACB of banks keeping in view various factors** such as coverage of areas, skill sets required, number of staff required and time to be devoted to audit.

REPORTING SYSTEMS:

1. There **should be proper reporting of the findings of the concurrent auditors**. For this purpose, each bank should **prepare a structured format**. The **major deficiencies/ aberrations noticed during audit should**

be highlighted in a special note and given immediately to the bank's branch/controlling offices. A quarterly review containing key features brought out during the concurrent audits should be placed before the ACB.

2. There **should be zone-wise reporting of the findings of the concurrent audit** to ACB and an annual appraisal/report of the audit system should be placed before the ACB.

3. **Before submission of the report the auditor** should discuss the important **issues on which he/she wishes to report with the branch manager and concerned officers**. This will enable the auditor to take into consideration the opposite viewpoint and clarify any doubts.

4. Minor irregularities pointed out by the concurrent auditors are to be rectified in a timely manner. **Serious irregularities should be reported to the controlling offices/ Head Offices for immediate action**.

5. **Whenever fraudulent transactions are detected, they should immediately be reported** to Inspection & Audit Department (Head Office) as also the Chief Vigilance Officer as well as Branch Managers concerned **(unless the branch manager is involved).**

6. **Follow-up action on the concurrent audit reports should be given high priority** by the controlling office/Inspection and Audit Department and rectification of the features done without any loss of time.

AUDIT COMMITTEE IN THE CONTEXT OF BANKS

Banks **are required to constitute an Audit Committee** of their Board in pursuance of RBI guidelines. One of the **functions of this committee is to provide direction and also oversee the operations of the total audit function** in the bank.

The Audit Committee is, **connected with the functioning of the system of concurrent audit**. The **method of appointment of auditors, their remuneration and the quality of their work** is to be reviewed by the Audit Committee. It is in this context that periodical meetings by the audit committee with the concurrent auditors and statutory auditors help the **audit committee to oversee the operations of the total audit function** in the bank.

4B. AUDIT OF NBFC'S

DEFINITION, CRITERIA & REGISTRATION OF NBFC AS PER RBI ACT

A. AMENDMENT IN NBFC

Pursuant to the announcement of *Scale Based Regulation (SBR)*: *A Revised Regulatory Framework for NBFCs has been notified by* RBI on NBFC Classification and regulation like Capital Requirements, Governance Standards, Prudential Regulations, etc. **based on 4 layers that are defined based on their size, activity, and perceived riskiness.**

Details of **NBFCs populating the various layers** is mentioned below:

BASE LAYER

The Base Layer shall comprise of:

a. **Non-deposit** taking NBFCs **below the asset size of ₹1000 crore** and
b. NBFCs undertaking the following activities:
   i. NBFC-**Peer to Peer** Lending Platform (NBFC-P2P),
   ii. NBFC-**Account Aggregator** (NBFC-AA),
   iii. **Non-Operative Financial Holding Company** (NOFHC) and
   iv. NBFCs **not availing public funds** and **not having any customer interface.**

MIDDLE LAYER

The Middle Layer shall consist of

a. **All deposit taking NBFCs** (NBFC-Ds), irrespective of asset size,
b. Non-deposit taking NBFCs **with asset size of ₹1000 crore and above** and
c. NBFCs undertaking the following activities
   i. **Standalone Primary Dealers** (SPDs),
   ii. **Infrastructure Debt Fund** - Non-Banking Financial Companies (IDF-NBFCs),
   iii. **Core Investment Companies** (CICs),
   iv. **Housing Finance Companies** (HFCs) and
   v. **Infrastructure Finance Companies** (NBFC-IFCs).

UPPER LAYER

The Upper Layer shall comprise of **those NBFCs which are specifically identified by the Reserve Bank** as warranting enhanced regulatory requirement based on a set of parameters and scoring methodology as provided in the Appendix to this circular. **The top 10 eligible NBFCs in terms of their asset size shall always reside in the upper layer**, irrespective of any other factor.

TOP LAYER

The Top Layer **will ideally remain empty**. This layer **can get populated if the Reserve Bank is of the opinion** that **there is a substantial increase in the potential systemic risk** from specific NBFCs in the Upper Layer. Such **NBFCs shall move to the Top Layer from the Upper Layer**.

Categorisation of NBFCs carrying out specific activity

As the **regulatory structure envisages scale based as well as activity-based regulation**, the following **prescriptions** shall apply in respect of the NBFCs

a) **NBFC-P2P, NBFC-AA, NOFHC and NBFCs without public funds** and customer interface **will always remain in the Base Layer** of the regulatory structure.

b) **NBFC-D, CIC, IFC and HFC** will be included **in Middle Layer or the Upper Layer (and not in the Base layer), as the case may be**. **SPD and IDF-NBFC will always remain in the Middle Layer.**

c) **The remaining NBFCs**, viz., Investment and Credit Companies (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factors and Mortgage Guarantee Companies (NBFC-MGC) **could lie in any of the layers** of the regulatory structure **depending on the parameters of the scale based regulatory framework.**

d) **Government owned NBFCs shall be placed in the Base Layer or Middle Layer,** as the case may be. They will not be placed in the Upper Layer till further notice.

References to NBFC-ND, NBFC-ND-SI & NBFC-D - From October 01, 2022:

All references to **NBFC-ND shall mean NBFC-BL** and all references to **NBFC-D and NBFC-NDSI shall mean NBFC-ML or NBFC-UL**, as the case may be.

B. DEFINITION:

45 I(f) of **Reserve Bank of India (Amendment) Act, 1997** defines a non-banking financial company as:

I. A financial institution which is **a company**.
II. A non-banking institution which is a company, and which has as its **principal business the receiving of deposits**, under any scheme or arrangement or in any other manner, or **lending** in any manner.
III. **Such other non-banking** institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and **by notification in the Official Gazette**, specify.

C. MEANING OF PRINCIPAL BUSINESS:

1. The company will be treated as NBFC when:
    a. a company's **financial assets constitute more than 50 % of the total assets** (netted off by intangible assets) and
    b. **income from financial assets constitute more than 50 % of the gross income**.

2. A company **which fulfils both these criteria shall qualify as an NBFC** and would require to be registered as NBFC by RBI.

D. REGISTRATION AND REGULATION OF NBFC:

1. **COMPLSORY REGISTRATION: NO non-banking financial company is allowed to commence** or carry on the business of a non-banking financial institution **without**:
    a. Obtaining **a certificate of registration** issued by the Reserve Bank of India.
    b. Having **a net owned fund (NOF) of Rs. 25 lakhs (Rs. 2 crores since April 1999) not exceeding Rs. 200 lakhs**, as the RBI may, by notification in the Official Gazette, specify.

NOTE: A company incorporated under the Companies Act and **desirous of commencing business of non-banking financial institution** as defined under Section 45-IA of the RBI Act, 1934 **can apply to the Reserve Bank of India** in prescribed form along with necessary documents for registration.

2. **DIRECTIONS TO NBFC:** The Reserve Bank of India has issued **directions to non-banking financial companies** on:
    a. **Acceptance of public deposits**,

b. **Prudential norms** like capital adequacy,
c. **Income recognition**,
d. **Asset classification**,
e. **Provision** for bad and doubtful debts,
f. **Risk exposure norms** and
g. Other measures to **monitor the financial solvency** and
h. **Reporting by NBFCs**.

3. **DIRECTIONS TO AUDITORS: Directions were also issued to auditors to report non-compliance** with the RBI Act and the Regulations to the RBI, Board of Directors, and shareholders.

TYPES OF NBFC'S

1. **INCLUDES:** Non-banking financial company (NBFC) is **a company registered under the Act**, engaged in the business of:
   a. **Loans and advances**,
   b. **Acquisition** of shares/stocks/bonds/ debentures/ securities issued by Government or local authority or other marketable securities of a like nature,
   c. **Leasing**,
   d. **Hire-purchase**,
   e. **Insurance business**,
   f. **Chit business**

2. **DO NOT INCLUDE:** but **does not include any institution whose principal business** is that of:
   a. **Agriculture activity**,
   b. **Industrial activity**,
   c. **Purchase or sale of any goods** (other than securities) or providing any services and
   d. Sale/purchase/construction of **immovable property**.

3. A non-banking institution which is a company and **has principal business of receiving deposits under any scheme or arrangement** in one lump sum or in installments by way of contributions or in any other manner, is **also a non-banking financial company** (Residuary non-banking company).

4. NBFCs registered with RBI are categorized as follows:
   a. **D / ND:** In terms **deposit acceptance or otherwise** into Deposit and Non-Deposit accepting NBFCs.

b. **SI / NON-SI:** **Non - deposit taking NBFCs by their size** into systemically important and non-systemically important (NBFC-NDSI and NBFC-ND) and

c. **ACTIVITIES:** By **the kind of activities, they conduct** namely:

   i. **Investment and Credit Company** (ICC).
   ii. **Infrastructure Finance Company** (IFC).
   iii. Systematically Important **Core Investment Company** (CIC-ND-SI).
   iv. **Infrastructure Debt Fund**-Non-Banking Financial Company (IDF-NBFC).
   v. Non-Banking Financial Company – **Micro Finance Institution** (NBFC-MFI).
   vi. Non-Banking Financial Company – **Factors** (NBFC-Factors).
   vii. NBFC-**Non-Operative Financial Holding Company** (NOFHC).

NOTE: **All NBFCs are either deposit taking or non-deposit taking**. If they are non-deposit taking, ND is suffixed to their name (NBFC-ND).

NBFC'S EXEMPTED FROM REGISTRATION UNDER RBI

Companies that do financial business but **are regulated by other regulators are given specific exemption** by the Reserve Bank from its regulatory requirements for **avoiding duality of regulation**. Following NBFCs have **been exempted from the requirement of registration under Section 45-IA of the RBI Act**, 1934 subject to certain conditions.

1. **Housing Finance Institutions** (regulated by National Housing Bank).
2. **Merchant Banking Companies** (regulated by Securities and Exchange Board of India).
3. **Stock Exchanges** (regulated by Securities and Exchange Board of India).
4. Companies engaged in the **business of stock-broking/sub-broking** (regulated by Securities and Exchange Board of India).
5. **Venture Capital Fund Companies** (regulated by Securities and Exchange Board of India).
6. **Nidhi Companies** (regulated by Ministry of Corporate Affairs, Government of India).
7. **Insurance companies** (regulated by Insurance Regulatory and Development Authority) and
8. **Chit Companies** (as defined in clause (b) of section 2 of the Chit Funds Act, 1982 (Act 40 of 1982)).
9. **Micro Finance Companies** [MFI].
10. **Securitisation and Reconstruction** Companies.
11. **Mutual Benefit Companies**.

12. **Mortgage Guarantee Companies**.
13. **Core Investment Companies** i.e., a non-banking financial company being a Core Investment Company referred to in the Core Investment Companies (Reserve Bank) Directions, 2016, which **is not a Systemically Important Core Investment Company**
14. **Alternative Investment Fund** (AIF) Companies.

NOTE:

1. It may also be mentioned that **Mortgage Guarantee Companies** have been notified as Non-Banking Financial Companies under Section 45 I(f)(iii) of the RBI Act, 1934.
2. **Core Investment Companies** with **asset size of less than ₹ 100 crore**, and those **with asset size of ₹ 100 crore and above but not accessing public funds are exempted from registration** with the RBI.

DIFFERENCE BETWEEN BANKS & NBFC'S

1. **NBFC cannot accept demand deposits**, however some NBFCs can accept Term Deposits.
2. **NBFCs do not form part of the payment and settlement system** and cannot issue cheques drawn on itself.
3. **Deposit insurance facility** of Deposit Insurance and Credit Guarantee Corporation (DICGC) is **not available to depositors of NBFCs**, unlike in case of banks.
4. **No Minimum Exposure to Priority Sector** required by NBFCs.

CAPITAL REQUIREMENTS UNDER PRUDENTIAL NORMS FOR NBFC'S

1. Every applicable NBFC as defined in the Master Direction- Non-Banking Financial Company – Systemically Important Non-Deposit Taking Company & Deposit Taking Company (Reserve Bank) Directions, 2016 shall **maintain a minimum capital ratio consisting of Tier I and Tier II capital which shall not be less than 15 % of its aggregate risk weighted assets on-balance sheet and of risk adjusted value of off-balance sheet items**.
2. The **Tier I capital in respect of applicable NBFCs** (other than NBFC-MFI and IDF-NBFC), at any point of time, **shall not be less than 10% by March 31, 2017**.

3. Applicable NBFCs **primarily engaged in lending against gold jewellery** (such loans comprising 50 percent or more of their financial assets) **shall maintain a minimum Tier I capital of 12 %.**

4. However, in the case of **Non-Systemically Important Non-Deposit Taking Company** (Reserve Bank) Directions, 2016, **Net Owned Fund requirements have to be complied**.

Explanations: In these Directions, **degrees of credit risk expressed as percentage weightages have been assigned to balance sheet assets**. For example, percentage weights assigned to Fixed Assets is 100, Cash & Bank Balances is 0, etc. Hence, the value of each asset / item requires to be multiplied by the relevant risk weights to arrive at risk adjusted value of assets. The aggregate shall be taken into account **for reckoning the minimum capital ratio**.

INCOME RECOGNITION AND ASSET CLASSIFICATION NORMS FOR NBFC'S

A. INCOME RECOGNITION:

1. The income recognition shall be based on **recognized accounting principles i.e., Accrual Basis**.
2. **Income on NPA** shall be recognized only **when it is actually realized**.
3. Any such income recognized before the asset became non-performing and remaining **unrealized shall be reversed**.

B. ASSET CLASSIFICATION:

The asset classification norms as given below **shall apply to every applicable NBFC (except NBFC-MFIs)**:

1. Every NBFC shall, after taking into account the **degree of well-defined credit weaknesses and extent of dependence on collateral security for realisation, classify** its lease/hire purchase assets, loans and advances and any other forms of credit into the following classes, namely:
   a. **Standard assets.**
   b. **Sub-standard assets.**
   c. **Doubtful assets and**
   d. **Loss assets**.

2. **DEFINITIONS OF ASSETS UNDER NPA CLASSICATION:**
   a. **Standard asset** shall mean the asset in respect of which, **no default in repayment of principal or payment of interest** is perceived and which does not disclose any problem or carry more than normal risk attached to the business.

   b. **Sub-Standard Asset**
      i. An asset which has been **classified as non-performing asset for a period not exceeding 18 months** (in case of NBFCs covered in Non-Banking Financial Company – **Non-Systemically Important Non-Deposit taking** Company (Reserve Bank) Directions, 2016).
      The period '**not exceeding 12 months**' for the financial year ended March 31, 2018 and thereafter for NBFCs covered in Non-Banking Financial Company - **Systemically Important Non-Deposit taking Company** and Deposit taking Company (Reserve Bank) Directions, 2016.
      ii. An asset where the **terms of the agreement** regarding interest and / or principal have **been renegotiated or rescheduled or restructured** after commencement of operations, **until the expiry of 1 YEAR of satisfactory performance under the renegotiated** or rescheduled or restructured terms.

   c. **Doubtful Asset shall mean:**
   NBFC NON – SI ID: A term loan, or a lease asset, or a hire purchase asset, or any other asset, which **remains a sub-standard asset for a period 'exceeding 18 months'** for NBFCs covered in Non-Banking Financial Company **– Non-Systemically Important Non-Deposit taking Company** (Reserve Bank) Directions, 2016.
   NBFC SI-ID: A term loan, or a lease asset, or a hire purchase asset, or any other asset, which **remains a sub-standard asset for a period 'exceeding 12 months'** for the financial year ended March 31, 2018, and thereafter for NBFCs covered in Non-Banking Financial Company - **Systemically Important Non-Deposit taking Company and Deposit taking** Company (Reserve Bank) Directions, 2016.
   d. **Loss Asset shall mean:**
      i. an asset which has been **identified as loss asset by the applicable NBFC or its internal or external auditor or by**

the Bank during the inspection of the applicable NBFC, to the extent it is not written off by the applicable NBFC and

ii. an asset which is **adversely affected by a potential threat of non-recoverability** due to either erosion in the value of security or non-availability of security or due to any fraudulent act or omission on the part of the borrower

3. **Non-Performing Asset (referred as "NPA") shall mean:**
   a. An **asset**, in respect of which**, interest has remained overdue for a period of 6 months or more**.
   b. A **term loan** inclusive of unpaid interest when **the instalment is overdue for a period of 6 months** or more or **on which interest amount remained overdue for a period of 6 months** or more.
   c. A **demand or call loan**, which remained **overdue for a period of 6 months or more from the date of demand or call or on which interest amount remained overdue** for a period of 6 months or more.
   d. A **bill** which remains **overdue for a period of 6 months** or more.
   e. The **interest in respect of a debt or the income on receivables** under the head 'other current assets' in the nature of short-term loans/advances, which **facility remained overdue for a period of 6 months or more**.
   f. Any **dues on account of sale of assets or services rendered or reimbursement of expenses** incurred, which remained overdue for a period of 6 months or more.
      IMP NOTE: *NBFCs covered in Non-Banking Financial Company - **Systemically Important Non-Deposit taking** Company and Deposit taking Company (Reserve Bank) Directions, 2016, period of **'6 months or more' stipulated in sub-clauses (a) to (f) shall be '3 months or more', for the financial year ended March 31, 2018 and thereafter].***

      *This implies for NBFCs covered in Non-Banking Financial Company – **Non-Systemically Important Non-Deposit** taking Company (Reserve Bank) Directions, 2016, **the criteria is 6 months only**.*

   g. The **lease rental and hire purchase instalment,** which **has become overdue for a period of 12 months or more**.

      IMP NOTE: *NBFCs covered in Non-Banking Financial Company - **Systemically Important Non-Deposit taking Company** and*

Deposit taking Company (Reserve Bank) Directions, 2016, the period **of '12 months or more' stipulated in this sub-clause shall be '3 months or more' for the financial year ended March 31, 2018 and thereafter].**

It implies that as per Non-Banking Financial Company – Non-**Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016, the criteria is 12 months only**.

h. In respect **of loans, advances and other credit facilities** (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) **made available to the same borrower/beneficiary when any of the above credit facilities becomes non-performing asset**. Provided that in the case of lease and hire purchase transactions, an applicable NBFC shall classify each such account on the basis of its record of recovery.

PROVISIONING NORMS FOR NBFC'S

ALL NBFC's [EXCEPT NMFB - MFI]:

The provisioning requirement in respect of loans, advances and other credit facilities including bills purchased and discounted shall be as under:

1. **LOSS ASSETS:** The entire asset shall **be written off**. If the assets are permitted to remain in the books for any reason, **100% of the outstanding shall be provided for**.

2. **DOUBTFUL ASSETS:**
   a. **100% provision to the extent to which the advance is not covered** by the realisable value of the security to which the applicable NBFC has a valid recourse shall be made. The realisable value is to be estimated on a realistic basis.
   b. In addition to item (a) above, depending upon the period for which the asset has remained doubtful, **provision to the extent of 20% to 50% of the secured portion** (i.e., Estimated realisable value of the outstanding) shall be made on the following basis:

Period for which the asset has been considered as doubtful	Percent of provision
Up to 1 year	20
1 to 3 years	30

More than 3 years	**50**

3. **SUB-STANDARD ASSETS:** A **general provision of 10 percent of total outstanding** shall be made.

4. **STANDARD ASSET PROVISIONING:** Every NBFC (covered under Non-Banking Financial Company - **Systemically Important Non-Deposit taking Company and Deposit taking Company** (Reserve Bank) Directions, 2016) shall make **provisions for standard assets at 0.40 % by the end of March 2018 and thereafter**, of the outstanding, which shall not be reckoned for arriving at net NPAs.
   Note: As per Non-Banking Financial Company – **Non-Systemically Important Non-Deposit taking Company** (Reserve Bank) Directions, 2016, every applicable NBFC shall make provision **for standard assets at 0.25 % of the outstanding amount**.

The **provision towards standard assets** need not be netted from gross advances but shall be shown separately as **'Contingent Provisions against Standard Assets'** in the balance sheet.

STEPS INVOLVED IN AUDIT OF NBFC

STEP 1: ASCERTAINING THE BUSINESS OF THE COMPANY:

1. **MOA AND AOA:** The first step in carrying out the audit of a NBFC is to **scan through the Memorandum and Articles of Association** of the company, so as to understand with the type of business that the company is engaged into.
2. **BUSINESS POLICY:** An auditor should make a careful study of the business policy of the company so as to **ascertain its principal business activities**.
3. **MINUTES:** For this purpose, an auditor may **also scan through the minutes of the Board/Committee Meetings** and hold discussions with the top-level management to **ascertain the corporate business plan/strategy** which would give him a clear picture as to the principal objects of the company.
4. **ACTUAL BUSINESS:** An auditor should **then independently corroborate his findings** with the actual business done by the company, as reflected by the company's financial results.

STEP 2: EVALUATION OF INTERNAL CONTROL SYSTEM:

1. **MANAGEMENT RESPONSIBILITY:** The responsibility of maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of its **business vests with the management**.

2. An auditor **should gain an understanding of the accounting system and related internal controls** adopted by the NBFC to determine the nature, timing and extent of his audit procedures. An auditor should also ascertain whether the **internal controls are adequate and are being effectively followed**.

3. **CHECK PERIODICAL REVIEW BY MANAGEMENT:** In particular, an auditor should **review the effectiveness of the system of recovery prevalent at the NBFC**. He should ascertain whether the NBFC has an effective system of **periodical review of advances in place** which would facilitate effective monitoring and follow up.

STEP 3: CHECK REGISTRATION WITH THE RBI:

1. **REGISTRATION COPY:** An auditor should **obtain a copy of the certificate of registration** granted by the RBI or in case the certificate of registration has not been granted, a copy of the application form filed with the RBI for registration.
2. **DUAL CONDITIONS:** An auditor should verify whether the dual **conditions relating to registration with the RBI and maintenance of minimum net owned funds** have been duly complied with by the concerned NBFC.
3. **CHECK MANDATORY INVESTMENTS IN LIQUID ASSETS:**
   a. Every NBFC holding public deposits is required **to invest a specified percentage** (as the RBI may specify from time to time). The RBI has also prescribed a format for reporting to ensure compliance with **the requirement of maintenance of liquid assets on a quarterly basis**.
   b. This quarterly return (duly signed by an officer of the NBFC) is required to be **submitted within prescribed time limit from the end of the relevant quarter**.
   c. The auditor should ascertain whether investment in prescribed liquid assets have been **made and whether quarterly returns as mentioned above have been regularly filed** with the RBI by the concerned NBFC.

STEP 4: CHECK NBFC ACCEPTANCE OF PUBLIC DEPOSIT DIRECTIONS (NON-BANKING FINANCIAL COMPANIES ACCEPTANCE OF PUBLIC DEPOSITS (RESERVE BANK) DIRECTIONS, 2016):

The company must comply with the following aspects in relation to the activity of mobilisation of public deposits:

1. **Credit rating:**
   a. The ceiling on **quantum of public deposits has been linked to its credit rating** as given by an approved credit rating agency. **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.

   b. In the event of **a upgrading/downgrading of credit rating**, the auditor should bear in mind that the **NBFC will have to increase/reduce its public deposits in accordance with the revised credit rating** assigned to it within a specified time frame and should ensure that the NBFC has **informed about the same to the RBI in writing**.

   c. In the event of **downgrading of credit rating below the minimum specified investment grade**, a NBFC, being an **investment and credit company or a factor, shall regularise the excess deposit** as provided hereunder:
      i. With immediate effect, **stop accepting fresh public deposits** and renewing existing deposits.
      ii. All **existing deposits shall run off to maturity** and
      iii. **Report the position within 15 working days**, to the concerned Regional Office of the RBI where the NBFC is registered.

      Provided **no matured public deposit shall be renewed without the express and voluntary consent** of the depositor.

2. **INTEREST CALCULATIONS:** Test check the **interest calculations in respect of public deposits mobilised** by a NBFC to ascertain that the NBFC has not paid interest in excess as per specification. Likewise, test check the **brokerage/ commission/ incentive calculations with the bills and vouchers**.

3. **WRITTEN APPLICATION:** Ascertain whether the NBFC has **accepted or renewed any public deposit only after a written application form the depositor** in the form to be supplied by the company and shall contain all particulars specified.

4. **REGISTER OF DEPOSITORS:** **Verify the deposit register** and **test check the particulars that have been entered** with supporting receipts issued to the depositors. Also check whether the **NBFC is regularly paying its deposits on due dates** and in the case of a delay/default, the reasons for the delay/default and the actual date of payment.

5. **INVESTMENT IN APPROVED LIQID ASSETS:** Check whether the **investments made in approved liquid assets by a NBFC** holding public deposits have been lodged in safe custody with a designated scheduled commercial bank and also whether **certificate was obtained from the RBI** to that effect.

6. **TIMELY FILING OF RETURNS:** Check whether the **NBFC has filed its prescribed returns in a timely manner**.

7. **NO DEPOSITS – BOARD RESOLUTION:** In the case of NBFCs not accepting/holding public deposits, check **whether a board resolution has been passed by the NBFC to the effect** that it has neither accepted any public deposits nor would it accept any public deposits during the year.

8. **GROUP HOLDING INVESTMENT COMPANIES:** Check whether the NBFC has **passed a board resolution to the effect that the company has invested or would invest/hold its investments in share and securities of group companies** specifying the names of the companies.

STEP 5: NBFC PRUDENTIAL NORMS:

1. Check **compliance with prudential norms encompassing income recognition**, income from investments, accounting standards, accounting for investments, asset classification, provisioning for bad and doubtful debts, capital adequacy norms, prohibition on granting of loans by a NBFC against its own shares, prohibition on loans and investments for failure to repay public deposits and norms for concentration of credit/investments.

2. An auditor should ensure that the Board of Directors of **every NBFC granting/intending to grant demand/call loans shall frame and implement a policy** for the company.

3. An auditor should verify **that advances and other credit facilities have been properly classified** as standard/substandard/doubtful/loss and that **proper provision has been made** in accordance with the Directions.

4. In respect of Non-Performing Assets, an **auditor should check whether the unrealised income in respect of such assets has not been taken to the Profit & Loss** Account on an accrual basis. **Income from NPAs should be accounted for on realisation basis** only.
5. Check whether **all accounts which have been classified as NPAs in the previous year also continue to be shown as such** in the current year also. If the same is not treated as an NPA in the current year, the auditor should specifically examine such accounts to ascertain whether the account has **become regular and the same can be treated as performing** as per the Directions.

CLASSIFICATION OF FRAUDS BY NBFC'S

In order to have uniformity in reporting, frauds have been classified as under based mainly on the provisions of the Indian Penal Code:

a. **Misappropriation and criminal breach** of trust.
b. **Fraudulent encashment through forged instruments,** manipulation of books of account or through fictitious accounts and conversion of property.
c. **Unauthorised credit facilities extended** for reward or for illegal gratification.
d. **Negligence and cash shortages**.
e. **Cheating and forgery**.
f. **Irregularities in foreign exchange** transactions.
g. Any other type of fraud not coming under the specific heads as above.

NOTE: Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (d) and (f) above **are to be reported as fraud if the intention to cheat/ defraud is suspected/ proved**. However, the following cases **where fraudulent intention is not suspected/ proved**, at the time of detection, will be treated as fraud and reported accordingly:

1. Cases of **cash shortages more than Rs. 10,000/-** and
2. Cases of **cash shortages more than Rs. 5000/-** if detected by management/ auditor/ inspecting officer and **not reported on the occurrence by the persons** handling cash.

OVERSEAS BRANCHES: NBFCs, covered in Master Direction - Monitoring of Frauds in NBFCs (Reserve Bank) Directions, 2016, having overseas branches/offices should **report all frauds perpetrated at such branches/offices also to the Reserve Bank** as per the prescribed format and procedures.

SPECIAL AUDIT CHECKLIST FOR NBFC'S

Some important points that may be covered in the audit of NBFCs, in addition to the audit points that may be covered for companies in general, are given below:

SAMPLE AUDIT CHECKLIST FOR NBFC – ICC: [INVESTMENT AND CREDIT COMPANY]:

1. **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.

2. Verify whether the NBFC has **not advanced any loans against the security of its own shares**.

3. **INCOME RECOGNITION ON SECURITIES:**

    a. Verify that **dividend income wherever declared by a company, has been duly received and interest** wherever due [except in case of NPAs] has been **duly accounted for**.
    b. NBFC Prudential Norms require dividend income on shares of companies and units of mutual funds to be **recognised on cash basis**. However, the NBFC has an **option to account for dividend income on accrual basis,** if the same has been declared by the body corporate in its Annual General Meeting and its right to receive the payment has been established.
    c. Income from **bonds/debentures of corporate bodies is to be accounted on accrual basis only if the interest rate on these instruments is predetermined** and interest is serviced regularly and not in arrears.

4. **INVESTMENTS BY NBFC:**
    a. **CLASSIFICATION OF INVESTMENTS:** Verify the **Board Minutes for purchase and sale of investments.** Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long-Term Investments.
    b. **VALUATION OF INVESMENTS:** Check whether the **investments have been valued in accordance with the NBFC Prudential Norms and adequate provision** for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.

c. **INVESTMENT IN GROUP COMPANIES:** Obtain **a list of subsidiary/group companies & verify the investments** made in subsidiary/group companies during the year. **Ascertain the basis for arriving at the price** paid for the acquisition of such shares and whether the Valuation is as per Prudential norms.
d. **ACCOUNTING STANDARDS:** An 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**.
e. **CONFIRMATION CERFICIATE:** In respect of shares/securities held through a depository, obtain a **confirmation from the depository regarding the shares/securities** held by it on behalf of the NBFC.
f. **UNQUOTED INVESTMENTS:** 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.
g. **LIMITS SINGLE BORROWER:** 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.

5. **LOANS AND ADVANCES:**
   a. **PROPER SANCTION:** An auditor should examine **whether each loan or advance has been properly sanctioned**. He should verify the conditions attached to the sanction of each loan or advance
   b. **REVIEW OF SECURITY:** He must **ascertain the nature and value of security** and the net worth of the borrower/guarantor to determine the extent to which **an advance could be considered realisable**.
   c. **CONFIRMATIONS:** Obtain **balance confirmations** from the concerned parties.

6. **BILLS DISCOUNTED:**
   a. Verify that **proper records/documents have been maintained** for every bill discounted/rediscounted by the NBFC.
   b. **Test check some transactions** with reference to the documents maintained and ascertain whether the discounting charges, wherever, due, have been duly accounted for by the NBFC.

7. **NON-PERFORMING ASSETS:**
   a. An auditor should verify whether the **NBFC has an adequate system of proper appraisal and follow up** of loans and advances.

b. In addition, he may **analyse the trend of its recovery performance** to ascertain that the NBFC does not have an unduly high level of NPAs.
c. Check the **classification of loans and advances** 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.

ADDITIONAL DUTIES OF AN AUDITOR FOR AUDIT OF NBFC'S UNDER RBI DIRECTIONS

The following are the important duties of an auditor -

COMPLIANCE WITH NBFC AUDITOR'S REPORT - RBI DIRECTIONS:

*The RBI Directions have considerably increased the responsibility of auditors of NBFCs. This **reporting requirement is in addition to the normal reporting requirements** to the shareholders under section 143 of the Companies Act, 2013.*
*Auditors will have to be very careful whilst carrying out audits of NBFCs to ensure that all matters which they are required to take into **consideration for the purposes of reporting to the RBI** have been taken due care of.*

REPORT TO RBI FOR NBFC – DEPOSITS [NON-COMPLIANCES]:

1. As per RBI Act, the auditor of a non-banking financial company or a non-banking miscellaneous company **which has accepted public deposits, has to inquire whether or not the company has furnished to the RBI** statements, information of particulars relating to the deposits as are required

2. The provision further states that if on inquiry the auditor is not satisfied about the compliance by the company, it is his duty to make to the **RBI giving the aggregate amount of deposits held by the company**. The auditor is also **required to incorporate the report** or intended to be made to the RBI in his report to the company under Section 143 of the Companies Act, 2013.

REPORT TO BOARD OF DIRECTORS AS PER RBI DIRECTIONS:

1. The Reserve Bank of India (RBI) has issued **Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016** (the Directions) **to auditor of every non-banking financial companies**. The

Directions shall apply to every auditor of a non-banking financial company as defined in section 45 I(f) of the Reserve Bank of India Act, 1934.

2. **Auditors to submit additional Report to the Board of Directors:** In addition to the Report made by the auditor under the Companies Act, on the accounts of a non-banking financial company examined for every financial year ending on any day on or after the commencement of these Directions, the auditor **shall also make a separate report to the Board of Directors** of the Company on the matters specified in paragraphs 3 and 4 below.

3. **MATERIAL TO BE INCLUDED IN THE AUDITOR'S REPORT TO THE BOARD OF DIRECTORS:** The auditor's report on the accounts of a non-banking financial company shall include a statement on the following matters:

   a. **FOR ALL NON-BANKING FINANCIAL COMPANIES:**
      i. Company engaged in the business of non-banking financial institution and meeting the Principal Business Criteria (Financial asset/income pattern), **the auditor shall examine whether the company has obtained a Certificate of Registration** (CoR) from the RBI.
      ii. In case of a company holding CoR issued by the RBI, whether **that company is entitled to continue to hold such CoR** in terms of its Principal Business Criteria (Financial asset/income pattern) as on March 31 of the applicable year.
      iii. Whether the non-banking financial company **is meeting the required net owned fund requirement as laid down in Master Direction**

   NOTE: Certificate of statutory auditor: Every non-banking financial company **shall submit a Certificate from its Statutory Auditor that it is engaged in the business of non-banking financial** institution requiring it to hold a Certificate of Registration under Section 45-IA of the RBI Act and **is eligible to hold it**. To be submitted to the **Regional Office of the Department of Non-Banking Supervision** under whose jurisdiction the non-banking financial company is registered, **within 1 month from the date of finalization of the balance sheet** and in any **case not later than December 30th of that year**.

b. **FOR NON-BANKING FINANCIAL COMPANIES ACCEPTING/HOLDING PUBLIC DEPOSITS:** Apart from the matters enumerated in (A) above, the auditor shall include a statement on the following matters:

   i. **OVER ALL LIMITS:** Whether the public deposits accepted by the company together with other borrowings:
      1. From public by issue of **unsecured non-convertible debentures/bonds**.
      2. From its **shareholders (if it is a public limited company)**
      3. **Are within the limits admissible to the company as per the provisions** of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

   ii. **REGULARISED:** Whether the public deposits held by the company **in excess of the quantum of such deposits permissible** to it **are regularised in the manner provided in the said Directions**.

   iii. **WITHOUT GRADE CREDIT RATING:** Whether the non-banking financial company is **accepting "public deposit" without minimum investment grade credit rating**

   iv. **CRAR:** Whether the **capital adequacy ratio as disclosed** in the return submitted to the Bank has **been correctly determined and whether such ratio is in compliance** with the minimum CRAR prescribed therein.

   v. In respect of non-banking financial companies referred to in clause (iii) above,
      1. whether the credit rating, for each of the fixed deposits schemes that has **been assigned by one of the Credit Rating Agencies listed** in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 is in force and
      2. whether the **aggregate amount of deposits outstanding** as at any point during the year has **exceeded the limit specified by the such Credit Rating** Agency.

   vi. **RESTRICTIONS ON ACCEPTANCE OF DEPOSITS:** Whether the company **has violated any restriction on acceptance of public deposit**.

   vii. **DEFAUTS IN REPAYMENT:** Whether the company has **defaulted in paying to its depositors the interest and /or principal amount** of the deposits after such interest and/or principal became due.

viii. **PRUDENTIAL NORMS:** Whether the **company has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning** for bad and doubtful debts, and concentration of credit/investments as specified in the Directions issued by the Bank in terms of the Master Direction

ix. **LIQUID ASSETS REQUIREMENT:** Whether the company has complied with the liquid assets requirement as prescribed by the Bank in exercise of powers under section 45-IB of the RBI Act and whether the **details of the designated bank in which the approved securities are held is communicated to the office concerned of the RBI**

x. **RETURN ON DEPOSITS:** Whether the company **has furnished to the RBI** within the stipulated period **the return on deposits**.

xi. **QUARTERLY RETURN:** Whether the company has **furnished the quarterly return on prudential norms** within the stipulated time.

xii. **NEW BRANCHES / AGENTS:** Whether, in the case **of opening of new branches or offices** to collect deposits or in the case of closure of existing branches/offices or in the case of appointment of agent, the company **has complied with the requirements contained** in the Directions, 2016.

c. **IN THE CASE OF A NON-BANKING FINANCIAL COMPANY NOT ACCEPTING PUBLIC DEPOSITS:** Apart from the aspects enumerated in (A) above, the auditor shall include a statement on the following matters:

i. Whether the **Board of Directors has passed a resolution** for non- acceptance of any public deposits.

ii. Whether the company **has accepted any public deposits** during the relevant period/year.

iii. Whether the company has **complied with the prudential norms relating** to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms the directions 2016.

iv. In respect of **Systemically Important Non-deposit** taking NBFCs as defined in Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016:

1. Whether the **capital adequacy ratio as disclosed** in the return submitted to the RBI in form NBS - 7, has been **correctly arrived at and whether such ratio is in compliance** with the minimum CRAR prescribed by the RBI.
2. Whether the company has **furnished to the RBI the annual statement** of capital funds, risk assets/exposures and risk asset ratio (NBS-7) within the stipulated period.

v. whether the non-banking financial company **has been correctly classified as NBFC Micro Finance Institutions** (MFI) as defined in the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

d. **IN THE CASE OF A COMPANY ENGAGED IN THE BUSINESS OF NON-BANKING FINANCIAL INSTITUTION NOT REQUIRED TO HOLD COR SUBJECT TO CERTAIN CONDITIONS:**
Apart from the matters enumerated in (A)(I) above where a company has obtained a specific **advice from the RBI that it is not required to hold CoR from the RBI**, **the auditor shall include a statement that the company is complying** with the conditions stipulated as advised by the RBI.

4. **REASONS TO BE STATED FOR UNFAVOURABLE OR QUALIFIED STATEMENTS:** Where, in the auditor's report, the statement regarding any of the items referred to in paragraph 3 above is **unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified statement**, as the case may be. Where the auditor is **unable to express any opinion his report shall indicate such fact** together with reasons therefor.

5. **OBLIGATION OF AUDITOR TO SUBMIT AN EXCEPTION REPORT TO THE RBI:**
I. Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 above, is **unfavorable or qualified**, or in the opinion of the auditor the **company has not complied with**:
a. The provisions of **Chapter III B of RBI** Act (Act 2 of 1934) or

b. Non-Banking Financial Companies **Acceptance of Public Deposits (Reserve Bank) Directions, 2016** or
c. Non-Banking Financial Company – **Non-Systemically Important** Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - **Systemically Important** Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

It shall be the **obligation of the auditor to make a report** containing the details of such **unfavourable or qualified statements** and/or about the non-compliance, as the case may be, in respect of the company **to the concerned Regional Office of the Department** of Non-Banking Supervision of the RBI under whose jurisdiction the registered office of the company is located

II. **REPORT ONLY CONTRAVENTIONS AND NOT ABOUT COMPLIANCES:** The duty of the Auditor under sub-paragraph (I) **shall be to report only the contraventions of the provisions of RBI Act**, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report **shall not contain any statement with respect to compliance** of any of those provisions.

AUDITORS DUTY RELATING TO COMPLIANCE WITH CARO, 2020

As per CARO 2020, the auditor is required to report that:

CLAUSE 3 - INVESTMENTS, GUARANTEE, SECURITY, LOANS OR ADVANCES:

a. **APPLICABILITY:** Whether during the year **the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security** to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate:

I. **TO RELATED PARTIES:** The aggregate amount during the year, and balance **outstanding at the balance sheet date** with respect to such loans or advances and guarantees or security **to subsidiaries, joint ventures and associates**.

II. **TO UNRELATED PARTIES:** The aggregate amount during the year, and **balance outstanding at the balance sheet date** with respect to such loans or advances and guarantees or security **to parties OTHER THAN** subsidiaries, joint ventures and associates.

b. TERMS AND CONDITIONS:

Whether the investments made, guarantees provided, security given and **the terms and conditions** of the grant of all loans and advances in the nature of loans and guarantees provided **are not prejudicial to the company's interest**.

c. REPAYMENT REGULARITY:

In respect of loans and advances in the nature of loans, whether the **schedule of repayment of principal and payment of interest has been stipulated** and whether the repayments or receipts are regular.

d. OVERDUE > 90 DAYS:

If the **amount is overdue, state the total amount overdue for more than ninety days,** and whether reasonable **steps have been taken by the company for recovery** of the principal and interest.

e. RESCHEDULING OR EXTENTION OF OVERDUE LOANS (NEWLY ADDED IN 2020):

Whether any loan or advance in the nature of loan granted which has fallen due during the year, has been **renewed or extended or fresh loans granted to settle the overdues** of existing loans given to the same parties, if so,

I. **Specify the aggregate amount** of such dues renewed or extended or settled by fresh loans and

II. The **percentage of the aggregate to the total loans or advances** in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans].

f. DEMAND LOANS WITHOUT REPAYMENT PERIOD:

Whether the company has granted any loans or advances in the nature of loans **either repayable on demand or without specifying any terms or period of repayment**, if so,

I. **Specify the aggregate amount**, percentage thereof to the total loans granted,

II. **Aggregate amount of loans granted to Promoters**, related parties as defined in clause (76) of section 2 of the Companies Act, 2013

CLAUSE 16 - NON-BANKING FINANCIAL INSTITUTION:

a. 45IA OF RBI ACT: Whether **the company is required to be registered**

under section 45-IA of Reserve Bank of India Act 1934, and If so, whether the registration has been obtained.

b. **NBFC ACTIVITIES (NEW):** Whether the company has **conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration** (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934.

c. **CORE INVESTMENT COMPANY (NEW):**

   I. Whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so,

   II. Whether it continues to **fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC**, whether it continues to fulfil such criteria.

   III. Whether the **Group has more than one CIC as part of the Group**, if yes, **indicate the number of CICs** which are part of the Group.

APPLICABILITY OF IND AS ON NBFC'S

As per Rule 4 (1)(iv) of the Companies (Indian Accounting Standards) Rules, 2015 and as amended by Companies (Indian Accounting Standards) (Amendment) Rules, 2016, NBFCs are required to comply with Indian Accounting Standards (Ind AS) as under-

1. **Accounting periods beginning 1 April 2018:**
   a. **Listed NBFC's and unlisted NBFCs** having a **net worth of Rs. 500 crore or more** and
   b. Holding, subsidiary, joint venture or associate **companies of such NBFCs**

2. **Accounting periods beginning 1 April 2019:**
   a. All other **listed NBFCs**,
   b. Unlisted NBFCs having a **net worth of Rs. 250 crore or more but less than Rs. 500 crore** and holding, subsidiary, joint venture or associate **companies of such NBFCs**.

The net worth shall be calculated in accordance with the **standalone financial statements** of the NBFCs **as on 31st March 2016 or the first audited financial statements** for accounting period which **ends after that date.**

NOTE: For Format of Financial Statements of NBFC, Please Refer ICAI SM – October 2021 Edition Page. 11.26

DIFFERENCE BETWEEN DIVISION II [IND AS – NON NBFC] AND DIVISION III [IND AS – NBFC]

The presentation requirements under **Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following**:

a. NBFCs have been **allowed to present the items of the balance sheet in order of their liquidity** which is not allowed to companies required to follow Division II.

b. An NBFC is required to **separately disclose by way of a note** any item of **'other income' or 'other expenditure' which exceeds 1 % of the total income**. Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds 1 % of the revenue from operations or Rs.10 lakhs, whichever is higher.

c. NBFCs are required to **separately disclose under 'receivables', the debts due from any Limited Liability Partnership** (LLP) in which its director is a partner or member.

d. NBFCs are also required to disclose items **comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss** instead of showing those only as part of the notes.

e. Separate disclosure **of trade receivable which have significant increase in credit risk & credit impaired**.

f. The **conditions or restrictions for distribution attached to statutory reserves have to be separately disclosed** in the notes as stipulated by the relevant statute.

5. GROUP AUDIT

OVERVIEW ABOUT CONSOLIDATED FINANCIAL STATEMENTS

1. **CFS AFRFW:** Accounting Standard (AS) 21 'Consolidated Financial Statements' and Indian Accounting Standard (Ind AS) 110, 'Consolidated Financial Statements' lay **down principles and procedures for preparation and presentation of consolidated financial statements** under AS and Ind AS respectively.
2. **FORMAT OF CFS:** Consolidated financial statements are presented, to the extent possible, in the **same format as adopted by the parent for its separate financial statements**. The formats for preparation of balance sheet, statement of profit and loss and a statement of change in equity (if applicable) **are prescribed under the Schedule III of the Companies Act, 2013**.
3. **AUDIT OF CFS:**
    a. An entity which prepares the consolidated financial statements **might be required to or otherwise engage the auditor** for conducting the audit of consolidated financial statements.
    b. However, a law or regulation governing the entity **may require the consolidated financial statements to be audited by the statutory auditor of the entity** (i.e., the auditor who audits standalone financial statements of the entity).
    c. **GN ON CFS**:
        i. The Guidance Note on Audit of Consolidated Financial Statements provides guidance on the specific issues and **audit procedures to be applied in an audit of consolidated financial statements**.
        ii. This Guidance Note can also be used **while auditing consolidated financial statements prepared for special purpose**, to the extent applicable but it does not deal with accounting matters arising on consolidation of financial statements.

PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS UNDER COMPANIES ACT, 2013

1. **APPLICABILITY OF CFS:** According to the Companies Act, 2013**, where a company has one or more subsidiaries, including associate company and joint venture,** it shall, **in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries** in the same form and manner as that of its own.
2. **SFS PROVISIONS TO CFS:** Further, the said Act, provides that **the provisions applicable to the preparation, adoption and audit** of the financial statements of a holding company **shall, mutatis mutandis, also apply to its the consolidated financial statements**.
3. **APPROVAL BY BOARD AND MEMBERS:** The consolidated financial statements shall **also be approved by the Board of Directors before they are signed on behalf of the Board**, along with **its standalone financial statements and shall also be laid before the annual general meeting** of the company along with the laying of its standalone financial statement.
4. **SALIENT FEATURES OF F/S OF SUBSIDIARIES:** The company shall also attach along with its financial statement, **a separate statement containing the salient features of the financial statement of its subsidiary(ies)** in Form AOC-1.
5. **SCH III FORMAT:** According to the Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company **shall be made in accordance with the provisions of Schedule III** to the Act and the applicable accounting standards. However, a company which is **not required to prepare consolidated financial statements under the Accounting Standards**, **it shall be sufficient if the company complies with provisions of consolidated financial statements provided in Schedule III** of the Act.

6. **EXEMPTION FROM CFS:** The requirement related to preparation of consolidated financial statements **shall not apply to a company if it meets the following conditions**:
   a. **CONSENT OF OTHER MEMBERS:** it is **a wholly-owned subsidiary, or is a partially-owned subsidiary** of another company and all its other members, including those not otherwise entitled to vote, **having been intimated in writing and for which the proof of delivery of such intimation is available** with the company, **do not object to the company** not presenting consolidated financial statements

b. **UNLISTED COMPANIES:** it is **a company whose securities are not listed or are not in the process of listing** on any stock exchange, whether in India or outside India and
c. **CHAIN COMPANY:** its **ultimate or any intermediate holding company files** consolidated financial statements **with the Registrar** which are in compliance with the applicable Accounting Standards.
d. **BY NOTIFICATION:** As the Companies Act, 2013, **the Central Government may, on its own or on an application** by a class or classes of companies, by notification, **exempt any class or classes of companies from complying** with any of the requirements of CFS, if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.

7. **INVESTMENT ENTITY:**
   a. An investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, **to measure all of its subsidiaries at fair value through profit or loss**.
   b. A **parent shall determine whether it is an investment entity**.
   c. **MEANING:** An investment entity is an entity that:
      i. Obtains **funds from one or more investors** for the purpose of providing those investor(s) with investment management services
      ii. Commits to its **investor(s) that its business purpose is to invest funds** solely for returns from capital appreciation, investment income, or both and
      iii. **Measures and evaluates the performance** of substantially all of its **investments on a fair value basis**.
   d. As per paragraph 33 of Ind AS 110**, parent of an investment entity shall consolidate all entities** that it controls, including those controlled through an investment entity subsidiary, **unless the parent itself is an investment entity**.

RESPONSIBILITY OF PARENT

1. The **responsibility for the preparation and presentation of consolidated financial statements**, is **that of the management of the parent**. This includes:

a. **Identifying components, and including the financial information** of the components to be included in the consolidated financial statements.
b. Where appropriate, **identifying reportable segments** for segmental reporting.
c. **Identifying related parties and related party transactions** for reporting.
d. Obtaining **accurate and complete financial information** from components.
e. Making **appropriate consolidation adjustments**.
f. Harmonization of **accounting policies and accounting framework** and
g. **GAAP conversion**, where applicable.

2. Apart from the above, the **parent ordinarily issues instructions to the management of the component** specifying the **parent's requirements relating to financial information** of the components to be included in the consolidated financial statements. The instructions ordinarily cover:
   a. The **accounting policies to be applied**,
   b. **Statutory and other disclosure requirements** applicable to the parent,
   c. The **identification of and reporting on reportable segments**, and
   d. **Related parties and related party transactions**, and a reporting timetable.

AUDITORS'S RESPONSIBILTY FOR AUDIT OF CONSOLIDATED FINANCIAL STATEMENTS

1. The **principal auditor** of the consolidated financial statements is responsible for **expressing an opinion on whether the consolidated financial statements are prepared**, **in all material respects, in accordance with the financial reporting framework** under which the parent prepares the consolidated financial statements **in addition to reporting on the additional matters as required under the Companies Act, 2013** and any other statute to the extent applicable.

2. The **auditor's objectives** in an audit of consolidated financial statements are:
   a. to satisfy himself that the CFS have been **prepared in accordance with the requirements** of applicable financial reporting framework

b. to enable himself **to express an opinion on the true and fair view presented** by the CFS
c. to **enquire into the matters** as specified in **section 143(1)** of the Companies Act, 2013
d. The auditor should also **validate the requirement of preparation of CFS** for the company as per applicable financial reporting framework.

3. **Standards on Auditing, Statements and Guidance Notes** on auditing matters issued by the ICAI **apply in the same manner to audit of consolidated financial statements** as they apply to audit of standalone financial statements.

AUDIT CONSIDERATIONS WHILE CONDUCTING AUDIT OF CONSOLIDATED FINANCIAL STATEMENTS

The following features of consolidated financial statements have an impact on the related audit procedures:

1. **BASIS:**
   a. The consolidated financial statements **are prepared on the basis of separate financial statements of the parent and its components and also other financial information**, using the consolidation procedures prescribed **by Accounting Standards under applicable financial reporting framework**; and
   b. The auditor of the consolidated financial statements **may use the work of other auditors as per requirement of Standards on Auditing**.
   c. The '**other financial information**' would **include disclosures to be made in the consolidated financial statements about the components, proportion of items** included in the consolidated financial statements to which different accounting policies have been applied where permitted, adjustments made for the effects of significant transactions, etc..

2. **USE OF OTHER AUDITORS:**
   a. **The auditor should assess whether based on his work alone he would be able to express an opinion** on the true and fair view presented by the **consolidated financial statements**. If the auditor is of the view **that his own participation may not be sufficient**, he should consider **using the work of 'other auditors'**.

b. Such 'other auditors' might be the statutory auditors of the separate financial statements of one or more of the components or the auditors **appointed specifically for assisting the auditor of the consolidated financial statements (the principal auditor).** Where the statutory auditors of one or more of the components of the parent are also **requested to assist the principal auditor**, the work to be performed by such statutory auditors for use by the principal **auditor would constitute an assignment separate from the assignment to conduct the statutory audit** of the respective component.

c. The principal auditor, if he decides to use the work of another auditor in relation to the audit of consolidated financial statements, **should comply with the requirements of SA 600**.

3. **MATERIALITY DETERMINATION:** With regard to determination of materiality during the audit of consolidated financial statements (CFS), the **auditor should consider the following**:
   a. The auditor is required to **compute the materiality for the group** as a whole.
   b. This materiality should be used **to assess the appropriateness of the consolidation adjustments**.
   c. The parent auditor can also use the materiality computed on the group level to **determine whether the component's financial statements are material to the group** to determine whether they should scope in additional components and consider using the work of other auditors as applicable.
   d. The **principal auditor also computes materiality for each component and communicates to the component auditor**, if he believes is required for true and fair view on CFS.
4. **CONFIRMATION FROM COMPONENT AUDITORS:** The principal auditor also **obtains certain confirmations from component auditor** like independence, code of ethics, certain information required for consolidation and disclosure requirements etc.
5. **MODIFIED OPINION IN OTHER AUDITORS' REPORTS:** While considering the **observations (for instance modification and /or emphasis of matter/other matter) of the component auditor** in his report on the standalone financial statements, the parent auditor should comply with the requirements of SA 600, "Using the Work of Another Auditor". Therefore, **the concept of materiality would be considered** while considering the observations of the component auditor.

AUDIT PROCESS FOR AUDIT OF CONSOLIDATED FS

1. **AUDIT PLANNING:** The auditor should make plans, For the following:
   a. **Understanding of the group structure and group-wide controls** including assessment of Information Technology (IT) system and related general and applications IT related controls (manual and automated) for consolidation process
   b. **Understanding of accounting policies of the parent and its components as well as of the consolidation process** including the process of translation of financial statements of foreign components
   c. **Determining and programming the nature, timing, and extent of the audit procedures** to be performed based on the assessment of the risk of material misstatement in consolidation process.
   d. Determining **the extent of use of other auditor's work in the audit and Coordinating the work** to be performed.

2. **AUDIT PROCESS:**
   a. The auditor **should obtain a listing of all the components included in the CFS and review the information provided by the management** of the parent identifying the components. The auditor should **verify that all the components have been included** in the CFS unless these components meet criterion for exclusion.
   b. In respect of **completeness of this information**, the auditor should perform the following procedures:
      i. Review **his working papers for the prior years** for the known components.
      ii. Review the **parent's procedures for identification** of various components
      iii. Make inquiries of the management **to identify any new components or any component which goes out of** CFS.
      iv. **Review the investments of parent as well as its components** to determine the shareholding in other entities
      v. Review **the joint ventures and joint arrangements** as applicable.
      vi. Review the **other arrangements entered** by the parent that have not been included in the CFS of the group.
      vii. Review **the statutory records maintained by the parent**
      viii. Identify **the changes in the shareholding** that might have taken place during the reporting period.

c. The auditor should **document procedures performed for assessing completeness** of the components to be consolidated.
d. There would be **various means by which control, joint control or significant influence can be obtained**. In this regard:
    i. The auditor may verify the **Board's minutes, shareholder agreements** entered into by the parent, agreements with the entities to which the parent might have **provided any technology or know how, enforcement of statute**, as the case may be, etc.
    ii. The auditor may **also review the minutes of the meetings of the Board of Directors subsequent to the year-end** to understand if there has been **any liquidation of investments or any further investments** have been made as these may provide further evidence to understand if the control was meant to be temporary in nature or otherwise.

e. **EXCLUDED COMPONENTS FROM CFS:** Where a component is excluded from the CFS, **the auditor should examine the reasons for exclusion and whether such exclusion is in conformity** with the applicable financial reporting framework, for example:
    i. **ACCOUNTING STANDARDS [AS 21] :** Under the Companies (Accounting Standards) Rules, 2006, there **could be two reasons for exclusion** of a subsidiary, associate, or jointly controlled entity:
        1. One, **that the relationship of parent** with the subsidiary, associate or jointly controlled **entity is intended to be temporary** or
        2. The subsidiary, associate or joint venture **operates under severe long-term restrictions which significantly impair its ability to transfer funds** to the parent.

    ii. **COMPANIES ACT:** Similarly, under the Companies Act, 2013, **intermediate subsidiary in India is not required to present CFS**, if a company meets the following conditions:
        1. It is a wholly-owned subsidiary, or is a partially partially-owned subsidiary of **another company and all its other members, *including those not otherwise entitled to vote*, having been intimated in writing and for which the proof of delivery** of such intimation is available with the company**, *do not object to the company not presenting CFS***.

2. It is a company whose securities **are not listed or are not in the process of listing** on any stock exchange, whether in India or outside India and
3. **Its ultimate or any intermediate holding company files CFS with the Registrar** which are in compliance with the applicable Accounting Standards.

iii. **IND AS [IND AS 110]:** Ind AS 110 also prescribes certain criteria where consolidated financial statements are not required. The **relationship of parent** with the other entity as subsidiary, associate or joint venture **is temporary**, the auditor should verify that the **intention of the parent, to dispose off** the subsidiary, investment in associate or interest in jointly controlled entity, in **the near future, existed at the time of acquisition of the subsidiary, making investment** in associate or jointly controlled entity. The auditor **should also verify that the reasons for exclusion are given [DISCLOSED]** in the CFS.

iv. **ANYOTHER REASON – MODIFIED OPINION:** If an entity is excluded from the consolidated financial statements for reasons **other than those allowed by the applicable financial reporting framework, the auditor should consider its effect on the auditor's report to be issued**.

f. **CHANGES IN STATUS OF COMPONENTS:**

i. The auditor should also examine whether there is any **change in the status of a component** (e.g., subsidiary to associate, JV to associate or vice – versa).

ii. The auditor, in such cases, should **examine whether these changes have been appropriately accounted** for in the consolidated financial statements as required by the relevant accounting standards/Ind AS under the applicable financial reporting framework.

3. METHOD OF CONSOLIDATION:

a. **UNDER ACCOUNTING STADARDS:** In preparing consolidated financial statements in accordance with the Companies (Accounting Standards) Rules, 2006:

i. **SUBSIDIARIES:**

1. The financial statements of the parent and its subsidiaries **are combined on a line by line basis by**

adding together like items of assets, liabilities, income, expenses and cash flows and

2. Then certain **calculations like determination of goodwill or capital reserve, minorities interest and adjustments** etc. are **made in accordance with the requirements** of Accounting Standard (AS) 21, "Consolidated Financial Statements".

ii. **ASSOCIATES:** Investments in **associates are accounted for using the Equity Method** as prescribed in Accounting Standard (AS) 23, "Accounting for Investments in Associates in Consolidated Financial Statements".

iii. **JOINT VENTURE:** A parent that has **an interest in a jointly controlled entity, reports its interest in the CFS using proportionate consolidation method** in accordance with Accounting Standard (AS) 27, "Financial Reporting of Interests in Joint Ventures".

b. **UNDER IND AS:**

i. **SUBSIDIARIES:**

1. The financial statements of the parent and its subsidiaries are combined as per Ind AS 110, "Consolidated Financial Statements" on **a line by line basis by adding together**
2. **Related goodwill/ capital reserve** (or gain on bargain purchase) and non-controlling interest is determined as **per Ind AS 103**
3. Business combinations involving entities or businesses under common control shall be accounted for using the **pooling of interest method in accordance with Ind AS 103**.
4. **Adjustments like elimination of intra group transactions**, balances, unrealised profits and deferred tax etc. are made in accordance with the **requirements of Ind AS 110**

ii. **ASSOCIATES AND JOINT VENTURES:**

1. **Investments in associates and joint ventures are accounted for using the Equity Method** as prescribed in Indian Accounting Standard (Ind AS) 28, "Investments in Associates and Joint Ventures".
2. **Interests in assets, liabilities, revenues and expenses in a joint operation** are accounted for as part of separate financial statements of the entity in

accordance with Indian Accounting Standard **(Ind AS) 111, "Joint Arrangements"**

3. In a business combination achieved in stages, the **acquirer shall remeasure its previously held equity interest** in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in **profit or loss or other comprehensive income, as appropriate in accordance with Ind AS 103**.

c. **OTHER ADJUSTMENTS UNDER STANDARDS:**
   i. The auditor should verify that the adjustments warranted by the relevant accounting standards under the applicable financial reporting framework **have been made wherever required and have been properly approved by the management of the parent**.
   ii. The preparation of consolidated financial statements gives rise **to permanent consolidation adjustments and current period consolidation adjustments**.

d. **OFF B/S ENTITIES:** The auditor should also pay attention to off balance sheet entities which sometimes **do not qualify for the definition of subsidiary, however, parent might have transferred risks of various business** ventures to these entities.

e. **DFFACTO CONTROL:** Further, de-facto control should also be considered. De facto control means **an investor with less than majority of the voting rights has the practical ability to direct the relevant activities unilaterally**.

SPECIAL CONSIDERATIONS UNDER CONSOLIDATIONOF FS

A. PERMANENT CONSOLIDATION ADJUSTMENTS

1. Permanent consolidation adjustments are **those adjustments that are made only on the first occasion or subsequent occasions in which there is a change in the shareholding** of a particular entity which is consolidated. Permanent consolidation adjustments are:
   a. **Determination of goodwill lor capital reserve** as per applicable accounting Standards
   b. **Determination of amount of equity attributable to minority/ non-controlling interests**.
2. The auditor should verify that the above calculations have been made appropriately:

a. The auditor should **pay particular attention to the determination of pre-acquisition reserves** of the components. Date(s) of investment in components assumes importance in this regard.
b. The auditor should also examine whether the pre-acquisition reserves have been **allocated appropriately between the parent and the minority interests**/ non-controlling interests of the subsidiary.
c. The auditor should also verify the changes that might have taken place in these permanent consolidation adjustments on account of **subsequent acquisition of shares in the components, disposal of the components in the subsequent years**.

3. **NETOFF GOODWILL AND CAPITAL RESERVE:**
    a. **PERMITTED – NETOFF:** While working out the permanent consolidation adjustments, in the case of one subsidiary, goodwill arises and in the case of another subsidiary, capital reserve arises. The parent **may choose to net off these amounts to disclose a single amount** in the consolidated balance sheet were permitted by the applicable financial reporting framework.
    b. **DISCLOSE GROSS AMOUNTS:** In such cases, the auditor should verify that the gross amounts of goodwill and capital reserves arising on **acquisition of various subsidiaries have been disclosed in the notes** to the consolidated financial statements to reflect the excess/shortage over the parents' portion of the subsidiary's equity.

B. CURRENT PERIOD CONSOLIDATION ADJUSTMENTS

1. Current period adjustments are those **adjustments that are made in the accounting period for which the consolidation of financial statements is done**.
    a. **Intra-group interest paid and received**, or management fees, etc.
    b. **Unrealised intra-group profits** on assets acquired/ transferred from/ to other subsidiaries
    c. Record **deferred taxes on unrealised intercompany profits elimination** in accordance with Ind AS 12.
    d. **Intra-group indebtedness**.
    e. **DIFFERENT A/C POLICIES:** Adjustments related to **harmonising the different accounting policies** being followed by the parent and its components.

f. **SUBSEQUENT EVENTS:** Adjustments to the CFS **for recognized subsequent events or transactions that occur between the balance sheet date and the date of the auditor's report** on the consolidated financial statements of the group. There are 2 types of subsequent events:

1. **ADJUSTING EVENTS:** The first type of subsequent events consists of events or transactions **that provide additional evidence about conditions that existed at the date of the financial statements**, including the estimates inherent in the process of preparing financial statements.
2. **NONADJUSTING EVENETS:** The second type of subsequent events consists of events that **provide evidence about conditions that did not exist at the date of the financial statements** but arose subsequent to that date.

NOTE: Events occurring after balance sheet date which **do not require adjustments would not normally require disclosure**, in the case of accounting standards and in the financial statements in case of Ind AS.

g. **DIFFERENT BALANCE SHEET DATES:** Adjustments for **the effects of significant transactions or other events that occur between the date of the components balance sheet** and not already recognised in its financial statements and **the date of the auditor's report on the group's CFS** when the FS of the component to be used for consolidation are **not drawn up to the same balance sheet date as that of the parent**.

h. **FOREIGN COMPONENTS:** In case of a foreign component, **adjustments to convert a component's audited financial statements** prepared under the component's local GAAP to the GAAP under which the consolidated financial statements are prepared;

i. **MINORITIES INTEREST:**

1. Determination of **movement in equity attributable to the minorities interest**/non-controlling interest since the date of acquisition of the subsidiary.
2. It should also be noted that under **Ind AS, non-controlling interest can also result in negative balance**, If the net worth of subsidiary is negative, non-controlling interest could have deficit balance.

j. **DEFERRED TAX:** Adjustments of deferred tax on account of **temporary differences arising out of elimination of profit and losses** resulting from intragroup transactions and undistributed profits of the component in case of consolidated financial statements prepared under Ind AS.

k. **MEMORANDUM RECORDS:** The adjustments required for preparation of consolidated financial statements are **made in memorandum records kept for the purpose by the parent**. The auditor **should review the memorandum records to verify the adjustment entries** made in the preparation of consolidated financial statements.

AUDIT PROCESS: Apart from reviewing the memorandum records, the auditor should inter alia:

1. Verify that the **intra group transactions and account balances** have been eliminated
2. Verify that the consolidated financial statements have been **prepared using uniform accounting policies** for like transactions and other events in similar circumstances.
3. Verify **that adequate disclosures have been made in accordance with AS 21** in the CFS for application of different accounting policies in case, it was impracticable to harmonize them.
4. **Verify the adjustments made to harmonise the different accounting policies** including adjustments made by management to convert a component's financial statements prepared under the component's GAAP to the GAAP under which the consolidated financial statements are prepared
5. **MINORITIES INTEREST:** Verify the **calculation of minorities/non-controlling interest**. The auditor also determines, in cases where the minority interests' **share of the losses exceed the minority/non-controlling interests' share of the equity**, the excess, and any further losses applicable to the minority interest, have been accounted for in accordance with the relevant accounting standards.
6. Verify **adjustments relating to deferred tax on account of temporary differences** arising out of elimination of profit and losses resulting from intergroup transactions (where the parent's accounts are maintained in Ind AS)
7. Verify that income and expenses of the subsidiary are included in CFS from **the date it gains control until the date when the entity ceases to control the subsidiary**.

8. **IMPAIRMENT LOSS OF GOODWILL:**
   a. One of the important adjustment that may be required in the current period **is determination of impairment loss that might exist for goodwill** arising on consolidation. Goodwill arising on consolidation is **carried at the value determined at the date of acquisition of the component**, **and the same is to be tested for impairment loss at every balance sheet date**.
   b. The auditor should examine whether any impairment loss has been determined by the parent. If yes, the auditor should **examine the procedure followed for determination of impairment loss and if it is fair**.
   c. In case the impairment loss in goodwill of **a component has been determined in foreign currency**, the auditor should verify if any amount of loss in local currency need to **be adjusted from currency translation reserve on account of movement** in the exchange rate, **FROM THE DATE when the goodwill was first accounted** for in the CFS of parent, **TO THE DATE of determination of impairment loss**.
   d. **INTRA GROUP LOSSES:** The auditor should also perform audit procedures to **understand and verify whether intragroup losses are indicating an impairment loss** that requires recognition in the consolidated financial statements.

9. **SAME REPORTING DATE:**
   a. The financial statements of the components used in the consolidation should be **drawn up to the same reporting date as that of the parent.**
   b. If it is **not practicable to draw up the financial statements of one or more components to such date** and, accordingly, those financial statements are drawn up to different reporting dates, **adjustments should be made for the effects of significant transactions** or other events that occur between those dates and the date of the parent's financial statements.
   c. In any case, the **difference between reporting dates should not be more than**:
      i. **6 months** in case of financial statements **under AS** and
      ii. **3 months** in case of financial statements **under Ind AS**.
   d. The auditor of the CFS should review other components' results between its **financial reporting date and that of the parent for significant transactions or other events** that have taken place

during the period and, therefore, **need to be reflected in the consolidated financial statements**.

10. **LENGTH OF REPORTING PERIOD:**
    a. The fundamental accounting assumption of "consistency" requires the auditor of the consolidated financial statements to **consider whether the length of the reporting periods and any difference in financial year-ends** are the same from period to period.
    b. If there have been any changes in the respective reporting periods of the components included in the consolidated financial statements that **have a material effect on the financial statements,** the auditor should **ensure that the entity discloses such changes and the manner of treatment** in the financial statements.

11. **DISCLOSURES IN CFS:** In the CFS, the company would need to give all disclosures relevant to CFS only. Further, Accounting Standard (AS) 21 also lays down certain principles that should be observed while giving the information which is **part of the separate financial statements of the Components but that need not be reported** in the notes and other explanatory material of the consolidated financial statements.
    The auditor should:
    a. Examine that the **notes required by the applicable standards which are necessary for presenting a true and fair view of the CFS** have been included in the consolidated financial statements as an integral part thereof **and**
    b. Examine that **additional statutory information disclosed** in the separate financial statements of the subsidiary and/or a parent having **bearing on the true and fair view of the consolidated financial statements** have been disclosed in the consolidated financial statements.
    c. EXAMPLE: Following information is also **required to be disclosed in the consolidated financial statements separately for the parent and each of its components** (including foreign component) which has been consolidated:
        i. **Amount of net assets** and net assets as **a % of consolidated net assets**.
        ii. Amount of **share in profit or loss** and the **% share in profit or loss as a percentage of consolidated profit or loss**.

iii. Amount in **other comprehensive income (OCI)** and the **percentage of OCI as a percentage of Consolidated OCI**.

d. As regards consolidation adjustments (including elimination of intra group transactions), it should **be ensured that these are either disclosed as a single line item separately or adjusted in the information** (e.g., net assets) disclosed for the parent and its each component.

12. **DISCLOSURES IN SFS BUT NOT IN CFS:**

a. CFS under Ind AS, requires only those **disclosures should be given which are relevant to CFS**.

b. The information such as **the following given in the notes to the separate financial statements** of the parent and/or the subsidiary, **need not be included in the CFS**:

   i. **Source from which bonus shares** are issued, e.g., capitalization of profits or reserves or from securities premium account.

   ii. Disclosure of **all unutilised monies out of the issue** indicating the form in which such unutilised funds have been invested.

   iii. A **statement of investments separately classifying trade investments and other investments**.

   iv. **Value of all imported raw materials, spare parts and components** consumed during the financial year

   v. The **amount remitted during the year in foreign currencies on account of dividends**, with a specific mention of the number of non-resident shareholders, the number of shares held by them on which the dividends were due and the year to which the dividends related.

   vi. **Earnings in foreign exchange classified** under the following heads, namely:

      1. **Export of goods calculated** on F.O.B. basis.
      2. **Royalty, know-how**, professional and consultation fees.
      3. **Interest and dividend**.
      4. **Other income**, indicating the nature thereof.

MANAGEMENT REPRESENTATIONS

1. SA 580, "Written Representations" requires the **auditor to obtain written representations from management** and, where appropriate, those charged with governance.
2. The auditor of the consolidated financial statements **should obtain evidence that the management** of the parent **acknowledges its responsibility** for a true and fair presentation of the consolidated financial statements in accordance with the financial reporting framework applicable to the parent and **that parent management has approved the consolidated financial statements**.
3. In addition, the auditor of the consolidated financial statements **obtains written representations from parent management on matters material** to the consolidated financial statements.

AUDIT REPORTING UNDER CONSOLIDATED FINANCIAL STATEMENTS

1. There could **be 2 situations** in an audit of consolidated financial statements:
    a. When the **parent's auditor is also the auditor of ALL the components** to be included in the consolidated financial statements and
    b. When the parent's **auditor is NOT the auditor of one or more components** and therefore, uses the work of other auditors in the audit.
2. The auditor should, while preparing the report, consider the requirements of Standard on Auditing (SA) 700, "Forming an Opinion and Reporting on Financial Statements", SA 705, "Modifications to the Opinion in the Independent Auditor's Report and SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report. Where, the auditor uses the work of other auditors in the audit of consolidated financial statements, the requirements of SA 600, "Using the Work of Another Auditor" should also be considered.

CASE A	CASE B	CASE C
When the Parent's Auditor is **also the Auditor of ALL its Components**	When the Parent's Auditor is **not the Auditor of its Components**.	When the Component(s) Auditor Reports on Financial Statements under an **Accounting Framework Different than that of the Parent**

CASE D	CASE E
When the Component(s) Auditor Reports under an **Auditing Framework Different than that of the Parent**.	Components **Not Audited**.

A. WHEN THE PARENT'S AUDITOR IS ALSO THE AUDITOR OF ALL ITS COMPONENTS

While drafting the audit report, the auditor should report:

1. Whether **principles and procedures for preparation and presentation of CFS** as laid down in the relevant accounting standards have been followed. In case of any **departure or deviation, the auditor should consider the requirements given in SA 705**, Modifications to the Opinion in the Independent Auditor's reports in the audit report so that users of the CFS are aware of such deviation.

2. Auditor should **issue an audit report expressing opinion whether the consolidated financial statements give a true and fair view** of the state of affairs of the Group as on balance sheet date and as to whether **consolidated profit and loss statement gives true and fair view** of the results of consolidated profit or losses of the Group for the period under audit

3. Where the CFS also include a **cash flow statement, the auditor should also give his opinion on the true and fair view of the cash flows** presented by the consolidated cash flow statements.

B. WHEN THE PARENT'S AUDITOR IS NOT THE AUDITOR OF ALL ITS COMPONENTS

1. **SA 706 OTHER MATTER PARA:** In a case where the **parent's auditor is not the auditor of all the components** included in the consolidated financial statements, the auditor of the consolidated financial statements should also consider the requirement of SA 600. As prescribed in SA 706, if the **auditor considers it necessary to make reference** to the audit of the other auditors, **the auditor's report on**

the CFS should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor(s).

2. **QUANTIFICAION:** This may be done by **stating aggregate RUPEE AMOUNTS or PERCENTAGES** of total assets, revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor

3. **UNAUDITED:** Total assets, revenues and cash flows **not audited by the parent's auditor should be presented before giving effect to permanent and current period** consolidation adjustments.

4. **STATEMENT OF NOT MODIFIED:** Reference in the report of the auditor on the consolidated financial statements to the **fact that part of the audit of the group was made by other auditor(s) is not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility between the auditors** of the parent and its subsidiaries.

C. WHEN THE COMPONENT(S) AUDITOR REPORTS ON FINANCIAL STATEMENTS UNDER AN ACCOUNTING FRAMEWORK DIFFERENT THAN THAT OF THE PARENT

1. **CONVERSION:** When **a component's financial statements are prepared under an accounting framework that is different than that of the framework used by the parent** in preparing group's consolidated financial statements, the **parent's management perform a conversion of the components' audited financial statements from the framework used by the component to the framework under which the CFS** are prepared. **The conversion adjustments are audited by the principal auditor** to ensure that the financial information of the component(s) is suitable and appropriate for the purposes of consolidation.

2. A **component may alternatively prepare financial statements on the basis of the parent's accounting policies**, as outlined in the group accounting manual. The group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are **consistent with the requirements of the financial reporting framework under which the group's CFS** are prepared. The local component auditor can then audit and issue an audit report on the components financial statements **prepared in accordance with "group accounting policies**"

3. When **applying the approach of using group accounting policies** as the financial accounting framework for components to report under, the **principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies** with the GAAP applicable to the parent's financial statements. This ensures that the information prepared under the requirements of the **group accounting policies will be directly usable and relevant for the preparation of consolidated financial statements by the parent entity**. The **Principal auditor can then decide whether or not to rely on the components' audit report** and make reference to it in the auditor's report on the consolidated financial statements.

D. WHEN THE COMPONENT(S) AUDITORS REPORTS UNDER AN AUDITING FRAMEWORK DIFFERENT THAN THAT OF THE PARENT

1. Audit of financial statements, including consolidated financial statements, are performed under auditing standards generally accepted in India ("Indian GAAS").
2. In order **to maintain consistency of the auditing framework** and to enable the parent auditor to rely and refer to the other auditor's audit report in their audit report on the CFS, the **components' financial statements should also be audited under a framework that corresponds to Indian GAAS**.

E. COMPONENTS NOT AUDITED

1. Where the financial statements of **one or more components continue to remain unaudited**, the auditor reporting on the CFS should **consider unaudited components in evaluating a possible modification** to his report on the CFS. The evaluation is necessary because the auditor has **not been able to obtain sufficient appropriate audit evidence in relation to such consolidated amounts/balances**. In such cases, the **auditor should evaluate both qualitative and quantitative factors on the possible effect** of such amounts remaining unaudited when reporting on the consolidated financial statements using the guidance provided in SA 705, "**Modifications to the Opinion in the Independent Auditor's Report**".

6. INTERNAL AUDIT

CONCEPT OF INTERNAL AUDIT AND ITS APPLICABILITY UNDER COMPANIES ACT, 2013.

A. DEFINITION OF INTERNAL AUDIT:

1. "Internal Audit provides **independent assurance on the effectiveness of internal controls** and **risk management** processes to **enhance governance and achieve organisational objectives**."
2. The internal auditing **need not to be confined financial transactions only.**
3. The **objectives and scope of Internal Audit Function** as per **SA 610**, "**Using the Work of an Internal Auditor**" may include:
    - **Monitoring of internal controls;**
    - **Examination of financial and operating information**
    - **Review of operating activities**
    - **Review of compliance with laws and regulations**
    - **Risk management**
    - **Governance**

Indicative Objectives & Scope of Internal Audit

Monitoring Internal Controls	Examination of Financial and operating information	Review of compliance with laws and regulations	Review of operating activities	Risk Management	Governance
Example Monitoring through Exception Reports of Continuous Control Management Tools in ERP System	**Example** Internal Audit for identifying reasons of year-to-year deviation in Profit & Loss Account items	**Example** Reviewing store management practices vis-à-vis Industry's Best Practices	**Example** Review of compliance with newly applicable Tax regime	**Example** Evaluation & Management of Risk Exposure for Complex Financial Instrument Transaction	**Example** Assessment of Governance process in the accomplishment of objectives on ethics and values

B. APPLICABILITY PROVISIONS UNDER COMPANIES ACT:

As per section 138 of the Companies Act, 2013, **following class of companies shall be required to appoint an internal auditor** , namely:

1. Every **LISTED COMPANY**
2. Every **unlisted public company** having:
   a. **Paid up share capital of 50 crore rupees or more** during the preceding financial year **or**
   b. **Turnover of 200 crore rupees or more** during the preceding financial year **or**
   c. **Outstanding loans or borrowings from banks or public financial institutions** exceeding **100 crore rupees or more** at **any point of time** during the preceding financial year **or**
   d. **Outstanding deposits of 25 crore rupees or more at any point of time** during the preceding financial year.
3. Every **private company having**:
   a. **Turnover of 200 crore rupees or more** during the preceding financial year **or**
   b. **Outstanding loans or borrowings** from banks or public financial institutions exceeding **100 crore rupees or more** at any point of time during the preceding financial year.

C. WHO CAN BE APPOINTED AS INTERNAL AUDITOR:

1. The internal auditor shall **either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional** as may be decided by the Board
2. The internal auditor **may or may not be an employee** of the company.
3. **The internal auditor must be regarded as a part of the management** and **not merely as an assistant thereto**. Furthermore, he or she must **have the authority to investigate every organisational activity** to meet the objectives and scope of the internal audit.

D. RESPONSIBILITIES OF INTERNAL AUDITOR:

The main responsibilities of an Internal Auditor are:

1. To **maintain an adequate system of internal control** by a **continuous examination** of accounting records and other records.
2. To **operate independently** of the accounting staff
3. To **observe facts and situations and bring them to notice of authorities**;

4. **To critically appraise various policies of the management** and **draw its attention to any deficiencies**.
5. Apart from providing basic assurance and advisory inputs, **the internal auditor is sometimes assigned certain operational responsibilities** (such as risk management, compliance, system automation, process re-engineering, etc.). **some limited operational role may be acceptable with due approvals**, and for a short duration, the internal auditor shall do so only **after communicating his limitations** along the following lines:
   (a) **Unable to assume ownership or accountability** of the process; and
   (b) **Inability to take operational decisions that may be subject to an internal audit later on.** In addition, **the audit committee** of the company or the board shall, in consultation with the internal auditor, **formulate the scope, functioning, periodicity and methodology for conducting the internal audit.**

MANAGEMENT FUNCTION AND SCOPE OF INTERNAL AUDITING

Management is a process by which the affairs of an enterprise are conducted in such a manner that its **goals and objectives are attained through optimum utilisation** of all available resources, within the legal, social, economic and environmental constraints.

Scope of Internal audit can be described in various parts as below:

A. REVIEW OF INTERNAL CONTROL SYSTEM AND PROCEDURES:

1. It involves **assessing the design and operational efficiency and effectiveness** of the internal control system **to strengthen the overall internal control environment** of the entity. The objective to review **is to minimise the overall internal audit risk,** i.e., the inherent risk, control risk and detection risk.
2. **Controls should be in-built in the operating functions**, if they are to be cost-effective.
3. Internal Control System should be **reviewed considering the limitations of internal controls**, i.e., cost-benefit comparison, human errors, collusion, and abuse by process owners.
4. It should also be seen **whether the internal controls were in use throughout the period** of intended reliance.

B. REVIEW OF CUSTODIANSHIP AND SAFEGUARDING OF ASSEETS:

1. This involves **verifying the existence of the assets**.
2. The internal auditor should **review the segregation of duties is in place.**
3. The internal auditor should review the control systems to **ensure that all assets are accounted for fully**. He should **review the means used for safeguarding assets** against losses e.g., fire, improper or negligent activity, theft and illegal acts, etc.
4. He should review the **control systems for intangible assets**

C. REVIEW OF COMPLIANCE WITH POLICIES, PLANS, PROCEDURES AND REGULATIONS:

1. It is essential that the **various functional segments of an enterprise comply** with the relevant **policies, plans, procedures, laws and regulations.**
2. He should **examine the system of periodical review of existing policies** particularly when there is a **change in the method and nature of operations of the enterprise**.
3. By **combining the results of his review** of the adequacy of the systems with the **result of his compliance tests**, the internal auditor should be **able to evaluate the effectiveness of the former**.
4. He should **point out specific weaknesses and suggest remedial action.**

D. REVIEW OF RELEVANCE AND RELIABILITY OF INFORMATION:

1. The internal auditor **should review the information systems to evaluate** the **reliability and integrity of financial and operating information** given to management and to external agencies such as governmental bodies, investors, trade organisations, labour unions, etc.
2. He should **examine the accuracy and reliability of financial and operational** records.
3. The **usefulness of the reports as well as of the records** should be evaluated with reference to their costs.
4. The internal auditor **should examine whether the reporting is by exception** i.e., the reports highlight the significant and distinctive features.

E. REVIEW OF THE ORGANISATION STRUCTURE:

The internal auditor should ascertain whether **organisation structure is in harmony with the objectives of the enterprise** and whether the assignment of responsibilities is in compliance therewith. For this purpose:

1. He should **review the manner in which the activities** of the enterprise are **grouped for managerial control.** It is also important to **review whether responsibility and authority** are in harmony with the grouping pattern.
2. He should **examine the organisation chart** to find out whether the structure **is simple and economical** and that **no function enjoys an undue dominance** over the others.
3. He should see that **the responsibilities of managerial staff at headquarters** do not **overlap with those of chief executives** at operating units.
4. Should **examine the reasonableness of the span of control** of each executive (the number of subordinates that an executive controls). He should examine **whether there is a unity of command** i.e., whether each person reports only to one superior.
5. Where **dual responsibilities cannot be avoided**, the **primary one should be specified** and the specific responsibility to each senior fixed. This must be **made known to all concerned**.
6. Finally, he **should evaluate the process of managerial development** in the enterprise.

F. REVIEW OF UTILISATION OF RESOURCES:

1. The internal auditor should **check whether proper operating standards and norms** have been established for **measuring the economical and efficient use of resources**. They should be **identifiable with specific operating responsibilities**
2. The internal auditor should **review the methods of establishing operating standards and norms**. He **should carefully examine the assumptions made while setting** the standards to ensure that they are appropriate and necessary.
3. Where there is a **wide divergence** between actual performance and the corresponding standards, **reasons may be considered**.
4. As a part of **evaluating resources utilisation**, **identifying the facilities which are under-utilized** is an important function of the internal auditor.

G. REVIEW OF ACCOMPLISHMENT OF GOALS AND OBJECTIVES:

1. The internal auditor **should review the overall objectives** of the enterprise to evaluate whether they are **clearly stated and are attainable.**
2. The internal auditor should examine whether, to the extent possible, **objectives are expressed in precise quantifiable** terms (both monetary and non-monetary) to facilitate **detailed planning to be made for achieving them**.

FUNDAMENTAL PRINCIPLES OF AN INTERNAL AUDIT & QUALITIES OF INTERNAL AUDITOR

A. FUNDAMENTAL PRINCIPLES:

There is a set of core principles fundamental to internal audit which **are critical to achieving the desired objectives** as set out in the Definition of Internal Audit. They are:

INDEPENDENCE:

1. The Internal Auditor **shall be free from any undue influences**. This independence **shall be not only in mind but also in appearance.**
2. The internal auditor **shall resist any undue pressure or interference in establishing the scope of the assignments** or the manner in which these are conducted and reported, in case these deviate from set objectives.
3. The **overall organisation structure of key personnel, the position and reporting of the Chief Internal Auditor** within this structure, along with the **powers and authority** which is derived from superiors further **establishes the independence of the Internal Auditor**.

INTEGRITY:

The Internal Auditor **shall be honest, truthful and be a person of high integrity**. He shall operate in a highly professional manner and seen to be fair in all his dealings. He shall **avoid all conflicts of interest and not seek to derive any undue personal benefit or advantage from his position.**

OBJECTIVITY:

The Internal Auditor shall conduct his work in a **highly objective manner**, especially in gathering and evaluation of facts and evidence. He shall **not allow prejudice or bias to override his objectivity**, especially in arriving at conclusions or reporting his opinion.

B. QUALITIES OF INTERNAL AUDITOR:

1. Hold **special expertise necessary for evaluating** management control systems, especially financial and accounting controls.
2. **Accounting and finance functions** provide basic data for **management control** of an enterprise. Therefore, the **internal auditor must have accounting and financial expertise** to be able to discharge his duties.
3. The **internal auditor is also expected to evaluate operational performance and non-monetary**, operational controls.
4. He should also **have a basic knowledge of commerce, laws, taxation**, cost accounting, economics, quantitative methods and EDP systems.
5. An **understanding of management principles and techniques** is another essential qualification to deal with people.
6. The internal auditor **should provide an assurance to the management** that the **confidentiality of such information would be maintained**.

INTERNAL AUDIT REPORT AND SUBSEQUENT FOLLOW UP

The internal auditor should **carefully review and assess the conclusions** drawn from the audit evidence obtained, as the **basis for his findings contained in his report** and suggest remedial action. In case the internal auditor **comes across any actual or suspected fraud** or any other misappropriation of assets, it **would be more appropriate for him to bring the same immediately** to the attention of the management.

As per **Standard on Internal Audit (SIA) 370 Reporting Results**, reporting of internal audit results is generally undertaken in two stages:

STAGE 1 – SPECIFIC REPORT ASSIGNMENT WISE:

1. At the **end of a particular audit assignment**, an Internal audit report **covering a specific area** is prepared by internal auditor **highlighting key observations.**
2. The report is generally issued by covering the following:
   a. **Manner** in which the assignment is conducted.
   b. **Key findings** from the procedures applied.
3. This report is **shared with auditee with the local and executive management** as agreed.
4. These reports may be part of **overall audit report being issued to top governing authority**.

STAGE 2 – COMPREHENSIVE / OVERALL REPORT COVERING ALL AREAS ISSUED PERIODICALLY

1. On a Periodic bases, on closure of a planned period, **a comprehensive report of all the internal audit activities covering the entity and the plan period** is prepared by the chief internal auditor [Engagement partner if an outsider firm].
2. Such a **reporting is normally prepared on quarterly basis** and **submitted to the top governing authority** such as **audit committee**.

NOTE: This Standard on Internal Audit (SIA) deals with the internal auditor's responsibility to issue only the **first type of reports**, the Internal Audit Report **pertaining to specific audit assignmen**ts and **not to the periodic (e.g., Quarterly) reporting for the whole entity** as per the Annual/Quarterly audit plan.

ELEMENTS OF INTERNAL AUDIT REPORT:

On the basis of the internal audit work completed, the **Internal Auditor shall issue a clear, well documented Internal Audit Report** which includes the following key elements:

1. An **overview of the objectives, scope and approach** of the audit assignments;
2. The fact that an internal audit has been **conducted in accordance the Standards of Internal Audit**;
3. An **executive summary of key observations** covering all important aspects, and specific to the scope of the assignment;
4. A summary of the **corrective actions required** for each observation;
5. **Nature of assurance**, if any, which can be derived from the observations.

Note: The **content and form of the Internal Audit Report** are to be established by the Internal Auditor based on his **best professional judgement**, in **consultation with the auditee** and, if necessary, with **inputs from other key stakeholders**.

DRAFT REPORT: **No internal audit report** shall be issued in final form **unless a written draft of the report has previously been shared** with the auditee.

PRINCIPLES TO BE APPLIED WHILE ISSUING THE INTERNAL AUDIT REPORT

A. **BASIS OF INTERNAL AUDIT REPORT:** Each internal audit report is prepared on the **basis of the audit procedures conducted and the analysis of the audit** evidence gathered. **Controls operating effectively have their own importance and should be acknowledged**, while the risk and significance of observations noted have a role to play in **prioritising the matters to be reported.**

B. **CONDUCTED IN ACCORDANCE WITH SIA's:** Where the **internal audit is conducted in compliance with the Standards of Internal Audit**, and the same can be **substantiated with supporting evidence** and documentation, the **internal audit report shall include a statement confirming** that "the internal audit was conducted in accordance with the Standards of Internal Audit issued by the Institute of Chartered Accountants of India".

C. **CONTENT AND FORMAT OF INTERNAL AUDIT REPORT:** The manner in which the internal audit report is **drafted and presented is a matter of professional judgment** and choice and could be **influenced by the preferences of the recipients**. The **SIA does not mandate any particular format or list of contents.** The Internal Auditor is **expected to exercise his best professional judgement** on matters regarding how and what to report. Where **some level of assurance is being provided**, the form and content of the report **shall be as per SIA 380, "Issuing Assurance Reports"**.

D. **DOCUMENTATION:** To confirm compliance of audit procedures with this SIA, the list of documents required is as follows:

1. **Copies of Draft and final audit reports** to be maintained.
2. If appropriate, management action plans may be counter signed by respective management personnel.

STAGE 3*: FOLLOWUP:

As per **SIA 390 Monitoring and Reporting of Prior Audit Issues**, the Chief Internal Auditor is responsible for **continuously monitoring the closure of prior audit issues** through timely **implementation of action plans** included in past audits. This **shall be done with a formal monitoring process**, The **responsibility to implement the action plans remains with the management**.

The term "Monitoring and Reporting" used in this Standard **refers to the periodic tracking of issues raised** during prior audits and **evaluation of the corrective actions undertaken** by the auditee to resolve them **and to report any open and pending matters to the management** and those charged with governance.

The internal auditor **should review whether follow-up action is taken by the management** on the basis of his report. **If no action is taken within a reasonable time**, he should **draw the management's attention to it**. Where the management **has not acted upon his suggestions** or not implemented his recommendations, the **internal auditor should ascertain the reasons thereof.**

DIFFERENCE BETWEEN INTERNAL AUDIT AND STATUTORY AUDIT

BASIS	INTERNAL AUDIT	EXTERNAL AUDIT
Meaning	It refers to an **ongoing audit function** performed **within an organization by a separate internal** auditing department.	It is an audit function **performed by the independent body** which is not a part of the organization.
Examination	The Internal auditor examines the **Operational efficiency** of the organisation.	The External auditor **examines the Accuracy and Validity** of Financial Statements.
Appointment	The Internal auditor is **appointed by the Management**	The External auditor is **appointed by the Members.**

Users of Report	The user of internal audit report is **Management.**	The user of external audit report is **Stakeholders.**
Period	Internal audit is a **Continuous Process throughout the year**	An External audit is done **once in a year.**
Opinion	The opinion is provided on the **effectiveness of the operational** activities of the organization.	The **opinion is provided on the truthfulness and fairness** of the financial statement of the company
Status of Auditor	The Internal auditor could be an **employee of the company.**	The External auditor is **mandatorily not an employee** of the company.

7. AUDIT OF PSU

FRAMEWORK FOR GOVERNMENT AUDIT

As defined under section 2(45) of the Companies Act, 2013, a **"Government Company"** is a company in which **not less than 51% of the paid-up share capital** is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary company of such a Government company.

In India, **audit of the above government companies is performed by an independent constitutional authority**, i.e., **Comptroller and Auditor General of India (C&AG), through the Indian Audit and Accounts Department.** The Constitution of India gives a **special status to the C&AG** and contains provisions to safeguard his independence.

Article 148

- Appointment of **C&AG by the President**
- Special Procedure for removal of C&AG, only on the **ground of proven misbehaviours or incapacity**.
- Salry & other **conditions of service** to be determined by the President.

Article 149

- Perform **such duties and exercise such powers in relation to the accounts of the Union & the States and of any other authority or body** as may be prescribed by or under any law made by the parliament.
- The C&AG's (Duties, Powers & Conditions of Service) Act , 1971 **defines these fiunctions and powers in detail**.

Article 150

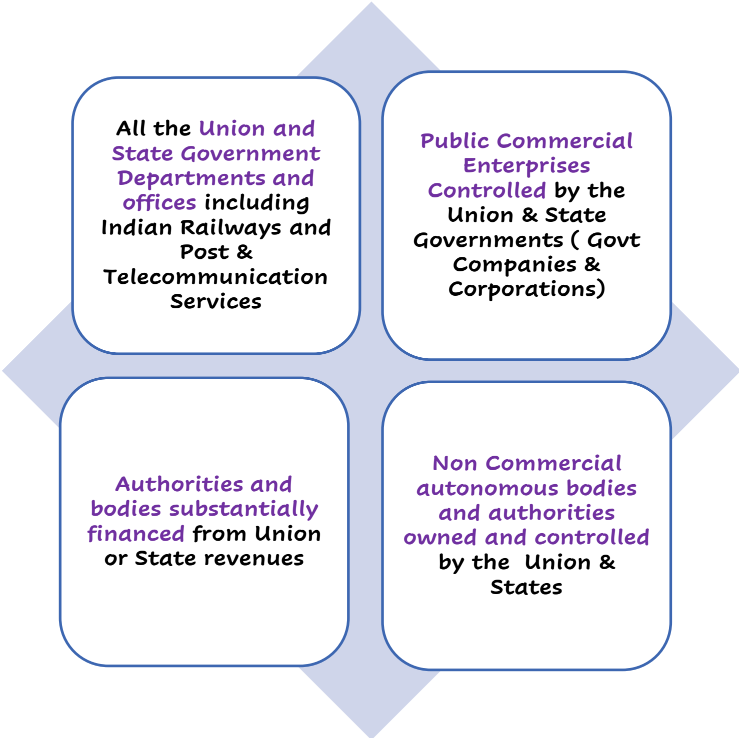
- On the advice of the C&AG, President to prescribe such form in **which accounts of the Union and the State shall be kept.**

Article 151

- Audit of the C&AG **relating to the accounts of the Central / State Government should be submitted to the President/Governor** of the sate who shall cause them to be laid before the Parliament or State Legislative Assemblies.

The Comptroller and Auditor General's (Duties, Power and Conditions of Services) Act, 1971, prescribes that **the C&AG shall hold office for a term of 6 years or up to the age of 65 years, whichever is earlier**. He can resign **at any time through a resignation letter** addressed to the President. The Act also assigns **the duties regarding the audit to be followed by C&AG**.

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



AUDIT OF GOVERNMENT COMPANIES (COMMERCIAL AUDIT):

The auditors of these companies are firms of Chartered Accountants, **appointed by the Comptroller & Auditor General, who gives the auditor directions** on the manner in which the audit should be conducted by them. He is also empowered to comment upon the audit reports of the auditors. In addition, **he has a right to conduct a supplementary audit** of such companies and cause test audit if considered necessary, by an order.

AUDIT BOARD SETUP IN COMMERCIAL AUDIT:

1. A unique feature of the audit conducted by the Indian Audit and Accounts Department is the **constitution of Audit Boards for conducting comprehensive audit** appraisals of the working of Public Sector Enterprises engaged in diverse sectors of the economy.
2. These Audit Boards associate with them **experts in disciplines relevant to the appraisals. They discuss their findings and conclusions with the managements** of the enterprises and their controlling ministries and departments of government to ascertain their view points before finalisation.
3. The results of such comprehensive appraisals are **incorporated by the C&AG in his reports**.

4. These Audit Boards have **no separate legal entity and work under the supervision and control of the C&AG**.

ACTION ON AUDIT REPORTS:

1. The scrutiny of the Annual Accounts and the Audit Reports thereon by the Parliament as a **whole would be a difficult task**, considering the limited time available to the Parliament for discussion of issues of national importance.
2. Therefore, the **Parliament and the State Legislatures have, constituted specialized Committees** like the Public Accounts Committee (PAC), Estimates Committee and the Committee on Public Undertakings (COPU), to which **these audit Reports and Annual Accounts automatically stand referred**.

PUBLIC ACCOUNTS COMMITTEE (PAC):

It is the duty of the Public Accounts Committee to satisfy itself:

1. That the moneys were **disbursed legally on the service or purpose to which they were applied**;
2. That the **expenditure incurred was authorised**;
3. That **re-appropriation** has been made in accordance **with the provisions made** (i.e., distribution of funds).

It is also the duty of the PAC to examine **the statement of accounts of autonomous and semi - autonomous** bodies, the audit of which is conducted by the Comptroller & Auditor General either under the directions of the President or by a Statute of Parliament.

ESTIMATES COMMITTEE: The Committee examines the estimates with a view to:

1. Report what **economies, improvements in organization, efficiency or administrative reform, consistent** with the policy underlying the estimates may be affected;
2. Suggest **alternative policies**;
3. Examine whether the **money is well laid out within the limit**; and
4. **Suggest the form in which the estimates shall be presented** to parliament.

The **Committee does not comment upon a policy approved by Parliament**, but where there is evidence that a **particular policy is not leading to the desired results it is the duty of the Committee to bring it to the notice of the House**.

COMMITTEE ON PUBLIC UNDERTAKINGS (COPU): The Committee on Public Undertakings **exercises the same financial control on the public sector undertakings as the PAC exercises over the functioning of the Government departments**. The functions of the Committee are –

1. To examine the **reports and accounts of public undertakings**.
2. To examine the **reports of the C & AG on public undertakings**.
3. To examine the **autonomy and efficiency of public undertakings** and to see whether they are being managed in accordance with sound business principles and prudent commercial practices.
4. To **exercise such other functions vested in the PAC** and the estimates committee as are not covered above and as may be allotted by the speaker from time to time.

The examination of public enterprises by the Committee takes the form of **comprehensive appraisal or evaluation of performance** of the undertaking. It involves a thorough examination, including evaluation of the policies, programmes and financial working of the undertaking.

The objective of the Financial Committees, is to **focus not only on the individual irregularity, but also on the defects in the system which led to such irregularity**, **and the need for correction of such systems and procedures.**

C&AG'S ROLE: The Comptroller & Auditor General of India plays a **key role in the functioning of the financial committees of Parliament and the State Legislatures**. He has come to be recognised as a 'friend, philosopher and guide' of the Committees.

1. His **Reports generally form the basis of the Committees' working**, although they are not precluded from examining issues not brought out in his Reports;
2. He **scrutinises the notes which the Ministries submit to the Committees** and helps the Committees to check the correctness of submissions to the Committees and facts and figures in their draft reports;
3. The **Financial Committees present their Report to the Parliament/ State Legislature** with their observations and recommendations. The various Ministries / Department of the Government are **required to inform the Committees of the action taken by them on the recommendations of the Committees** (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature;

4. In respect of those Audit Reports, which **could not be discussed in detail by the Committee, written answers are obtained from the Department / Ministry concerned** and are sometimes incorporated in the Reports presented to the Parliament / State Legislature. This **ensures that the Audit Reports are not taken lightly by the Government**.

OBJECTIVE AND SCOPE OF PUBLIC ENTERPRISES AUDIT

The C&AG's (Duties, Power and Conditions of Services) Act, 1971 specifies the **entities that come under audit purview of C&AG at the Union and State level**. However, the scope and extent of audit is determined by the C&AG itself.

1. Audit of public enterprises in India is **not restricted to financial and compliance audit; it extends also to performance** (efficiency, economy and effectiveness with which these operate and fulfil their objectives and goals). C & AG Conducts broadly **3 types of audits:**
    a. **Financial Audit.**
    b. **Compliance Audit.**
    c. **Performance Audit.**
2. **PROPRIETY AUDIT:** This audit is **directed towards an examination of management decisions** in sales, purchases, contracts, etc. to see whether these have been **taken in the best interests of the undertaking and conform** to accepted principles of financial propriety.
3. **COMPREHENSIVE AUDIT:** Under comprehensive audit, the C&AG do not really cover again the field which has already been covered. He **conducts an appraisal or an efficiency-cum-performance** audit. He sees whether the **undertakings have fulfilled the objectives for which they have been established**, whether value-for-money spent has been obtained, whether the targets have been achieved, etc. He **locates the areas of weakness including review of the decisions taken by the management and a comprehensive appraisal of the performance** of the undertaking.
4. **ORGANISATION'S DECISION TO BE TAKEN BY COMPETENT AUTHORITY:** In examining the decisions of a management, the **auditor examines that these were taken by the competent authority after examination of all aspects** (economic, technological, public interest) on the basis of all the relevant information available at that time and taking into consideration the different **alternatives available to management and**

that the decisions were consistent with the aims and objectives of the enterprise.

5. **HELPING GOVERNMENT:** The purpose of audit of public enterprises in India is to **help the Government and the enterprise managements improve their efficiency and effectiveness**. This is achieved by bringing out financial and operational deficiencies, inadequacies or ineffectiveness of systems, shortfalls in performance, etc. and by analysing the causes of shortfall from acceptable standards of performance.

6. **HIGHLIGHTING ISSUES OF EFFICIENT AND ECONOMIC OPERATIONS:** Financial performance is linked with physical performance and issues of efficient and economic operations and management of resources are highlighted. There is an **increasing emphasis on audit being an instrument of improvement.**

7. **FISCAL AND MANAGERIAL ACCOUNTABILITY:** In the broader context, Government audit encompasses two main elements, viz.,
    a. **Fiscal Accountability:** It includes **audit of provisions of funds, sanctions, compliances and propriety**; and
    b. **Managerial Accountability:** It includes **audit of efficiency, economy and effectiveness** (This is often referred to as efficiency-cum-performance audit).

ELEMENTS OF PSU AUDITS

Audit of all public-sector undertakings has the following basic elements:

A. THE THREE PARTIES - AUDITOR, RESPONSIBLE PARTY AND INTENDED USERS:

1. **AUDITOR:** The **role of auditor is fulfilled by Supreme Audit Institution (SAI)**, India and by its personnel delegated with the duty of conducting audits. The Comptroller and Auditor General of India (CAG) and the Indian Audit and Accounts Department (IAAD) functioning under him, **constitute the Supreme Audit Institution of India**
2. **RESPONSIBLE PARTY:** The relevant responsibilities are determined by constitutional or legislative arrangement. Generally, auditable entities and those charged with governance of the auditable entities would be the responsible parties. The **responsible parties**

may be responsible for the subject matter information, for managing the subject matter or for addressing recommendations.

3. **INTENDED USERS:** Intended users are the **individuals, organizations or classes thereof for whom the auditor prepares** the audit report.

B. SUBJECT MATTER, CRITERIA AND SUBJECT MATTER INFORMATION:

Subject Matter	This Refers to **the information, condition or activity that is measured or evaluated** against certain criteria
Criteria	These are the **benchmarks used to evaluate the subject matter**
Subject Matter Information	This Refers to the **outcome of evaluating or measuring the subject matter** against the criteria

C. TYPES OF ENGAGEMENT - ATTESTATION ENGAGEMENTS AND DIRECT REPORTING ENGAGEMENT:

Attestation Engagements :

- The **reponsible party measures the subject matter against the criteria and presents the subject matter information**, on which the auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for expressing a conclusion.

Direct Reporting Engagement :

- It is the **auditor who measures or evaluates the subject matter against the criteria**.

Financial audits are always attestation engagements, as they are based on financial information presented by the responsible party. **Performance audits and compliance audits are generally direct reporting engagements**.

PRINCIPLES OF PSU AUDITS

The principles of PSU Audits constitute the general standards that apply to SAI India's personnel as auditors and are fundamental to the conduct of all types of PSU Audits.

The **principles are categorized into 2 distinct groups** as below:

I. General Principles

II. Principles related to the Audit Process

General Principles

- Professional judgement Due care & Skepticism
- Documentation
- Communication
- Quality Control
- Ethics & Independence
- Materiality
- Audit Risk
- Audit Team Management & Skill

PRINCIPLES RELATED TO AUDIT PROCESS

Planning The Audit

- Establishthe terms of audit
- Obtain understanding of the entity
- Conduct Risk assessment of Problem analysis
- Develop an audit plan

Conducting the Audit

- Perform the Planned audit procedure to obtain audit evidence.
- Evaluate audit evidence and draw conclusions

Reporting & Follow-up

- Prepare the audit on the conclusion reached
- Follow-up on the reported matters as relevant

AUDIT OF GOVERNMENT COMPANIES

The following steps are involved in the audit of government companies:

APPOINTMENT OF AUDITORS UNDER SECTION 139(5) AND 139(7) READ WITH SECTION 143(5) OF THE COMPANIES ACT, 2013:

1. **Statutory auditors of Government Companies are appointed or reappointed by the C&AG**. In the case of government companies, though the appointment of statutory auditors is done by the C&AG, the **remuneration is left to the individual companies to decide based on certain guidelines** given by the C&AG in this regard.
2. The C&AG may **direct the appointed auditor on the manner in which the audit has to be carried** and the auditor so appointed has to **submit a copy of the audit report to the C&AG**. The report, among other things, includes the directions, if any, issued by the C&AG, the action taken thereon and its impact on the accounts and financial statement of the company.
3. The report under **section 143(5) is in addition to the reports issued by the Statutory Auditors** under various other clauses of section 143.

SUPPLEMENTARY AUDIT UNDER SECTION 143(6)(A) OF THE COMPANIES ACT, 2013:

The Comptroller and Auditor-General of India **shall within 60 days from the date of receipt of the audit report have a right to conduct a supplementary audit of the financial statements** of the government company by such person or persons as he may authorize in this behalf and for the purposes of such audit, **require information or additional information to be furnished to any person or persons, so authorised**, on such matters, by such person or persons, and in such form, as the C&AG may direct.

COMMENT UPON OR SUPPLEMENT SUCH AUDIT REPORT UNDER SECTION 143(6)(B) OF THE COMPANIES ACT, 2013:

Any comments given by the C&AG upon, or in supplement to, the audit report issued by the statutory auditors **shall be sent by the company to every person entitled to copies of audited financial statements** i.e., every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and **also be placed**

before the annual general meeting of the company at the same time and in the same manner as the audit report.

TEST AUDIT UNDER SECTION 143(7) OF THE COMPANIES ACT, 2013:

Without prejudice to the provisions relating to audit and auditor, the **C&AG may**, in case of any company covered under sub-section (5) or sub-section (7) of section 139 of the said Act, if he considers necessary**, by an order, cause test audit to be conducted of the accounts of such company** and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

CONCEPT OF FINANCIAL AUDIT

1. **Financial audit** is primarily conducted to:
   a. **express an audit opinion** on the financial statements; and
   b. enhance **the degree of confidence of intended users** in the financial statements.

2. The **C&AG shall express an opinion** as to whether the financial statements are in the case of financial statements prepared in accordance with a fair presentation financial reporting framework, whether the **financial statements are presented fairly, in all material respects, or give a true and fair view**, in accordance with that framework.

CONCEPT OF COMPLIANCE AUDIT

1. **Compliance audit** is the **independent assessment of whether a given subject matter is in compliance** with the applicable criteria.

2. This audit is carried out by assessing whether activities, financial transactions and information **comply in all material respects, with the regulatory and other rules which govern the audited entity**.

3. Compliance audit is concerned with:
   i. **Regularity: adherence of the subject matter** to the formal criteria resulting from relevant laws, regulations and agreements applicable to the entity.

ii. **Propriety**: observance of the general principles governing sound financial management and **the ethical conduct of public officials**.

4. While **regularity is emphasized in compliance auditing**, **propriety is equally pertinent in the public-sector context**, in which there are certain expectations concerning financial management and the conduct of officials.

5. **Perspective of Compliance Audit:** Compliance Audit is part of a combined audit that may also include other aspects. Compliance auditing is generally conducted either-
   i. in relation with the **audit of financial statements**, or
   ii. separately as **individual compliance audits**, or
   iii. **in combination with performance auditing**.

6. When **compliance auditing is part of a performance audit**, **compliance is seen as one of the aspects of economy, efficiency and effectiveness**. Noncompliance may be the cause of, an explanation for, or a consequence of the state of the activities that are the subject matter of the performance audit.

CONCEPT OF PERFORMANCE AUDIT

DEFINITION:

A performance audit is an **objective and systematic examination of evidence for the purpose of providing an independent assessment** of the performance of a government organization, program, activity, or function in order to provide information **to improve public accountability and facilitate decision-making** by parties with responsibility to oversee or initiate corrective action.

C & AG AND SUB ORDINATES:

Performance audit in PSUs **is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices** of Indian Audit and Accounts Department (IAAD). In conducting performance audit, **the subordinate offices are guided by manual and auditing standards** prescribed by C&AG.

ADVANTAGE OF PERFORMANCE AUDIT:

This **audit promotes accountability by assisting those charged with governance** and oversight responsibilities to improve performance through an examination of whether:

1. Decisions by the legislature or the executive are **efficiently and effectively prepared and implemented**; and
2. According to the guidelines issued by the C&AG, Performance Audits **usually address the issues of ECONOMY, EFFICIENCY AND EFFECTIVENESS**.

ECONOMY: It is **minimising the cost of resources used for an activity**, having regard to appropriate quantity, quality and at the best price. **Judging economy implies forming an opinion on the resources (e.g., human, financial and material) deployed**. This requires assessing whether the given **resources have been used economically and acquired** in due time, in appropriate quantity and quality at the best price.

EFFICIENCY: It is the input-output ratio. In the case of public spending, **efficiency is achieved when the output is maximised at the minimum of inputs**, or input is minimised for any given quantity and quality of output. Auditing efficiency includes aspects such as whether:

1. **Sound procurement** practices are followed.
2. Resources are properly **protected and maintained**.
3. Human, financial and other **resources are efficiently used**.
4. **Optimum number of resources** (staff, equipment, and facilities) are used in producing or delivering in a timely manner.
5. Public sector programmes, entities and activities are **efficiently managed, regulated, organised and executed.**
6. **Efficient operating proce**dures are used and

EFFECTIVENESS: It is the **extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity**. In auditing effectiveness, performance audit may, for instance:

1. Determine the **extent to which a program achieves a desired level of program results**.
2. Assess and establish with evidence whether **the observed direct or indirect social and economic impacts** of a policy are due to implementation of the policy or to other causes.
3. Identify factors **inhibiting satisfactory performance or goal-fulfilment**.
4. Assess whether the **programme complements, duplicates, overlaps or counteracts** other related programmes.
5. Determine **whether management has considered alternatives for carrying out the program** that might yield desired results more effectively or at a lower cost.
6. Assess the **adequacy of the management control system** for measuring, monitoring and reporting a programme's effectiveness.
7. Assess **compliance with laws and regulations** applicable to the program; and
8. Identify ways of **making programmes work more effectively**.

OBJECTIVE OF PERFORMANCE AUDIT

The objectives of performance auditing **are evaluation of economy, efficiency, and effectiveness** of policy, programmes, organization and management.

It also promotes **accountability by assisting those charged with governance and oversight responsibilities to improve performance**;

Performance auditing focuses **on areas in which it can add value which have the greatest potential for development**. It provides constructive incentives for the responsible parties to take appropriate action.

Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of **measurable objectives and performance indicators as also the systems of measurement rests** with the Government departments or Heads of entities. They are also required to **define intermediate and final outputs and outcomes** in measurable and monitorable terms, **standardise the unit cost of delivery** and benchmark quality of outputs and outcomes.

EXAMPLE:
Performance Audit of enforcement mechanism for administering the provision of Minimum Wages Act (a social welfare legislation)

The auditors, who undertake performance audit of a program or unit, **must possess knowledge of the industries or labour contracts** where these provisions are applicable and also **identify the population thereof before carrying out audit program**. He shall evaluate the standard of living before implementation and after implementation of the Act. Further, the auditor **shall have to evaluate the evidence available** as to nature of returns prescribed and obtained for taking appropriate action. The Performance Auditor shall also have to **evaluate the economy, efficiency and effectiveness in the welfare systems** to be audited. He can then **study the shortcomings in the coordination between different agencies** like labour department, EPF and ESI organization and the control systems and point out a set of relevant problems.

The auditor **shall also have to point out gaps, if any in the existing legal frame work or enforcement mechanism** to strengthen the objective of legislation. Another possible area of critical audit may be **to study actual level of compensation required** in each area keeping in mind the local living conditions and where the minimum wages prescribed in the statute is demonstrably different from this level, he may report the same to the Government for taking appropriate action.

In this manner, the **performance audit can not only examine the reasons for such adversities** but also **ensures that the legislation serves the intended purpose**. By reporting the same to the legislature, the corrective is made possible.

PLANNING OF STHE PERFORMANCE AUDIT

PLANNING FOR PERFORMANCE AUDIT

- Understanding the entity or programme
- Defining objective & Scope of audit
- Determining audit criteria
- Deciding audit approach
- Developing audit questions
- Assessing audit team skills & Expert advice
- Assessing audit team skills & Expert advice
- Preparing audit design matrix
- Establishing timetable & resources
- Intimation of Audit programme to audit entities

The following steps are suggested to the auditors for planning while conducting the performance audit:

STEP 1: UNDERSTANDING THE ENTITY/PROGRAMME:

It is the **starting point for planning individual performance audit**.

*
- **Documents of the entity (Incl legislative Docs)**
- **Policy Documents**

*
- **Academic or special research**
- **Past Audits**

*
- **Media Coverage**
- **Special focus groups**

The auditor may use the following sources for understanding the entity:

1. **DOCUMENTS OF THE ENTITY: Documents on administration and functions of the entity, policy files**, annual reports, budget documents, accounts, minutes of meetings, information on the website, internal audit reports, electronic databases and MIS reports, RTI material etc.
2. **LEGISLATIVE DOCUMENTS: Legislation, parliamentary questions and debates, reports of the Public Accounts Committee**, the Committee on Public Undertakings, the Estimates Committee and letters from Members of Parliament.
3. **POLICY DOCUMENTS:** Documents of **Planning Commission**, Ministry of Finance etc.
4. **ACADEMIC OR SPECIAL RESEARCH:** Independent **evaluations on the entity, academic research and similar work** done by other governments and other SAIs.
5. **PAST AUDITS: Past financial and performance audits** of the entity provide a major source of information and understanding.
6. **MEDIA COVERAGE:** Print and electronic **media - their systematic documentation on regular basis** in a transparent manner.
7. **SPECIAL FOCUS GROUPS: Audit Advisory Committee concerns**, annual and special reports of World Bank, Reserve Bank of India, reports by special interest groups, NGOs, etc.

STEP 2: DEFINING THE OBJECTIVES AND THE SCOPE OF AUDIT:

Setting audit objectives **ensures good quality performance audits**. It facilitates **clarity, demonstrates consistent quality** of audit and serves as a measure of quality assurance of the audit. Defining the scope **constricts the audit to significant issues** that relate to the audit objectives. It mainly **focuses the extent, timing and nature of the audit**.

STEP 3: DETERMINING AUDIT CRITERIA:

Audit criteria are the **standards used to determine whether a program meets or exceeds expectations**. Audit criteria are reasonable and attainable standards of performance **against which economy, efficiency and effectiveness of programmes and activities** can be assessed. The audit criteria may be sought to be obtained from the following sources:

1. **Procedure manuals** of the entity.
2. **Policies, standards**, directives and guidelines.
3. Criteria used by the **same entity or other entities in similar activities or programmes**.
4. **Independent expert opinion** and know how.

5. **New or established scientific knowledge** and other reliable information.
6. **General management and subject matter** literature and research papers.

STEP 4: DECIDING AUDIT APPROACH:

Some of the methods which could be used in conducting performance audits include:

1. **ANALYSIS OF PROCEDURES:** It **involves review of the systems in place for planning, conducting, checking and monitoring the activity**. This would consist of examination of documents such as financial reports, budgets, programme guidelines, procedure manuals, etc.
2. **CASE STUDIES:** A case study is a **descriptive analysis of an entity, scheme or a programme**. It involves analysis of a particular issue within the context of the whole area under review.
3. **USE OF EXISTING DATA:** The audit staff should **investigate the data held by entity management and by other relevant sources**. Audit conclusions based on testing of available data for correctness and completeness enhances the assurance level.
4. **SURVEYS:** Survey is a method of **collecting information from members of a population to assess the interrelation of events and conditions**. Surveys on predetermined parameters can supplement the audit findings and conclusions adding value to the performance audits.
5. **ANALYSIS OF RESULTS:** It requires the auditor **to carry out actual output-input analysis** to determine the efficiency of the programme.
6. **QUANTITATIVE ANALYSIS:** It involves **examination of available data relating to financials** It may not be possible for the auditor to work with complete data due to its high volume. In such cases, **sampling techniques are required to be used**.

STEP 5: DEVELOPING AUDIT QUESTIONS:

Subsequent to designing of audit objectives and determination of audit criteria, the audit team is required **to prepare a list of questions to which they would seek answers.** The questions should be framed in **comprehensive manner involving detailed hierarchy** of questions.

STEP 6: ASSESSING AUDIT TEAM SKILLS AND WHETHER OUTSIDE EXPERTISE REQUIRED:

1. The Auditing Standards of C&AG of India provide that the audit institution should **develop and train the auditors to enable them to perform their tasks effectively & efficiently** and should prepare manuals & other written guidance notes & instructions concerning conduct of audits.
2. Given the diverse range of subjects of performance auditing, the **audit team needs to develop sound understanding of the programme or entity** proposed to be audited.
3. The audit team needs to decide at the planning stage on **which aspect expertise is required**. Though, the Accountant General may use the work of an expert, **he retains full responsibility for the expression of opinion in the auditor's report**.

STEP 7: PREPARING AUDIT DESIGN MATRIX (ADM):

1. Audit team should prepare an Audit Design Matrix. It is a **structured and highly focused approach to designing a performance** audit study.
2. The **ADM highlights the data collection and analysis method** as well as the type and sources of evidence required to support audit opinion/findings.
3. An ADM is prepared **on the basis of information and knowledge obtained during the planning stage**. A well-designed ADM leads to effective audits. It is desirable to prepare ADM for each of the audit objectives.

A Specimen of ADM is given as under

Audit Objective (1)	Audit Questions (2)	Audit Criteria (3)	Evidence (4)	Data Collection & Analysis Method (5)

STEP 8: ESTABLISHING TIME TABLE AND RESOURCES:

1. **Considerations for selection of an appropriate audit team should be recorded along with the proposed timelines** for various activities to be undertaken as a part of audit process. The **progress should also be monitored against these timelines**.

2. The **Accountant General would be liable for ensuring that the performance audit is completed on time**. The variations between the required and actual time spent should be **compared and approved from the competent authority**.
3. The team **should build time for translation, approval and possible delays in their own schedule** in order to meet the targets.

STEP 9: INTIMATION OF AUDIT PROGRAMME TO AUDIT ENTITIES:

1. Audited **entities must be intimated about the intention of taking up planned performance audit** with the scope and extent of audit including the constitution of audit team and the **tentative time schedule, well before the commencement of Audit**. Acknowledgement of this may be requested and placed on record.
2. It may be required **to refine an audit's objectives as the audit progresses** for gathering the requisite information to fulfil the audit. **The reasons for such changes in the objectives should also be recorded and approved from** the competent authority.
3. The audit **programme should be flexible and reviewed from time to time** as it is not possible to anticipate all the contingencies at the early stage.
4. The **Accountant General should share all significant refinements in the approach** and additional tests and findings, concurrently with other audit teams when different persons conduct the audit at different locations. The **system of sharing of the significant field audit experience should be documented and reviewed**.

CONCEPT OF COMPREHENSIVE AUDIT

C&AG **conducts an efficiency-cum-performance audit** other than the field covered either by the internal auditor or by the professional auditors. He **locates the area of weakness and irregularities** for managements' information.

The covered areas are those of investment decisions, project formulation, organisational effectiveness, capacity utilisation, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, etc.

Some of the issues examined in comprehensive audit are:

1. How does the **overall capital cost of the project compare with the approved planned costs**? Were there any substantial increases and, if so, what are these and whether there is **evidence of extravagance or unnecessary expenditure**?
2. Has the **planned rate of return been achieved**?
3. Are **cost control measures adequate** and are there inefficiencies, wastages in raw materials consumption, etc.?
4. Are **procedures effective and economical**?
5. Is there any **poor or insufficient or inefficient project planning**?

The **Bureau of Public Enterprises has issued guidelines to be followed by the public sector enterprises in respect of general management, financial management, materials management, production management, construction management**, etc. and these guidelines provide another basis for appraising enterprise performance and its systems.

CONCEPT OF PROPRIETY AUDIT

A. DEFINITION AND PRINCIPLES:

E.L. Kohler has defined *the term* ***propriety*** *as "****that which meets the tests of public interest, commonly accepted customs, and standards of conduct,*** *and particularly as applied to professional performance, requirements of law, Government regulations and professional codes".*

1. On an analysis, **the tests boil down to tests on economy, efficiency and faithfulness**. Instead of too much dependence on documents, vouchers and evidence, it **shifts the emphasis to the substance of transactions and looks into the appropriateness** thereof on a consideration of financial prudence, public interest and prevention of wasteful expenditure.

2. It is also seen whether **every officer has exercised the same vigilance in respect of expenditure incurred** from public money, as a person of ordinary prudence would exercise in respect of expenditure **of his own money under similar circumstances**.

3. In 'propriety audit', the **auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations**.

4. **FOR EXAMPLE**, a school building may be constructed but used after five years of its completion is a case of avoidable expenditure.

5. It is **hard to frame any precise rules for regulating the course of audit against propriety**. Such an objective of **audit depends on the common sense and straight logic of the auditors** and of those whose financial transactions are subjected to propriety audit. However, some **general principles have been laid down in the Audit Code,** which have for long been recognised as standards of financial propriety.

6. **PRINCIPLES OF PROPRIETY:** Propriety requires the transactions, and more particularly expenditure, to conform to certain general principles. These principles are:
    a. that **the expenditure is not prima facie more than the occasion demands** and that every official exercise the same degree of vigilance in respect of expenditure as **a person of ordinary prudence would exercise in respect of his own money**;
    b. that the authority exercises its power of sanctioning expenditure to pass an order **which will not directly or indirectly accrue to its own advantage**;
    c. those funds are **not utilised for the benefit of a particular person or group of persons** and
    d. that, apart from the agreed remuneration or reward, **no other avenue is kept open to indirectly benefit** the management personnel, employees and others.

7. It may be stated that **it is the responsibility of the executive departments to enforce** economy in public expenditure. The **function of audit is to bring to the notice of the proper authorities of wastefulness in public administration** and cases of improper, avoidable and infructuous expenditure.

B. RELEVANT PROVISIONS IN THE COMPANIES ACT, 2013:

Some provisions in the Companies Act, having direct or indirect bearing on propriety. These provisions are:

1. **Section 143(1) requiring enquiry** into certain specified matters.
2. **Section 143(6) and 143(7) requiring a supplementary audit and test audit** respectively in respect of the Government companies on matters specified.
3. **Section 148 relating to Cost Records and Audit**.

4. Additional information in Part II of Schedule III.

All these are applicable to Government Companies. The requirement of the provisions of section 143(1) is essentially propriety-oriented Areas of propriety audit under the provisions of Section 143(1) may be following:

143(1)(a): Whether the **terms on which secured loans and secured advances have been made are prejudicial to the interests** of the company or its members.

143(1)(b): Whether transactions of the company which are **represented merely by book entries are prejudicial to the interests** of the company.

143(1)(c): Whether investment of companies, other than a banking or an investment company, in the **form of shares, debentures and other securities have been sold at a price lower than the cost**.

The intention, is not to know whether loss has occurred due to the sale. The auditor is required to **inquire into circumstances of sale of investments that resulted in loss**. Obviously, the duty cast on him is propriety based, i.e., reasonableness of the decision to sell at a loss.

143(1)(d): Whether **loans and advances made by the company have been shown as deposits**.

Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made.

143(1)(e): Whether **personal expenses have been charged to revenue.**

The effect of charging personal expenses to the business is to distort the profitability of the company and to secure a personal gain at the cost of the company. Obviously, the duty cast on him is propriety based.

143(1)(f): In case it is stated in the books and papers of the company that **shares have been allotted for cash, whether cash has actually been received in respect of such allotment**, and if no cash actually received, whether the position in books of account and balance sheet so stated is **correct, regular and not misleading.**

SEC. 148 – COST RECORDS AND AUDIT:

Cost records and the provisions of cost audit are designed to **inculcate cost consciousness in the management and to know whether productivity is of acceptable order** and whether undue wastage or loss etc. has occurred. Some of the matters in the additional information sought through the Statement of Profit and Loss **provide a basis for making more searching enquiries into such vital matters** as consumption of raw materials under broad heads, goods purchased under broad heads, work in progress under broad heads, any item of **income or expenditure which exceeds one percent of the revenue from operations or Rs. 1,00,000, whichever is higher**, etc.

C. PROPRIETY ELEMENTS UNDER CARO, 2020:

CLAUSE – III, IV, VIII, IX, X, XI, XIII, XV AND XVIII [REFER AUDIT REPORT CHAPTER]

The **audit conducted by the C&AG is a rule, procedure and propriety-based one**; and often it is said that the desired flexibility is lacking in the system and this has contributed in a large measure to the lack of rapport between the auditor and the audit-units. I

It is **necessary that compliance with rules should be insisted upon and non-compliance enquired into.**

PROBLEMS INVOLVED IN PROPRIETY AUDIT

1. The expression "propriety" can be understood by reference to the **concept of morality accepted by the society** at a given time.

2. In the **audit of financial accounts by reference to financial and legal requirements, propositions are built up about happening of events**, existence, accuracy, title, ownership, compliance with law and internal regulations etc., which are all verifiable. In **propriety audit the formulation of verifiable auditing propositions poses the problem**.

3. **Propriety audit has an inherent element of subjectivity** because it is **difficult to establish standards of public interest**, commonly accepted customs, standards for conduct which are **not firm basis for audit evaluation**. To take care of this situation, the **C&AG has developed the norms of propriety for expenditure of public funds** in our country. The norms so developed provide the **basis of verifying expenditure incurred** by various Government departments.

4. Propriety as a moral element should be a **matter of evaluation based on objectives and prevailing circumstances**. For example, a travel by air as such should not be considered wasteful unless it is proved that a travel by rail would have been feasible in the circumstances and would have brought the same results brought by the air travel.

5. The element of subjectivity has sometimes resulted in proper discharge of duty which **demands discretion, but wisdom of taking commercial decisions,** the same must be evaluated with reference to the circumstances in which these were taken and therefore, the auditor in his field must **reconstruct such circumstances**. The **judgment of the auditor must be objective** as otherwise propriety audit would prove itself to be counterproductive.

AUDIT REPORT OF C & AG

To facilitate a proper consideration, the reports of the C&AG on the **audit of PSUs are presented to the Parliament in several parts** consisting of the following:

1. **Introduction** containing a general review of the working results of Government companies, deemed Government companies and corporations.

2. **Results of comprehensive appraisals** of selected undertakings conducted by the Audit Board.

3. **Resume of the company auditors' reports** submitted by them under the directions issued by the C&AG and that of comments on the accounts of the Government companies; and

4. **Significant results of audit of the undertakings** not taken up for appraisal by the Audit Board.

For certain specified states, **the C&AG submits a separate audit report (commercial) to the legislature**, while for other States/Union Territories with legislature, there is a commercial chapter in the main audit report. The State audit reports, **contains both the results of audit appraisal of performance of selected companies/corporations** as well as important individual **instances of financial irregularities, wasteful expenditure, system deficiencies** noticed by the statutory auditors, and a general review of the working results of Government companies and corporations.

8. AUDIT STRATEGY AND PLANNING

BENEFITS OF AN ADEQUATE AUDIT PLAN IN THE AUDIT OF FINANCIAL STATEMENTS

Adequate planning benefits the audit of financial statements in several ways, including the following:

1. To **Focus and attentive on important audit areas**.
2. To **identify and resolve potential problems** on a timely basis.
3. To **properly organize and manage the audit engagement** so that it is performed in an effective and efficient manner.
4. Assisting in the **selection of engagement team members** with appropriate levels of capabilities and competence.
5. Facilitating the **direction and supervision of engagement team** members and the review of their work.
6. Assisting in **coordination of work done by auditors of components and experts**.

NATURE AND EXTENT OF PLANNING

The Nature and Extent of Planning will vary according to:

1. **SIZE AND COMPLEXITY OF THE AUDITEE:** If the size and complexity of organization of which audit is to be conducted is **large, then much more planning activities would be required** as compared to an entity whose size and complexity is small.

2. **PAST EXPERIENCE & EXPERTISE:** The **key engagement team members' previous experience & expertise** also contributes towards variation in planning activities.

3. **CHANGE IN CIRCUMSTANCES:** Another **factor contributing** towards variation in planning activities is **change in circumstances**.

AUDIT PLANNING IS A CONTINUOUS PROCESS

1. Planning is **not a discrete (specific) phase of an audit, but rather a continual and iterative (repetitive) process**. Planning begins after the completion of the previous audit and continues until the completion of the current audit engagement.

2. Planning includes consideration of the **timing of certain activities and audit procedures**. It also involves Audit Programming.
3. Further the audit plan **shall be reviewed periodically to ensure that it covers new audit areas identified** if any during the course of audit, making it up to date.

PLANNING INCLUDES CONSIDERATION OF FOLLOWING MATTERS:

1. Obtaining an understanding of the **legal and regulatory framework applicable to the entity** and how the entity is complying with that framework.
2. The **analytical procedures to be applied** as risk assessment procedures.
3. The determination of **materiality as per SA 320**.
4. The need of **expert's assistance**.
5. The performance of **other risk assessment procedures**.

PREPARATION OF AUDIT STRATEGY AND AUDIT PLAN ARE THE RESPONSIBILY OF THE AUDITOR

Auditor is ultimately responsible for audit strategy and planning. While developing the audit plan the auditor involves various persons:

A. INVOLVING OF ENTITIES PERSONNEL:

1. The auditor **may discuss the audit plan with the entity's management** to facilitate proper conduct of audit.
2. The auditor may take the **help of client's staff in certain audit areas**.
3. Recognize the fact that the **discussion of detailed audit plan** and procedures with the client may make the audit **ineffective as what auditor is going to conduct becomes highly predictable**.
4. The matters related to **surprise checks shall not be included** in the discussion with client.

B. INVOLVING OF ENGAGEMENT TEAM MEMBERS:

1. The auditor shall **involve the key engagement team members** while developing the overall audit strategy and plan.
2. This ensures **allocation of audit areas based on capabilities and experience** of engagement team members

ACCEPTANCE AND CONTINUATION OF CLIENT RELATINSHIPS AND AUDIT ENGAGEMENTS – PRELIMINARY ENGAGEMENT ACTIVITIES

PRELIMINARY ENGAGEMENT ACTIVITIES: The auditor shall undertake the following activities at the beginning of the current audit engagement-

1. As per the combined reading of SA 220 and SQC 1, information and procedures such as the following, assists the auditor in **determining whether the conclusions** reached regarding the acceptance and continuance of **client relationships and audit engagements are appropriate**:
    a. The **integrity of the principal owners**, key management and those charged with governance of the entity
    b. Whether the **engagement team is competent to perform the audit engagement** and has the necessary capabilities, expertise, including time and resources
    c. Whether the firm and the engagement team **can comply with relevant ethical requirements**; and
    d. **Significant matters** that have arisen during the **current or previous audit engagement, and their implications** for continuing the relationship.

2. Evaluating **compliance with ethical requirements**, including independence, as required by SA 220; and

3. Establishing an **understanding of the terms of the engagement**, as required by SA 210.

CONTENTS OF AUDIT PLAN

1. The auditor should develop an audit plan that shall include a description of:
    a. The **nature, timing and extent of planned risk assessment procedures**, as determined under SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".
    b. The **nature, timing and extent of planned further audit procedures at the assertion level**, as determined under SA 330 "The Auditor's Responses to Assessed Risks".

c. Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

2. The **audit plan is more detailed than the overall audit strategy** that includes the nature, timing and extent of audit procedures to be performed by engagement team members.
3. Planning for these audit procedures **takes place over the course of the audit** as the audit plan for the engagement develops.

CHANGE IN AUDIT PLAN

1. The auditor shall update and change the overall audit strategy and the **audit plan as and when necessary**.
2. **Reasons for change:**
   a. **Unexpected events**.
   b. **Changes in conditions**.
   c. **Information** received during the audit which is **different from the information available at the time of planning**.
3. In other words, the **audit plan should be dynamic and offer flexibility** that enables modifications

FACTORS THE AUDITOR WILL CONSIDER WHILE ESTABLISHING THE OVERALL STRATEGY

1. **CHARACTERISTICS OF ENGAGEMENT:** Identify the **characteristics of the engagement** that define its scope. Ex: Nature of business, number of locations to be audited and use of previous audit workings.
2. **REPORTING OBJECTIVES:** Ascertain the **reporting objectives of the engagement** to plan the timing of the audit and the nature of the communications required. Ex: Planning of audit meetings and meetings with management on a timely basis.
3. **TEAM's EFFORTS:** Consider the **factors that**, in the auditor's professional judgment, **are significant in directing the engagement team's efforts**.
4. **PRELIMINARY WORK:** Consider the results of **preliminary engagement activities**. Whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
5. **NTE OF RESOURCES:** Ascertain the **nature, timing and extent of resources necessary** to perform the engagement.

IDENTIFIATION OF CHARACTERISTICS OF ENGAGEMENT THAT DEFINES ITS SCOPE. [SELF STUDY]

The characteristics of audit engagements will include:

1. The Financial Reporting Framework.
2. **Industry-specific reporting requirements** such as reports mandated by industry regulators.
3. The **expected audit coverage**, including the number and locations of components to be included.
4. The **nature of the business segments** to be audited, including the need for specialized knowledge.
5. The **nature of the control relationships between a parent and its components** that determine how the group is to be consolidated.
6. The extent to which **components are audited by other auditors**.
7. The expected use of **audit evidence obtained in previous audits,** for example, audit evidence related to risk assessment procedures and tests of controls.
8. The **entity's use of service organizations and how the auditor may obtain evidence** concerning the design or operation of controls performed by them.
9. The **effect of information technology** on the audit procedures.
10. The availability of client personnel and data.

THE REPORTING OBJECTIVES OF THE ENGAGEMENT TO PLAN THE TIMING OF AUDIT AND NATURE OF COMMUNICATION REQUIRED

The reporting objectives of engagement team in light of SA – 300, Includes:

1. The entity's **timetable for reporting**, such as at interim and final stages.
2. The organization of meetings with management and those charged with governance **to discuss the nature, timing and extent of the audit work**.
3. The discussion with management and those charged with governance regarding the **expected type and timing of reports to be**.
4. Communication **with auditors of components regarding types and timing of reports** to be issued.

5. The nature and timing of communications **among engagement team members**.
6. Whether there are **any other expected communications with third parties**, including any statutory or contractual reporting responsibilities arising from the audit.

SIGNIFICANT FACTORS, PRELIMINARY ENGAGEMENT ACTIVITIES, AND KNOWLEDGE GAINED ON OTHER ENGAGEMENTS BEING A FACTOR FOR DEVELOPMENT OF OVERALL AUDIT STRATEGY

1. The **determination of materiality** in accordance with SA 320.
2. Preliminary identification of **areas where there may be a higher risk of material misstatement**.
3. The **impact of the assessed risk of material misstatement** at the overall financial statement level on direction, supervision and review.
4. **Results of previous audits** including the identified deficiencies and action taken to address them.
5. **Evidence** of management's commitment to the design, implementation and maintenance of **sound internal controls**.
6. **Volume of transactions** which may determine reliance on internal control.
7. **Significant changes** in the financial reporting framework, such as changes in accounting standards.
8. **Other significant relevant developments**, such as changes in the legal and regulatory environment affecting the entity.

BENEFITS OF OVERALL AUDIT STRATEGY IN DEVELOPING A DETAILED AUDIT PLAN

ASSISTANCE TO AUDITOR BY OVERALL AUDIT STRATEGY:

1. **Allocation of man power to specified audit areas based on evaluation of complexities** involved in such areas. Ex: In complex audit areas generally experienced team members will be assigned or sometimes experts help may be taken
2. **Expected date of starting of such specified audit area** and accordingly the team members shall be allocated. Ex: Starting inventory counting after completion of sales verification and

3. **Coordination, direction and supervision** of resources namely team members and time.
4. **Audit team meetings expected to be held and periodicity** of such meetings to discuss and review the status of work performed by engagement team.
5. **Location of these audit meetings** to take place. For example, On-site: Client premises and Off-site: Auditors premises

ABOUT DOCUMENTATION OF OVERALL AUDIT STRATEGY AND AUDIT PLAN

A. NEED FOR DOCUMENTATION:

1. It is a **record of the key decisions regarding planning** of the audit and to communicate to the engagement team.
2. It also serves as **evidence that the audit is properly planned and performed** in accordance with the standards on auditing.
3. The auditor may **summarize the overall audit strategy in the form of a memorandum** (Also Known As Audit Programme Memorandum) which may be in standard form or customized as per the client business nature.

B. THE AUDITOR SHALL DOCUMENT:

1. **The overall audit strategy**.
2. **The audit plans**.
3. Any **significant changes to the overall audit strategy** or the audit plan along **with the reasons** for such changes.
4. A summary of **discussions with the entity's key persons**.
5. **Other communications or agreements** with management or those charged with governance w.r.t any other services.

RELATIONSHIP BETWEEN OVERALL AUDIT STRATEGY AND AUDIT PLAN

The audit strategy is prepared before the audit plan. The audit plan is more detailed than the overall audit strategy. The **audit strategy provides the guidelines for developing the audit plan**. It establishes the **scope and conduct of the audit procedures** and, **works as basis for developing a detailed audit plan**. **Detailed audit plan would include the nature, timing and extent of the audit procedures** so as to obtain sufficient appropriate audit evidence.

DIRECTION, SUPERVISION AND REVIEW OF THE AUDIT BY THE AUDITOR OR REVIEWER

A. INCLUSION IN PLANNING:

1. While developing overall audit strategy and audit plan, the auditor shall also **include periodical review of audit procedures** performed by the engagement team.
2. This ensures whether the engagement team members are **complying with relevant auditing standards** and whether the audit is going on in a planned manner.
3. This review may be carried out by the **engagement partner or independent reviewer** who also belongs to the auditor's firm.

B. FACTORS INFLUENCING EXTENT OF DIRECTION, SUPERVISION AND REVIEW:

1. The **size and complexity** of the entity.
2. The **areas of the audit**.
3. The **assessed risks of material misstatement**.
4. The **capabilities and competence** of the individual team members performing the audit work.

Meaning of reviewer: Reviewer is **another person from the same audit firm but doesn't belong to engagement team**.

AUDIT PROGRAMME AND THE ELEMENTS OF SUCH PROGRAMME

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

2. The programme may contain **audit objectives for each area and should have sufficient detail** to serve as a set of instructions to the team involved in the audit and as means to control the proper execution of work, to link same with audit objectives and to ensure a purposeful audit

MATTERS NEED TO BE CONSIDERED:

1. **Nature of business in which the organisation is engaged:**
   a. On his first appointment, the auditor should **examine in detail the financial and accounting organisation** of the business by visiting the client's office; by observing **different stages through which documents pass before each transaction is authorised and recorded**; the record that is kept and the type of books maintained.
   b. In the case of an industrial concern, he must also visit the **factory to acquaint himself with the different processes of manufacture**, the quantitative records maintained and the manner in which statistics are compiled in respect of losses in process.
   c. The auditor, therefore, should draw up the audit programme after considering **the technical, financial and accounting set-up of the company**.

2. **Overall plan:**
   a. Overall plan for the audit programme **should be drawn up to ensure a systematic approach to the work**.
   b. If in drawing the audit programme, any divergence from the overall plan becomes necessary, **first the overall plan should be modified after due consideration** and thereafter, only that specific matter may be taken in the audit programme.
   c. The **framework provided under** the overall plan should be **strictly adhered to**.

3. **System of internal control and accounting procedures:**
   a. The **existence of a system of internal control** ensures that both financial and statistical **records are checked continuously**;
   b. It also unearths errors, both of omission and of commission. The auditor, in framing his opinion on financial statements needs **reasonable assurance that transactions are properly authorised and recorded** in the accounting records and that transactions have not been omitted.
   c. The **study and evaluation of internal control helps the auditor to establish the reliance he can place on the internal controls** in determining the nature, timing and extent of his substantive auditing procedures.
   d. The auditor's examination of the system of internal control should have **three features - review and preliminary evaluation, testing of compliance and evaluation**.

4. **Size of the organisation and structure of its management:**
   An increase in the size of the organisation **enhances the complexity of the examination of its accounting** records specially when it has a number of branches, deals in several products or has a very large turnover.

5. **Information as regards organisation of the business:** To plan audit programme, it is necessary that the auditor should obtain from his client information as regards **the client's history and business, purpose and nature of engagement** and time schedule for the completion of audit.

6. **Accounting and management policies:** The auditor should **review the financial statements of the past several years,** audited by his predecessors specially those of the immediately preceding previous year. This would **reveal to him a great deal of information regarding accounting and management policies** which have been followed in the past and whether these have been employed consistently.

DRAWING UP THE AUDIT PROGRAMME

1. **DRAWING UP THE AUDIT PROGRAMME:** After the auditor has collected the aforementioned information, he will be in a position to draw up the programme of audit. He can **now decide the areas to be covered by audit**, also those to be covered in detail and those which should be covered by the applications of the test checks. He will also be able **to decide the specific audit procedures which should be applied in each case**.

2. **FIRST TIME AUDIT:** When an **auditor is appointed to audit the accounts of an entity for the first time,** the audit programme should be **developed in three stages** stated below:
   a. To begin with, a **broad outline of the audit programme** should be drawn up.
   b. After the internal and accounting procedures have been reviewed, the details should be filled up on a consideration of the **deficiencies in the system of internal control**.
   c. After the detailed checking procedure is over, the extent to which the **special procedures (first time/ opening balance audit procedures) that are required** to be applied should be determined, e.g., independent verification of balances of debtors and creditors. At times, **special procedures may have to be applied**

based on the nature of business e.g. verification of provision for tax liability in case of a shipping company regarding freight booked in different countries.

3. **SUBSEQUENT AUDITS:**
   At each subsequent engagement, the programme should be reviewed and, if necessary, modified on account of:
   a. **Experience gained** during the previous audits.
   b. **Important changes that have taken place in the business** specially in the system of internal control, accounting procedures or in the structure of management or of the scope of business and
   c. **Evaluation of internal control** made for the current year.

CIRCUMSTANCES WHERE IN THE AUDIT PROGRAMME WOULD HAVE TO BE SUITABLY ALTERED:

1. If the audit procedures were designed for a certain volume of turnover and **subsequently the volume have substantially increased**. Also, when there have been **significant changes in the accounting organisation, procedures and personnel** subsequent to the audit procedures.

2. Where during the course of an audit, it has **been discovered that internal control procedures were not as effective** as assumed at the time the audit programme was framed.

3. Where there has been an **extraordinary increase in the amount of book debts** or that in the value of stocks as compared to that in the previous year.

4. When a **suspicion has aroused during the course of audit or information** has been received that asset of the company have been misappropriated.

It may be noted that the **audit plan and related programme should be reconsidered as the audit progresses**. Such re-consideration is based on the auditor's review of internal control, his preliminary evaluation thereof and the result of his compliance and substantive procedures.

AUDIT EXECUTION

Key phases in the audit execution stage are **Execution Planning**, **Risk and Control Evaluation**, **Testing** and **Reporting**.

A. EXECUTION PLANNING

The auditors **need to plan their work** in order to **carry out the audit in an effective, efficient and timely manner**. A detailed audit program is prepared laying down the **audit objectives, scope and audit approach**. The manpower requirement, audit team qualifications, and the time element, etc. are some of the important considerations during execution planning. In **order to plan effectively, the auditor may need some more information** about the audit area. A **preliminary survey would help** in gathering the required information.

B. RISK AND CONTROL EVALUATION:

For each segment of audit, the auditors **should conduct a detailed risk and control assessment** i.e., list the risks that must be reviewed in that segment, the controls that exist or those that are needed to protect against the risk, the work steps required **to test the effectiveness of the controls**. While making Risk & Control assessment, it is necessary to **bear in mind the Materiality levels as** the same is linked to Audit Risks.

C. TESTING:

Once a comprehensive understanding is gained of the key risks and the controls to be evaluated in a given audit area, **the auditors should test the operating effectiveness of the controls** to determine whether controls are operating as designed. There are **multiple test methods which can be used to arrive at the conclusions** on the effectiveness of the controls.

D. REPORTING:

SA 700, "Forming an Opinion and Reporting on Financial Statements" establishes standards on the form and content of the auditor's report issued as a result of an audit performed by an auditor of the financial statements of an entity. The **auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements**.

The auditor's report should **contain a clear written expression of opinion on the financial statements taken as a whole**. **A measure of uniformity in**

the form and content of the auditor's report is desirable because it helps to promote the reader's understanding of the auditor's report and to identify unusual circumstances when they occur.

9. RISK ASSESSMENT AND INTERNAL CONTROL

RISK ASSESSMENT AND COMPONENTS OF AUDIT RISK AND INTER RELATION BETWEEN THOSE COMPONENTS

A. RISK ASSESSMENT:

1. Risk assessment assesses the level of risk in the various business processes. Risk assessment **focuses on the business environment, regulatory environment, organisation structure**, organizational and business environmental changes and specific concerns of management and the audit committee **to determine the areas of greatest risk**.
2. The auditor **identifies assertions where there are risks of material misstatement** and concentrates audit procedures on those areas.
3. In designing and evaluating the results of performing procedures, the **auditor should consider the possibility of**:
    a. Selecting an **inappropriate audit procedure**.
    b. **Misapplying an appropriate audit procedure** or
    c. **Misinterpreting the results** from an audit procedure.

B. AUDIT RISK:

Audit risk is the **risk of expressing an inappropriate audit opinion** on financial statements that **are materially misstated**.

C. COMPONENTS OF AUDIT RISK:

1. INHERENT RISK:

a. **Susceptibility of an assertion to a misstatement** that could be material, individually or when aggregated with other misstatements, **assuming that there are no related controls**. Inherent risk is **addressed at both the financial statement level and at the assertion level**.

b. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement.

c. These are the **business and other risks that arise from the entity's objectives**, nature of operations and industry, the regulatory environment in which it operates and its size and complexity.

d. Risks of particular concern to the auditor might include:

I. **Complex calculations** which could be misstated
II. High value inventory
III. Accounting estimates that are subject to significant measurement uncertainty
IV. **Lack of sufficient working capital** to continue operations
V. A **declining or volatile industry** with many business failures and
VI. **Technological developments** that might make a particular product obsolete.

2. **CONTROL RISK:**
    a. Risk that the **entity's internal control system will not prevent, or detect and correct** on a timely basis, **a misstatement that could be material**, individually or when aggregated with other misstatements.
    b. The entity **should identify and assess its business and other risks** and respond by designing and implementing a system of internal control.
    c. **Entity level controls** such as board oversight, IT general controls, and HR policies are **pervasive to all assertions** whereas **Activity level controls generally, relate to specific assertions**.
    d. Some control risk will always **exist because of the inherent limitations** of any internal control system.
    e. The auditor is required to **understand the entity's internal control and perform procedures** to assess the risks of material misstatement at the assertion level.

3. **DETECTION RISK:**
    This is the **risk that the auditor will not detect a misstatement that exists** in an assertion that could be material, either individually or when aggregated with other misstatements.

D. RELATIONSHIP BETWEEN COMPONENTS:

1. The relationship can be defined as follows:
    a. Audit Risk = Risk of Material Misstatement X Detection Risk
    b. **RISK OF MATERIAL MISSTATEMENT:** Risk of material misstatement is **anticipated risk that a material misstatement may exist** in financial statement before start of the audit. It has two components inherent risk and control risk.

c. The relationship can be defined as **Risk of material Misstatement = Inherent risk X Control risk**
d. **DETECTION RISK:** It is a **risk that a material Misstatement remained undetected** even if all Audit procedures applied.

2. It should be noted that **the combined level of Inherent Risk and Control Risk is inversely related with Detection Risk**, **and Audit Materiality is also inversely related with audit risk**.

Audit Risk (AR) can be expressed as a product of Inherent Risk (IR), Control Risk (CR) and Detection Risk (DR), i.e., AR = IR x CR x DR

DIFFERENT TYPES OF ASSERTIONS MADE BY MANAGEMENT EXPLICITLY OR IMPLICTLY

Management makes number of assertions that are embedded as **part of financial statements and by way of representations**. These relate to the recognition, measurement, presentation and disclosure of the various elements (amounts and disclosures) in the financial statements.

EXAMPLE 1: Management of ABC Ltd. may assert to the auditor that the sales balance in the accounting records **contains all the sales transactions (completeness assertion)**, the transactions took place and **are valid (occurrence assertion),** and transactions have been **properly recorded in the accounting records and in the appropriate accounting period (accuracy and cut-off assertion)**.

The **objective of the audit is to reduce this audit risk to an acceptably low level**. This can be achieved by performing **audit procedures in response to the assessed risks at the financial statement**, class of transactions, account balance and assertion levels.

SA 315 - "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment" categorises the types of assertions used by the auditor, as follows:

A. ASSERTIONS ABOUT CLASSES OF TRANSACTIONS AND EVENTS FOR THE PERIOD UNDER AUDIT:

1. **OCCURRENCE:** Transactions and events that have been **recorded have occurred and pertain to the entity**.
2. **COMPLETENESS:** All transactions and events that **should have been recorded**.

3. **ACCURACY:** Amounts and other data relating to recorded transactions and events have been **recorded appropriately**.
4. **CUT-OFF:** Transactions and events have been recorded in the **correct accounting period**.
5. **CLASSIFICATION:** Transactions and events have been recorded in the **proper accounts**.

B. ASSERTIONS ABOUT ACCOUNT BALANCES:

1. **EXISTENCE:** Assets, liabilities, and equity **interests exist**.
2. **RIGHTS AND OBLIGATIONS:** The **entity holds or controls the rights** to assets, and liabilities are the obligations of the entity.
3. **COMPLETENESS:** All assets, liabilities and equity interests that should have been **recorded completely**.
4. **VALUATION AND ALLOCATION:** Assets, liabilities, and equity interests are included in the FS at appropriate amounts and any **resulting valuation or allocation adjustments are appropriately Recorded**.

C. ASSERTIONS ABOUT PRESENTATION AND DISCLOSURE:

1. **OCCURRENCE AND RIGHTS AND OBLIGATIONS:** Disclosed events, transactions, and other matters have **occurred and pertain to the entity**.
2. **COMPLETENESS:** All disclosures that should have been **included in the financial statements have been included**.
3. **CLASSIFICATION AND UNDERSTANDABILITY:** Financial information is appropriately presented and described, and disclosures **are clearly expressed**.
4. **ACCURACY AND VALUATION:** Financial and other information are **disclosed fairly and at appropriate amounts**.

LEVEL OF ASSESSMENT OF RISK OF MATERIAL MISSTATEMENTS

Auditors are required to assess the risks of material **misstatement at 2 levels**.

FINANCIAL STATEMENT LEVEL:

1. The risk at overall financial statement level refers to risks of material misstatement that relate pervasively to the **financial statements as a whole and potentially affect many assertions**.
2. EXAMPLE: If the top **accountant is not competent enough** for the assigned tasks, it **is quite possible that errors could occur in the**

financial statements. In addition, the error is not likely be confined to a single assertion such as the completeness of sales. It could easily relate to other assertions such as accuracy, existence and valuation.

ASSERSTION LEVEL:

1. The risks **identifiable with specific assertions at the class of transactions, account balance, or disclosure level**.
2. An assessment of risk (such as high, moderate, or low) should be **made for each individual assertion** being addressed.
3. EXAMPLE: While considering the valuation assertion, the auditor could assess the risk of error in payables as low;

STEPS INVOLVED IN RISK IDENTIFICATION

1. Assess the **significance of the assessed risk, impact of its occurrence** and also revise the materiality accordingly for the specific account balance.
2. Determine the **likelihood for assessed risk to occur and its impact** on our auditing procedures.
3. Document the **assertions that are affected**.
4. Consider the **impact of the risk on each of the assertions** (completeness, existence, accuracy, validity, valuation and presentation) relevant to the account balance, class of transactions, or disclosure.
5. Identify the **degree of Significant risks that would require separate attention** and response by the auditor. Planned audit procedures should directly address these risks.
6. Enquire and **document the management's response**.
7. Consider the **nature of the internal control system** in place and its possible **effectiveness in mitigating the risks involved**. Ensure the controls:
    a. **Routine** in nature (occur daily) or periodic such as monthly.
    b. Designed **to prevent or detect and correct** errors.
    c. Manual or automated.
8. Consider any **unique characteristics of the risk**.

POSSIBLE POTENTIAL MISSTATEMENT INDICATORS

COMPLETENESS:

1. Transactions **not identified**.
2. Source documents **not prepared**.
3. Source documents **not captured**.
4. Rejected source documents **not represented**.

EXISTENCE:

1. **Fictitious or unauthorised transactions** entered on source documents.
2. Source documents **overstated**.
3. **Transactions duplicated** on source documents.
4. Capture of source **documents duplicated**.
5. **Invalid source documents** captured on subsidiary ledgers.

RECORDING:

1. Source documents **captured inaccurately**.
2. **Inaccurate Processing** of transactions.
3. **Inaccurate adjustments** made in subsidiary ledgers.

CUT-OFF PROCEDURES: Transactions that **occur in one period are recorded in another period**.

RISK BASED AUDIT APPROACH

Audit should be **risk-based or focused on areas of greatest risk** to the achievement of the audited entity's objectives.

RISK BASED AUDIT:

1. Risk-based audit (RBA) is an approach to audit **that analyses audit risks, sets materiality thresholds based on audit risk analysis** and **develops audit programmes that allocate a larger portion of audit resources to high-risk areas**.
2. The auditor **needs to design audit programmes and procedures on areas earlier identified as major risks** that could result in the financial statements being materially misstated.
3. Risk Based Audit is an **essential element of financial audit**- both in the attest audit of the financial statements and in the audit of financial systems and transactions including evaluation of internal controls.

4. It focuses **primarily on the identification and assessment of the financial statement misstatement risks** and provides a framework to **reduce the impact of these identified risks to an acceptable level** before rendering an opinion on the financial statements.
5. It also **provides indicators of risks** as a basis for improvement of auditee risk management and control processes.

RBA – PERFORMANCE AUDIT VIEW:

1. In the context of performance audit, it is the risk to delivery of an activity or scheme or programme of the entity with **economy, efficiency and effectiveness**.
2. Awareness of areas which are at risk & helps to focus audit attention on them. The risk analysis provides a **framework for assurance in performance auditing**.

AUDIT RISK ANALYSIS

1. The auditor should perform an analysis of the audit risks **that impact on the auditee before undertaking specific audit procedures**. Risk assessment is a **subjective process**. It is **part of the professional judgment of the auditor** and of the particular circumstances. It is the risk that the auditor may **unknowingly fail to appropriately modify his opinion** on financial statements that are materially misstated.
2. Audit risks are brought about by error and fraud:
    a. **Error** is **an unintentional mistake** resulting from omission, as when legitimate transactions and/or balances are excluded from the financial statements; or by commission, as when erroneous transactions and/or balances are included in the financial statements.
    b. **Fraud** is an **intentional misstatement** in the accounting records or supporting documents from which the financial statements are prepared. It is **intended to deceive financial statement** users or to conceal misappropriations.
3. The auditor has the **responsibility to plan and perform the audit to obtain reasonable assurance** about whether the financial statements are **free of material misstatements**, whether caused by error or fraud.
4. An **error risk may arise from an error in principle**, estimate, critical information processing, financial reporting process or disclosure.
5. **Fraud risk involves manipulation, falsification of accounting records, or misrepresentation** in the financial statements of events, transactions or other significant information, or misapplication of accounting principles or misappropriation of funds.

GENERAL STEPS IN CONDUCTING RISK BASED AUDIT

1. The auditor's objective in a risk-based audit is to **obtain reasonable assurance that no material misstatements whether caused by fraud or errors exist** in the financial statements.
2. This involves the **following 3 key steps**:
   a. **Assessing the risks** of material misstatement in the financial statements
   b. **Designing and performing further audit procedures** that respond to assessed risks and reduce the risks of material misstatements in the financial statements **to an acceptably low level** and
   c. Issuing an **appropriate audit report** based on the audit findings.
3. The risk-based audit process is presented in **3 distinct phases**:
   a. Risk assessment.
   b. Risk response and
   c. Reporting.

THREE DISTINCT PHASES OF SRISK BASED AUDIT PROCESS

PHASE 1 – RISK ASSESSMENT:

The risk assessment phase of the audit involves the following steps:

1. Performing **client acceptance or continuance** procedures.
2. **Planning** the overall engagement.
3. Performing **risk assessment procedures to understand** the business and identify inherent and control risks.
4. Identifying relevant **internal control procedures and assessing their design and implementation**
5. Assessing the **risks of material misstatement** in the financial statements.
6. Identifying the **significant risks that require special audit consideration** and those risks for which substantive procedures alone are not sufficient.
7. **Communicating any material weaknesses** in the design and implementation of internal control to management and those charged with governance and
8. Making an **informed assessment of the risks of material misstatement** at the financial statement level and at the assertion level.

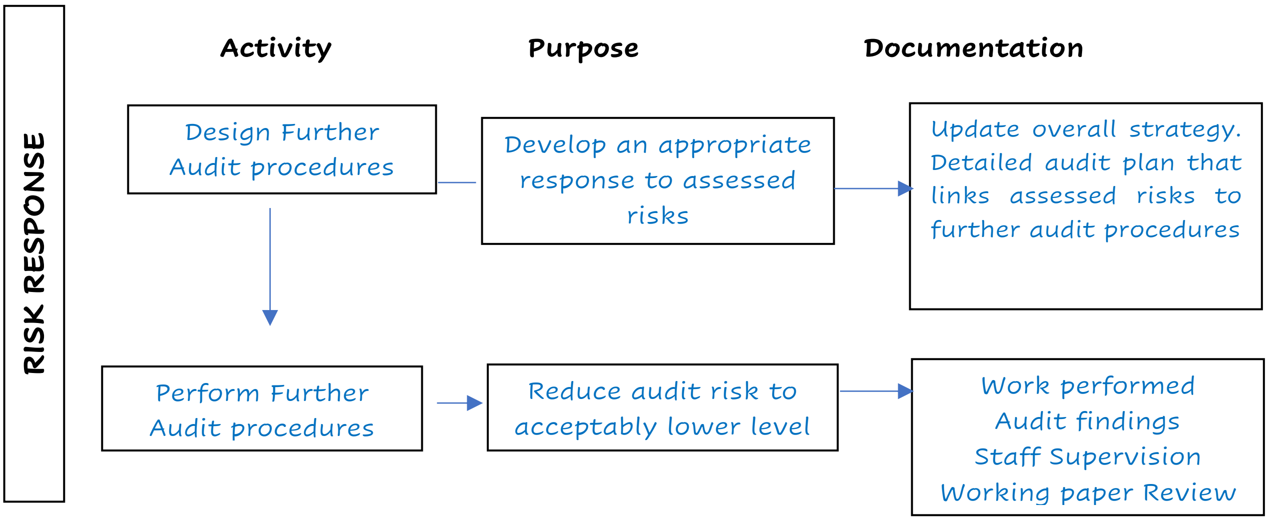
RISK ASSESSMENT

Activity	Purpose	Documentation
Perform acceptance or continuance procedures	Decide whether to accept engagement	Listing of risk factors Engagement letter
Plan the Audit	Develop an overall Audit strategy	Overall audit strategy. Materiality, Audit Team Discussion
Perform risk assessment procedures	Understand the entity, Identify & assess RMM	Business & Fraud risks incl significant risks | Design & implementation of internal controls | Assessed RMM at FS Level & assertion level

PHASE 2 – RISK RESPONSE:

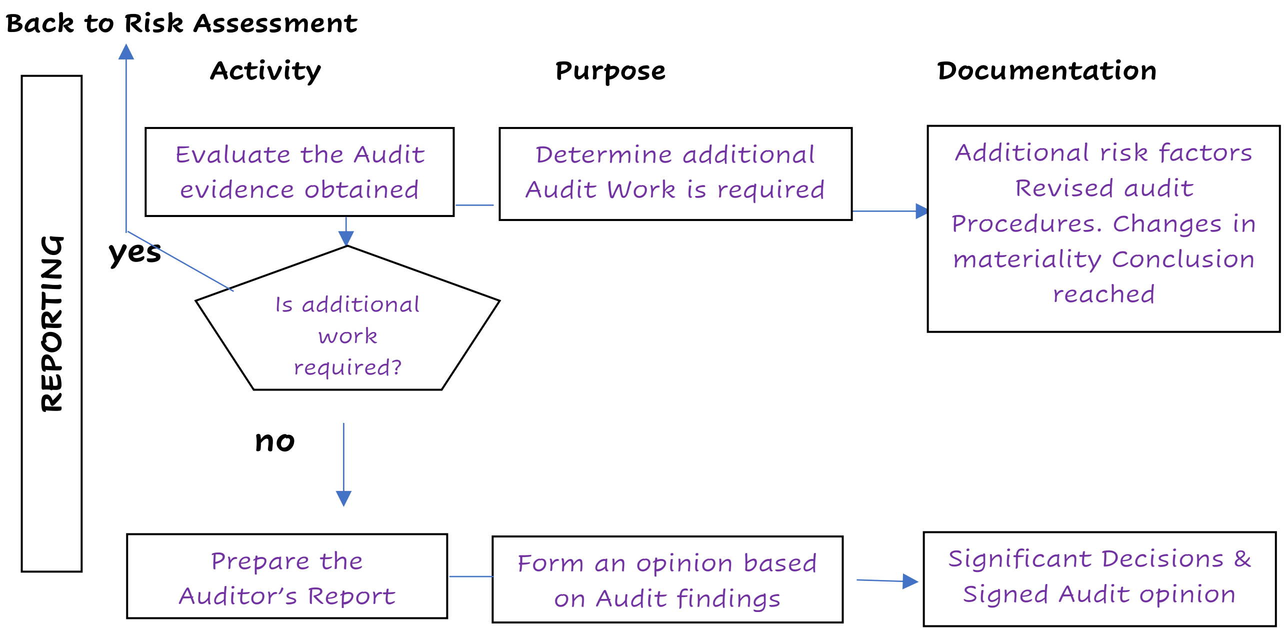
1. This phase of the audit is to **design and perform further audit procedures** that **respond to the assessed risks of material misstatement** and will provide the evidence necessary to support the audit opinion.
2. Some of **the matters the auditor should consider** when planning the audit procedures include:
    a. Assertions that **cannot be addressed by substantive procedures** alone. This can occur where there is **highly automated processing of transactions** with little or no manual intervention.
    b. **Existence of internal control, could reduce** the need/scope for other substantive procedures.
    c. The **potential for substantive analytical procedures** that would reduce the need/scope for other types of procedures.
    d. The need to incorporate an **element of unpredictability in procedures** performed.
    e. The need to perform further audit procedures to **address the potential for management override of controls or other fraud scenarios**.
    f. The need to perform **specific procedures to address "significant risks"** that have been identified.
    g. Audit procedures designed to address the assessed risks could include a mixture of:
        i. Tests of the operational **effectiveness of internal control** and

ii. **Substantive procedures** such as tests of details and analytical procedures.



PHASE 3 – REPORTING:

1. The final phase of the audit is to **assess the audit evidence obtained and determine whether it is sufficient and appropriate** to reduce the risks of material misstatement in the financial statements to an **acceptably low level**.
2. It is important at this stage to determine:
   a. If there had been a **change in the assessed level of risk**.
   b. Whether **conclusions drawn are appropriate** and
   c. If any **suspicious circumstances** have been encountered.
   d. Any **additional risks should be appropriately assessed**, and further audit procedures performed as required.
3. When all procedures have been performed and conclusions reached:
   a. Audit **findings should be reported to management** and those charged with governance; and
   b. An **audit opinion should be formed,** and a decision made on the appropriate wording for the auditor's report.



INTERNAL CONTROL SYSTEMS

DEFINITION:

"Internal Control System" means **all the policies and procedures** (internal controls) **adopted by the management of an entity** to assist in **achieving management's objective** of ensuring, as far as practicable, the **orderly and efficient conduct of its business**, including **adherence to management policies**, the **safeguarding of assets**, the **prevention and detection of fraud and error**, the **accuracy and completeness of the accounting records**, and the **timely preparation of reliable financial information**.

RELEVANCE OF UNDERSTANDING OF INTERNAL CONTROL:

1. The auditor should obtain an **understanding of the control environment sufficient to assess** management's attitudes, awareness and actions **regarding internal controls and their importance** in the entity. Such an understanding would also help the **auditor to make a preliminary assessment of the adequacy of the accounting and internal control systems** as a basis for the preparation of the financial statements, and of the likely **nature, timing and extent of audit procedures**.
2. The auditor should **obtain audit evidence through tests of control** to support any assessment of control risk which is less than high. The **lower the assessment of control risk, the more evidence the auditor should obtain** that accounting and internal control systems are suitably designed and operating effectively.

3. When obtaining audit **evidence about the effective operation of internal controls**, the auditor considers:
    a. **how they were applied**,
    b. the **consistency with which they were applied** during the period and
    c. **by whom they were applied**
4. Deviations from prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions and human error. When **deviations are detected, the auditor makes specific inquiries regarding these matters**, the timing of staff changes in key internal control functions. The auditor then ensures that **the tests of control appropriately cover such a period** of change or fluctuation.
5. Based on the results of the tests of control, the auditor should evaluate whether the internal controls are **designed and operating as contemplated in the preliminary assessment** of control risk. The evaluation of deviations may result in the auditor **concluding that the assessed level of control risk needs to be revised**. In such cases, the auditor would modify the nature, timing and extent of planned substantive procedures.

6. The auditor should consider **whether the internal controls were in use throughout the period**. If substantially different controls were used at different times during the period, the auditor would consider each separately. A **breakdown in internal controls for a specific portion of the period requires separate consideration** of the nature, timing, and extent of the audit procedures to be applied to the transactions and other events of that period.

NATURE OF INTERNAL CONTROL

1. A set of internally **generated policies and procedures** adopted by the management of an enterprise is a **prerequisite for an organisations efficient and effective performance**. It is, a primary responsibility of every management to create and maintain an **adequate system of internal control appropriate to the size and nature** of the business entity.

2. SA 315 defines the system of internal control as the process **designed, implemented, and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives** with regard to

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

3. Any system of internal control is **based on a consideration of significant risks in operations, compliance, and financial reporting**.

SCOPE OF INTERNAL CONTROL AS PER SA 315

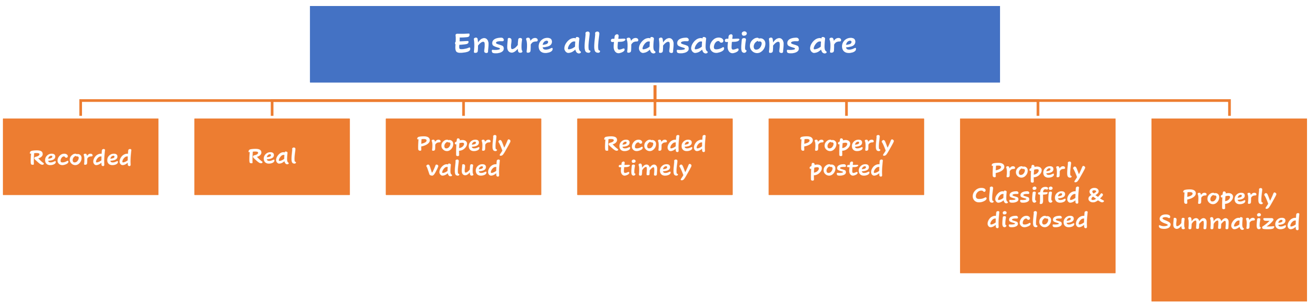
1. The scope of internal controls **extends beyond mere accounting controls and includes all administrative controls concerned with the decision - making** process leading to managements authorization of transaction, such controls include, production method, time and motion study, pricing policies, quality control, etc.
2. In an **independent financial audit**, the auditor is primarily concerned with those policies and procedures having a **bearing on the assertions underlying the financial statements**. These comprise primarily controls relating to:
    a. **Safeguarding of assets**,
    b. **Prevention and detection of fraud and error**,
    c. **Accuracy and completeness** of accounting records and
    d. Timely preparation of **reliable financial information**.
3. **Administrative controls**, have **only a remote relationship with financial records** and the auditor may evaluate only those administrative controls which have a bearing on the reliability of the financial records.
4. Fundamental to a system of internal control is that it is **integral to the activities of the company**, and not something practiced in isolation.

EXAMPLES:

1. If production statistics were used as a basis for an analytical procedure, the controls to ensure the accuracy of such data would be relevant.

OBJECTIVES OF INTERNAL CONTROLS

1. The objectives of internal control systems are **determined by the management, after considering the nature of business, scale** operations, the extent of professionalism of the management etc. The objectives of **internal controls relating to the accounting system** are:
    a. Transactions are executed through **general or specific management authorization**.
    b. All transactions are **promptly recorded** in an appropriate manner to permit the preparation of financial information and to **maintain accountability of assets**.
    c. Assets and records are **safeguarded from unauthorized access**, use or disposition.
    d. Assets are **verified at reasonable intervals** and appropriate action is taken about the discrepancies.
2. Precisely, the **control objectives ensure that the transactions processed are complete, valid, and accurate**. The basic accounting control objectives which are sought to be achieved by any accounting control system are:



3. If the **response to all the above answer is positive**, the auditor would be **justified in limiting his account** balance tests considerably.
4. Where in a system **a particular control is found to be deficient, audit attention can be focused on the areas** where basic accounting control objectives are not being adhered to.

   EXAMPLE: In case, if it **found that sales transactions are not being properly valued** in accordance with the price list determined by the management, the auditor would have to **perform extensive searching tests on sales invoices** to assure himself that the **recoverable amounts are correctly posted**. He may also want to **expand his confirmation request at the year end** to cover a large majority of trade receivables.

LIMITATIONS OF INTERNAL CONTROLS

Internal control systems are subject to certain inherent limitations, such as:

1. Management's consideration that the **cost of an internal control** does not **exceed the expected benefits** to be derived.
2. The fact that most internal controls do not tend to be directed at **transactions of unusual nature**.
3. The **potential for human error**, such as, due to carelessness, distraction, mistakes of judgement and misunderstanding of instructions.
4. The **possibility of circumvention of internal controls through collusion** with employees or with parties outside the entity.
5. The possibility that a **person responsible for exercising an internal control could abuse** that responsibility, for example, a member of management overriding an internal control.
6. **Manipulations by management** with respect to transactions or estimates and judgements required in the preparation of financial statements.

STRUCTURE OF INTERNAL CONTROL

To achieve the objectives of internal controls, it is **necessary to establish adequate control policies and procedures**. Most of these policies and procedures cover:

A. SEGREGATION OF DUTIES:

1. **WHY AND WHERE:** Transaction processing **are allocated to different persons** in such a manner that no one person can carry through the completion of a transaction from start to finish. The purpose is to **minimize the occurrence of fraud and errors and to detect them on a timely basis** when they take place. The following functions are segregated –
   a. **Authorization** of transactions.
   b. **Execution** of transactions.
   c. **Physical custody** of related assets and
   d. **Maintenance of records** and documents.

2. **CARE TO BE TAKEN:** While allocating duties, the **considerations of cost and efficacy should be kept in mind** to job more persons than what is required resulting in cumbersome procedures, over-elaboration of records and unduly high cost of administration.

3. **ROTATION OF DUTIES:** The rotation of duties seeks to ensure that if **a fraud and error is committed by a person, it does not remain undetected** for long. This also makes an employee to be careful because he is aware that **his performed tasks will be reviewed by others when duties are rotated**.

B. AUTHORIZATION OF TRANSACTION:

1. Delegation of **authority to different levels** and to particular persons are required to **establish by the management for controlling the execution of transaction** in accordance with prescribed conditions. Authorization may be general, or it may be specific with reference to a single transaction.
2. It is necessary to establish procedures which provide assurance that **authorizations are issued by persons acting within the scope of their authority**, and that the transactions conform to the terms of the authorizations. This objective can be **achieved by making independent comparison of transaction document** with general or specific authorizations.

C. ADEQUACY OF RECORDS AND DOCUMENTS:

[AKA ACCOUNTING CONTROLS]

1. Accounting controls should ensure that:
   a. Transactions are **executed in accordance with management's general or specific authorization**. Transactions and other events are promptly recorded at correct amounts.
   b. Transactions should be **classified in appropriate accounts and in the appropriate period** to which it relates.
   c. Transaction should be recorded in a manner so as **to facilitate preparation of financial statements** in accordance with applicable financial reporting framework.
   d. Recording of transaction **should facilitate maintaining accountability for assets**.
   e. Records are required to be **protected from unauthorized access, use or disposition**.
   f. Records of assets such as **sufficient description of the assets (to facilitate identification) its location** should also be maintained so that the assets could be physically verified periodically.

2. For **prompt, accurate, complete, and appropriate recording** of accounting transaction, several procedures are often established by the management.

D. ACCOUNTABILITY AND SAFEGUARDING OF ASSETS:

1. The process of **accountability of assets commences from acquisitions** of assets its use and final disposal. Safeguarding of assets **requires appropriate maintenance of records**, their periodic reconciliation.
2. Assets like cash, inventories, investment scrips require frequent **physical verification** with book records & **effective controls**.
3. Assets which are considered **sensitive or susceptible to error need to be reconcile more frequently than others**.
4. For proper safeguarding of assets, only **authorized personnel should be given access to such asset**. This not only means physical access but also exercising **control over processing of documents** relating to authorization for use and disposal of assets.

E. INDEPENDENT CHECKS:

Independent verification of the control systems, designed and implemented by the management, **involves periodic or regular review by independent persons to ascertain whether the control procedures are operating effectively or not**.

COMPONENTS OF INTERNAL CONTROLS

The following are the 5 components of control environment:

1. The **control Environment** (Governance, management structure and Culture of honesty).
2. Entity's **risk assessment process** (Identification of risk to design a control to mitigate it).
3. **Information system**, including related business process, relevant to financial reporting.
4. **Control activities** (Implement and Review of policies to be implemented).
5. **Monitoring of controls** (Testing of controls to update them).

CONTROL ENVIRONMENT & ITS ELEMENTS

CONTROL ENVIRONMENT INCLUDES:

The control environment includes:

1. The **governance and management functions**.
2. The **attitudes, awareness, and actions** of those charged with governance and management.
3. The control environment sets the tone of an organization, **influencing the control consciousness** of its people.

ELEMENTS OF CONTROL ENVIRONMENT:

Elements of control environment may be relevant to obtain an understanding of control environment which includes the following:

1. COMMUNICATION AND ENFORCEMENT OF INTEGRITY AND ETHICAL VALUES:

a. The **effectiveness of controls cannot rise above the integrity and ethical values** of the people who create, administer, and monitor them.

b. Integrity and ethical behaviour **are the product of the entity's ethical and behavioural standards**, how they are communicated, and how they are reinforced in practice.

c. The **communication of entity policies on integrity, ethical values** & **behavioural standards** to personnel through policy statements and codes of conduct and by example.

2. COMMITMENT TO COMPETENCE:

Competence is the knowledge and **skills necessary to accomplish tasks** that define the individual's job.

3. PARTICIPATION BY THOSE CHARGED WITH GOVERNANCE:

An entity's control consciousness is **influenced significantly by those charged with governance**. The importance of the responsibilities of those charged with governance is recognised in **codes of practice and other laws and regulations or guidance** produced for the benefit of those charged with governance. Other responsibilities of those charged with governance **include oversight of the design and effective operation of whistle blower procedures** **and the process for reviewing the effectiveness of the entity's internal control**.

4. MANAGEMENT'S PHILOSOPHY AND OPERATING STYLE:

Management's philosophy and operating style encompass a broad range of characteristics. For example, management's attitudes and actions toward **financial reporting may be assessed through selection of accounting principles**, or conscientiousness and conservatism with which accounting estimates are developed.

5. ORGANISATIONAL STRUCTURE:

Establishing a relevant organizational structure includes **considering key areas of authority and responsibility and appropriate lines of reporting**. The appropriateness of an entity's organisational structure depends, in part, on its size and the nature of its activities.

6. ASSIGNMENT OF AUTHORITY AND RESPONSIBILITY:

a. The assignment of authority and responsibility may include **policies relating to appropriate business practices**, knowledge and experience of key personnel, and **resources provided for carrying out duties**.

b. In addition, it may include **policies and communications** directed at ensuring that all personnel understand the **entity's objectives**, know how their individual actions **interrelate and contribute to those objectives**, and recognize how and for what they will be held accountable.

7. HUMAN RESOURCE POLICIES AND PRACTICES:

a. **RECRUITMENT POLICY:** Human resource policies and practices often **demonstrate important matters in relation to the control consciousness of an entity**. For example, standards for recruiting the most qualified individuals – with emphasis on educational background, prior work experience, past accomplishments, and evidence of integrity and ethical behaviour – demonstrate an entity's commitment **to competent and trustworthy people**.

b. **TRANING POLICY:** Training policies that communicate **prospective roles and responsibilities** and include practices such as training schools and seminars illustrate expected levels of performance and behaviour.

c. **APPRAISALS POLICY:** Promotions driven by **periodic performance appraisals demonstrate the entity's commitment** to the advancement of qualified personnel to higher levels of responsibility.

RISK ASSESSMENT PROCESS, AS A COMPONENT OF CONTROL ENVIRONMENT

1. The auditor shall obtain an understanding of whether **the entity has a process** for:
    a. **Identifying business risks** relevant to financial reporting objectives.
    b. Estimating the **significance of the risks**.
    c. Assessing the **likelihood of their occurrence** and
    d. Deciding about **actions to address those risks**.
2. The entity's risk assessment process helps to identify the basis for the risks to be managed. If that process is appropriate, it would **assist the auditor in identifying risks of material misstatement**.
3. Risks can arise or change due to circumstances such as the following:
    a. **Changes in operating environment: Changes in the regulatory or operating environment** can result in changes in competitive pressures and significantly different risks.
    b. **New personnel: new personnel may have a different focus** on or understanding of internal control.
    c. **New or revamped information systems: Significant and rapid changes in information systems** can change the risk relating to internal control.
    d. **Rapid growth: Significant and rapid expansion of operations** can strain controls and increase the risk of a breakdown in controls.
    e. **New technology:** Incorporating **new technologies into production processes** or information systems may change the risk associated with internal control.
    f. **New business models, products, or activities:** Entering into business areas or transactions with **which an entity has little experience may introduce new risks** associated with internal control.
    g. **Corporate restructurings:** Restructurings may be accompanied by **staff reductions and changes in supervision** and segregation of duties that may change the risk associated with internal control.
    h. **Expanded foreign operations:** The expansion or acquisition of foreign operations carries new and **often unique risks that may affect internal control**, for example, additional or changed risks from foreign currency transactions.

i. **New accounting pronouncements:** Adoption of **new accounting principles or changing accounting principles** may affect risks in preparing financial statements.

CONTROL ACTIVITIES AS A COMPONENT OF INTERNAL CONTROL SYSTEM

MEANING OF CONTROL ACTIVITIES: The policies and procedures that help **ensure that management directives are carried out**.

A. PERFORMANCE REVIEWS:

These control activities **include reviews and analyses of actual performance versus budgets, forecasts, and prior period performance**; relating different sets of data – operating or financial – to one another, together with analyses of the relationships and investigative and corrective actions; **comparing internal data with external sources of information**; and **review of functional or activity performance**.

B. INFORMATION PROCESSING:

1. The **2 broad groups of information systems control activities** are **application controls**, **which apply to the processing of individual applications**, and **general IT-controls**, **which are policies and procedures that relate to many applications** and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems.
2. Examples of application controls include checking the arithmetical accuracy of records, maintaining, and reviewing accounts and trial balances.
3. Examples of general IT-controls are program change controls, controls that restrict access to programs or data, controls over the implementation of new releases of packaged software application.

C. PHYSICAL CONTROLS:

Controls that encompass:

1. The **physical security of assets**, including adequate safeguards such as secured facilities over access to assets and records.
2. The **authorisation for access** to computer programs and data files.

3. The **periodic counting and comparison** with amounts shown on control records (for example, comparing the results of cash, security and inventory counts with accounting records).
4. The **extent to which physical controls intended to prevent theft of assets** are relevant to the reliability of financial statement preparation, the audit, depends on circumstances such as when assets are highly susceptible to misappropriation.

D. SEGREGATION OF DUTIES:

1. Assigning **different people, the responsibilities** of *authorising* transactions, recording transactions, and maintaining custody of assets.
2. Segregation of duties is intended to reduce the opportunities to allow **any person to be in a position to both perpetrate and conceal errors or fraud** in the normal course of the person's duties.
3. Certain control activities **may depend on the existence of appropriate higher-level policies** established by management or those charged with governance.

INFORMATION SYSTEMS AND RELATED BUSINESS PROCESS, AS A COMPONENT OF INTERNAL CONTROL

1. An information system **consists of infrastructure, software, people, procedures, and data**. Many information systems make extensive use of information technology (IT).
2. The information system relevant to financial reporting objectives, which includes the financial reporting system, encompasses methods and records that:
   a. **Identify and record** all valid transactions.
   b. Describe on a timely basis the **transactions in sufficient detail to permit proper classification** of transactions for financial reporting.
   c. Measure **the value of transactions** in a manner that permits recording their proper monetary value in the financial statements.
   d. Determine the time in which transactions occurred **to permit recording of transactions in the proper accounting period**.
   e. **Present properly the transactions and related disclosures** in the financial statements

3. The quality of system-generated **information affects management's ability to make appropriate decisions** in managing and controlling the entity's activities and to prepare reliable financial reports.
4. **Communication may be as policy manuals, accounting and financial reporting manuals**, and memoranda. Communication also can be made electronically, orally, and through the actions of management.

MONITORING OF CONTROLS, AS A COMPONENT OF INTERNAL CONTROL

1. **OBJECTIVE:** Management's monitoring of controls includes **considering whether they are operating as intended and that they are modified as appropriate** for changes in conditions. Monitoring is done also to ensure that controls continue to operate effectively over time. For
2. **INCLUDES:** Monitoring of controls may include activities such as,
   a. Management's review of whether **bank reconciliations** are being prepared on a timely basis,
   b. Internal auditors' **evaluation of sales personnel's compliance** with the entity's policies on terms of sales contracts, and
   c. A legal department's **oversight of compliance with the entity's ethical** or business practice policies.
   d. Monitoring activities may include **using information / communications from external parties** that may indicate problems or highlight areas in need of improvement.

3. **WHO PERFORMS MONITORING:** **Internal auditors** or personnel performing similar functions **may contribute to the monitoring of an entity's controls through separate evaluations**. Ordinarily, they regularly provide information about the functioning and evaluating the effectiveness of internal control, and **communicate information about strengths and deficiencies** in internal control and **recommendations for improving internal control**.

CONCEPTS, OBJECTIVES AND GENERALISATIONS OF INTERNAL CHECK

CONCEPT AND MEANING: Internal check system **implies organizing the overall system of book-keeping and arrangement of Staff duties** in such a way that no one person can carry through a transaction and record every aspect thereof.

The system provides **existence of checks on the day-to-day transactions which operate continuously as part of the routine system** whereby the work of **each person is either proved independently or is made complimentary to the work** of another.

OBJECTIVES OF INTERNAL CHECK: The following are the objectives of the internal check system:

1. To **detect error and frauds** with ease.
2. To **avoid and minimize the possibility of commission** of errors and fraud by any staff.
3. To **increase the efficiency of the staff working** within the organization.
4. To **locate the responsibility area or the stages** where actual fraud and error occurs.
5. To **protect the integrity of the business** by ensuring that accounts are always subject to proper scrutiny and check.
6. To **prevent and avoid the misappropriation or embezzlement** of cash and falsification of accounts.

FACTORS FOR EFFECTIVENESS OF INTERNAL CHECKS: The effectiveness of an efficient system of internal check depends on the following considerations:

1. **Clarity of Responsibility:** The responsibility of different persons engaged in **various operations of business transactions with their specific functions should be properly identified**.
2. **Division of Work:** The segregation of work should be made in such a manner that the free flow of work is not interrupted and helps to determine that the **work of one person is complementary to the other**. **Rotation of different employees** through various components of job should be effectively implemented.
3. **Standardization:** The entire **process of accounting should be standardized by creating suitable policies** commensurate with the nature of the business, so as to strengthen the system of internal check.
4. **Appraisal:** **Periodic review should be made** of the chain of operations and workflow. Such process may be carried out by preparing an audit flow chart.

GENERAL CONDITIONS OR ASPECTS OF INTERNAL CHECK: The general condition pertaining to the internal check system may be summarized as under:

1. **SEGREGATION OF DUTIES:** **No single person should have complete control** over any important aspect of the business operation.
2. **ROTATION OF DUTIES:** **Staff duties should be rotated from time to time** so that members do not perform the same function for a considerable length of time.
3. **MANDATORY LEAVES:** Every member of the **staff should be encouraged to go on leave** at least once a year.
4. Persons having **physical custody of assets** must **not be permitted to have access to the books of accounts**.
5. **ACCOUNTING CONTROL:** There should exist an **accounting control in respect of each class of assets**, in addition, there should be periodical inspection so as to establish their physical condition.
6. Mechanical devices should be used, wherever **practicable to prevent loss or misappropriation** of cash.
7. Budgetary control should be exercised, and **wide deviations observed should be reconciled**.
8. For inventory taking, at the close of the year, **trading activities should, if possible be suspended**, and it should be done by staff belonging to several sections of the organization.
9. The financial and administrative powers should be **distributed very judiciously among different officers** and the manner in which those are actually exercised should be reviewed periodically.
10. Procedures should be laid down for **periodical verification and testing of different sections of accounting records** to ensure that they are accurate.

REVIEW OF SYSTEM OF INTERNAL CONTROLS BY THE AUDITOR

1. Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of **effectively preventing, or detecting and correcting, material misstatements**.

2. Implementation of a control means that the **control exists, and that the entity is using it**.

3. An **improperly designed control may represent a material weakness or significant deficiency** in the entity's internal control.

4. The **use of manual or automated elements** in internal control also affects the **manner in which transactions are initiated, recorded, processed, and reported**.

5. **Manual elements** in internal control may be **more suitable where judgment and discretion are required** such as for the following circumstances:
   a. **Large, unusual, or non-recurring** transactions.
   b. Circumstances where **errors are difficult to define**, anticipate or predict.
   c. In monitoring the **effectiveness of automated controls**.

6. The extent and nature of the risks to internal control vary **depending on the nature and characteristics of the entity's information system**.

7. **REVIEW OF INTERNAL CONTROLS:** The review of the internal control system enables the auditor:
   a. To **formulate his opinion** as to the reliance he may place on the system itself i.e., whether the system is such as would enable the management **to produce a true and fair set of financial statements**; and
   b. To **locate the areas of weakness in the system** so that the audit programme audit procedures can be adjusted to meet the situation.

8. **TIMING OF REVIEW OF INTERNAL CONTROLS:**
   a. Deciding the point of time appropriate for undertaking the review of the internal controls is a **matter for individual judgement of the auditor**. This decision can be taken **on a consideration of the size and complexity of the client's** operations.
   b. If the auditor, because of his continuing relationship with his client, **is already aware of the features and efficacy of internal controls**, **he may just review the changes** that have taken place in the intervening period because of changes in the operations of the client. However, **a comprehensive review in such cases must be made at an interval of, 3 years**.
   c. Ordinarily, the review of internal controls should be undertaken as a **distinct phase of audit before finalisation** of the audit programme.

9. **LETTER OF WEAKNESS:** When the **auditor finds inadequacies or weaknesses in the internal control** system, **he should advise his client about the same**. It should be the **duty of the auditor** to see, in the course of his audit, **to check whether the inadequacies and weaknesses have been removed**. He will take this **into account in preparing his audit report**. It is a useful practice to note the following after each function, set out in the audit programme -

a. Any **change in the system of internal control** from that record in the appropriate section of the internal control questionnaire.
b. Any **further weakness noted** in the internal control.
c. Any instance where the **prescribed system or procedure has not been followed**.

These should be considered in deciding whether **any further modification in the audit programme** is called for. Also, these should be communicated to the client and confirmation should be sought as regards changes in the system.

10. **REVIEW PROCEDURES:** The review of internal control consists mainly of **enquiries of personnel at various organisational levels** within the enterprise together with reference to documentation, to gain knowledge about the controls which the auditor has identified as significant to his audit. The purpose of the preliminary evaluation is to **identify the particular controls on which the auditor intends to rely and to test through compliance procedures**.

INTERNAL CONTROL ASSESSMENT AND EVALUATION

COMMITMENT OF TCWG: The quality & effectiveness of internal controls **is directly dependent on the organisational environment & TWCG.**

Following are some of the key components to assess & evaluate the controls environment:

1. **STANDARD OPERATING PROCEDURES (SOPS):** A well-defined set of **SOPs helps define role, responsibilities, process & controls** & thus helps clearly communicate the operating controls to all touch points of a process.

2. **ENTERPRISE RISK MANAGEMENT:** An organization which has **robust process to identify & mitigate risks** across the enterprise & its **periodical review will assist in early identification** of gaps & taking effective control measures.

3. **SEGREGATION OF JOB RESPONSIBILITIES:** A key element of control is that **multiple activities in a transaction/decision should not be concentrated with one individual**. Segregation of duties is an important element of control such that **no two commercial activities should be conducted by the same person**.

4. **JOB ROTATION IN SENSITIVE AREAS:** Any job carried out by the same **person over a long period of time** is likely to lead **to complacency & possible misuse in sensitive areas**. It is therefore important that in key commercial functions, the **job rotation is regularly followed to avoid degeneration of controls**.

5. **DELEGATION OF FINANCIAL POWERS DOCUMENT:** A **clearly defined document** on delegation of powers allows **controls to be clearly operated without being dependent on individuals**.

6. **INFORMATION TECHNOLOGY BASED CONTROLS:** With the advent of computers & enterprise resource planning (ERP) systems, **the failure rate for IT embedded controls is likely to be low & have better audit trail** makes it easier to monitor.

TECHNIQUES OF EVALUATION OF INTERNAL CONTROLS

The following are the **3 popular techniques of evaluation of internal control**:

QUESTIONNAIRE

1. **QUESTIONS:** A questionnaire is a set of questions framed in an organised manner, about each functional area, which has as purpose the **evaluation of the effectiveness of control and detection of its weakness** if any.
2. **ADDRESSES VARIOUS AREAS:** A questionnaire usually **consists of several separate sections** devoted to areas such as purchases, sales, trade receivables, trade payables, wages, etc.
3. **FILLED BY CLIENT:**
    a. The questionnaire is intended to be **filled by the company executives** who are in charge of the various areas.
    b. It is an accepted practice that the auditor (or his representative) **arranges meetings and gets the answers filled by each executive**. Sometimes, the auditor himself may be required to fill the answers. In such a case, he should ensure that the concerned **executive has initiated the answers as a token of his agreement** therewith.
    c. Questions are so framed as generally to enable the executive to provide a just **'Yes', 'No' or 'Not applicable' form of reply**.

   d. The scheme of questions should be **consistent, sequential, logical, and if possible corroborative**.
   e. Wherever it is necessary, slightly **detailed answers also may be asked for to bring clarity** to the matter.
4. **STANDARDISED ICQ:** In the use of standardized internal control questionnaire, **certain basic assumptions about elements of good control** are taken into account. These are:
   a. Organisations have **an extensive division of duties and responsibilities**.
   b. Employees concerned with **accounting function are not assigned any custodial function**.
   c. **No single person** is thrust with the responsibility of **completing a transaction all by himself**.
   d. There should always be evidence **to identify the person who has done the work.**
   e. The **work performed** by each one is **reviewed by another** in the usual course of routine.
   f. There is **proper documentation and recording** of the transactions.
5. The **questionnaire serves the purpose of a record** so far as the auditor is concerned about the state of internal control as given to him officially.
6. **PERIODICITY:** A question naturally arises as to whether it is necessary to issue questionnaire for every year of the auditor's engagement.
   a. For the **first year** of engagements issue of **questionnaire is necessary**.
   b. For **subsequent years**, the auditor, instead of issuing a questionnaire again, may **request the client to confirm whether any change** in the nature and scope of business or whether the control system has undergone a change.
   c. If there **has been a change**, the auditor should take note of it on the **relevant part of the questionnaire**.
   d. **EVERY 3RD YEAR:** It would be a good practice in the case of continuing engagements **to issue a questionnaire irrespective of any change, say, every 3rd year**.

CHECK LIST

1. It is a **series of *instructions* or questions on internal control** which the auditor must follow or answer.
2. If it is in the form of a question, the answer **generally 'Yes', 'No' or 'Not Applicable'** is entered opposite the question.

3. A check list is more in the **nature of a reminder to the auditor about the matters to be checked for testing** the internal control system.
4. The question form of check list may even be **meant for the auditor's own staff**.
5. **ICQ vs CHECKLIST:** While **a questionnaire is basically a set of questions put to the client, a check list** which may be in a form of instructions, questions or just points to be **checked may be meant for the auditor's own staff**. The basic distinction between internal control questionnaire and check list are as under:
   a. The ICQ incorporates **a large number of detailed questions**, but the check list generally contains questions relating to the **main control objective with the area** under review.
   b. ICQ, the **weaknesses are highlighted by the 'Yes'** while in the **check list, it is indicated by 'No'**.
   c. The **significance of 'No' in an ICQ does indicate a weakness** but the significance of that weakness is not revealed automatically. However, in the **check list, a specific statement is required where an apparent weakness** may prove to be material in relation to the accounts as a whole.

FLOW CHART

1. **GRAPHICAL:** It is a **graphic presentation of internal controls** in the organisation and is normally drawn up to show the controls in each section or sub-section. It provides the **most concise and comprehensive way** for reviewing the internal controls and the evaluator's findings.
2. **LESS NARRATIVES:** In a flow chart, narratives, are reduced to the minimum and it can bring the **whole control structure, in a condensed but wholly meaningful manner**.
3. **BIRD EYE VIEW:** It gives a **bird's eye view of the system** and is drawn up as a result of the auditor's review thereof.
4. **EVERY DETAIL:** It **should, not be understood that details are not reflected in a flow chart**. Every detail relevant from the control point of view and the details about how an operation is performed can be included in the flow chart.
5. **A DIAGRAM:** Essentially a flow chart is **a diagram full with lines and symbols**, it is **probably the most effective way of presenting the state of internal controls** in the client's organisation.
6. **FLOW OF ACTIVITIES:** A properly drawn up flow chart can provide a neat visual picture of the whole activities of the section or department **involving flow of documents and activities**.

The flow charts should be **made section-wise or department-wise**. The suggestion has been made to ensure **readability and intelligibility of the flow charts**.

[Note: Students are advised to read "Drawing of Flow Charts is Discussed in Detailed in ICAI Study Material Pg. 3.37 to 3.43"]

COMMUNICATING WEAKNESSES IDENTIFIED IN INTERNAL CONTROLS

Material weaknesses are defined as absence of **adequate controls on flow of transactions that increases the possibility of errors and frauds** in the financial statements of the entity.
The auditor **should communicate such material weaknesses to the management or the audit committee**, on a timely basis. This communication should be, **in writing through a letter of weakness or management letter**.

Important points with regard to such a letter are as follows:

1. The letter **lists down the area of weaknesses** in the system and offers suggestions for improvement.
2. It should clearly indicate that it **discusses only weaknesses which have come to the attention of the auditor** because of his audit and that his examination **has not been designed to determine the adequacy of internal control** for management.
3. This letter **serves as a valuable reference document** for management for the purpose of revising the system and insisting on its strict implementation.
4. It should be appreciated that by writing a letter to the management about the weaknesses in the system, the **auditor is not absolved from his duty to report the shortcomings in the accounts by way of qualification where the defects have not been corrected** to the auditor's satisfaction weighing the materiality of weaknesses and their impact, if considered necessary.
5. **AUDITOR':**
   The practice of the issue of letter of weaknesses has **a great merit in relieving the auditor from liability in case serious frauds or losses** have occurred, which probably would not have taken place had the client taken due note of the auditor's points in the letter of weakness to the management.

6. **SA 265 VIEW:**
 The Council of ICAI has issued SA 265 on "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management" in this regard. This Standard on Auditing (SA) deals with the auditor's responsibility **to communicate appropriately to those charged with governance and management deficiencies** in internal control that the auditor has identified in an audit of financial statements. This SA **does not impose additional responsibilities** on the auditor **over and above the requirements of SA 315 and SA 330**.

7. **AUDIT PROCEDURE:**
   a. The auditor shall determine whether, on the basis of the audit work performed, the auditor **has identified one or more deficiencies in internal control**.
   b. **If the auditor has identified** one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, **whether they constitute significant deficiencies**.
   c. The auditor shall also **communicate to management** at an appropriate level of responsibility on a timely basis in writing. Deficiencies include
      i. **Significant deficiencies** in internal control that the auditor has **communicated or intends to communicate to those charged with governance**, unless it would be inappropriate to communicate directly to management in the circumstances; and
      ii. **Other deficiencies** in internal control **identified during the audit that have not been communicated to management** by other parties and

8. **CONTENTS OF LETTER OF WEAKNESS:**
The auditor shall include in the written communication of significant deficiencies in internal control:
   a. A **description of the deficiencies and an explanation** of their potential effects and
   b. In particular, the auditor shall explain that:
      i. The **purpose of the audit** was for the auditor to express an opinion on the financial statements.
      ii. The audit **included consideration of internal control relevant to the preparation of the financial statements** in order to design audit procedures that are appropriate in the

circumstances, but **not for the purpose** of expressing an **opinion on the effectiveness of internal control** and

iii. The **matters being reported are limited to those deficiencies** that the auditor has **identified during the audit** and that the auditor has concluded **are of sufficient importance to merit being reported** to those charged with governance.

NEED OF INTERNAL CONTROL FRAMEWORKS

NEED OF ICS:

1. There are **a number of global internal control frameworks that provide guidance** to entities for developing and establishing their internal control systems.
2. Control should be **built and established within the processes through which the company pursues its objective**. The board of directors or those charged with governance **need to consider whether they have enough timely, relevant, and reliable reports** on progress against business objectives and significant risks.

OBJECTIVE OF ICS:

Internal control is fundamental **to the successful operation and day-to-day running of a business**, and it assists the company in achieving its business objectives. It is **wider in scope and encompasses all controls** incorporated into the strategic, governance and management process, **covering the company's entire range of activities** and operations.

INTERNATIONALLY RECOGNISED INTERNAL CONTROL FRAMEWORKS

COSO [Committee of Sponsoring Organisation] FRAMEWORK

Integrated Framework issued by **Committee of the Sponsoring Organisations of the Treadway Commission (COSO Framework)**

1. **COSO's Internal Control:**
   Integrated Framework was introduced in 1992 as **guidance on how to establish better controls so that companies** can achieve their objectives. **COSO categorizes entity-level objectives** into operations, financial reporting, and compliance.
2. **COMPONENTS:**

The **framework includes more than 20 basic principles** representing the fundamental concepts associated with its **5 components**:

a. **Control environment**,
b. **Risk assessment**,
c. **Control activities**,
d. **Information and communication**, and
e. **Monitoring**.

3. **17 PRINCIPLES:** COSO Framework was largely done through the articulation of the 17 principles, which are relevant to every entity and **must be present and functioning in order to have an effective system** of internal control.

   The tiles of the 17 internal control principles by internal control component as presented in COSO's framework:

   a. **CONTROL ENVIRONMENT:**
      i. Demonstrates **commitment to integrity** and ethical values.
      ii. Exercises **oversight responsibility**.
      iii. Establishes **structure, authority**, and responsibility.
      iv. Demonstrates commitment to **competence**.
      v. Enforces **accountability**.
   b. **RISK ASSESSMENT:**
      i. Specifies **suitable objectives**.
      ii. **Identifies and analyses risk**.
      iii. Assesses **fraud** risk.
      iv. Identifies and analyses **significant changes**.
   c. **CONTROL ACTIVITIES:**
      i. Selects and develops **control activities**.
      ii. Selects and **develops general controls** over technology.
      iii. Deploys through **policies and procedures**.
   d. **INFORMATION AND COMMUNICATION:**
      i. Uses **relevant information**.
      ii. **Communicates** internally.
      iii. Communicates externally.
   e. **MONITORING:**
      i. Conducts **ongoing and/or separate** evaluations.
      ii. Evaluates and **communicate deficiencies**.

4. **OBJECTIVES OF COSO:**
   The COSO Framework is **designed to be used by organizations to assess the effectiveness** of the system of internal control to achieve

objectives as determined by management. The Framework **lists 3 categories of objectives** as below:

a. **Operations Objectives:** Related to the **effectiveness and efficiency of the entity's operations,** including operational and financial performance goals, and safeguarding assets against loss.
b. **Reporting Objectives:** Related to internal and **external financial and non-financial reporting to stakeholders**, which would encompass reliability, timeliness, transparency, or other terms as established by regulators, standard setters, or the entity's policies.
c. **Compliance objectives:** Relating to the entity's **compliance with applicable laws and regulations**. The Framework considers the increased demands and complexities in laws, regulations, and accounting standards.

5. **LIMITATIONS OF INTERNAL CONTROL:**
   a. Controls **are performed by people and are subject to human error**, uncertainties inherent in judgment, management override, and their circumvention due to collusion.
   b. An effective system of internal control **recognizes their inherent limitations and addresses ways to minimize these risks** by the design, implementation, and conduct of the system of internal control. However, an **effective system will not eliminate these risks**. An effective system of internal control **provides reasonable assurance, not absolute assurance**, that the entity will achieve its defined operating, reporting, and compliance objectives.

COCO [Criteria of Control] FRAMEWORK

1. The **Criteria of Control (CoCo) framework** was developed by the Canadian Institute of Chartered Accountants with the objective of **improving organisational performance and decision making with better controls**, risk management, and corporate governance. [Introduced in 1992]

2. The **framework includes 20 criteria** for effective control in 4 areas of an organization:
   a. **Purpose** (direction),
   b. **Commitment** (identity and values),
   c. **Capability** (competence) and
   d. **Monitoring and learning** (evolution).

3. The framework emphasizes **that control involves the entire organization but begins on an individual level**, with the employee.

4. In order to assess whether controls exist and are operating effectively, each **criterion would be examined to identify the controls** that are in place to address them.

COBIT [Control Objectives for Information and Related Technology]

1. It is a **framework created by the ISACA (Information Systems Audit and Control Association)** for IT governance and management.
2. COBIT has **34 high-level processes that cover 210 control objectives** categorized **in 4 domains: planning and organization, acquisition and implementation, delivery and support, and monitoring and evaluation**.
3. It is designed as a supportive tool for managers and allows **bridging the crucial gap between technical issues, business risks and control requirements**.
4. Business managers are equipped with a model to practice **better risk management practices associated with the IT processes**.
5. It is a control model that **guarantees the integrity of the information system**.
6. It is a thoroughly recognized guideline that can be applied to any organization across industries. **COBIT ensures quality, control and reliability of information systems in organization**, which is also the most important aspect of every modern business.
7. This framework **guides an organization on how to use IT resources** (i.e., applications, information, infrastructure, and people) **to manage IT domains, processes, and activities to respond to business requirements**, which include compliance, effectiveness, efficiency, confidentiality, integrity, availability, and reliability.
8. **Well-governed IT practices can assist businesses in complying** with laws, regulations, and contractual arrangements.

COMBINED CODE OF COMMITTEE ON CORPORATE GOVERNANCE

Guidance for Directors on the Combined Code, published by the Institute of Chartered Accountants in England & Wales (known as the Turnbull Report).

The key principles of the Code are enunciated as below:

1. The board should **maintain a sound system of internal control** to safeguard shareholders' investment and the company's assets.

2. The **directors should, at least annually, conduct a review of the effectiveness** of the group's system of internal control and should report to shareholders that they have done so. The **review should cover all controls**, including financial, operational and compliance controls and risk management.
3. Companies which **do not have an internal audit function should review the need** for one.
4. The guidance requires **directors to exercise judgement in reviewing** how the company has **implemented the requirements of the Code** relating to internal control and reporting to shareholders thereon.
5. The guidance is based on the **adoption by a company's board of a risk-based approach** to establishing a sound system of internal control and reviewing its effectiveness. This should be **incorporated by the company within its normal management** and governance processes.
6. It should **not be treated as a separate exercise** undertaken to meet regulatory requirements.

SARBANES-OXLEY SECTION 404

1. **SOX Section 404 (Sarbanes-Oxley Act Section 404)** mandates that **all publicly traded companies must establish internal controls and procedures for financial reporting** and must document, test and maintain those controls and procedures to ensure their effectiveness.
2. The purpose of SOX is to **reduce the possibilities of corporate fraud** by increasing the **stringency of procedures and requirements** for financial reporting.
3. The Sarbanes Oxley Act, signed into law in 2002, has **revamped federal regulations pertaining to publicly traded companies'** corporate governance and reporting obligations.
4. The **SEC rules and PCAOB** [Public Company Accounting Oversight Board] [Similar to NFRA in India] standards require that:
    a. Management performs **a formal assessment of its controls** over financial reporting including **tests that confirm the design and operating effectiveness** of the controls.
    b. Management **includes in its annual report an assessment of ICFR**.
    c. The external auditors **provide 2 opinions** as part of a single integrated audit of the company:
        i. An independent **opinion on the effectiveness** of the system of ICFR.
        ii. The traditional **opinion on the financial statements**.

5. Management needs to determine whether the system of internal control in effect as of the date of the assessment **provides reasonable assurance that material errors**, in either interim or annual financial statements, **will be prevented or detected**.
6. The **rules issued by Securities and Exchange Commission** require a company's annual report to include an internal control report of management that contains:
    a. A statement of **management's responsibility for establishing and maintaining adequate internal control** over financial reporting for the company.
    b. A statement **identifying the framework used by managemen**t to conduct the required evaluation of the effectiveness of the company's internal control over financial reporting.
    c. Management's **assessment of the effectiveness of the company's internal control** over financial reporting as of the end of the company's **most recent fiscal year**, including a statement as to **whether or not the company's internal control over financial reporting is effective**. The assessment **must include disclosure of any "material weaknesses"** in the company's internal control over financial reporting **identified by management**. Management is **not permitted to conclude** that the company's internal control over financial reporting is **effective if there are one or more material weaknesses** in the company's internal control over financial reporting.
    d. A statement that the registered public accounting firm that audited the financial statements included in the annual report has issued **an attestation report on management's assessment of the registrant's internal control** over financial reporting.
7. The final rules also **require a company to file**, as part of the company's annual report, the **attestation report of the registered public accounting firm** that audited the company's financial statements.

10A. DUE DILIGENCE

CONCEPT OF DUE DILIGENCE

Due Diligence is **used to investigate and evaluate a business opportunity**. It implies a general duty to exercise care in any transaction.

Most legal definition of due diligence describe it as **a measure of prudence activity as is properly to be expected from**, and ordinarily exercised by, **a reasonable and prudent person** under the particular circumstance, **not measure by any absolute standard but depends on the relative facts** of the special case.

1. Due diligence **is a process of investigation, performed by investors**, into the **details of a potential investment** such as an examination of operations and management and the verification of material facts.
2. It **entails conducting inquiries** for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, **which may influence the outcome of the transaction**.
3. Due diligence involves **a careful study of the financial as well as non-financial possibilities** for successful implementation of restructuring plans.
4. Due diligence **involves an analysis carried out before acquiring a controlling interest in a company** to determine that the conditions of the business conform with what has been presented about the target business.
5. **Due diligence can apply to recommendation for an investment or advancing a loan/credit**.
6. Due Diligence **may also require to be performed in cases** of corporate restructuring, venture capital financing, lending, leveraged buyouts, public offerings, disinvestment, corporatisation, etc.

DIFFERENCE BETWEEN DUE DILIGENCE AND AUDIT

AUDIT: Audit is an **independent examination and evaluation of the financial statements** on an organization with a view to express an opinion thereon.

DUE DILIGENCE: Whereas, due **diligence refers to an examination of a potential investment to confirms all material facts of the prospective business opportunity**. It involves **review of financial and non-financial**

records as deemed relevant and material. Due diligence **aims to take the care that a reasonable person should take before** entering into an agreement or a transaction with another party.

IMPORTANCE OF DUE DILIGENCE

When a business opportunity first arises, it continues throughout the talks, initial data collection and evaluation commence. **Thorough detailed due diligence is conducted after the parties involved in a proposed transaction have agreed in principle that a deal should be pursued and after a preliminary understanding has been reached**, **but prior to the signing of a binding contract.**

The purpose of due diligence is **to assist the purchaser or the investor in finding out all the care that a reasonable person can take**, about the business he is acquiring or investing in prior to completion of the transaction **including its critical success factors as well as its strength and weaknesses.**

In addition, it may **expose problems or potential problems that can be addressed in the price negotiations** or by dealing suitable clauses in the contractual documentation, in particular, warranty and or indemnity provisions.

There are many reasons for carrying out due diligence including:

1. To confirm that **the business is what it appears to be**;
2. To identify **potential 'deal killer' defects** in the target company and avoid a bad business transaction;
3. To gain **information that will be useful for valuing assets**, defining representations and warranties, and/or negotiating price concessions; and
4. To verify that the **transaction complies with investment or acquisition criteria.**

CLASSIFICATION OF DUE DILIGENCE

Due Diligence can be **sub-classified into discipline-wise** exercises in following manner:

1. **COMMERCIAL/OPERATIONAL DUE DILIGENCE:** It is generally performed by the concerned acquire **enterprise involving an evaluation from commercial,** strategic and operational perspectives. For example, whether **proposed merger would create operational synergies**.
2. **FINANCIAL DUE DILIGENCE:** It involves **analysis of the books of accounts and other information** pertaining to financial matters of the entity. It should be performed **after completion of commercial due diligence**.
3. **TAX DUE DILIGENCE:** It is a **separate due diligence exercise but since it is an integral component** of the financial status of a company, it is generally included in the financial due diligence. The accountant has to **look at the tax effect of the merger or acquisition.**
4. **INFORMATION SYSTEMS DUE DILIGENCE:** It **pertains to all computer systems** and related matter of the entity.
5. **LEGAL DUE DILIGENCE:** This may be **required where legal aspects of functioning of the entity are reviewed**.
6. **ENVIRONMENTAL DUE DILIGENCE:** It is carried out **in order to study the entity's environment**, its flexibility and adaptiveness to the acquirer entity.
7. **PERSONNEL DUE DILIGENCE:** It is carried out **to ascertain that the entity's personnel policies are in line** or can be changed to suit the requirements of the restructuring.

FINANCIAL DUE DILIGENCE

Financial due diligence review is interpreted as complete due diligence review since it is **supposed to ascertain the financial implications of all the other due diligence reviews**. This is, **however, not appropriate.**

Unless the scope of financial due diligence to be performed is wide enough to cover all the aspects, it should **not be confused with overall due diligence review.**

The role of financial due diligence **commences only after a price has been agreed for the business or a restructuring plan is framed**. The initial price and other decisions are taken on the basis of net worth as well as trend of profitability of the target company, with an assumption that all contingent liabilities that may impact the future of the business have been recorded. **The principal objective of financial due diligence, therefore, is usually to look behind the veil of initial information** provided by the company and **to assess the benefits and costs of the proposed acquisition/merger** by inquiring into all relevant aspects of the past, present and future of the business to be acquired/merged with.

In order to achieve its objective, the due diligence process can include any or all of the following objectives for individual areas of the verification:

1. Brief **description of the history** of business
2. The background and **standing of promoters**.
3. **Accounting policies and practices** followed by the organization
4. **Management information systems**.
5. Details of **management structure**.
6. **Trading results** both past and the recent past
7. **Assets and liabilities** as per latest balance sheet
8. Current **status of Income tax assessments** including appeals pending against tax liabilities assessed by tax authority.
9. **Cash flow patterns**.
10. Brief description of **commercial and/or other activities** carried out by the organization.
11. The **projection of future profitability**.

FULL FLEDGED FINANCIAL DUE DILIGENCE

If a full-fledged financial due diligence is conducted, it would include the following matters, in its scope:

A. **Brief history of the target company and background of its promoter;**
B. **Accounting policies;**
C. **Review of financial statements;**
D. **Taxation;**
E. **Cash flow;**
F. **Financial Projection;**
G. **Management and employees;**
H. **Statutory Compliance.**

A. BRIEF HISTORY OF THE TARGET COMPANY AND BACKGROUND OF ITS PROMOTER:

The accountant should **begin the financial due diligence review by looking** into the **history of the company and the background of the promoters**.

An eye into the history of the **target company may reveal its turning points, survival strategies adopted by the target company.**

Few other relevant inquiries include:

1. **Nature of business:** Manufacturer/ trader, wholesaler, financial services, import/export.
2. **Location of production facilities**, warehouses, offices.
3. **Employment:** By location, supply, wage levels, union contracts, pension commitments, government regulation.
4. **Products or services and markets:** Major customers and contracts, terms of payment, profit margins, market share, competitors, exports, pricing policies, reputation of products, warranties, order book, trends, marketing strategy and objectives, manufacturing processes.
5. **History of the business with important suppliers of goods and services**: Long-term contracts, stability of supply, terms of payment, imports, methods of delivery such as "just-in-time".
6. **Inventories:** Locations, Quantities.
7. **Franchises**, licenses, patents.
8. Important **expense categories**.
9. **R & D:** Research and development.
10. **Foreign currency** assets, liabilities and transactions.
11. **Legislation and regulation** that significantly affect the entity.
12. **Information systems**.

B. ACCOUNTING POLICIES:

1. The accountant **should study the accounting policies** being followed by the target company and ascertain **whether any accounting policy is inappropriate.**
2. The accountant **should also see the effects of the recent changes** in the accounting policies.
3. The **overall scope has to be based on the accounting policies** adopted by the management in the period subjected to review carefully. The accountant has to **look at any material effect of accounting policies on the overall profitability and their correctness**.
4. **REPORT**: The accountant's report should include a **summary of significant accounting policies** used by the target company, that **changes that have been made** to the accounting policies in the recent past, the **areas in which accounting policies followed by the target company are different from those adopted by the acquiring enterprise, the effect of such differences**.

C. REVIEW OF FINANCIAL STATEMENTS:

1. Before commencing the review of each of the aspect covered by the financial statements, the accountant should examine whether **the financial statements of the target company** have been **prepared in accordance with the Statute governing** the target company, Framework for Preparation and Presentation of the Financial Statements and the relevant Accounting Standards.
2. **If not, the accountant should record the deviations** from the above and consider whether it warrant an inclusion in the final report on due diligence.
3. The accountant should **review the operating results of the target company** in great detail. It is important to make an **evaluation of the profit reported by the target company.** The reason being that the **price of the target company would be largely based upon its operating results**.
4. The accountant should **consider the presence of an extraordinary item of income or expense** that might have affected the operating results of the target company.
5. It is **advisable to compare the actual figures with the budgeted figures** for the period under review and those of the previous accounting period. This comparison could lead the accountant to **the reasons behind the variations**.
6. It is important that the **trading results for the past four to five years are compared** and the trend of normal operating profit arrived at. The normal operating profits should **further be benchmarked against other similar companies**.
7. Based on the trend of operating results, the accountant has to advise the acquiring enterprise, **on the indicative valuation of the business**.
8. In the case of many enterprises, the **valuation is mainly based on the value of net worth only**.
9. For **valuation of immovable properties and plant**, if required, the assistance of **expert valuers could also to be taken**.
10. The exercise to **evaluate the balance sheet** of the target company has to take into consideration the basis upon which assets have been valued and liabilities have been recognised.
11. The **net worth of the business has to be arrived** at by taking into account the **impact of over/under valuation** of assets and liabilities. The accountant should **pay particular attention to the valuation of intangible assets.**

12. The objective of the Due Diligence exercise will be to look **specifically for any hidden liabilities or over-valued assets**. [Examples: Please Refer Page No. 16.7 to 16.9 in ICAI SM]

D. TAXATION:

Tax due diligence is a separate due diligence exercise but since it is an **integral component of the financial status of a company**, it is generally included in the financial due diligence. It is important to check if the **company is regular in paying various taxes to the Government**. The accountant has to also look at **the tax effects of the merger or acquisition.**

E. CASHFLOW:

A **review of historical cash flows** and their pattern would reflect the **cash generating abilities of the target company and should highlight the major trends**. It is necessary to check that:

a. Is the company **able to honour its commitments** to its trade payables, to the banks, to government and other stakeholders?
b. How well is the company **able to turn its trade receivables and inventories?**
c. How well **does it deploy its funds?**
d. Are there any **funds lying idle or is the company able to reap maximum benefits** out of the available funds?
e. What is the **investment pattern of the company** and are they easily realisable?

F. FINANCIAL PROJECTIONS:

1. The accountant should obtain from the target company the **projections for the next five years with detailed assumptions and workings.** He should ask the target company to **give projections on optimistic, pessimistic and most likely bases.**
2. The accountant **evaluates the appropriateness of assumption used** in the preparation and presentation of financial projections.
3. If, the accountant is of the **opinion that as assumption used by the target company is unrealistic**, the **accountant should consider its impact on the overall valuation** of the company. He should **offer his comments** on all the assumption, highlighting those which, in his opinion are not inappropriate.
4. In case he feels the **projections provided by the target company are not achievable or aggressive** he has to **mention this in his report**. He

should **thoroughly check the arithmetical accuracy of the calculations** made for financial projections.

G. MANAGEMENT AND EMPLOYEES:

1. In most of the **companies which are available for take over** the **problem of excess work force is often witnessed**. It is **important to work out how much of the labour force has to be retained.** It is also important to **judge the job profile of the administrative and managerial** staff to see which of these matches the requirements of the new incumbents.
2. Due to **complex set of labour laws applicable** to them, companies **often have to face protracted litigation from its workforce** and it is important to **check the likely impact of such litigation**.
3. It is **important to see if all employee benefits** have been **properly paid/ provided for/funded.** In case of **un-funded Gratuity, an actuarial valuation of the liability** has to be obtained from a reputed actuary.
4. The **assumptions regarding increase** in salaries, interest rate, retirement etc. have to **be checked if they are reasonable**.
5. It is important **to consider the pay packages of the key employees** as this can be a **crucial factor in future costs**.
6. One has to **carefully look at Employees Stock Option Plans**; deferred compensation plans; Economic Value Addition and other performance linked pay; sales incentives that have been promised etc.

It is also important to **identify the key employees who will not continue after the acquisition.**

H. STATUTORY COMPLIANCE:

1. During a due diligence this is one aspect that has to be investigated in detail. It is important therefore, to **make a list of laws/ statues that are applicable to the entity** as well as to make a **checklist of compliance required** from the company under those laws.
2. If the company **has not been regular in its legal compliance it could lead to punitive charges under the law**. These may have to be **quantified and factored into the financial results** of the company.

WORK APPROACH TO DUE DILIGENCE

The purchase of business requires **some caution should be exercised through the due diligence process.** Therefore, assessing the businesses fair value passes through.

Reviewing and reporting on the financials submitted by the target company.

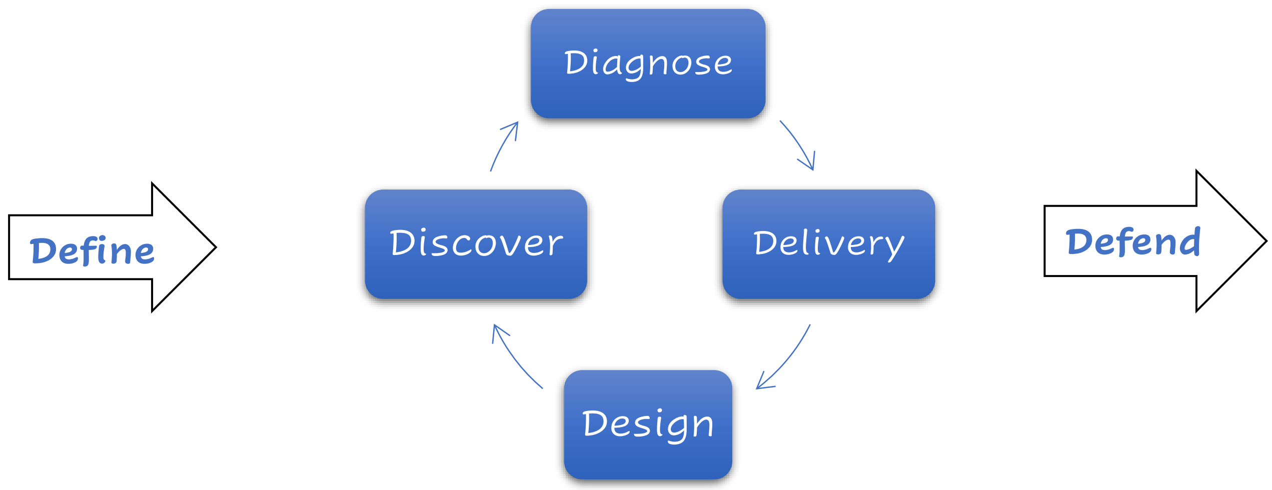
Assessing the business first hand by a site visit (if applicable).

Working through the due diligence process with the acquisitioning company or investor by defining the key areas.

Helping prepare an offer based on completion of due diligence

when a company and its products are turned to match needs and expectations of **decision makers and influencers involved in purchase decision-exceptional changes in performance can occur.**

SIX-DIMENSIONAL PROCESS FRAMEWORK



HOW IS DUE DILIGENCE CONDUCTED

1. Start with an open mind. Do not assume that anything wrong will be found and look for it. What **needs to be done is to identify trouble spots and ask for explanations**.
2. Get the **best team of people**. If you **do not have a group of people inside** your firm that can do the task **there are due diligence experts that you can hire**. When hiring such professionals, look for their experience record in the industry.
3. **Get help in all areas** like finance, tax accounting, legal, marketing, technology, and any others relevant to the assignment so **that you get a 360-degree view of the acquisition** candidate.
4. **Talk to customers, suppliers, business partners, and employees are great resources**.
5. Take a **risk management approach**. So, while you want to do your research, you also want to **make sure that you do not go against the team of people of the target company**.
6. Prepare a **comprehensive report detailing the compliances and substantive risks/issues**.

Pre-Due Diligence Period

- Discussion with the client **to gain understanding of the transaction**
- Assessment of the most appropriate **scope of work and methodology**
- Centralised **co-ordination of project team**
- **Preparation of due diligence request list** to target specific areas of concern

Due Diligence Process & Negotiation Process

- Working **off-site or on-site**
- **Flexible approach** even after Project kick-off
- **Q&A process** with management
- **Report drafting**, including assistance in the definition of financial aggregates and working of financial clauses
- Support for **preparation of negotiation terms**
- **Regular updates** with client

Closing & Post-closing process

- Preparation & **review of closing documents** by the Target
- **PPA assistance** & other post-closing transaction review
- Involvement in **price adjustment procedures** using the findings of the due diligence

CONTENTS OF DUE DILIGENCE REPORT

The contents of a due diligence report will always vary with individual circumstances. Following headings are illustrative:

Headings of a Due Diligence Report

1. **Executive Summary**
2. Introduction
3. **Background of Target company**
4. **Objective of due diligence**
5. Terms of reference and scope of verification
6. **Brief history** of the company
7. **Share holding pattern**
8. Observations on the review
9. Assessment of **management structure**
10. Assessment of **financial liabilities**
11. Assessment of **valuation of assets**
12. Comments on **properties, terms of leases, lien and encumbrances**.
13. Assessment of **operating results**
14. Assessment of **taxation and statutory liabilities**
15. Assessment of **possible liabilities on account of litigation** and legal proceedings against the company
16. Assessment of **net worth**.
17. **Interlocking investments and financial obligations with group / associates companies,** amounts receivables subject to litigation, any other likely liability which is not provided for in the books of account
18. SWOT Analysis
19. **Comments on future projections**
20. **Status of charges, liens, mortgages, assets and properties** of the company
21. Suggestion on **ways and means including affidavits, indemnities**, to be executed to cover unforeseen and undetected contingent liabilities
22. Suggestions on various aspects to be taken care of **before and after the proposed merger/acquisition.**

10B. FRAUD INVESTIGATION

DIFFERENCE BETWEEN AUDIT AND INVESTIGATION

Investigation differs substantially from an audit assignment. Audit **aims at collection of sufficient appropriate audit evidence to enable the auditor to form a judgement and express an opinion** on the financial statements or other data under examination. **An investigation, on the other hand, requires special in-depth examination of the particular records or transaction** with the objective of **establishing a part or happening or assessing a particular situation.** The scope of audit is broad based and general in nature whereas **investigation is narrow and specific.**

The difference is tabulated below:

BASIS	INVESTIGATION	AUDIT
1. Objective	An investigation aims at **establishing a fact or a happening** or at assessing a particular situation.	The main objective of an audit is to verify **whether the financial statements display a true and fair view** of the state of affairs and the working results of an entity.
2. Scope	The scope of investigation may be **governed by statute or it may be non-statutory**.	The scope of audit is wide and in case of statutory audit the **scope of work is determined by the provisions of relevant law**.
3. Periodicity	The work is **not limited by rigid time frame**. It may cover several years, as the outcome of the same is not certain.	The audit is carried on either **quarterly, half-yearly or yearly**
4. Nature	Requires a **detailed study and examination of facts and figures**. Investigation is voluntary in nature.	Involves **tests checking or sample technique to draw evidences** for forming a judgement and expression

		of opinion. It is mandatory for companies.
5. **Inherent Limitations**	**No inherent limitation** owing to its nature of engagement.	Audit suffers from **inherent limitation**.
6. **Evidence**	It seeks **conclusive evidence**.	Audit is mainly concerned with **prima- facie evidence**. [Persuasive is most accurate term]
7. **Observance of Accounting Principles**	It is **analytical in nature** and requires a thorough mind, capable of observing, collecting and evaluating facts.	Is governed by **compliance with generally accepted accounting principles, audit procedures** and disclosure requirements.
8. **Appointing Agency**	Even **third party can appoint Investigator**	Auditor is **appointed by owner/ shareholders** of company/ enterprise
9. **Reporting**	The outcome is **reported to the person(s) on whose behalf** investigation is carried out	**The outcome is reported to the owners** of the business entity.

STEPS INVOLVED IN INVESTIGATION

STEP 1: DETERMINATION OF OBJECTIVES AND ESTABLISHMENT OF SCOPE OF INVESTIGATION:

At the stage of acceptance of the assignment, it **would be proper for the investigator to have the matters discussed** and obtain clearly written **instructions covering the object, the scope and purpose of investigations** and the issues incidental thereto.

The **period to be covered under investigation should be clearly specified**.

STEP 2: FORMULATION OF THE INVESTIGATION PROGRAMME:

It is **not possible to draw up one programme to serve different types of investigations** The investigation programme should be drawn up having regard to:

a. The **nature of the business**
b. The **structure of business organization**
c. The instructions from the client embodying **the objectives and scope of work**
d. The **consequent scope and depth of investigation**
e. The **necessity to extend the investigation** into books and records belonging to others.
f. The **investigator should concentrate on areas considered relevant** rather than to undertake a wide-ranging verification.

The **programme should also be flexible** so that knowledge gained with the progress of work can be used.

STEP 3: COLLECTION OF EVIDENCE:

1. **INQUIRY OF CLIENT:** In the course of examination of the documents and records, the investigator may **require to obtain oral explanations from various person**nel of the concerned business.
2. **CLIENT AUTHORISATIONS – 3RD PARTIES:** In case his client is a person external to the business, it may be **necessary for the investigator to get the matter formally** agreed to by the business through the client.
3. The investigator should **look for the most convincing evidence**; he should seek and **examine all the available evidence and by a process of elimination and corroboration**. The investigating accountant can take help of external experts/ persons like, related parties outside the organization, valuation experts etc. to obtain specific evidence.
4. The work of investigating accountant should ensure that **the process of obtaining evidence does not interfere with the regular work** of client.

STEP 4: ANALYSIS AND INTERPRETATION OF FINDINGS:

Careful analysis and correlation of facts and figures will be necessary before the investigator can reach his conclusion. The conclusion should be **well reasoned, backed by established facts and evidenced by proper records/ data**. He **should not draw conclusions according to pre-conceived notions**. While interpreting the figures, the investigator must keep in mind various factors e.g., the political and economic considerations, competition faced by the business, etc. **The interpretation should be brief, clear and free from doubts.**

STEP 5: REPORTING OF FINDINGS:

An investigation results in a report. It is submitted and addressed to the party at whose instance the investigation has been carried out. The **nature of the report is governed mainly by two factors** –

a. The **instructions given by the client** as regards the special aspects of the business which are required to be investigated;
b. The **findings of the investigating accountant/ investigator**.

The important issues to be kept in mind while preparing his report are as follows:

a. The report **should not contain anything which is not relevant**.
b. **Every word or expression used should be properly considered** so that the possibility of arriving at a different meaning or interpretation can be minimized.
c. Relevant facts and conclusions should be properly **linked with evidence**.
d. **Bases and assumptions made should be explicitly stated**. Care should be taken to see that none of the bases and assumptions can be considered to be in conflict with the objective of the investigation.
e. The report should **clearly spell out the nature and objective** of the assignment accepted its scope and limitations, if any.
f. The **report should also state restrictions or limitations**, if any, imposed on the instructions given by the client. Preferably the **reasons for placing such restrictions and their impact** on the final result should also be stated.
g. The **opinion of the investigator should appear in the final paragraph of the report**.

SPECIAL ISSUES IN INVESTIGATION

Investigations broadly **range between two extremes**:

1. In respect of **which complete accounts, documents, records** and other information **are available**, and
2. in respect of which **little information, besides published accounts and statistical data, is available**.

Some more issues often arise in investigation. They are stated below:

A. WHETHER AN INVESTIGATOR IS REQUIRED TO UNDERTAKE A 100% VERIFICATION APPROACH OR WHETHER HE CAN ADOPT SELECTIVE VERIFICATION:

1. The answer to this question depends on the **exact circumstances of the case** under investigation.
   a. If the investigator has to establish the amount of cash **defalcated by the cashier**, he has probably **no option but to carefully examine ALL the cash vouchers and related records**.
   b. if he is to **arrive at the profitability of a concern**, he may verify constituent transactions on a selective basis taking extreme care to see that **no material transaction that affects profit has remained concealed** from his eyes.
2. In investigation, it is always **safer to go by statistically recognised sampling methods** than to depend on the so-called "test checks" where circumstances permit selective verification.

B. WHETHER THE INVESTIGATOR CAN PUT RELIANCE ON THE ALREADY AUDITED STATEMENT OF ACCOUNT:

1. If the **investigation has been launched because of some doubt in the audited statement of account**, **no question of reliance on the audited statement of account arises**.
2. However, if the **investigator has been requested to establish value of a business** or a share or the amount of goodwill payable by an incoming partner, ordinarily the **investigator would be entitled to put reliance on audited materials** made available to him unless, in the course of his test verification, **he finds the audit to have been carried on very casually or unless his terms of appointment clearly require to test everything afresh**.
3. It is, therefore, desirable for the investigator to ascertain from the client, **in advance, in writing**, whether the audited statements of **account produced to him should be taken as correct**.
4. If the statements of account produced before the investigator were **not audited by a qualified accountant**, then of course **there arises a natural duty to get the figures in the accounts properly checked and verified**.
5. Nevertheless, it would be prudent to see first that such accounts were prepared **with objectivity and that no bias has crept in to give advantage to the person on whose behalf these were prepared**.

C. WHETHER AN INVESTIGATOR NECESSARILY REQUIRES ASSISTANCE OF EXPERT:

Often an investigator may feel the necessity of obtaining views and opinions of experts in various fields to properly conduct the investigation. It would be therefore, proper for the investigator to get the **written general consent of his client, to refer special matters for views of different experts at the beginning of investigation** and he should settle the question of costs for obtaining the views and other related implications.

D. INVESTIGATION OUT OF DISPUTES AND CONFLICTING CLAIMS:

1. The **investigator should remain above disputes or conflicting claims** and **be alert to the possibilities of the information or documents made available to him to be prejudiced**.
2. Even the client, openly or indirectly, **may try to influence his reports**.
3. The **investigator should keep him without compromise and being professional** and should keep the interest of all the involved parties in view.

E. BASIS OF OPINION OF AN INVESTOR:

The investigator should **confine his opinion to the established facts and nothing more**. If the facts, as conveyed through the books, records, papers and other evidence, **are not capable of being properly established, he should not express an opinion** or, if at all he expresses any opinion, he should **qualify the opinion by clearly stating the reasons**. This problem may particularly arise in **cases where incomplete books and records are produced for investigation** **where Significant assumptions are used.**

F. WHETHER AN INVESTIGATOR CAN MAKE FUTURISTIC STATEMENTS:

Even if the **appointing authority is willing to obtain a futuristic** statement, **the investigator should refuse to be futuristic**. He may assume that the established trend in the business will continue in the near future, in the **absence of any contrary evidence**, in arriving at the present value of a business. He, however, **should not project the trend into any future years** to establish a value.

G. WHETHER TO RETAIN WORKING PAPERS OR NOT:

The investigator should **retain in his files full notes of the work carried out**, copies of schedules and all working papers, annexures, facts, figures, record of conversations and the like. The **working papers should link up the figures as shown by the books of business** with the final figures produced by the investigating accountant. Wherever required the investigator should **take representation letter from the appointing authority.** In the absence thereof, he would not be able to explain the figures; for quite often **the conclusions of the accountant are challenged by parties whose interest is adversely affected** by his findings.

SPECIAL ASPECTS IN CONNECTION WITH BUSINESS INVESTIGATIONS

We discuss below the factors to be considered by a professional accountant while carrying out the **investigation for attaining satisfactory results**:

A. STUDYING THE OVERALL PICTURE:

1. **OVERALL PICTURE:** In a business investigation, it is of utmost importance first to have **an overall picture of the position of the business**. This is because figures are only symbols; and it is **impossible to interpret them intelligently without knowledge of the background** in which they have emerged.

2. **PRODUCT LINES:** Further, it is important to know whether the **business is engaged in the manufacture of one or two important lines of products**, is principally processing materials or is concerned only with the sale of a single product.

3. **LOCAL OR IMPORTED:** Also, whether **it is a business which depends for its success on imported raw materials** or supply of parts and components from ancillary businesses or uses indigenous materials and parts which are manufactured locally.

4. **DISTRIBUTION CHANNEL:** The **method of distribution of products**, either through wholesalers or retailers also must be examined.

5. **POLITICAL AND ECONOMIC FACTORS:** political or economic factors also may affect the fortunes of a business like changes in government policies etc. Apart from these preliminary enquiries, the investigating accountant should study:
   a. the **character of management**
   b. the **economic and political forces** to which the business is subject; and
   c. the **position it enjoys in the market** as against its competitors.

6. It is, therefore **necessary that the impact of all these factors should be studied** and **their effect on the business** judged on a consideration of the profits in the past.

7. For **studying the economic and financial position** of the business, the following should be considered:
    a. The adequacy or otherwise of **fixed and working capital**. Are these sufficient for the growth of the business?
    b. What will be the **trend of the sales and profits** in the future?
    c. Whether the **profit which the business could be expected to maintain** in the **future would yield an adequate return** on the capital employed?
    d. Whether the business is **operating at its 100 percent capacity or improvements can be made** to reach at full productivity?

B. STATEMENT OF PROFIT AND LOSS:

1. **MULTIPLE YEARS DATA:** To study the Statement of Profit and Loss of a concern, it is necessary **to consider each item, included therein, in relation to the corresponding items** in the previous years. It is therefore, necessary that a summary, should be prepared of the balances included in the **Statement of Profit and Loss of the business for a period of 5 to 7 years.**

2. **INVENTORY VALUATION:** It should also be verified that the **inventories have been valued on a consistent basis throughout the period** under review. If **there has been a change**, the values of **inventories should be adjusted**.

3. In the preparation of the summary attention should also be paid to the following matters:

    a. **TURNOVER – PRODUCT WISE:** The figures of sales should be broken down between the **various products sold to show variations in turnover of individual products from year to year.** In this way, it would be possible to find out the products the sales of which have been increasing and those the sales of which have been falling. [SEGMENT WISE]

    b. **EXPENSES – PRODUCT WISE:** If the business consists of **activities which are dissimilar in operation**, like manufacturing and agency, then apart from splitting the income between the two sources, **expenses should also be apportioned between them to separately** arrive at the figures of profit from each of the activities.

c. **KEY CUSTOMER ANALYSIS:** By reference to the list of customers, in the Order Books, it should be ascertained whether the **business has a very large turnover with a few customers or vice versa**.

d. **FICTICIOUS SALES:** The Order Books should also be examined to find out if **fictitious sales have been entered in any year to boost up profits**. If so, the figures of sales of the year or years should be adjusted.

e. **WAGE STRUCTURE:** The **method of computing wages and the rates of wages should be examined**. On occasions a business may have to pay higher wages than those prevailing in other business in the same neighbourhood in pursuance of an industrial award. Another factor which is important to consider in this connection is the **relationship of the business with its workers/ labour unions.**

   A business which has suffered several industrial disputes, strikes, etc. and has had its working interrupted by them frequently cannot be expected to prosper.

f. **DEPRECIATION AND MAINTENANCE:** The charge on account of **depreciation and maintenance of machinery and other assets** included in the accounts of different years should be compared to verify that depreciation has been provided from **year to year on a consistent basis and that it is adequate**. Also, the **necessary adjustment in the depreciation charge** should be made if it is the practice of the company to write off the assets on a renewal basis.

g. **REVALUATION:** Further, if assets have been revalued, it should be **confirmed that depreciation on the increased valuation has been adjusted**. Generally, with age, the cost of maintenance of assets should increase. If it has not, the reason thereof should be ascertained.

h. **LEASES:** In case of leasehold property, it should be ascertained **whether an adequate provision has been made for the dilapidation** charge which may be payable at the end of the lease. Further, compliance of relevant AS should also be verified.

i. **MANAGERIAL REMUNERATION** - It should be verified that the **remuneration payable to various members of managerial personnel is not excessive in relation to the profits** of the business after taking into account the time devoted by each of them. In case of company, **requirement of relevant section of Companies Act, 2013 is to be seen.** It has to be assured that **calculation of profit** for arriving at the remuneration is correct.

j. **EXCEPTIONAL AND NON-RECURRING ITEMS**: It is **customary to adjust exceptional items in the summary of Statement of Profit and Loss** in order that they may not obscure the trend of the profits. In the matter of non-recurring items, adjustments are to be made items which do not recur from year to year or can be considered exceptional having regard to their materiality or periodicity.

k. **INCOME TAX DISPUTES:** In this connection, it is worthwhile to **examine the income tax assessment orders of the business to find out the items** which have been treated as revenue but have been considered inadmissible by the taxing authority. Where the **effect of these has been abnormal on the tax paid** by the company from year to year, suitable adjustments should be made in the figures of taxes paid, as well as in the asset's amounts.

l. **REPAIRS AND MAINTENANCE:** It is one of the recurring expenses of a business. Occasionally it is **noticed that this expenditure is unduly heavy in some of the years**, while quite low in some others. Generally, companies, as a matter of routine undertake major repairs, **overhauls and maintenance programme at an interval of 3 or 4 years** while running repairs and maintenance continue in the usual manner which gives rise to fluctuating charges in the accounts.

m. **CAPITAL AND REVENUE:** Due to **wrong allocation of expenses between capital and revenue, repair charges may appear to be heavy or low**. If fluctuating and abnormal charges for repairs is noticed, it **would be the duty of the investigating accountant to scrutinise this head** thoroughly to establish correct and normal charge for repairs.

n. **UNUSUAL YEAR: A company's record of profitability may show a trend of increasing or decreasing profit or loss** or it may be highly erratic and fluctuating. Where a **definite trend is discernible**, he can adopt recent years' record of profitability as the basis for estimating future maintainable profit having regard to the inflationary state in the economy. But if **the same is fluctuating**, there would be **more demand on judgement of the accountant in** selecting the period to be covered for estimation of profitability. In such cases it may even be necessary to take into consideration results of **past 9 to 10 years with a view to iron out the fluctuation**.

C. BALANCE SHEET:

a. **FIXED ASSETS:** Fixed assets, usually, are **shown in accounts at cost less depreciation** but the accounts **do not show the ages of different assets.** It is desirable, therefore, to obtain **age analysis of various items of fixed assets.** **Assets which are old or are obsolete would naturally have to be replaced**. It should be seen that their values are not in excess of the value of service that they could be expected to render to the business during the balance period of their active life and the amount they would fetch on sale as scrap. **Title deeds should be verified to ascertain the extent of enterprise's ownership** in such assets, like land and building jointly owned by two or more companies or their subsidiaries.

   Further, investigator has to assure whether assets whose **recoverable amount is less than carrying amount are impaired and requirement of AS 28, "Impairment of Asset"**, has been complied.

b. **INVESTMENTS:** Investments should be broadly classified into long term investments and current investments. **A current investment is by its nature readily realisable** and is intended to be held for **not more than one year**. All other investments are long term investments. Current investments are valued on the basis of **lower of cost and fair value determined either on an individual investment basis or by category of investment but not on an overall basis**. **Long-term investments are usually carried at cost**. However, when there is a **permanent decline in the value of long-term investments**, the carrying amount **should be reduced to recognise the decline**. The carrying amount of long-term investments is **determined on an individual investment basis**. Interest, dividends and rentals **receivable in connection with investment are generally regarded as income**. However, in some cases, such receipts represent recovery of cost and should therefore be reduced from, the cost of investment (e.g., dividend out of pre-acquisition profits).

c. **INVENTORIES:** It should be seen that **inventories have been valued consistently and that the basis of valuation** was such that the value placed on inventories **did not include any element of profit.** Also, there should be **due allowance for damaged, obsolete and slow-moving inventories.** In some cases, **physical verification of inventories is necessary** where the inventories belonging to the entity **are held by other parties**. Examine the **appropriateness of valuation of work in progress** as disclosed in the books.

d. **TRADE RECEIVABLES** - In assessing their value, the following should be taken into account:
   i. Whether **provision for bad debts have been made in the years** in which the relevant sales took place **instead of in the year in which they have been written off,** except when debts have had to be written off on account of a slump or a fall in international prices, during a period subsequent to the period in which sales had taken place.
   ii. The length of the **credit period allowed or any excessive discounts allowed** throughout the period under investigation, to determine whether it has been necessary to increase the credit period in order to affect the sales. If it has been so, it would **indicate that the demand** for the goods manufactured has been diminishing gradually.
   iii. **Debts should be classified according to their age**. This would disclose the character of the parties with whom the company trades and the amount of working capital that will be necessarily blocked on this account in the course of business. Determine Debtors to Sales Ratio.

e. **OTHER LIQUID ASSETS:** It should be ascertained that the assets so **described are readily realisable**.

f. **IDLE ASSETS:** On a scrutiny, it may appear that **certain assets are remaining idle and are not being properly applied** in the business. These may come from all sections of assets.
   For example, certain plant and machinery may have been put to use after a long period of time after acquisition.

g. **LIABILITIES:** To be checked **whether liabilities are stated fully or understated or overstated.** In other words, whether the **profits of the business have been inflated by suppression of liabilities or there are any free reserves included** in the liabilities. In either case, an adjustment would be necessary. Secondly, it **should be**

ascertained that liabilities are not unduly large or are not outstanding for a long time, in such cases, it would be necessary to pay off some of them which would cause a drain on the liquid resources of the concern. The fact should be stated in the report.

h. **TAXATION:** Orders in respect of **assessments completed should be studied** and it should be verified that an **adequate provision has been made in respect of liabilities for taxes** which have not been assessed. Also, it should be seen that in the past there has been no reopening of assessments. If so, the **company may be liable for an undisclosed sum of taxes plus penalties**. Any temporary tax benefit should also be disregarded.

i. **CAPITAL:** In this regard, it is necessary to ascertain:

Whether the **capital is well balanced**. **Low equity capital would handicap the company** in raising further equity capital, on favourable terms for financing the business or to pay off capital commitment. Further, when **the capital is highly geared**, it would **affect the value of the equity capital**;

The **amount of capital is reasonable compared to the value of fixed assets and the amount of working capital required**.

D. INTERPRETATION OF FIGURES:

a. **FIXED ASSETS:** For the continuation of the business, in its existing stage, it should be assessed having regard to the under-mentioned factors:

1. The amount **required for the replacement of assets** when these would become worn out or obsolete;
2. The expenditure **which will be necessary to replace obsolete machinery by more sophisticated machinery** for manufacturing different types of goods for which there is demand.

b. **TURNOVER:** In assessing the turnover the following factors should be taken into account:

1. **Trend:** Whether in the **past sales trends** have been increasing consistently or they have been fluctuating.
2. **Marketability:** Is it **possible to extend the sales** into new markets or that these have been fully exploited? Product wise estimation should be made.
3. **Political and economic considerations:** Are the **policies pursued by the Government likely to promote the extension** of the

market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?

4. **Competition:** What is the **likely effect on the business if other manufacturers** enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing?

c. WORKING CAPITAL: In making assessment of the working capital requirements in the future, the following matters should be taken into account:

1. Has the **ratio of inventory to turnover been increasing** and if so, is it a continuing or only a temporary trend?
2. Are the **trade payables being paid promptly** or is there a backlog which will have to be dealt with?
3. What will be the **effect on inventory, trade receivables and trade payables,** if the turnover is increased or if new products are introduced?

d. ESTIMATING FUTURE MAINTAINABLE PROFITS: Fluctuations in profits during the years under review should be examined **after adjusting the profits for extraneous factors**. If the percentage of profits before taxation to capital has been stable or has been increasing, it would indicate that the business would continue to earn the same rate of profit as it has done in the past. If, on the other hand, the percentage has been falling, and there is no evidence that the factors responsible therefore have ceased to operate, **investment of further capital in the business would not be commercially advisable**.

DIFFERENT TYPES OF INVESTIGATION

Types of Investigation

- **Statutory**
  - Investigation into the affairs of the company
    - By inspector through an order of the central Government (section n 210)
    - By Serious Fraud Investigation office (section n 212)
    - Other Cases (section n 213)
  - Investigation of ownership of company (Sec 216)
- **Non-Statutory**
  - Investigation on behalf of an incoming partner
  - Investigation for valuation of shares in private company
  - Investigation on behalf of a bank / financial institution proposing to advance a loan to a company
  - Investigation in connection with review of profit / financial forecast
  - Investigation of Frauds
  - Investigation on behalf of an individual or a firm proposing to buy a business

INVESTIGATION INTO AFAIRS OF THE COMPANY UNDER COMPANIES ACT,2013

This may further be divided into **three parts**:

1. Investigation into the affairs of a company **by inspector through an order of the Central Government** as envisaged under Section 210.
2. Investigation into the affairs of a company **by Serious Fraud Investigation Office** as prescribed under Section 212.
3. Investigation into the **affairs of a company in other cases** as provided under Section 213.

A. INVESTIGATION INTO THE AFFAIRS OF A COMPANY AS ENVISAGED UNDER SECTION 210:

WHEN:
Where the **Central Government** is of the opinion, that it **is necessary to investigate into the affairs of a company**-

1. On the **receipt of a report of the Registrar or inspector**;
2. On intimation of a **special resolution passed by a company** that the affairs of the company ought to be investigated; or
3. In **public interest**,

It **may order an investigation** into the affairs of the company.

NOTE: **where an order is passed by a court; or the Tribunal requiring investigation**, the Central **Government shall order an investigation** into the affairs of that company.

WHO: The Central Government **would appoint one or more persons as inspectors** to investigate into the affairs of the company and to report thereon in such manner as the Central Government may direct.

B. INVESTIGATION INTO THE AFFAIRS OF A COMPANY BY SERIOUS FRAUD INVESTIGATION OFFICE [SFIO] UNDER SECTION 212:

WHO: The Central Government may, by an order, assign the investigation, into the affairs of the company, to the **Serious Fraud Investigation Office**, when it considers necessary to investigate into the affairs of the company:

1. **on receipt of a report of the Registrar** or inspector; or
2. **on intimation of a special resolution** passed by a company; or
3. In **public interest**; or
4. **on request from the Department** of the Central Government, or a State Government.

NOTE: Where the Central Government assign any case to the Serious Fraud Investigation Office for investigation under this Act, **NO other investigating agency of Central Government or any State Government shall proceed with investigation** in such case.

REPORT BY SFIO:

1. The **SFIO shall follow the manner and procedure as provided and submit its report** to the Central Government. The Central Government **may also direct to submit an interim report**.

2. Where the **report states that fraud has taken place** in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, **has taken undue advantage or benefit**, whether in the form of any asset, property or cash or in any other manner, **the Central Government may file an application before the Tribunal** for appropriate orders with regard to **disgorgement of such asset, property or cash and also for holding such** director, key managerial personnel, other officer or any other person **liable personally without any limitation of liability.**

C. INVESTIGATION INTO THE AFFAIRS OF A COMPANY IN OTHER CASES AS PROVIDED UNDER SECTION 213:

WHO: The **Tribunal may order investigation** into affairs of the company:

1. on an **application received by specified number of members** and **supported by such evidence or**
2. on an application made to it **by any other person or otherwise,**

WHEN: If it is **satisfied that** there are circumstances like:

1. the business of the company is being conducted with **intent to defraud its creditors, or**
2. that **the company was formed for any fraudulent or unlawful purpose, or**
3. the **members of the company have not been given all the information** with respect to its affairs, which they might reasonably expect, etc.

The investigation may be ordered, after giving a reasonable opportunity of being heard to the parties concerned.

INVESTIGATION PROVED: It may be noted that if after investigation it is proved that The business of the company is being **conducted with intent to defraud** its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose, or that the company was formed for **any fraudulent or unlawful purpose**; or Any person concerned in the formation of the company or the management of its affairs have in **connection therewith been guilty of fraud, misfeasance or other misconduct**, then, **every officer of the company who is in default** and the person or persons **concerned in the formation of the company or the management** of its affairs **SHALL BE PUNISHABLE FOR FRAUD**.

WHO CAN BE APPOINTED AS AN INSPECTOR: A firm, body corporate or other association cannot be appointed as an inspector. **Only an individual accountant can be appointed as investigators.**

POWER OF INSPECTOR TO CONDUCT INVESTIGATION [SECTION 219]:

An inspector appointed under section 210 or section 212 or section 213 to investigate into the affairs of a company may also investigate, subject to approval of the Central Government, into the affairs of—

1. Any other body corporate which is, or has at any **relevant time been the company's subsidiary company or holding company**, **or a subsidiary company of its holding company;** ***[I.e., Related party companies]***
2. Any other body corporate which is, or has at any relevant time **been managed by any person as managing director or as manager**, who is, or was, at the relevant time, **the managing director or the manager of the company;** ***[Entities with common Management]***
3. Any other body corporate **whose Board of Directors comprises nominees of the company or is accustomed to act** in accordance **with the directions or instructions of the company or any of its directors**; or
4. Any person who is or has at any relevant time been the **company's managing director or manager or employee**.

It may be noted that **he shall**, subject to the **prior approval of the Central Government**, **investigate** into and REPORT ON the affairs of the other body corporate or of the managing director or manager, in so far as he **considers that the results of his investigation are relevant to the investigation of the affairs of the company for which he is appointed**.

OBJECTIVE OF INVESTIGATION:

1. The objective of these investigations, is to **determine whether any provision of the Act has been violated or there has been a breach of duty on the part of a director or an officer** of the company **resulting in a loss to shareholders or a class of them**.

2. The term "affairs of a company" was considered in **R.V. Board of Trade Ex. parte St. Martin Preserving Company Ltd.** It was held that it can **cover investigations into all aspects of its business**;

PROCEDURE, POWERS ETC. OF INSPECTORS [Section 217]:

The procedures, powers of the Inspectors as follows:

1. **Duty of officers and employees of the company towards inspector:** It shall be the duty of all officers and other employees and agents **including the former officers, employees and agents** of a company which is under investigation in accordance with the provisions, and **where the affairs of any other body corporate or a person are investigated** under section 219, of all officers and other employees and agents including former officers, employees and agents of such body corporate or a person:
   a. to **preserve and to produce to an inspector** or any person authorised by him in this behalf **all books and papers of, or relating to, the company** or, as the case may be, relating to the other body corporate or the person, which are in their custody or power; and
   b. to **give to the inspector all assistance in connection** with the investigation which they are reasonably able to give.

2. **Inspector may ask information from any body corporate:** The inspector may require any body corporate, other than a body corporate referred to in point (1), **to furnish such information to, or produce such books and papers before him or any person authorised by him** in this behalf as he may consider necessary, If the furnishing of such information or the production of such books and papers is relevant or necessary for the purpose of his investigation.

3. **Not to keep Books and Papers in custody for more than 180 days:** The **inspector shall not keep in his custody any books and papers produced under sub-section (1) or sub-section (2), for more than 180 days and return the same** to the company, body corporate, firm or individual by whom, or on whose behalf the books and papers were produced. The inspector **may call the books and papers again, if needed, for a further period of 180 days by an order in writing**.

4. **Examine on oath:** The inspector **may examine on oath any of the persons referred in (1) above**; **and with the prior approval of the Central Government,** any other person in relation to the affairs of the company, or other body corporate or person, as the case may be and for that purpose, **may require any of the persons to appear before him personally.**

5. **Inspector to possess all the Powers of Civil Court:** The inspector, being an officer of the Central Government, making an investigation shall **have all the powers as are vested in a civil court under the Code of Civil Procedure**, while trying a suit in respect of specified matters.

6. **Assistance by Officers of Government to Inspector: The officers of the Central Government, State Government, police or statutory authority shall provide necessary assistance to the inspector** for the purpose of inspection, investigation etc.

7. **Evidence from place outside India:** If in the course of an investigation into the affairs of the company, **an application is made to the competent court in India by the inspector stating that evidence may be available in a country or place outside India**, **such court may issue a letter of request to a court or an authority in such country or place for seeking such evidence.**

8. **Punishment for non-compliance of order of Inspector: If any director or officer disobeys the direction issued by the inspector,** or any officer fails without any reasonable cause or refuses to furnish any information or, appear before the inspector personally; **the director or the officer shall be punishable with imprisonment and with fine**.

INSPECTOR'S REPORT [Section 223]:

1. An inspector shall, directed by the Central Government, **submit interim reports to that Government, and on the conclusion of the investigation, shall submit a final report** to the Central Government.
2. Every report made **shall be in writing or printed as directed by the Central Government**.
3. A **copy of the report may be obtained by members, creditors or any other person** whose interest is likely to be affected by making an application to the Central Government.
4. The report of any inspector **shall be authenticated either by the seal of the company** whose affairs have been investigated, or by a certificate of a public officer having custody of the report, and **such report shall be admissible in any legal proceeding as evidence** in relation to any matter contained in the report.

NOTE: Section 224 of the Companies Act, 2013, deal with follow-up of the inspector's report and gives power to the central government to launch prosecution; **apply for winding up of the company etc.**

GENERAL APPROACH FOR INVESTIGATION:

1. The general approach for investigation under Sections 210, 212 and 213 of the Companies Act, 2013 is **conditioned by the legal requirements in these regards.**
2. The **affairs of the company may include everything** such as goodwill, profit and loss, contracts, investments, assets, shareholding in subsidiaries, decision making, etc. Also, the specific circumstances mentioned in these sections like fraud, mismanagement, oppression of minority shareholder etc. come within the term "affairs of the company."
3. Investigation under Sections 210 and 213 **do not call for any special approach.**
4. Approach/Steps for pursuing the investigation are:

   a. **Clarity of Terms of Reference:**
   The approach to any investigation is determined on a **consideration of the nature of the investigation and the terms of reference**. The inspector should **ensure that the terms of reference are clear, unambiguous and in writing**. If he has any doubt about any item in the terms, he **should obtain clarification in writing**. It should also be, seen that the **terms of reference are not too general**, **the scope of the investigation will become purposeless and ill defined**. An investigation order to investigate into the affairs of the company **would be an instance at point. Therefore, the inspector should ask for reframing of the order specifying the exact matters** to be investigated. He should also take into consideration the **possible effect of limitations**, put in the terms of reference and **should keep the Central Government informed in writing** about their effect on the investigation.

   b. **Scope of Investigation:** At this stage, it may be useful for the inspector to go into the history of the company and its affiliates or associates. He should **evaluate the terms of reference in sketching the scope of investigation**; this will enable him to locate the limitation, in the terms of reference, if not clearly mentioned. For a purposeful investigation, **he may need to stretch his inquiry into the books and records of allied and associated persons** and concerns and may require to arm himself with the powers given under the Companies Act.

   c. **Period for investigation:** He should also have **regard to the period over which the investigation can stretch**. The evaluation of terms of reference and the consequential determination of the scope of investigation are the twin props on which the entire investigation would rest.

d. **Framing of Programme:** The next step is the investigator/inspector **should frame his programme for investigation in a systematic manner**. He should keep adequate working notes and papers with references and cross references in a proper and methodical way to aid him in the preparation of the report. The **actual process of investigation would be essentially an evidence gathering procedure** He should also keep his mind open to the revelations he comes across in the process of evidence collection and should assess whether the **programme of investigation needs amendment or modification**.

e. **Using the work of Experts:** He should also consider **whether assistance of other experts** like engineers, lawyers, etc., is necessary in the interest of a **comprehensive and full proof examination of the documents and information**.

f. **Legal requirements and investigation Report:** Only after he has completed the steps in the investigation programme and has **obtained and concluded all the information** that he needed should he prepare his report. He, can also make interim report wherever required. The **findings should be completed and exhaustive**. Before he makes his final report, he should **obtain and keep on record the evidences relied upon by him**. Such **evidence should be as conclusive as possible** depending on circumstances of the case. He **should make his report in accordance with the provisions of the section 223** of the Companies Act, 2013. He should ensure that the report prepared by him is **fair and unbiased**.

g. The general approach for investigations under Sections 210 and 213 should, **be formulated having regard to the terms of reference, scope, the period, the programme and procedure** of the investigation and the attending legal requirements specified above.

INVESTIGATION OF OWNERSHIP OF THE COMPANY [SEC. 216]

WHEN:

According to Section 216 of the Companies Act, 2013, where it appears to the **Central Government that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons**,

a. who **are or have been financially interested in the success or failure**, whether real or apparent, of the company; or
b. who are or have been **able to control or to materially influence the policy** of the company; or
c. who have or had **beneficial interest in shares of a company or who are or have been beneficial owners or significant beneficial owner** of a company.

In case, if the **Tribunal, in the course of any proceeding before it, directs by an order that the affairs of the company ought to be investigated** as regards the membership of the company, **the Central Government shall appoint one or more inspectors.**

SCOPE AND EXTENT OF INVESTIGATION:

1. While appointing an inspector, the Central Government may **define the scope of the investigation as respects the matters or the period to which it is to extend**. It may limit the investigation to matters connected with particular shares or debentures. **Powers of inspectors shall extend to the investigation of any circumstances** suggesting the existence of any arrangement or understanding.

2. When a **chartered accountant is appointed to carry out an investigation** under any of the aforementioned provisions, the extent of enquiry, the objective of the investigation and the various matters referred to for investigation are **specified in the order of investigation issued by the appointing authority**.

3. On a consideration thereof, the **investigating accountant should determine the areas of accounts which require investigation** and the extent to which the enquiry is to be made as well as his general approach to the enquiry.

4. In case of a **company having subsidiaries or where one or more directors are interested in one or more concerns**, **all the dealings with these concerns should be examined** for these may have been entered into with the intention of transferring profit

5. Any **breach of duty or abdication of responsibility** for purposes of investigation would be **material only if it has resulted in a loss to the company**.

6. **Negligence would be blameable only if it was in relation to a duty cast by the Act,** Articles of Association or by a resolution of the shareholders or that of the Board of Directors.

7. Any **negligence in the discharge of duty of a director or any other managerial personnel must be construed very broadly**, for apart from being the agents of the company, **they are trustees of its property**. It is **their duty to safeguard the property of the company and protect the interest of the shareholders**. **As long as the decisions of the Board at which the director was present were taken on a proper consideration of the evidence available and in the best interest of the company, he would not be responsible for any losses suffered by the company.**

8. It may be **necessary for an investigator to interrogate directors**, officers, agents, and others concerned with matters under his enquiry. **Before drawing up his brief in this regard as well as for framing his conclusions**, he should, if necessary, take legal assistance.

9. If the Investigating accountant is **required to report on the efficiency of the management**, he should be very careful in expressing his opinion. Usually, it is **sufficient if he merely indicates the general limitations of the management**. **The inspector must ensure that the persons who figure in the investigation get the fullest opportunity to explain their action and conduct**. **The inspector cannot hold out any assurance to anybody except the assurance of fairness is required in the job**.

INVESTIGATION ON BEHALF OF INCOMING PARTNER

An incoming partner would be interested to know whether the terms offered to him are reasonable having regard to the nature of the business, profit records, capital contribution, personal capability of the existing partners, socio-economic setting, etc., and **whether he would be capable of deriving continuing benefit by the way of return on capital to be**

contributed and remuneration for services to be rendered, **which can be justified by the overall economic conditions** prevailing and other considerations considering his own personality and achievements.

Broadly, the steps involved are the following:

1. **HISTORY:** Ascertainment of the **history of the inception and growth** of the firm.

2. **DEED:** Study of the provisions of **the deed of partnership, particularly for composition of partners**, their capital contribution, drawing rights, retirement benefits, job allocation, financial management, goodwill, etc.

3. **PROFITABILITY:** Scrutiny of the **record of profitability of the firm's business** over a suitable number of years, with **usual adjustments that are necessary in ascertaining the true record of business profits**. Particular attention on the nature of partners' remuneration, which may be excessive or inadequate in relation to the nature and profitability of the business, qualification and expertise of the partners and such other factors.

4. **ASSETS AND LIABILITIES:** Examination of **the asset and liability position to determine the tangible asset backing for the partner's investment**, appraisal of the value of intangibles like goodwill, know how, patents, etc. impending liabilities including contingent liabilities and those pending for tax assessment.

5. **CUSTOMERS AND CLIENTS: Position of orders at hand and the range and quality of clients** should be thoroughly examined, which the firm is presently operating.

6. **LOANS AND ADVANCES: Position and terms of loan finance** would call for a scrutiny to assess its **usefulness and implication for the overall financial position**; reason for its absence or negative impact should be studied.

7. **COMPOSITION OF EMPLOYEES:** It would be interesting to study the **composition and quality of key personnel employed** by the firm and any likelihood of their leaving the organisation in the near future.

8. **LEGAL OBLIGATIONS: Important contractual and legal obligations should be ascertained** and their nature studied. It may be the case that the firm has standing agreement with the employees as regards salary and wages, bonus, gratuity and other incidental benefits.

9. **REASONS FOR NEW ADMISSION OF PARTNER:** **Reasons for the offer of admission to a new partner should be ascertained and it should be determined whether the same synchronises with the retirement of any senior partner** whose association may have had considerable bearing on the firm's success.

10. **RETURN ON CAPITAL:** **Appraisal of the record of capital employed and the rate of return.** It is necessary to have a **comparison with alternative business avenues for investments and evaluation** of possible results on a changed capital and organisation structure, if any, envisaged along with the admission of the partner.

11. **FIRMS SPECIALISATION:** It would be useful to **have a first-hand knowledge about the specialisation,** if any, attained by the firm in any of its activities.

12. **GOODWILL COMPUTATION:** **Manner of computation of goodwill on admission as also on retirement.**

INVESTIGATION FOR VALUATION OF SHARES IN A PVT. COY

The necessity for valuation of shares of a private company arises, for under the Companies Act, a private company **must restrict the transfer of its shares**. In consequence, the shares of a private company **do not have a free market in which their prices** could be determined by interaction of the forces of supply and demand.

EQUITY SHARES: **There are two main methods of valuation**.

First Method, value is determined **on the basis of net worth of the company.** The amount of **net worth is divided by the number of shares comprising the equity capital to arrive at the value for one share**. When this method is followed, goodwill of the business, and non-trading assets (like investments) based on the estimated future maintainable profit, is included among the assets to arrive at the amount of net worth.

Second method, the **average profit earned by the business during the preceding 5 to 7 years is computed**. Afterwards, on the assumption that the same would continue to be earned in the future, **the value of business is calculated by capitalising it at a reasonable rate of interest**. If the rate assumed is high, the value of the business would be smaller. Correspondingly, it would be high if the rate of interest applied is low.

The **rate of return that an investor expects to earn in a business** of the type in which the company is engaged, is **ascertained from the prices of the shares of companies engaged in a similar business** quoted on the stock exchange.

PREFERENCE SHARES: The value of preference shares is estimated **on the basis of the yield on preference shares of companies engaged in a similar trade or industry** after making allowance for factors like restriction on transferability, average rate of earnings as compared to the rate of dividend, etc.

SPECIAL FEATURES:

Net worth basis:

Each asset should be **revalued on taking into account its utility to the business as a going concern**.

The **assets should be revalued at their replacement cost** i.e., **the cost of similar assets at the prevailing market price, reduced by the amount of depreciation which they would have suffered**, if they were in use during the period that the corresponding assets have been in use. But the cost adopted, in cash, should be the cost of the assets as were originally purchased or that of their substitutes considered more suitable in the circumstances of the case.

The **value of goodwill of a business is primarily dependent on its capacity to earn super-profit** and the period over which these are expected to arise. The super profits that the business would earn in the future are estimated on the basis of profits earned in the past.

Yield basis:

The value of shares on yield basis is arrived at **on the basis of present value of the right to receive dividends in the future**. It is an exercise of projecting the trend of profits and predicting the policy that the company might follow in the matter of declaration of dividends.

The **rate at which the amount of dividends should be capitalised is decided on taking into account the risk that shareholders** are taking for declaration of dividends being continued in future, **assessed in the background** of past history of the company, the amount of reserves the company possesses, future prospects of the line of manufacture or trade of the company and the impact of various social and political factors that are likely to emerge on the company's profitability.

NOTE: *In any valuation of shares, with the transfer of shares control is also to pass,* ***a separate value should be ascertained for the control and added to the value.***

INVESTIGATION ON BEHALF OF A BANK / FIN. INSTITUTION PROPOSING TO ADVANCE LOAN TO A COMPANY

A bank is **primarily interested in knowing the purpose for which a loan is required**, the **sources from which it would be repaid and the security that would be available to it**.

On these considerations, the investigating accountant, in the course of his enquiry, should collect following information.

PURPOSE OF LOAN: The purpose for which the loan is required and the manner in which the **borrower proposes to invest the amount of the loan**.

PROJECTIONS: The **schedule of repayment of loan submitted** by the borrower, particularly the **assumptions made therein as regards amounts of profits** that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case.

CREDIBILITY: The **financial standing and reputation for business integrity** enjoyed by directors and officers of the company.

AUTHORISATION UNDER BYELAWS: Whether the company is **authorised by the Memorandum or the Articles of Association to borrow money** for the purpose for which the loan will be used.

HISTORY: The **history of growth and development of the company** and its performance during the past 5 years.

ECONOMIC POSITION: How the economic position of the company would be **affected by economic, political and social changes** that are likely to take place during the period of loan.

PREVIOUS LOAN APPLICATIONS: Whether any **loan application to any other Bank or Financial Institution** was made, and if so, the reasons for rejection thereof.

INVESTIGATION FRAUD IN THE CONTEXT OF SA 240

In the Companies Act, 2013 meaning of **fraud has been considered in two specific sections** viz. **Section 143(10), where the SAs specified by the ICAI** are deemed to be the auditing standards for purposes of the Act, which, inter alia, **define fraud, and in Section 447 where punishment for fraud has been prescribed**.

Fraud has been defined in paragraph 11(a) of SA 240, "The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements" as ***'an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.'***

Section 447 of the Act has explained the term 'fraud' as "fraud in relation to affairs of a company or a body corporate, includes any act, omission, concealment of fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss."

TYPES OF FRAUD IN CONTEXT OF SA 240:

FRAUDULENT FINANCIAL REPORTING:

1. **Alteration or falsification** of records & documents
2. **Misrepresentation in or intentional omission** of events, transactions or information
3. **Intentional misapplication** of accounting principles
4. **Fictitious Journal Entries**
5. **Adjusting assumptions** and changing Judgments
6. **Omitting, advancing or delaying** the recognition of events or transactions.
7. **Abnormal Year End Transactions**.

MISAPPROPRIATION OF ASSETS:

1. **Embezzlement of receipts** in respect of written-off accounts
2. **Stealing** physical assets or intellectual properties
3. Introduction of **fictitious vendors**
4. Payment to **fictitious employees**
5. Using entities **assets for personal use**.

Frauds may be classified as **defalcations involving misappropriation**, either of money or that of goods, and **manipulation of accounts not involving a defalcation**.

On this account, a brief description thereof at different level is given below:

A. FRAUD FOR PERSONAL GAINS:

Bribery: Money, gift or other favours offered **to procure (often illegal or dishonest) action or decision in favour of the giver**. These are also relatable to contract fraud or procurement fraud and are, out of books transactions. The auditor normally **conducts a propriety audit over the veracity of the transactions and review** of any undue favours to vendors.

B. CORPORATE FRAUDS/ IRREGULARITIES:

Advance Billing: Advance billing is a situation **where the company officials indulge in booking fictitious sales in anticipation of actual sales**. This results in **misrepresentation of revenue in the books thereby misleading financers and stakeholders**. When the management treats borrowings from money lenders as customer advances in the books against sale orders or for adjusting bills receivables, the fraudulent act gets unnoticed for an extended period, **this could be termed as management fraud.**

Shell/ Dummy Company Schemes: It represents **a fictitious company or a 'paper company' to transfer profits or funds from the main company**.

The books could be falsified by wrong classification of expenses, inflating the expense claims, fictitious expenses or multiple reimbursements. **A review of controls, normally, leads to the uncovering of expense booking that are prima facie not incurred**.

Money-Laundering Activities:

The person indulging in money laundering looks for avenues with **weak banking controls for converting illegal money into the banking system**. Any excess credit in the bank accounts **that does not belong to the customer or is parked for a temporary period should raise suspicion of such activities**. Companies with **extensive cash handling and inadequate control** over source of money or **involved in remittance of money for import/ export** of goods etc. **are susceptible to money laundering activities.**

C. FRAUD AT OPERATIONAL LEVEL EMPLOYEES:

Tampering of Cheques/Drafts/On-line payments/receipts: Tampering of cheques, payee name being altered, or preparation of cheques without the same being issued to payee, etc., are methods that **may also lead to falsification of accounts**.

On-line payments generally are considered a transparent mechanism to prevent the above frauds. **The ATM is a popular technological advancement that has inherent control gaps**.

D. OFF BOOK FRAUDS:

In off book frauds, the **fraud perpetrator misappropriates the cash before these are recorded** in the books or before the sale is recorded in the books. These **frauds are difficult to unearth and establish due to absence of audit trails** and are more prevalent in businesses that have extensive cash dealings.

The above fraudulent schemes can be **established based on circumstantial evidence or validation through external sources** such as, customer balance confirmations and customer copy of the receipts or other documents that are retained by them. **Verification of all the receipts and issues of stock recorded** in stock register is another way to identify this type of fraud.

E. CASH MISAPPROPRIATION:

Cash is misappropriated after the accounting entries are already passed in the books. These are identified **through surprise checks and through shortages** in cash balances. These occur when **there are delays in accounting of cash collections and there are no laid down cash flow controls**. Unaccounted money in any form in an entity is a **serious red flag in uncovering of irregularities**.

F. TEEMING AND LADING:

This is also achieved **through cash deposits or cheques collected from customers being overlapped with the collections from subsequent customers and the amount collected is diverted to personal account**. Reconciliation of customer accounts at a single point of time and confirmation from customers for amounts outstanding in their accounts helps in identifying any leakage in collections.

G. FRAUDULENT DISBURSEMENTS:

Fraudulent disbursements or reimbursements take place either by **issuing or submission of false bills, or personal expense bills** being converted into official expenses bills. The other method that is resorted to by the perpetrator of fraud is to inflate the refunds due to a customer and skim the excess refunds.

H. EXPENSE REIMBURSEMENT SCHEMES: These fraudulent schemes **involve employees resorting to treating their personal expenses as incurred for business purpose and claiming reimbursement**. In some cases, employees may get reimbursed by third parties (such as distributors) as well as by claiming these expenses from the company. Multiple expense claims based on duplicate bills or photostat copies.

I. PAYROLL FRAUD: The payroll fraud could include **payment to non-existent employees or in a contractual arrangement inflating of the manpower resources** than those actually deployed while billing the client. The process would **require a detailed review of statutory declarations/filings under various labour law statutes** including disclosures in financial statements of retirement benefits such as P.F, Gratuity and Superannuation benefits from evidence gathering perspective.

J. COMMISSION SCHEMES:

The salesman exaggerates the sales through fictitious billings to earn higher commission or alter the sales prices of the products sold from those stipulated by the company or share the sales volumes achieved with other employees to share higher commission. **Commission schemes in mega deals backed by legal documents are often tools used to camouflage kickbacks.** These are often difficult to uncover and would need to be supplemented by the monetary trails across entities and geographies.

PROCEDURE FOR INVESTIGATION OF FRAUD:

1. Before proceeding to investigate frauds, the **investigator should ascertain the exact duties of the person concerned who is suspected to have committed a fraud**; his relationship to the **general routine** of the office, and the **circumstances in which any known instances of defalcation** have come to light.
2. **Greater the authority of the individual suspected of a fraud, wider would be the field which would have to be covered** by the investigation.

3. At times, an accountant is called upon **to investigate a suspected fraud, the details or the nature whereof is not known**. In such a case, for localising the source of the fraud, the investigating accountant will have **to study the financial and accounting structure of the organisation**.
4. As a first step, he **should examine the line of responsibility** between the various members of the staff. He should have a look at the **system of internal control in operation for spotting out the weaknesses**, if any, that may exist in it.

EMBEZZLEMENT OF CASH:

Some of the situations in which money may be embezzled and the various forms that such frauds usually take place along with their investigation procedure include the following:

Cash receipts: In cases like holding back cash sales, collections by travelling salesmen, or casual receipts, **the amount or amounts of receipts embezzled** may be subsequently **covered up by the perpetrator adopting one or other of the under-mentioned** devices:

1. Issuing a **receipt to the payee for the full amount** collected and entering **only a part of the amount on the counterfoil**.
2. Showing a **larger cash discount** than actually allowed.
3. Adjusting a **fictitious credit in the account of a customer** for the value of goods returned by him.
4. Adjusting a **cash sale as a credit sale**, and raising a debit in the account of the customer.
5. **Writing off a good debt as bad and irrecoverable** to cover up the amount collected which has been misappropriated.
6. **Short-debiting the customer's account** in the ledger with an intention to withdraw the difference when the full amount payable by him is collected.
7. **Verification of Cash Receipts:**
   a. On the assumption that some of these may have been diverted before being entered in the books, **evidence as regards income received from different sources** should be scrutinised, e.g., inventory, sales summaries, rental registers, correspondence with customers, advices of travelling salesmen and counterfoils or receipts.
   b. **Carbon copies of receipts marked 'duplicate'**, should be scrutinised to confirm that they are in fact copies of receipts issued earlier.

c. In addition, by **recalling paying-in-slips from the bank the details** of cash deposited on each day **should be compared with those shown in the Cash Book.**
d. The record of sales of scrap of waste paper, that of collection of rents from labourers temporarily accommodated in the company's quarters, that of refunds of amounts deposited with the electric supply co., or any other Government authorities should be examined for **finding out if any of these amounts have been misappropriated.**
e. Cash sales should be **vouched in detail**. Recoveries from customers and sundry parties should be checked with the copies of receipts issued to them; deductions made on account of cash discounts should be reviewed.
f. All withdrawals from the bank **should be checked by reference to corresponding entries** in the bank pass book.

Inflating cash payment: Cash payment frauds may be in the form of:

1. **Making double payment** of an invoice or paying a false invoice.
2. **Paying personal expenses out of the business** by falsifying details. e.g., showing betting losses as advertisement charges.
3. **Withdrawing unclaimed credit balances** of customers or amounts falsely credited in the accounts of parties.
4. **Falsely adjusting a refund** in the account of a customer and withdrawing the credit balance.
5. **Wrong totalling of the wage sheets** and misappropriating the excess amount withdrawn from the bank for payment of wages.
6. **Verification of Cash Payments:**
   a. All the evidence as regards cash payments made, including **acknowledgement by parties** for payments shown to have been made to them, should be carefully scrutinised.
   b. In the case where a **figure appears to have been erased or altered** on the receipts issued by the party, on reference to the party concerned, the **actual amount paid to him should be confirmed**.
   c. All **payments by bearer cheques should be examined**.
   d. The **system of recording of wages should be reviewed,** as regards possible over-totalling of wage sheets, and entries in them of dummy workmen.
   e. The **system of ordering and receiving goods should be reviewed** so as to confirm that no payment has been made in respect of supplies which have not been received.

f. **Confirmations should be obtained from partners or Directors** in respect of amounts shown to have been paid to them.
g. The **Petty Cash Book should be vouched** and totalled.

SELF STUDY: [REF PAGE NO. 16.53 TO 16.55] ICAI MATERIAL NOV 2020 EDITION

1. Frauds through suppliers' ledger
2. Customers' ledger
3. Verification Procedure for Defalcation of inventory.
4. Indicators of Fraud

RESPONSES TO FRAUD

RESPONSES TO FRAUD:

1. SA 330 states the auditor's responses to assessed risks. It requires **auditor to assign and supervise personnel** taking into account of the knowledge, skill and ability of the individuals.
2. Evaluation of **selection and application of accounting policies** by the entity and **incorporation of an element of unpredictability in the selection** of the nature, timing and extent of audit procedure.
3. **Response to the risks related to management override of controls** includes:
   a. Testing the **appropriateness of journal entries and other adjustments** made in preparation of the Financial Statements,
   b. Review of **accounting estimates for biases** and
   c. Review the **significant transactions that are outside the normal course of business** for the entity or that otherwise appear to be unusual.
4. The **responses to fraud will include communications to management** and with those charged with governance, **communication to regulatory and enforcement authorities** and appropriate documentation on his assessment of the risks of material misstatement.
5. **Auditor's ability to detect fraud depends** on factors such as:
   a. The **skilfulness of the perpetrator**.
   b. The **frequency & extent of manipulation**.
   c. The **degree of collusion involved**.
   d. The **relative size of individual amounts manipulated** and
   e. The **seniority of those individuals involved**.
6. Detection of Fraud **depends upon effectiveness of Audit Procedure**.

7. Detection risk, however, can **only be reduced, not eliminated**.

INVESTIGATION ON BEHALF OF AN INDIVIDUAL OR FIRM PROPOSING TO BUY A BUSINESS

SCOPE OF INVESTIGATION:

The objective of such an investigation **is to collect such information as would enable the purchaser to decide whether it is worthwhile to buy the business and if so, for what amount.** The investigation should proceed **broadly on the same lines as for valuation of shares.**

IN CASE OF PROPRIETARY CONCERNS OR PARTNERSHIPS:

1. **Reasons for the sale of the business and the effect on turnover and profits** that there would be on retirement of the present proprietor (or partners).
2. The **length of lease under which the premises are held**; the prospects of its renewal or extension.
3. The **unexpired period of any patents** owned by the vendors.
4. The **age of the present managerial staff and the prospects of continuing in service** under the new proprietorship.
5. the **possible liability, not already provided for that would arise** as regards payment of pensions or gratuities in case of old and aged employees/ retrenched employees.
6. If the **bulk of sales are made to customers whose number is small**, the profitability of the **business would be greatly shaken on withdrawing their support**. This would be an element of weakness which should be investigated as it might affect future profitability.
7. The **valuation that could be placed on goodwill** to determine whether that appearing in the book is less or more; if none is included to determine the amount that should be included.

IF THE BUSINESS BELONGS TO A LIMITED COMPANY:

On that account, the following additional matters would also require consideration:

1. The **authorised and issued capital** of the company.
2. Whether there is any **uncalled liability on the shares**.

3. If the capital is divided into different classes of shares - **the rights that are attached to each class.**
4. Particulars of **dividends paid in the past and the amounts thereof which are in arrear** (on cumulative preference shares).
5. If there are **any mortgages/ charge created on the assets** appearing in the company's books, a **search should be made in the Register of Charges** in the office of the Registrar of Companies.
6. The **price at which the shares are being offered**. If the **company is a public company**, **the price will usually be in excess of market price quoted on the Stock Exchange**, but **in the case of unquoted shares** particularly where the company whose shares are being acquired is a private company, **a valuation will have to be placed on the shares for the purpose of purchase**.

INVESTIGATION IN CONNECTION WITH REVIEW OF PROFIT / FIN. FORECASTS [SELF STUDY]

There are many investigations which involve an examination of future profits like:

1. Profit reports can be required as part of a **general investigation into the purchase of a business** or,
2. By banks and financial institutions **with regard to project cash flow and profitability statements** for appraisal of loan applications submitted by the intending borrowers.
3. All forecasts depend, to a large extent, on the nature of the business with its **numerous and substantial uncertainties**. **Such situations involve special review as these depart from the auditor's traditional** role of expressing an opinion in relation to past events.

11. STANDARDS ON AUDITING

1.	SA 200	Overall Objectives of an Independent auditor and conduct of an audit in accordance with standards on auditing [CA Inter]
2.	SA 210	Agreeing the terms of audit engagement [CA Inter]
3.	SA 220	Quality Control for an audit of financial statements [Discussed]
4.	SA 230	Audit Documentation [CA Inter]
5.	SA 240	Auditors' responsibility relating to fraud in an audit of financial statements [Discussed]
6.	SA 250	Consideration of Laws and Regulations in an audit of financial statements [Discussed]
7.	SA 260	Communication with Those charged with governance [Discussed in depth in this]
8.	SA 265	Communicating deficiencies in internal control with those charged with governance and management [Chapter 9 – Risk Assessment and Internal Control]
9.	SA 299	Responsibility of Joint auditor's [Chapter 2 – Audit Reporting]
10.	SA 300	Planning an audit of financial statements [Chapter 8 – Audit Strategy]
11.	SA 315	Identifying and assessing risk of material misstatement through understanding the entity and its environment [Chapter 9 – Risk Assessment and Internal Control]
12.	SA 320	Materiality in planning and performing an audit [Discussed]
13.	SA 330	The Auditor's Responses to Assessed Risks [Chapter 9 – Risk Assessment and Internal Control]
14.	SA 402	Audit Considerations Relating to an Entity Using a Service Organisation [Discussed]
15.	SA 450	Evaluation of Misstatements identified During the Audit [Discussed in Every Standard and This standard is mainly dealt along with SA 530 which is covered in CA Inter]
16.	SA 500	Audit Evidence [CA Inter]
17.	SA 501	Audit Evidence - Specific Considerations for Selected Items [Discussed]
18.	SA 505	External Confirmations [Discussed]
19.	SA 510	Initial Audit Engagements - Opening Balances [Discussed]
20.	SA 520	Analytical Procedures [CA Inter]
21.	SA 530	Audit Sampling [CA Inter]
22.	SA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures [Discussed]
23.	SA 550	Related Parties [Discussed]
24.	SA 560	Subsequent Events [Discussed]
25.	SA 570	Going Concern [Chapter 2 – Audit Reporting]
26.	SA 580	Written Representations [Discussed]
27.	SA 600	Using the Work of Another Auditor [Chapter 2 – Audit Reporting]
28.	SA 610	Using the Work of Internal Auditors [Chapter 2 – Audit Reporting]

29.	SA 620	Using the Work of an Auditor's Expert [Chapter 2 – Audit Reporting]
30.	SA 700	Forming an Opinion and Reporting on Financial Statements [Chapter 2 – Audit Reporting]
31.	SA 701	Communicating Key Audit Matters in the Independent Auditor's Report [Chapter 2 – Audit Reporting]
32.	SA 705	Modifications to the Opinion in the Independent Auditor's Report [Chapter 2 – Audit Reporting]
33.	SA 706	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report [Chapter 2 – Audit Reporting]
34.	SA 710	Comparative Information - Corresponding Figures and Comparative Financial Statements [Chapter 2 – Audit Reporting]
35.	SA 720	The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements [Chapter 2 – Audit Reporting]
36.	SQC	Quality Control for Firms that Perform Audits and Review of Historical Financial Statements, Other Assurance and Related Services Engagements [Discussed]

SA 240 – THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS

A. DEFINITION OF FRAUD:

1. **SA – 240** defines the term **'fraud' as "An intentional act by one or more individuals among management**, those charged with governance, employees, or third parties, involving the use of deception **to obtain an unjust or illegal advantage"**.
2. Although fraud is a broad legal concept and the **auditor is concerned only with the type of fraud** that causes a **material misstatement in the financial statements**.
3. Misstatements in the financial statements can **arise from either fraud or error.** The distinguishing factor between fraud and error is **whether the underlying action that results in the misstatement** of the financial statements **is intentional or unintentional.**

B. OBJECTIVES OF SA 240:

The objectives of the auditor in accordance with SA 240 are:

1. To **identify and assess the risks** of material misstatement in the financial statements due to fraud.
2. To **obtain sufficient appropriate audit evidence** about the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses and
3. To **respond appropriately** to identified or suspected fraud.

C. TYPES OF FRAUDS:

1. **Fraudulent financial reporting** - Intentional Misstatements like Omissions, Misrepresentation
2. **Misappropriation of assets** - Theft or Unauthorised usage of entity's assets.

D. FRAUD RISK FACTORS:

Fraud, whether due to misstatements resulting from fraudulent financial reporting or misappropriation of assets involves:

1. **Incentive or Pressure** to commit fraud
2. A **perceived opportunity** to do so
3. Some **rationalization of the act**

FRAUDULENT FINANCIAL REPORTING

WHY: Fraudulent financial reporting **involves intentional misstatements including omissions of amounts or disclosures** in financial statements to **deceive financial statement users.**

1. It can be caused by **the efforts of management to manage earnings** in order to deceive financial statement users by **influencing their perceptions as to the entity's performance and profitability**.
2. Such **earnings manipulation may start out with small actions** or inappropriate adjustment of assumptions and changes in judgments by management. **Pressures and incentives may lead these** actions to increase to the extent that they result in fraudulent financial reporting.
3. **Due to pressures to meet market expectations** or a desire to maximize compensation based on performance, management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial statements.
4. **Management may be motivated to reduce earnings** by a material amount to minimize tax or to inflate earnings to secure bank financing.

HOW: Fraudulent financial reporting may be accomplished by the following**:**

1. **Manipulation, falsification (including forgery), or alteration** of accounting records or supporting documentation from which the financial statements are prepared.
2. **Misrepresentation in or intentional omission from, the financial statements** of events, transactions or other significant information.
3. Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.
4. **OVERRIDING INTERNAL CONTROLS:** Fraudulent financial reporting often involves **management override of controls that otherwise may appear to be operating effectively**. Fraud can be committed by management overriding controls using such techniques as:
    a. **Recording fictitious journal entries,** particularly close to the end of an accounting period, to **manipulate operating results** or achieve other objectives.
    b. Inappropriately **adjusting assumptions and changing judgments** used to estimate account balances.
    c. **Omitting, advancing or delaying recognition in the financial statements** of events and transactions that have occurred during the reporting period.
    d. **Concealing, or not disclosing, facts** that could affect the amounts recorded in the financial statements.
    e. Engaging in **complex transactions that are structured to misrepresent** the financial position or financial performance

of the entity.

f. **Altering records and terms** related to significant and unusual transactions.

MISAPPROPRIATION OF ASSETS

1. **MEANING: Misappropriation of assets involves the theft of an entity's assets** and is often perpetrated by employees **in relatively small and immaterial amounts.** It can also involve management who are usually more able to disguise or conceal misappropriations in **ways that are difficult to detect**.
2. **WAYS:** Misappropriation of assets can be accomplished in a variety of ways including:
   a. **MANIPULATION OF CASH: Embezzling receipts**
   b. **THEFT OF ASSETS: Stealing physical assets** or intellectual property
   c. **FICTITIOUS TXNS:** Causing an entity **to pay for goods and services not received**.
   d. **PERSONAL USE: Using an entity's assets for personal use.**
3. **MAA WITH SUPPORTING EVIDENCES:** Misappropriation of assets is **often accompanied by false or misleading records or documents** in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

Note: Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does **not make legal determinations of whether fraud has actually occurred**.

PRIMARY RESPONSIBILITY IS TO PREVENT AND DETECT FRAUD

PRIMARY RESPONSIBILITY:

1. The primary responsibility for the prevention and detection of fraud rests **with both those charged with governance of the entity and management.**
2. It is important that management, with the oversight of those charged with governance, **place a strong emphasis on *fraud prevention*, which may reduce opportunities for fraud to take place, and *fraud* deterrence**, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment.

3. This involves a **commitment to creating a culture of honesty and ethical behavior** which can be reinforced by an active oversight by those charged with governance.

RESPONSIBILITIES OF THE AUDITOR IN RELATION TO FRAUD:

1. **OBJECTIVE OF AUDIT:** An auditor conducting an audit in accordance with SAs is **responsible for obtaining reasonable assurance** that the financial statements **taken as a whole are free from material misstatement, whether caused by fraud or error**.
2. **INHERENT LIMITATIONS OF AN AUDIT:**
   - **a.** Owing to the inherent limitations of an audit, there is an **unavoidable risk that some material misstatements of the financial statements may not be detected,** even though the audit is properly planned and performed in accordance with the SAs.
   - **b.** In the case of **misstatement resulting from fraud.**
   - **c.** The risk of **not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error.** This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more **difficult to detect when accompanied by collusion.** Collusion may cause the auditor to **believe that audit evidence is persuasive when it is, in fact, false.**
   - **d.** The auditor's ability to detect a fraud depends on factors such as:
     - i. **the skillfulness** of the perpetrator,
     - ii. the **frequency and extent of manipulation**,
     - iii. the **degree of collusion involved**,
     - iv. the **relative size of individual amounts manipulated**, and
     - v. the **seniority of those individuals involved**.
   - **e.** The **risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud**, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.

3. **MAINTAIN PROFESSIONAL SKEPTICISM:** When obtaining reasonable assurance, **the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing** the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud.

FRAUD RISK FACTORS

Fraud risk factors are **events or conditions that indicate an incentive or pressure** to commit fraud or provide an opportunity to commit fraud.

EVALUATION OF FRAUD RISK FACTORS

1. The auditor shall **evaluate whether one or more fraud risk factors are present.** While fraud risk factors **may not necessarily indicate the existence of fraud,** they have often been present in circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud.
2. The determination of **whether a fraud risk factor is present and whether it is to be considered in assessing the risks of material misstatement** of the financial statements due to fraud **requires the exercise of professional judgment.**
3. **Maintaining Professional Skepticism:**
   a. The auditor **shall maintain professional skepticism** throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and **integrity of the entity's management** and those charged with governance.
   b. **Unless the auditor has reason to believe** the contrary, the auditor may accept records and documents as genuine. If **conditions identified during the audit cause the auditor to believe that a document may not be authentic** or that terms in a document have been modified but not disclosed to the auditor, the **auditor shall investigate further**.
   c. Where **responses to inquiries** of management or those charged with governance are **inconsistent, the auditor shall investigate the inconsistencies.**

4. **Discussion among the engagement team:**
   a. The discussion among the engagement team shall place particular **emphasis on how and where the entity's financial statements may be susceptible to material misstatement** due to fraud, including how fraud might occur.

b. The **discussion shall occur notwithstanding the engagement team members' beliefs** that management and those charged with governance are **honest and have integrity**.

RISK ASSESSMENT PROCEDURES IN IDENTIFYING RISK OF MATERIAL MISSTATEMENT DUE TO FRAUD

When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, **the auditor shall perform the procedures to obtain information for use in identifying the risks** of material misstatement due to fraud like:

1. **Inquiries of management** and others within the entity,
2. Obtaining **understanding as to how those charged with governance exercise oversight** of management's processes for identifying and responding to the risks of fraud in the entity and
3. The **internal control that management has established** to mitigate these risks and evaluation of unexpected relationships identified in performing analytical procedures which may indicate risks of material misstatement due to fraud.
4. The **auditor shall evaluate whether the information obtained** from the other risk assessment procedures and related activities performed **indicates that one or more fraud risk factors are present**.

RESPONSES TO THE ASSESSED RISKS OF MATERIAL MISSTATEMENT DUE TO FRAUD

A. AT FINANCIAL STATEMENT LEVEL:

1. Assign and supervise personnel **taking account of the knowledge, skill and ability of the individuals to be given significant engagement** responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement
2. Evaluate whether the **selection and application of accounting policies by the entity**, particularly those related to subjective measurements and complex transactions, **may be indicative of fraudulent financial reporting resulting from management's effort to manage earnings**; and
3. Incorporate **an element of unpredictability in the selection of the nature**, timing and extent of audit procedures.

B. AT ASSERTION STATEMENT LEVEL:

1. The auditor shall design and perform **further audit procedures whose nature, timing and extent are responsive to the assessed risks** of material misstatement due to fraud at the assertion level.
2. In doing so the **auditor may change nature, timing and extent of audit procedures to obtain** audit evidence that is more reliable and relevant or to obtain additional corroborative information.

C. AUDIT PROCEDURES RESPONSIVE TO RISKS RELATED TO MANAGEMENT OVERRIDE OF CONTROLS:

1. Management is in a **position to perpetrate fraud because of management's ability to manipulate accounting records** and prepare fraudulent financial statements **by overriding controls that otherwise appear to be operating effectively**.
2. **Irrespective** of the auditor's assessment of the **risks of management override of controls, the auditor shall design** and perform audit procedures to
   a. Test the **appropriateness of journal entries recorded** in the general ledger and other adjustments made in the preparation of the financial statements.
   b. **Review accounting estimates for biases** and evaluate whether the circumstances producing the bias, represent a risk of material misstatement due to fraud.
   c. **For significant transactions** or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment and other information obtained during the audit, the auditor shall evaluate **whether the business rationale (or the lack thereof) of the transactions suggests** that they may have been entered into to **engage in fraudulent financial reporting or to conceal misappropriation of assets**.
3. The auditor shall determine whether, in order to **respond to the identified risks of management override of controls**, the auditor needs **to perform other audit procedures in addition to those specifically referred to above**.

EVALUATION OF AUDIT EVIDENCE

1. The auditor shall evaluate **whether analytical procedures that are performed when forming an overall conclusion** as to whether the financial statements as a whole **are consistent with the auditor's understanding of the entity** and its environment indicate a previously unrecognized risk of material misstatement due to fraud.

2. When the **auditor identifies a misstatement, the auditor shall evaluate whether such a misstatement is indicative of fraud**. If there is such an indication, the **auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit**, particularly the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence.
3. If the auditor identifies a misstatement, whether material or not, and the auditor has reason to believe that it is or **may be the result of fraud and that management (in particular, senior management) is involved,** the auditor shall **re- evaluate the assessment of the risks of material misstatement due to fraud** and its resulting impact on the nature, timing and extent of audit procedures to respond to the assessed risks.
4. The auditor shall **also consider whether circumstances or conditions indicate possible collusion** involving employees, management or third parties when reconsidering the reliability of evidence previously obtained.
5. When the auditor confirms that, or **is unable to conclude** whether, the financial statements are **materially misstated as a result of fraud, the auditor shall evaluate the implications for the audit.**

CIRCUMSTANCES IN WHICH AUDITOR IS UNABLE TO CONTINUE THE ENGAGEMENT

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor **encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit**, the auditor shall:

1. Determine **the professional and legal responsibilities applicable** in the circumstances, including whether there is a **requirement for the auditor to report to the person or persons** who made the audit appointment or, in some cases, to regulatory authorities.
2. Consider **whether it is appropriate to withdraw from the engagement**, where withdrawal from the engagement is legally permitted and
3. If the auditor withdraws:
    a. Discuss **with the appropriate level of management** and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal and
    b. Determine whether **there is a professional or legal requirement to report to the person or persons** who made the audit appointment or, in some cases, to regulatory authorities, the

auditor's withdrawal from the engagement and the reasons for the withdrawal.

COMMUNICATION OF MMS IDENTIFIED WITH TCWG ON WITHDRAWAL

When the auditor decides to withdraw **before withdrawing**, the auditor **shall communicate to those charged with governance any matters regarding misstatements identified during the audit** that would have given rise to a modification of the opinion.

WHERE AUDITORS' WITHDRAWAL IS NOT PERMITTED

The listing agreement and **the SEBIs directive on the resignation** of auditor **does not permit withdrawing from the engagement without issuing the audit / review report.** It provides that:

If the auditor proposes to resign:

a. **within 45 days from the end of any of the quarters** of a period covered under the appointment, then the auditor shall, **before such resignation, issue the audit / limited review report for such quarter**.
b. **after 45 days from the end any of the quarters** of a period covered under the appointment, then we shall, before such resignation, **issue the audit / Limited review report for such quarter as well as the next quarter.**
c. **If the Limited review report has been issued for all the three quarters**, then **the auditor shall issue the audit report for the full year before resigning from the engagement**.

ICAI ANNOUNCEMENT ON THE RESIGNATION OF AUDITOR FOR UNLISTED COMPANIES:

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

OBTAINING MANAGEMENT REPRESENTATION IN THE CONTEXT OF FRAUD BY AUDITOR

The auditor shall obtain written representations from management and, where applicable, those charged with governance that:

1. **MANAGEMENT RESPONSIBILITY FOR ICS:**
   They **acknowledge their responsibility for the design, implementation** and maintenance of internal control to prevent and detect fraud
2. **DISLOSED ENTITIES RISK ASSESSSMENT RESULTS:**
   They **have disclosed to the auditor the results of management's assessment of the risk** that the financial statements may be materially misstated as a result of fraud.
3. **DISCLOSED INFO ABOUT FRAUDS:**
   They **have disclosed to the auditor their knowledge of fraud or suspected fraud** affecting the entity involving management, employees who have significant roles in internal control or others where the fraud could have a material effect on the financial statements.
4. **DISCLOSED ALLEGATIONS:**
   They **have disclosed to the auditor their knowledge of any allegations of fraud**, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

COMMUNICATIONS TO MANAGEMENT AND WITH THOSE CHARGED WITH GOVERNANCE ABOUT FRAUDS IDENTIFIED BY THE AUDITOR

1. **COMMUNICATE TO MANAGEMENT:**
   If the auditor has **identified a fraud or has obtained information that indicates that a fraud may exist**, the **auditor shall communicate these matters on a timely basis to the appropriate level** of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.

2. **COMMUNICATE TO TCWG ON A TIMELY BASIS:**
   Unless all of those charged with governance are involved in managing the entity, if the auditor has **identified or suspects fraud involving management, employees who have significant roles** in internal control or others where the fraud results in a material misstatement in the financial statements, the auditor **shall communicate these matters to those charged with governance on a timely basis**.
3. **COMMUNICATE NTE OF AUDIT PROCEDURES WITH TCWG:**

If the auditor **suspects fraud involving management**, the auditor shall **communicate these suspicions to those charged with governance** and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit.

COMMUNICATIONS TO REGULATORY AND ENFORCEMENT AUTHORITIES OF FRAUD IDENTIFIED BY THE AUDITOR

1. If the auditor has identified or suspects a fraud, the auditor shall determine whether there is a **responsibility to report the occurrence or suspicion to a party outside the entity.**
2. Although the **auditor's professional duty to maintain the confidentiality** of client information may preclude such reporting, **the auditor's legal responsibilities may override the duty of confidentiality in some circumstances**.
3. In some entities the auditor may have a **duty to report misstatements to authorities in those cases where management** and those charged with governance **fail to take corrective action**.
4. In some cases requirements for reporting fraud, whether or not discovered through the audit process, **may be subject to specific provisions of the audit mandate or related legislation or regulation**.

DOCUMENTATION OF THE UNDERSTANDING OF THE ENTITY AND ITS ENVIRONMENT AND THE ASSESSMENT OF THE RISKS OF MATERIAL MISSTATEMENT RELATED TO FRAUD

1. The **auditor's documentation of the understanding of the entity** and its environment and the assessment of the risks of material misstatement required shall include:
   a. The **significant decisions reached** during the discussion among the engagement team **regarding the susceptibility of the entity's financial statements to material misstatement due to fraud** and
   b. The **identified and assessed risks of material misstatement due to fraud** at the financial statement level and at the assertion level.
2. The **auditor's documentation of the responses to the assessed risks** of material misstatement required shall include:
   a. The overall responses to the assessed risks of material misstatement due to fraud at the financial statement level **and the nature, timing and extent of audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud** at the assertion level; and
   b. The **results of the audit procedures, including those designed to address the risk of management override of controls**.

3. The auditor **shall document communications about fraud made to management**, those charged with governance, regulators and others.
4. When the auditor **has concluded that the presumption** that there is a risk of material misstatement due to **fraud related to revenue recognition is not applicable in the circumstances of the engagement, the auditor shall document the reasons for that conclusion**.

SA 250 - CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS

SCOPE: SA 250 deals with **auditor's responsibility to consider laws and regulations** when performing an audit of financial statements. It **does not apply to other assurance engagements** in which the auditor is specifically engaged to test and report separately on compliance with specific laws or regulations.

The requirements in this SA are designed to assist the auditor in **identifying material misstatement of the financial statements due to non-compliance with laws and regulations.**

EFFECT OF LAWS AND REGULATIONS ON FINANCIAL STATEMENTS OF AN ENTITY

LEGAL AND REGULATORY FRAMEWORK: Those laws and regulations to which an entity is subject **constitute the legal and regulatory framework.** The effect on the financial statements of laws and regulations varies considerably.

1. **TYPE 1 LAWS AND REGULATIONS:**
   The **provisions of some laws or regulations have a direct effect on the financial statements** in that they determine the reported amounts and disclosures in an entity's financial statements.

2. **TYPE 2 LAWS & REGULATIONS:**
   Other laws or regulations are to be **complied with by management** or set the provisions under which the **entity is allowed to conduct its business but do not have a direct effect on an entity's financial statements.**

OBJECTIVES OF AUDITOR IN ACCORDANCE WITH SA 250

The objectives of the auditor in accordance with SA 250 are:

1. To **obtain sufficient appropriate audit evidence** regarding compliance with the provisions of those laws and regulations generally **recognised to have a direct effect on the determination of material amounts** and disclosures in the financial statements.
2. To **perform specified audit procedures to help identify instances of non-compliance** with other laws and regulations that may have a material effect on the financial statements and
3. To **respond appropriately to non-compliance** or suspected non-compliance with laws and regulations identified during the audit.

RESPONSIBILITY OF MANAGEMENT FOR COMPLIANCE WITH LAWS AND REGULATIONS

1. It is the **responsibility of management**, with the oversight of those charged with governance, to **ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations** that determine the reported amounts and disclosures in an entity's financial statements.
2. The following are examples of the **types of policies and procedures an entity may implement to assist in the prevention and detection of non-compliance** with laws and regulations:
    a. **Monitoring legal requirements** and ensuring that operating procedures are designed to meet these requirements.
    b. Instituting and operating **appropriate systems of internal control.**
    c. Developing, **publicizing and following a code of conduct.**
    d. Ensuring **employees are properly trained and understand the code of conduct.**
    e. **Monitoring compliance with the code of conduct** and acting appropriately to discipline employees who fail to comply with it.
    f. Engaging **legal advisors to assist in monitoring** legal requirements.
    g. Maintaining a register of significant laws and regulations with which the entity has to comply within its **particular industry and a record of complaints.**
3. In larger entities, these policies and procedures may be supplemented by assigning **appropriate responsibilities to an internal audit function, an audit committee, a compliance function.**

RESPONSIBILITIES OF THE AUDITOR IN RELATION TO LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS

1. The auditor is **not responsible for preventing non-compliance** and cannot be expected to **detect non- compliance with all laws and regulations.**
2. The auditor is **responsible for obtaining reasonable assurance** that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error.
3. In conducting an audit of financial statements, the **auditor takes into account the applicable legal and regulatory framework.**
4. **INHERENT LIMITATIONS:** Owing to the inherent limitations of an audit, there is an **unavoidable risk that some material misstatem**ents

in the financial statements **may not be detected,** even though the audit is properly planned and performed in accordance with the SAs. In the context of laws and regulations, **the potential effects of inherent limitations on the auditor's ability** to detect material misstatements are greater for such reasons as the following:

a. There are **many laws and regulations**, relating principally to the operating aspects of an entity that **typically do not affect the financial statements and are not captured by the entity's information systems** relevant to financial reporting.
b. **Non-compliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure** to record transactions, management override of controls or intentional misrepresentations being made to the auditor.
c. Whether **an act constitutes non-compliance is ultimately a matter for legal determination** by a court of law

5. SA 250 distinguishes **the auditor's responsibilities in relation to compliance with 2 different categories of laws and regulations** as follows:

   a. **TYPE 1:**
      i. The provisions of those laws and regulations generally **recognised to have a direct effect on the determination of material amounts** and disclosures in the financial statements such as tax and labour laws and
      ii. The auditor's responsibility **is to obtain sufficient appropriate audit evidence about compliance** with the provisions of those laws and regulations.

   b. **TYPE 2:**
      i. Other laws and regulations that **do not have a direct effect on the determination of the amounts and disclosures** in the financial statements, **but compliance with which may be fundamental to the operating aspects** of the business, to an entity's ability to continue its business, or to avoid material penalties. **Non-compliance** with such laws and regulations may, therefore, **have a material effect** on the financial statements.
      ii. The auditor's responsibility is limited to undertaking specified **audit procedures to help identify non-compliance with those laws and regulations** that may have a material effect on the financial statements.

6. The **auditor is to remain alert to the possibility** that other audit procedures applied for the purpose of forming an opinion on financial statements **may bring instances of identified or suspected non-compliance to the auditor's attention**.
7. **Maintaining professional skepticism throughout the audit,** is important in this context, given the extent of laws and regulations that affect the entity.

AUDITOR'S CONSIDERATION OF COMPLIANCE WITH LAWS AND REGULATIONS and PROCEDURES TO OBTAIN SUFFICIENT AND APPROPRIATE AUDIT EVIDENCE

1. As part of obtaining an understanding of the entity and its environment, the auditor shall obtain a general understanding of:
    a. The **legal and regulatory framework applicable to the entity** and the industry or sector in which the entity operates and
    b. How the **entity is complying with that framework**.
2. The auditor shall obtain sufficient appropriate audit evidence regarding **compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts** and disclosures in the financial statements.
3. **SPECIFIED AUDIT PROCEDURES FOR TYPE 2 LAWS:** The auditor shall perform the following specified audit procedures **to help identify instances of non- compliance with other laws and regulations** that may have a material effect on the financial statements:
4. **Non-compliance with laws and regulations that have a fundamental effect on the operations of the entity** may cause the entity to cease operations, or call into question the entity's continuance as a going concern.
5. There are also many laws and regulations relating principally to the operating aspects of the entity that **typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting**.
6. Audit procedures **applied to form an opinion on the financial statements may bring instances of non- compliance** or suspected non-compliance with laws and regulations to the auditor's attention.
7. During the audit, the **auditor shall remain alert to the possibility** that other audit procedures applied **may bring instances of non-compliance or suspected non-compliance with laws** and regulations to the auditor's attention.
8. **WRITTEN REPRESENTATION:** The auditor shall request management and, where appropriate, those charged with governance to **provide**

written representations that all known instances of non-compliance or suspected non- compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor.

AUDIT PROCEDURES WHEN NON-COMPLIANCE IS IDENTIFIED OR SUSPECTED

1. If the auditor **becomes aware** of information concerning an instance of **non-compliance or suspected non-compliance** with laws and regulations, the auditor shall obtain:
    a. An **understanding of the nature of the act** and the circumstances in which it has occurred and
    b. **Further information to evaluate the possible effect** on the financial statements.
2. If the auditor suspects there may be non-compliance, the auditor **shall discuss the matter with management a**nd, where appropriate, those charged with governance.
    a. If management or, those charged with governance **do not provide sufficient information** that supports that the entity is in compliance with laws and regulations and, in the auditor's judgment, **the effect of the suspected non-compliance may be material** to the financial statements, the auditor shall consider **the need to obtain legal advice**.
    b. If sufficient information about suspected non-compliance cannot be obtained, the auditor shall **evaluate the effect of the lack** of sufficient appropriate audit evidence on the auditor's opinion
    c. The auditor shall evaluate the **implications of non-compliance** in relation to other aspects of the audit, **including the auditor's risk assessment and the reliability** of written representations, and take appropriate action.

REPORTING OF IDENTIFIED OR SUSPECTED NON-COMPLIANCE

A. REPORTING NON-COMPLIANCE TO THOSE CHARGED WITH GOVERNANCE:

1. Unless all of **those charged with governance are involved in management of the entity, and are aware of matters** involving identified or suspected non-compliance already **communicated by the auditor**, the auditor **shall communicate** with those charged with governance matters involving non- compliance with laws and regulations that come to the auditor's attention during the course of the audit, **other than when the matters are clearly inconsequential.**
2. In the auditor's judgment, **the non-compliance referred to above is believed to be intentional and material**, the auditor **shall communicate** the matter to those charged with governance as soon as practicable.
3. If the auditor suspects that **management or those charged with governance are involved in non- compliance**, the auditor shall **communicate the matter to the next higher level of authority** at the entity.
4. Where **no higher authority exists**, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report**, the auditor shall consider the need to obtain legal advice.**

B. REPORTING NON-COMPLIANCE IN THE AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS:

1. **MMS IN F/S – Q.O / A.O:**
   If the auditor **concludes that the non-compliance has a material effect** on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall, in accordance with SA 705, **express a qualified or adverse opinion on the financial statements**.
2. **UNABLE TO GET EVIDENCE – Q.O / D.O.O:**
   If the **auditor is precluded by management** or those charged with governance **from obtaining sufficient appropriate audit evidence** to evaluate whether non-compliance that may be material to the financial statements has, or is likely to have, occurred, the auditor **shall express a qualified opinion or disclaim an opinion on the financial statements** on the basis of a limitation on the scope of the audit in accordance with SA 705.
3. **UNABLE TO DETERMINE NON-COMPLIANCE – Q.O / D.O.O:**

If the auditor is **unable to determine whether non-compliance has occurred** because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor shall **evaluate the effect on the auditor's opinion** in accordance with SA 705.

C. REPORTING NON-COMPLIANCE TO REGULATORY AND ENFORCEMENT AUTHORITIES:

If the auditor has **identified or suspects non-compliance** with laws and regulations, the auditor shall determine **whether the auditor has a responsibility to report the identified or suspected non- compliance to parties outside the entity**.

D. DOCUMENTATION:

The auditor **shall document identified or suspected non-compliance** with laws and regulations and the results of discussion with management and, where applicable, **those charged with governance and other parties outside the entity**.

INDICATORS OF NON-COMPLIANCES WITH LAWS AND REGULATIONS

The following are few indicators of Non compliances with various laws and regulation. This list is only illustrative and not exhaustive. It only provides the auditor the guidance to identify non compliances.

1. **Investigations by regulatory organisations** and government departments.
2. Payment of **fines or penalties**
3. Payments for **unspecified services or loans** to consultants, related parties, employees or government employees
4. Purchasing at prices **significantly above or below market price**.
5. **Unusual payments in cash** or payments in form of bearer cheques
6. Unusual **payments towards legal and retainership fees**
7. Unusual **transactions with companies registered in tax havens**.
8. **Unauthorised transactions** or improperly recorded transactions.
9. **Adverse media comment**.

SA 260 - COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

"THOSE CHARGED WITH GOVERNANCE"

1. The person(s) or organization(s) with **responsibility for overseeing the strategic direction** of the entity and **obligations related to the accountability of the entity**.
2. This includes **those overseeing the financial reporting process**.
3. For some entities, those charged with governance **may include management personnel,** for example, executive members of a governance board of a private or public sector entity, or an owner-manager
4. Governance structures **vary by entities, reflecting influences** such as different cultural and legal backgrounds, size and ownership characteristics.
5. In some cases, **some or all of those charged with governance are involved in managing the entity**.
6. In most entities**, governance is the collective responsibility of a governing body, such as a board of directors**, a supervisory board, partners, proprietors, a committee of management, trustees, or equivalent persons.
7. In some **smaller entities, one person may be charged with governance**.
8. It is **not possible to specify for all audits** the persons **with whom the auditor is to communicate particular matters**.
9. In some cases, **the appropriate persons with whom to communicate may not be clearly identifiable from the applicable legal framework** or other engagement circumstances.
10. In such cases, **the auditor may need to discuss and agree** with the engaging party the relevant persons **with whom to communicate.**
11. In deciding with whom to communicate, the **auditor's understanding of an entity's governance structure and processes obtained** in accordance with SA 315 is relevant. The **appropriate persons with whom to communicate may vary depending on the matter** to be communicated.

SIGNIFICANCE OF COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

An effective **two-way communication** is important in assisting:

1. The auditor and those charged with governance **in understanding matters related to the audit** in context, **and in developing a**

constructive working relationship. This relationship is developed while maintaining the auditor's **independence and objectivity.**

2. The auditor in obtaining from those charged with governance **information relevant to the audit**.
3. Those charged with governance **in fulfilling their responsibility to oversee the financial reporting process,** thereby reducing the risks of material misstatement of the financial statements.

OBJECTIVES OF AUDITOR IN ACCORDANCE WITH SA 260

The objectives of the auditor are:

1. To communicate clearly with those charged with governance **responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing** of the audit;
2. To obtain from those charged with governance **information relevant to the audit.**
3. **To provide** those charged with governance **with timely observations arising from the audit that are significant and relevant to their res**ponsibility to oversee the financial reporting process; and
4. To **promote effective two-way communication** between the auditor and those charged with governance.

MATTERS TO BE COMMUNICATED BY THE AUDITOR

A. THE AUDITOR'S RESPONSIBILITIES IN RELATION TO THE FINANCIAL STATEMENT AUDIT:

The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that:

1. The auditor **is responsible for forming and expressing an opinion** on the financial statements that have been **prepared by management with the oversight of those charged with governance** and
2. The audit of the financial statements **does not relieve management or those charged with governance of their responsibilities**.

B. PLANNED SCOPE AND TIMING OF THE AUDIT:

Communication regarding the planned scope and timing of the audit may:

1. **Assist those charged with governance to understand better** the consequences of the auditor's work, to **discuss issues of risk and the concept of materiality** with the auditor, and to identify any areas in which they may request the auditor **to undertake additional procedures** and

2. Assist the auditor **to understand better the entity and its environment**.
3. The auditor shall communicate with those charged with governance an **overview of the planned scope and timing** of the audit, which includes communicating about the **significant risks identified by the auditor**.
4. Communicating significant risks identified by the auditor **helps those charged with governance understand those matters and why they require special audit consideration**. The communication about significant risks may assist those charged with governance in **fulfilling their responsibility to oversee the financial reporting process.**
5. While communication with those charged with governance may assist the auditor to plan the scope and timing of the audit**, it does not change the auditor's sole responsibility to establish the overall audit strategy and the audit plan,** including the nature, timing and extent of procedures necessary to obtain sufficient appropriate audit evidence.
6. **Care is necessary when communicating** with those charged with governance about the planned scope and timing of the audit so as **not to compromise the effectiveness of the audit,** where some or all of those charged with governance are involved in managing the entity.

C. SIGNIFICANT FINDINGS FROM THE AUDIT:

The auditor shall communicate with those charged with governance:

1. The **auditor's views about significant qualitative aspects of the entity's accounting practices**, including accounting policies, accounting estimates and financial statement disclosures.
2. **Significant difficulties, if any** encountered during the audit:
   a. **Significant delays** by management, the unavailability of entity personnel, or an unwillingness by management **to provide information necessary** for the auditor to perform the auditor's procedures.
   b. An **unreasonably brief time** within which to complete the audit.
   c. Extensive **unexpected effort required to obtain sufficient appropriate audit evidence.**
   d. The **unavailability of expected information**.
   e. **Restrictions imposed** on the auditor by management.
   f. **Management's unwillingness to make or extend its assessment** of the entity's ability to continue as a going concern when requested

3. **Significant matters arising during the audit** that were discussed, or subject to correspondence, with management:
    a. **Significant events or transactions** that occurred during the year.
    b. **Business conditions affecting the entity,** and business plans and strategies that may affect the risks of material misstatement.
    c. **Concerns about management's consultations** with other accountants on accounting or auditing matters.
    d. Discussions or correspondence in connection with the initial or **recurring appointment of the auditor regarding accounting practices,** the application of auditing standards, or fees for audit or other services.
    e. **Significant matters on which there was disagreement with management**, except for initial differences of opinion because of incomplete facts or preliminary information that are **later resolved by the auditor** obtaining additional relevant facts or information.
4. **Written representations** the auditor is requesting.
5. **Circumstances that affect the form and content of the auditor's report**, and
6. **Any other significant matters arising during the audit** that, in the auditor's professional judgment, are **relevant to the oversight of the financial reporting process.**

D. COMMUNICATION OF AUDITOR'S INDEPENDENCE IN CASE OF LISTED ENTITIES:

In **the case of listed entities,** the auditor shall communicate with those charged with governance:

1. A statement that the **engagement team and others in the firm as appropriate,** the firm and, network firms **have complied with relevant ethical requirements** regarding independence and
2. **All relationships and other matters** between the firm, network firms, and the entity that, in the auditor's professional judgment, **may reasonably be thought to bear on independence**.
3. This shall include **total fees charged** during the period covered by the financial statements **for audit and non-audit services** provided by the firm and network firms to the entity and components controlled by the entity.
4. These fees **shall be allocated to categories** that are appropriate **to assist those charged with governance in assessing the effect of services** on the independence of the auditor; and
5. The **related safeguards that have been applied to eliminate** identified threats to independence **or reduce them to an acceptable level.**

E. TERMS OF AUDIT ENGAGEMENT:

The agreed terms of the audit engagement are required to be **recorded in an audit engagement letter** or other suitable form of written agreement and include, among other things, **reference to the expected form and content of the auditor's report.** Communication in this respect is intended to inform those charged with governance about **circumstances in which the auditor's report may differ from its expected form and content or may include additional information about the audit** that was performed.

F. REPORTING AS PER REQUIREMENT UNDER SA 700 SERIES:

1. Circumstances in which the auditor is **required to include additional information in the auditor's report** in accordance with the SAs, and for **which communication with those charged with governance is required,** include when:
   a. The auditor **expects to modify the opinion** in the auditor's report in accordance with SA 705.
   b. A **material uncertainty related to going concern** is reported in accordance with SA 570.
   c. **Key audit matters are communicated** in accordance with SA 701
   d. The auditor **considers it necessary to include an Emphasis of Matter paragraph** or Other Matter paragraph in accordance with SA 706 or is required to do so by other SAs.
   e. The auditor **has concluded that there is an uncorrected material misstatement** of the other information in accordance with SA 720
2. In such circumstances, the auditor may consider it useful to provide those charged with governance with **a draft of the auditor's report to facilitate a discussion of how such matters will be addressed** in the auditor's report.

COMMUNICATION PROCESS AND DOCUMENTATION AS PER SA 260

1. The auditor shall communicate with those charged with governance **the form, timing and expected general content of communications.**
2. The auditor shall communicate **in writing** with those charged with governance regarding **significant findings from the audit**, in the auditor's professional judgment, **oral communication would not be adequate**.
3. Written communications need **not include all matters that arose during the course of the audit.** The auditor shall communicate in

writing with those charged with governance **regarding auditor independence when required in case of listed entities.**

4. The auditor shall communicate with those charged with governance **on a timely basis.**

5. **ADEQUACY OF THE COMMUNICATION PROCESS:**
    a. The auditor shall e**valuate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit.**
    b. If it has not, the **auditor shall evaluate the effect, on the auditor's assessment of the risks** of material misstatement and **ability to obtain sufficient appropriate audit evidence,** and shall take appropriate action.

6. **DOCUMENTATION:**
    a. Where matters required by SA 260 to be communicated **are communicated orally, the auditor shall include them in the audit documentation,** and when and to whom they were communicated.
    b. Where matters have been **communicated in writing, the auditor shall retain a copy of the communication** as part of the audit documentation.

SA 402 - AUDIT CONSIDERATIONS RELATING TO AN ENTITY USING A SERVICE ORGANISATION

SERVICE ORGANIZATION [S/O]: Service organisation is a third-party organisation (or segment of a third-party organisation) that **provides services to user entities** that are **part of those entities' information systems relevant to financial reporting.**

USER ENTITY [U/E]: User entity is an entity that **uses a service organisation and whose financial statements are being audited.**

SERVICE AUDITOR [S/A]: Service auditor is an auditor who, at the request of the service organisation, **provides an assurance report** [type 1 or type 2] **on the controls of a service organisation.**

USER AUDITOR [U/A]: User auditor is an auditor **who audits and reports on the financial statements of a user entity**.

SERVICES PROVIDED BY A SERVICE ORGANIZATION ARE RELEVANT TO THE AUDIT OF A USER ENTITY'S FINANCIAL STATEMENTS

1. Services provided **by a service organisation are relevant** to the audit of a user entity's financial statements **when those services, and the controls over them, are part of the user entity's information system,** including related business processes, relevant to financial reporting. Although most controls at the service organisation are likely to relate to financial reporting, there **may be other controls that may also be relevant to the audit,** such as controls over the safeguarding of assets.
2. A service organisation's services are part of a user entity's information system, including related business processes, **relevant to financial reporting if these services affect any** of the following:
    a. The **classes of transactions in the user entity's operations** that are significant to the user entity's financial statements.
    b. The procedures, within both information technology (IT) and manual systems, by which the **user entity's transactions are initiated, recorded, processed,** corrected as necessary, transferred to the general ledger and **reported in the financial statements**.
    c. The **related accounting records,** either in electronic or manual form, **supporting information and specific accounts** in the user entity's financial statements that are used to initiate, record, process and report the user entity's transactions
    d. **How the user entity's information system captures events and conditions**, other than transactions, that are significant to the financial statements
    e. The **financial reporting process used to prepare** the user entity's financial statements, including significant accounting estimates and disclosures and
    f. **Controls surrounding journal entries**, including non-standard journal entries used to record non- recurring, unusual transactions or adjustments
3. The **nature and extent of work to be performed** by the user auditor regarding the services provided by a service organisation depend **on the nature and significance of those services to the user entity** and the relevance of those services to the audit.

OBJECTIVES OF USER AUDITOR IN ACCORDANCE WITH SA 402

1. To obtain **an understanding of the nature and significance of the**

services provided by the service organisation and their effect on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement; and

2. To **design and perform audit procedures** responsive to those risks.

TYPE 1 AND TYPE 2 REPORTS AS REFERRED UNDER SA 402

TYPE 1 REPORT	TYPE 2 REPORT
A description, **prepared by management of the service organisation,** of the service organisation's system, control objectives and related controls that have been designed and implemented **as at a specified date** and	A description, **prepared by management of the service organisation**, of the service organisation's system, control objectives and related controls, their design and **implementation as at a specified date or throughout a specified period and, their operating effectiveness throughout a specified period** and
A **report by the service auditor** with the objective **of conveying reasonable assurance** that includes the service auditor's opinion **on the description of the service organisation's system, control objectives and related controls** and the suitability of the design of the controls to achieve the specified control objectives.	A **report by the service auditor** with the objective **of conveying reasonable assurance** that includes: a. The service auditor's opinion on the **description of the service organisation's system, control objectives and related controls,** the suitability of the design of the controls to achieve the specified control objectives, **and the operating effectiveness of the controls** **AND** b. A **description of the service auditor's tests of the controls** and the results thereof.

OBTAINING AN UNDERSTANDING OF THE SERVICES PROVIDED BY S/O

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

1. **NATURE OF SERVICES BY S/O:**
   The **nature of the services provided** by the service organisation and the significance of those services to the user entity, including **the effect thereof on the user entity's internal control**.
   Information on nature of services provided by a user organization may be **available from sources such as user manuals, contract** between the user entity and service organization, reports by service auditors etc.

2. **MATERIALITY OF TXNS PROCESSED BY S/O:**
   The transactions processed and the accounts affected by the service organisation **may not appear to be material to the user entity's financial statements, but the nature of the transactions processed may be significant** and the user auditor may determine that an **understanding of those controls is necessary** in the circumstances.

3. **DEGREE OF INTERACTION BETWEEN U/E AND S/O:**

   The degree of interaction refers to **the extent to which a user entity is able to and elects to implement effective controls over the processing performed by the service organisation**.

4. **RELATIONSHIP BETWEEN U/E AND S/O:**
   The **nature of the relationship** between the user entity and the service organisation, including the relevant **contractual terms for the activities undertaken by the service organisation.**

OBTAINING AN UNDERSTANDING OF INTERNAL CONTROL RELEVANT TO THE AUDIT IN ACCORDANCE WITH SA 315 WHEN THE U/E IS USING SERVICES OF S/O

1. **EVALUATE IC:**
   The user auditor **shall evaluate the design and implementation** of relevant **controls at the user entity that relate to the services provided** by the service organisation, including those that are **applied to the transactions processed by the service organisation**.

2. **UNDERSTAND SERVICES BY S/O FROM U/E:**
   The user auditor shall determine **whether a sufficient understanding of**

the nature and significance of the services provided by the service organisation and **their effect on the user entity's internal control relevant to the audit** has been obtained to provide a basis for the identification and assessment of risks of material misstatement.

3. **UNABLE TO OBTAIN UNDERSTANDING OF SERVICES BY S/O FROM U/E:** If the user auditor **is unable to obtain a sufficient understanding** from the user entity, the user auditor shall obtain that understanding from one or more of the following procedures:

    a. Obtaining **a Type 1 or Type 2 report**.
    b. **Contacting the service organisation,** through the user entity, to obtain specific information. [Follow SA 505 Procedures]
    c. **Visiting the service organisation and performing procedures** that will provide the necessary information about the relevant controls at the service organisation or
    d. **Using another auditor to perform procedures** that will provide the necessary information about the relevant controls at the service organization.

USING OF TYPE 1 OR TYPE 2 REPORTS BY U/A OF U/E W.R.T SERVICES PROVIDED BY S/O

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

    a. The **service auditor's professional competence** (except where the service auditor is a member of the Institute of Chartered Accountants of India) and independence from the service organisation and

    b. The **adequacy of the standards** under which the Type 1 or Type 2 **report was issued.**

2. If the user auditor **plans to use a Type 1 or Type 2 report as audit evidence to support the user auditor's** understanding about the design and implementation of controls at the service organisation, the **user auditor** shall:

    a. Evaluate **whether the description and design of controls** at the service organisation is at a date or for a period that is appropriate for the user auditor's purposes.
    b. Evaluate the **sufficiency and appropriateness of the evidence provided by the report** for the understanding of the user entity's internal control relevant to the audit and

3. Determine **whether complementary user entity controls identified by service organisation** are relevant to the user entity and, obtain an understanding of whether the user entity has **designed and implemented such controls.**

   CUEC: Complementary user entity controls refer to **controls that the service organisation assumes,** in the design of its service, **will be implemented by user entities, and necessary to achieve control objectives,** are identified in the description of its system.

RESPONDING TO THE ASSESSED RISKS OF MATERIAL MISSTATEMENT IN RELATION TO SERVICES PROVIDED BY S/O

1. In **responding to assessed risks** in accordance with SA 330, the user auditor shall:
2. Determine **whether sufficient appropriate audit evidence** concerning the relevant financial statement assertions **is available from records held at the user entity** if not,
3. **Perform further audit procedures** to obtain sufficient appropriate audit evidence or use another auditor to perform those procedures at the service organisation on the user auditor's behalf.

4. **TESTS OF CONTROLS:** When the user auditor's risk assessment includes **an expectation that controls at the service organisation are operating effectively,** the user auditor **shall obtain audit evidence** about the operating effectiveness of those controls from one or more of the following procedures:

   a. **Obtaining a Type 2 report,** if available.
   b. Performing **appropriate tests of controls at the service organisation**.
   c. Using **another auditor to perform tests of controls at the service organisation on behalf** of the user auditor.

USING A TYPE 2 REPORT AS AUDIT EVIDENCE THAT CONTROLS AT THE SERVICE ORGANISATION ARE OPERATING EFFECTIVELY

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

1. Evaluating whether **the description, design and operating effectiveness of controls at the service organisation is at a date or for a period** that is appropriate for the user auditor's purposes.

2. Determining **whether complementary user entity controls identified by the service organisation are relevant** to the user entity and, **obtaining an understanding of whether the user entity has designed and implemented** such controls and, **testing their operating effectiveness**.
3. Evaluating the **adequacy of the time period covered by the tests of controls and the time elapsed** since the performance of the tests of controls and
4. Evaluating whether **the tests of controls performed by the service auditor and the results**, as described in the service auditor's report, **are relevant to the assertions in the user entity's financial statements** and provide sufficient appropriate audit evidence to support the user auditor's risk assessment.

FRAUD, NON-COMPLIANCE WITH LAWS AND REGULATIONS AND UNCORRECTED MISSTATEMENTS IN RELATION TO ACTIVITIES AT THE SERVICE ORGANISATION AND REPORTING THERE OF IN THE AUDITORS REPORT BY USER AUDITOR

A. MMS IN F/S RELATED TO S/O SERVICES:

1. The user auditor **shall inquire of management of the user entity** whether the service organisation has reported to the user entity, or whether the user entity is otherwise aware of, **any fraud, non-compliance with laws and regulations or uncorrected misstatements affecting the financial statements of the user entity**.
2. The user auditor shall evaluate how such **matters affect the nature, timing and extent of the user auditor's further audit procedures**, including the effect on the user auditor's conclusions and user auditor's report.

B. REFERENCE IN AUDIT REPORT THE USER AUDITOR:

1. UNMODIFIED OPINION:

The **user auditor shall not refer to the work of a service auditor** in the user auditor's report **containing an unmodified opinion unless required by law or regulation to do so**. If such **reference is required by law or regulation**, the user auditor's report **shall indicate that the reference does not diminish the user auditor's responsibility** for the audit opinion.

2. NO S & A EVIDENCE – MODIFID OPINION:

a. The **user auditor shall modify the opinion** in the user auditor's report in accordance with SA 705 **if the user auditor is unable to obtain sufficient appropriate** audit evidence regarding the services provided by the service organization relevant to the audit of the user entity's financial statements.

b. If **reference to the work of a service auditor is relevant** to an understanding of a modification to the user auditor's opinion, the **user auditor's report shall indicate that such reference does not diminish the user auditor's responsibility** for that opinion.

SA 500 – AUDIT EVIDENCE

A. AUDIT EVIDENCE: **Audit evidence is the information used by the auditor in arriving at the conclusions** on which the auditor's opinion is based. Audit evidence includes both information contained in the **accounting records underlying the financial statements and other information**.

B. SCOPE OF THE SA 500:

1. This SA deals with **the auditor's responsibility to design and perform audit procedures to obtain sufficient and appropriate audit evidence** to be able **to draw reasonable conclusions on which to base the auditor's opinion**.
2. This SA is applicable to **all the audit evidence obtained** during the course of audit.

C. OBJECTIVE OF THE AUDITOR: To **design and perform audit procedures** in such a way as to enable the auditor **to obtain sufficient appropriate audit evidence** to be able to draw reasonable conclusions on which to base auditor's opinion.

D. INFORMATION TO BE USED AS AUDIT EVIDENCE:

1. The auditor shall consider the **relevance and reliability of the information** to be used as audit evidence.
2. When information from management expert is used, the **auditor shall evaluate the competence, objectivity of the expert, appropriateness** of the expert's work.
3. When using information produced by the entity, the **auditor shall evaluate the reliability, completeness, accuracy of the information**.

E. AUDIT PROCEDURES TO OBTAIN AUDIT EVIDENCE: Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

1. **Risk Assessment procedures**
   a. Inquiries
   b. Inspection and Observation

c. Analytical Procedures

2. **Further audit procedures comprising of:**

   a. Test of controls and

   b. Substantive procedures:

      i. Test of Details

      ii. Substantive Analytical Procedures

F. INCONSISTENCY IN OR DOUBTS OVER RELIABILITY OF AUDIT EVIDENCE:

The auditors shall determine **what modifications or additions to audit procedures are necessary to resolve the matter and shall consider the effect of the matter, on other aspects of the audit.**

SA 501 - AUDIT EVIDENCE - SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS

A. OBJECTIVE OF THE AUDITOR: The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:

1. Existence and condition of **Inventory**.
2. Completeness of **litigation and claims involving the entity**. and
3. Presentation and disclosure of **segment information in accordance** with the applicable financial reporting framework.

B. EXISTENCE AND CONDITION OF INVENTORY:

1. ATTEND MANAGEMENT INVENTORY COUNTING:

a. The auditor shall obtain sufficient appropriate audit evidence regarding the **existence and condition of inventory as at year end**.

b. Attendance at physical inventory counting performed by management to:

   i. Evaluate **management's instructions and procedures for recording and controlling** the results of the entity's physical inventory counting.

   ii. **Observe Management Count**

   iii. **Inspect the inventory**

   iv. Perform **test counts** and

c. **Reconcile the physical inventory with the inventory records** to identify any discrepancies.

d. If inventory **counting is carried at other than balance sheet date** then the auditor shall identify the **changes occurred** between balance sheet date and count date and shall ensure whether the changes are properly recorded.

2. **PHYSICAL INSPECTION BY AUDITOR DIRECTLY:** If the auditor is **unable to attend physical inventory counting by management** due to unforeseen circumstances, the auditor shall make or observe some physical counts on an **alternative date and perform audit procedures** on intervening transactions.

3. **PHYSICAL INSPECTION IMPRACTICABILITY:**
   a. If attendance at **physical inventory counting is impracticable**, the auditor shall perform **alternative audit procedures to obtain sufficient appropriate audit evidence** regarding the existence and condition of inventory.
   b. The **alternative procedure includes inspection of documentation of subsequent sale of specific items** of inventory purchased on or before balance sheet date.
   c. If alternative procedures are not possible to do so, **the auditor shall modify the opinion in the auditor's report** in accordance with SA 705.

4. **INVENTORY IN THE CUSTODY OF THIRD PARTY:**
   a. When inventory under **the custody and control of a third party the auditor shall obtain sufficient appropriate audit evidence** regarding the existence and condition of that inventory by performing one or both of the following:
   b. Request **confirmation from the third party as to the quantities and condition** of inventory held on behalf of the entity. (SA 505)
   c. If there **exist doubts as to reliability of confirmation** provided by third parties then the auditor may perform the below procedures:
      i. **Attending or arranging another auditor** for physical count procedures of third parties, if practicable.
      ii. **Obtaining another auditor report** on adequacy of third party count procedures.
      iii. **Inspecting documentation** regarding inventory held by third party eg: warehouse receipts.
      iv. Requesting **confirmation from other parties** where the inventory is **pledged as collateral**.

C. LITIGATION AND CLAIMS:

1. The auditor shall design and perform audit procedures in order to **identify litigation and claims involving the entity which may give rise to a risk** of material misstatement, including:
   a. **Inquiry of management** and, others within the entity, including in-house legal counsel.
   b. **Reviewing minutes of meetings** of those charged with governance and correspondence between the entity and its external legal counsel and
   c. **Reviewing legal expense accounts**.
   d. **CONFIRMATION FROM EXTERNAL LEGAL COUNCIL:** the auditor shall, in addition to the procedures required by other SAs, **seek direct communication with the entity's external legal counsel** in the following cases:
      i. If the auditor assesses **a risk of material misstatement regarding litigation or clai**ms that have been identified, or
      ii. When audit procedures performed **indicate that other material litigation** or claims may exist,
      iii. For **obtaining more clear understanding of existing litigations** and claims.

      The **auditor shall do so through a letter of inquiry, prepared by management and sent by the auditor**, requesting the entity's external legal counsel to communicate directly with the auditor.
2. If **management refuses to give the auditor permission** to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to **respond appropriately to the letter of inquiry, or is prohibited from responding**; and
3. If the auditor is **unable to obtain sufficient appropriate** audit evidence by performing alternative audit procedures, then the auditor **shall modify the opinion in the auditor's report** in accordance with SA 705.
4. **WRITTEN REPRESENTATIONS:** The auditor shall request management and, where appropriate, those charged with governance to provide **written representations that all known actual or possible litigation and claims** whose effects should be considered when preparing the financial statements have **been disclosed to the auditor and**

appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

D. SEGMENT INFORMATION: The auditor shall obtain **sufficient appropriate audit evidence regarding the presentation and disclosure of segment information** in accordance with the applicable financial reporting framework by:

1. Obtaining an understanding of the methods used by management in determining segment information, and:
   a. Evaluating whether such methods are likely **to result in disclosure in accordance with the applicable financial reporting framework**:
      i. Sales, transfers and charges between segments, and elimination of intersegment amounts.
      ii. **Comparisons with budgets and other expected results**, for example, operating profits as a percentage of sales.
      iii. The **allocation of assets** and costs among segments.
      iv. **Consistency with prior periods**, and the adequacy of the disclosures with
      v. respect to inconsistencies
   b. Where appropriate, **testing the application of such methods** and
2. Performing **analytical procedures or other audit procedures appropriate** in the circumstances.

SA 505 - EXTERNAL CONFIRMATIONS

A. DEFINITIONS:

1. **EXTERNAL CONFIRMATION:**
   Audit evidence obtained as a **direct written response to the auditor** from a third party, in paper form, or by electronic or other medium.

2. **POSITIVE CONFIRMATION REQUEST:**
   A request that the **confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees** with the information in the request, or providing the requested information.

3. **NEGATIVE CONFIRMATION REQUEST:**
   A request that the confirming party respond directly to the auditor **only if the confirming party disagrees with the information provided in the request**.

4. **EXCEPTION:**
   A response indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

B. EXTERNAL CONFIRMATION PROCEDURES:

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

STEP 1: DETERMINING THE INFORMATION TO BE CONFIRMED OR REQUESTED:

External confirmation procedures frequently are **performed to confirm or request information regarding account balances and their elements.** They may also be used:

1. To **confirm terms of agreements**,
2. **Contracts**, or
3. **Transactions** between an entity and other parties, or
4. To **confirm the absence of certain conditions**, such as a "side agreement".
5. Amounts **due to lenders**.
6. Property **title deeds held by lawyers or financiers** for safe custody or as security.
7. **Investments held for safekeeping by third parties**, or purchased from stockbrokers but not delivered at the balance sheet date.

STEP 2: SELECTING THE APPROPRIATE CONFIRMING PARTY:

Responses to confirmation requests **provide more relevant and reliable audit evidence** when confirmation requests are sent to a confirming party the **auditor believes is knowledgeable about the information to be confirmed.**

STEP 3: DESIGNING THE CONFIRMATION REQUESTS:

1. The **design of a confirmation request may directly affect the confirmation response rate**, and the reliability and the nature of the audit evidence obtained from responses.
2. The following are the factors when designing the confirmation request:
    a. **Specific identified risks of material misstatement**, including fraud risks.
    b. The **layout and presentation** of the confirmation request.
    c. **Prior experience** on the audit or similar engagements.
    d. The **assertions being addressed**.
    e. The **method of communication**
    f. **Management's authorisation** or encouragement to the confirming parties to respond to the auditor. *Confirming parties may only be willing to respond to a confirmation request containing management's authorisation.*
    g. The **ability of the intended confirming party to confirm** or provide the requested information.

STEP 4:

Sending the requests, **including follow-up requests when applicable,** to the confirming party.

C. MANAGEMENT'S REFUSAL TO ALLOW THE AUDITOR TO SEND A CONFIRMATION REQUEST:

If **management refuses to allow the auditor to send** a confirmation request, the auditor shall:

1. **Inquire as to management's reasons** for the refusal, and seek audit evidence as to their validity and reasonableness.
2. **Evaluate the implications** of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures and
3. **Perform alternative audit procedures** designed to obtain relevant and reliable audit evidence.

4. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is **unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence** from alternative audit procedures, the auditor shall **communicate with those charged with governance in accordance with SA 260**.
5. The auditor also shall determine **the implications for the audit and the auditor's opinion in accordance with SA 705.**

D. DOUBTS ABOUT RELIABILITY OF RESPONSES TO CONFIRMATION REQUESTS

1. If the auditor identifies factors that give **rise to doubts about the reliability** of the response to a confirmation request, the auditor **shall obtain further audit evidence to resolve those doubts.**
2. If the auditor determines that **a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment** of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.

E. NEGATIVE CONFIRMATIONS:

Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor **shall not use negative confirmation requests as the sole substantive** audit procedure to address an assessed risk of material misstatement at the assertion level **UNLESS ALL** of the following are present:

a. The auditor has assessed the **risk of material misstatement as low** and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion
b. The population of items subject to **negative confirmation procedures comprises a large number of small, homogeneous**, account balances, transactions or conditions;
c. A very **low exception rate** is expected; and
d. **Very low chances of non-response** from third party.

SA 510 – INTITIAL AUDIT ENGAGEMENTS – OPENING BALANCES

A. OBJECTIVE OF THE AUDITOR:

In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

1. **Opening balances contain misstatements** that materially affect the current period's financial statements; and
2. Appropriate **accounting policies reflected in the opening balances have been consistently applied** in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

B. DEFINITIONS:

1. INITIAL AUDIT ENGAGEMENT:

An engagement in which either:

a. The financial statements for the **prior period were not audited**; or

b. The financial statements for the **prior period were audited by a predecessor auditor**.

2. OPENING BALANCES:

Those **account balances that exist at the beginning of the period.**

a. Opening balances are **based upon the closing balances** of the **prior period and reflect the effects of transactions and events of prior periods and accounting policies** applied in the prior period.

b. Opening balances **also include matters requiring disclosure** that existed at the beginning of the period, such as **contingencies and commitments.**

3. PREDECESSOR AUDITOR:

Predecessor auditor means the **auditor from a different audit firm, who audited the financial statements of an entity in the prior period** and who has been replaced by the current auditor.

C. AUDIT PROCEDURES FOR AUDIT OF OPENING BALANCES:

1. The auditor shall obtain sufficient appropriate **audit evidence about whether the opening balances contain misstatements** that materially affect the current period's financial statements by:

a. Determining whether the prior period's **closing balances have been correctly brought forward** to the current period or, when appropriate, any **adjustments have been disclosed as prior period items** in the current year's Statement of Profit and Loss;
b. Determining whether the **opening balances reflect the application of appropriate accounting policies**; and
c. Whether audit procedures performed in **the current period provide evidence relevant to the opening balances**; or
d. Performing **specific audit procedures to obtain evidence** regarding the opening balances.

2. If the auditor obtains audit evidence **that the opening balances contain misstatements that could materially affect the current period's financial statements,** the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall **communicate the misstatements with the appropriate level** of management and those charged with governance in accordance with SA 450.

D. CONSISTENCY OF ACCOUNTING POLICIES:

The auditor shall obtain sufficient appropriate audit evidence about whether the **accounting policies reflected in the opening balances have been consistently applied** in the current period's financial statements, and whether changes in the accounting policies have been properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

E. AUDIT CONCLUSIONS AND REPORTING - OPENING BALANCES:

1. If the **auditor concludes that the opening balances contain a misstatement that materially affects** the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, **the auditor shall express a qualified opinion or an adverse opinion, as appropriate,** in accordance with SA 705.
2. If the auditor is **unable to obtain sufficient appropriate audit evidence regarding the opening balances,** the auditor shall express a **qualified opinion or a disclaimer of opinion, as appropriate,** in accordance with SA 705.

F. AUDIT CONCLUSIONS AND REPORTING – CONSISTENCY OF ACCOUNTING POLICIES:

1. If the auditor concludes that:
   a. The **current period's accounting policies are not consistently applied in relation to opening balances** in accordance with the applicable financial reporting framework; or
   b. **Changes in accounting policies is not properly accounted** for or not adequately presented or disclosed in accordance with the applicable financial reporting framework.
2. Then the auditor **shall express a qualified opinion or an adverse opinion** as appropriate in accordance with SA 705.

G. MODIFICATIONS IN THE PREDECESSOR AUDITOR'S REPORT:

If **there exist a modification in the predecessor audit report** and the modification is remain relevant and material for the current period under audit then the current auditor **shall also modify the opinion** in accordance with SA 705.

SA 530 – AUDIT SAMPLING

SA 530

"Audit Sampling"

Scope of the SA & Objective of the auditor

Scope

This SA applies when the auditor has decided to use audit sampling in performing audit procedures. It deals with auditor's use of statistical and non statistical sampling.

Objective

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

Sample design, size and selection of items for testing

1. While designing audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population.
2. The auditor shall determine sample size sufficient to reduce sampling risk to an acceptably low level.
3. The auditor shall select items for the sample such that each sampling unit in the population has a chance of selection.

Performing Audit Procedures

1. The auditor shall perform appropriate audit procedure on each item selected.
2. If audit procedure is not applicable on the selected item, apply the procedure on a replacement item.
3. If the auditor is unable to apply the designed audit procedure to a selected item, treat that item as a deviation from the prescribed control, in case of tests of controls, or a misstatement, in the case of tests of details.

Other points of consideration

1. The auditor shall investigate the nature and cause of deviation or misstatement identified and evalute its possible effect.
2. When a deviation / misstatement is considered as anomaly, the auditor shall perform audit procedures to obtain high degree of certainity that it is not representative of the population.
3. For test of details, the auditor shall project misstatements found in the sample to the population.
4. The auditor shall evaluate the results of the sample and whether the use of audit sampling has provided a reasonable basis for conclusion about the population tested.

SA 550 - RELATED PARTIES

Scope of the SA

This SA deals with **the auditor's responsibilities regarding related party relationships and transactions**. It expands on how SA 315, SA 330, SA 240 are to be applied in relation to related party relationships and transactions.

Objectives of the auditor

To obtain an understanding of the related party transactions to:

1. **recognize fraud risk factors** arising from such transactions.

2. conclude whether financial statements in so far as they are **affected by such transactions**

a) achieve a true and fair presentation.

b) are not misleading.

To obtain audit evidence as to whether the **related party transactions are properly identified, accounted for, and disclosed** in the financial statements.

Requirements of the SA

1. Risk Assessment procedures and related activities.

2. **Understanding the Entity's related party relationships and transactions**.

3. Maintaining alertness for related party information when reviewing records or documents.

4. Sharing related party information with the Engagement team.

5. **Identification and assessment of the risk of material misstatement** associated with related party transactions and relationships.

6. Responses to the Risks of Material Misstatement associated with related party relationships and transactions.

Identification of previously unidentified or undisclosed related part transactions.

1. Auditor shall determine whether the **underlying circumstances confirm the existence of such transactions**.

2. Communicate within the team.

3. Request **managment to identify all transactions with newly identified related parties**.

4. Perform more substantive procedures.

5. Reconsider risks with respect to other related parties.

5. If non disclosure by the management appears intentional, evaluate the implications for the audit.6

Identified significant related party transactions outside the entity's normal course of business

1. Inspect the underlying contracts and evaluate:

a) the business rationale of the transactions.

b) whether the **terms of transactions are consistent with managment's explanations**.

c) whether such transactions have been **properly accounted** for.

2. Obtain **audit evidence that the transactions have been appropriately authorised** and approved.

Other important points

The auditor shall obatin Written Representation that:

a) all the related parties and related party transactions **have been disclosed to the auditor** and

b) all such transactions have **been properly accounted** for and disclosed.

Communication with TCWG

The auditor shall communicate with TCWG significant matters arising **during the audit in connection with the entity's related parties**.

Documentation :

The auditor shall include in audit documentation names of the related parties and the nature of the related party transactions.

SA 560 - SUBSEQUENT EVENTS

A. OBJECTIVES:

The objectives of the auditor are to:

1. Obtain sufficient appropriate audit evidence about whether events occurring **between the date of the financial statements and the date of the auditor's report that require adjustment** in the financial statements are appropriately reflected in those financial statements; and
2. **Respond appropriately to facts that become known to the auditor after the date of the auditor's report** that may have caused the auditor to amend the auditor's report

B. DEFINITIONS:

1. **SUBSEQUENT EVENTS**:
   The **events occurring** between the date of the financial statements and the date of the auditor's report, and **facts that become known to the auditor after the date of the auditor's report.**
2. **DATE OF THE FINANCIAL STATEMENTS:**
   The **date of the end of the latest period** covered by the financial statements.
3. **DATE OF APPROVAL OF THE FINANCIAL STATEMENTS:**
   The date on which all the statements that comprise the financial statements, including the related notes, have been **prepared and those with the recognised authority have asserted that they have taken responsibility** for those financial statements.
4. **DATE OF THE AUDITOR'S REPORT:**
   The **date the auditor dates the report on the financial statements** in accordance with SA 700.
5. **DATE THE FINANCIAL STATEMENTS ARE ISSUED**:
   The date that the auditor's report and audited financial statements are **made available to third parties.**

C. AUDIT PROCEDURE FOR IDENTIFICATION OF SUBSEQUENT EVENTS:

1. The auditor shall perform the procedures to identify subsequent events which shall include the following:
2. Obtaining an **understanding of any management procedures** established to ensure that subsequent events are identified.

3. **Inquiring of management and those charged with governance as to whether any subsequent events have occurred**. Specifically, the auditor shall evaluate the following:
    a. Whether **new commitments, borrowings or guarantees** have been entered into.
    b. **Whether sales or acquisitions of assets** have occurred or are planned.
    c. Whether **any assets have been appropriated by government or destroyed**
    d. Whether **there have been any developments regarding contingencies**.
    e. Whether **any unusual accounting adjustments** have been made or are Contemplated
    f. Whether any events have occurred or are likely to occur which will **bring into question the appropriateness of accounting policies** used in the financial statements.
4. **Reading minutes of the meetings,** of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements.
5. Reading **the entity's latest subsequent interim financial statements**.

CASE – I – FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE DATE OF THE AUDITOR'S REPORT BUT BEFORE THE DATE THE FINANCIAL STATEMENTS ARE ISSUED:

1. The **auditor has no obligation** to perform any audit procedures regarding the **financial statements after the date of the auditor's report.**
2. When, **after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor** at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
    a. **Discuss the matter with management** and those charged with governance.
    b. Determine **whether the financial statements need amendment**
    c. **Inquire how management intends to address** the matter in the financial statements.
    d. **IF MANAGEMENT AMENDS THE FINANCIAL STATEMENTS**: the auditor shall:

i. **Carry out the audit procedures necessary** in the circumstances on the amendment.
ii. Obtain sufficient and appropriate **evidence regarding the amendment such subsequent events.**

e. **IF MANAGEMENT DOES NOT AMEND THE FINANCIAL STATEMENTS:**
   i. Where the **auditor concludes that the financial statements are not amended** and If the **auditor's report has not yet been provided to the entity, the auditor shall modify the opinion** as required by SA 705 and then provide the auditor's report; or
   ii. If **the auditor's report has already been provided** to the entity, the **auditor shall notify management and those charged with governance not to issue the financial statements to third parties** before the necessary amendments have been made.
   iii. If the **financial statements are nevertheless subsequently issued without the necessary amendments, the auditor shall take appropriate action, to seek to prevent reliance** on the auditor's report.

CASE – II – FACTS WHICH BECOME KNOWN TO THE AUDITOR AFTER THE FINANCIAL STATEMENTS HAVE BEEN ISSUED:

1. After the financial statements have been issued, **the auditor has no obligation to perform any audit procedures** regarding such financial statements.
2. When, **after the financial statements have been issued, a fact becomes known to the auditor** that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
   a. Discuss the **matter with management** and, those charged with governance.
   b. Determine **whether the financial statements need amendment** and, if so,
   c. Inquire **how management intends to address** the matter in the financial statements.
      i. **IF THE MANAGEMENT AMENDS THE FINANCIAL STATEMENTS:** The auditor shall:
         1. **Carry out the audit procedures** necessary in the circumstances on the amendment.

2. **Review the steps taken by management** to ensure that **anyone in receipt of the previously issued** financial statements together with the auditor's report thereon is informed of the situation.
3. Provide a **new auditor's report** on the amended financial statements. The **report shall include an emphasis of matter or other matter paragraph** describing the effect of amendment of financial statements on the earlier issued F/S and earlier issued audit report.

ii. **IF MANAGEMENT DOES NOT TAKE NECESSARY STEPS:** The **auditor shall take appropriate action to seek prevent reliance** on the audit report and financial statements **that are already issued to third parties.**

SA 580 – WRITTEN REPRESENTATION

A. DEFINITION OF WRITTEN REPRESENTATION:

written statement by provided by management to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context **do not include financial statements**, the assertions therein, or supporting books and records.

B. WRITTEN REPRESENTATIONS AS AUDIT EVIDENCE:

1. **Written representations are necessary information that the auditor requires in connection with the audit** of the entity's financial statements.
2. Although written representations provide necessary audit evidence, **they do not provide sufficient appropriate audit evidence on their own.**

C. OBJECTIVES:

The objectives of the auditor are:

1. To obtain written representations from management that they believe that they have **fulfilled their responsibility for the preparation of the financial statements and for the completeness** of the information provided to the auditor.
2. To **support other audit evidence relevant to the financial statements or specific assertions** in the financial statements by means of written representations, as determined necessary by the auditor or required by other SAs and

3. To **respond appropriately to written representations** provided by management.

D. DATE OF AND PERIOD COVERED BY WRITTEN REPRESENTATIONS:

1. The date shall be **as near as practicable to, but not later than the date of the auditor's report** on the financial statements.
2. The written representations **shall be for all financial statements and period referred to in the auditor's report.**

E. WRITTEN REPRESENTATION FROM WHOM:

1. The auditor shall **request written representations from management with appropriate responsibilities** for the financial statements and knowledge of the matters concerned.
2. Written representations are **requested from those responsible for the preparation and presentation of the financial statements**. Those individuals may vary depending on the governance structure of the entity, and relevant law or regulation. Management (rather than those charged with governance) is often the responsible party.
3. Written representations **may therefore be requested from the entity's chief executive officer and chief financial officer**, or other equivalent persons in entities that do not use such titles.
4. In some circumstances**, other parties, such as those charged with governance, are also responsible for the preparation** and presentation of the financial statements. [E.g., Accountants under the direction of Audit Committee]
5. Due to its **responsibility for the preparation and presentation** of the financial statements, and its **responsibilities for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process** followed by the entity in preparing and presenting the financial statements and the assertions therein on which to base the written representations.
6. In some cases, **management may decide to make inquiries of others** who participate in preparing and presenting the financial statements and assertions therein, **including individuals who have specialized knowledge relating to the matters about which written representations are requested**. Such individuals may include:
    a. An **actuary responsible for actuarially determined accounting measurements.**
    b. **Staff engineers who may have responsibility for and specialized knowledge** about environmental liability measurements.
    c. **Internal counsel who may provide information essential** to provisions for legal claims.

7. **QUALIFYING LANGUAGE:** In some cases, management may include in the **written representations qualifying language to the effect that representations are made to the best of its knowledge and belief.** It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate **responsibilities and knowledge of the matters** included in the representations.

F. DOUBT AS TO THE RELIABILITY OF WRITTEN REPRESENTATIONS:

1. If the **auditor has concerns about the competence, integrity of ma**nagement, the auditor **shall determine the effect that may have on the reliability of representations and audit evidence** in general.
2. In particular, if **written representations are inconsistent with other audit evidence**, the auditor s**hall perform audit procedures to attempt to resolve the matter.**
3. If the auditor concludes that the **written representations are not reliable, the auditor shall take appropriate actions**, including determining the possible effect on the opinion in the **auditor's report in accordance with SA 705.** (Usually expresses a disclaimer of opinion)

G. WRITTEN REPRESENTATIONS NOT PROVIDED:

If **management does not provide one or more** of the requested written representations, the auditor shall:

1. **Discuss the matter** with management;
2. **Re-evaluate the integrity** of management and **evaluate the effect** that may have on the reliability of representations; and
3. Take **appropriate actions in accordance with SA 705.** (Expresses a disclaimer of opinion)

SA 320 - MATERIALITY IN PLANNING AND PERFORMANCE OF AN AUDIT

CONCEPT OF MATERIALITY

1. Financial statements should **disclose all 'material items, i.e., the items the knowledge of which might influence the decisions of the user** of the financial statement.
2. Materiality is **not always a matter of relative size**.
3. In certain cases, **quantitative limits of materiality is specified**. A few of such cases are given below:

a. A company should **disclose by way of notes additional information** regarding any item of **income or expenditure which exceeds 1% of the revenue from operations or Rs.1,00,000 whichever is higher** (Schedule III to the Companies Act, 2013).
b. A company should disclose in Notes to Accounts, shares in the company held by each shareholder holding more than 5 % shares specifying the number of shares held.

4. Standard on Auditing (SA) -320 on "Materiality in Planning and Performing an Audit" deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements. SA 450 explains **how materiality is applied in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements** on the financial statements.
5. **MATERIALITY IF FRFW DO NOT CONTAIN ANY REFERENCE THERETO:** Financial reporting frameworks **often discuss the concept of materiality in the context of the preparation and presentation of financial statements**. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:
   a. Misstatements a**re material if expected to influence the economic decisions of users** taken on the basis of the financial statements.
   b. Judgments about **materiality are affected by the size or nature of a misstatement** or combination of both.
   c. Judgments about matters that are material are **based on a consideration of the common financial information needs of users** as a group. The **possible effect of misstatements on specific individual users**, whose needs **may vary widely, is not considered**.

   If the applicable financial reporting framework **does not include a discussion of the concept of materiality, the characteristics referred above** provide the auditor with such a frame of reference.

DETERMINATION OF MATERIALITY IS A MATTER OF PROFESSIONAL JUDGMENT OF AUDITOR

The **auditor's determination of materiality is a matter of professional judgment**, and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, it is **reasonable for the auditor to assume that** users:

1. Have a reasonable knowledge of business and economic activities and accounting and **a willingness to study the information in the financial statements** with reasonable diligence.
2. **Understand that financial statements are prepared, presented and audited** to levels of materiality.

3. **Recognize the uncertainties inherent in the measurement** of amounts based on the use of estimates, judgment and the consideration of future events and
4. Make **reasonable economic decisions on the basis of the information** in the financial statements.

THE CONCEPT OF MATERIALITY IS APPLIED BY THE AUDITOR BOTH IN PLANNING AND PERFORMING THE AUDIT, AND IN EVALUATING THE EFFECT OF IDENTIFIED MISSTATEMENTS ON THE AUDIT AND OF UNCORRECTED MISSTATEMENTS, ON THE FINANCIAL STATEMENTS AND IN FORMING THE OPINION IN THE AUDITOR'S REPORT

1. **Materiality is an important consideration** for an auditor to evaluate whether the **financial statements reflect a true and fair view or not.**
2. SA 320 on "Materiality in Planning and Performing an Audit" requires **that an auditor should consider materiality and its relationship with audit risk** while conducting an audit.
3. When planning the audit, the auditor considers **what would make the financial information materially misstated.**
4. The **auditor's preliminary assessment of materiality** related to specific account balances and classes of transactions **helps the auditor decide such questions as what items to examine and whether to use sampling and analytical procedures**.
5. This enables the **auditor to select audit procedures** that, in combination, can be expected to support the audit opinion at an acceptably low degree of audit risk.
6. It may be noted that the **auditor's assessment of materiality and audit risk may be different at the time of initially planning** of the audit **as against at the time of evaluating the results of audit procedures**.
7. At the planning stage, the auditor needs **to consider the materiality for the financial statements as a whole.** The auditor has to carry out a preliminary identification of significant components and material classes of transactions, account balances and disclosure which he plans to examine.
8. What could be considered material for all situations cannot be defined precisely and **an amount or transaction material in one situation may not be material in other situation**.
9. The auditor **has to apply his professional judgement in determining materiality,** choosing appropriate benchmark and determining level of benchmark.
10. Materiality forms the **basis for determination of audit scope and the levels of testing the transactions.**

11. **If there is any statutory requirement of disclosure, it is to be considered material** irrespective of the value of amount.

PERFORMANCE MATERIALITY

1. When **establishing the overall audit strategy, the auditor shall determine materiality** for the financial statements as a whole.
2. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which **misstatements of lesser amounts than the materiality** for the financial statements as a whole, **could reasonably be expected to influence the economic decisions of users** taken on the basis of the financial statements, **the auditor shall also determine** the materiality level or levels **to be applied to those particular classes** of transactions, account balances or disclosures.
3. **PERFORMANCE MATERIALITY:** Performance materiality **means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole** to reduce to an appropriately low level **the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality** for the financial statements as a whole.

   If applicable, **performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level** or levels for particular classes of transactions, account balances or disclosures.

USE OF BENCHMARKS IN DETERMINING MATERIALITY FOR THE FINANCIAL STATEMENTS AS A WHOLE

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

Factors that may affect the identification of an appropriate benchmark include the following:

1. The **elements of the financial statements**.
2. Whether there are items on which **the attention of the users** of the particular entity's financial statements **tends to be focused**
3. The nature of the entity, where the entity is **at in its life cycle, and the industry and economic environment** in which the entity operates
4. The **entity's ownership structure** and the way it is financed
5. The **relative volatility of the benchmark**.

BENCHMARKS THAT HELPS IN DETERMINGING MATERIALITY

SELECTION OF CHOOSEN BENCHMARK: In relation to the chosen benchmark, relevant financial data ordinarily includes:

1. **Prior periods' financial results** and financial positions,
2. The **period to-date financial results** and financial position, and
3. **Budgets or forecasts** for the current period,

Adjusted for significant changes in the circumstances of the entity and relevant changes of conditions in the industry or economic environment in which the entity operates.

APPLY A PERCENTAGE ON CHOOSEN BENCHMARK: Determining a percentage to be applied to a chosen benchmark **involves the exercise of professional judgment.** There is a **relationship between the percentage and the chosen benchmark,** such that a **percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue**.

MATERIALITY LEVEL OR LEVELS FOR PARTICULAR CLASSES OF TRANSACTIONS, ACCOUNT BALANCES OR DISCLOSURES

Factors that **may indicate the existence of one or more particular classes of transactions**, account balances or disclosures for **which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions** of users taken on the basis of the financial statements include the following:

1. Whether law, regulations or the applicable financial reporting framework **affect users' expectations regarding the measurement or disclosure** of certain items.
2. The **key disclosures in relation to the industry** in which the entity operates.
3. Whether **attention is focused on a particular aspect of the entity's business** that is separately disclosed in the financial statements.

REVISION AND DOCUMENTATION OF MATERIALITY

REVISION IN MATERIALITY LEVEL:

The overall materiality and performance materiality may need to be changed as the audit progresses in the following cases:

1. A **change in circumstances that occurred during the audit**.
2. Availability of **additional information**.
3. A **change in actual financial results than the anticipated results** at the beginning of the audit.
4. **Increase in estimated risk** than the original prediction resulting in revision of materiality level.

5. A **change in auditor's knowledge of client's business** and understanding of the same.

DOCUMENTATION OF MATERIALITY:

The auditor shall document the following:

1. **Materiality for the financial statements as a whole** (Overall materiality);
2. If applicable, **the materiality level or levels for particular classes of transactions**, account balances or disclosures;
3. General **Performance materiality**; and
4. **Any revision** of the above.

SQC 1 – QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF HISTORICAL FINANCIAL INFORMATION, AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS

A. SCOPE AND OBJECTIVE:

1. SQC 1 requires that **the firm should establish a system of quality control designed to provide it with reasonable assurance** that the firm and its personnel comply with professional standards and regulatory and legal requirements and that **reports issued by the firm or engagement partners are appropriate** in the circumstances.
2. Firm's system of **quality control should consist of policies designed to achieve these objectives**.
3. This **quality control standard applies to all firms irrespective** of their constitution.
4. Quality control policies and procedures **should be documented and communicated to the firm's personnel**. By communicating, the firm recognizes the **importance of obtaining feedback** on its quality control system from its personnel. Therefore, **the firm encourages its personnel to communicate their views or concerns on quality control matters**.

B. ELEMENTS OF SYSTEM OF QUALITY CONTROL:

The firm's system of quality control should include policies and procedures addressing each of the following elements: -

1. **Leadership responsibilities for quality** within the firm
2. **Ethical requirements**
3. **Acceptance and continuance of client relationships** and specific

engagements

4. **Human resources**
5. **Engagement performance**
6. **Monitoring**

C. LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM:

1. SQC 1 requires firms to establish policies and procedures designed **to promote an internal culture based on the recognition that quality is essential** in performing engagements.
2. Such policies and procedures should **require the firm's chief executive officer** or the firm's managing partners **to assume ultimate responsibility for the firm's system of quality control.**
3. **Persons assigned operational responsibilities** for the firm's quality control system by the firm's chief executive officer or managing partners **should have sufficient and appropriate experience, ability, and the necessary authority** to assume that responsibility.
4. It has been laid down clearly that firm's business strategy is subject to the **overriding requirement for the firm to achieve quality in all the engagements** that the firm performs. It is non-negotiable. In this regard, it should be ensured that:
   a. The **firm assigns its management responsibilities** so that commercial considerations do not override the quality of work performed.
   b. The firm's policies and procedures **addressing performance evaluation, compensation, and promotion (including incentive systems) with regard to its personnel** are designed to demonstrate the firm's overriding commitment to quality and
   c. The **firm devotes sufficient resources for the development, documentation** and support of its quality control policies and procedures.

D. ETHICAL REQUIREMENTS:

1. The firm should **establish policies and procedures** designed to provide it with **reasonable assurance** that the firm and its personnel **comply with relevant ethical requirements** contained in the Code of ethics issued by ICAI. The **Code establishes** the fundamental principles of professional ethics which include **integrity, objectivity, professional competence and due care, confidentiality and professional behavior**. Fundamental principles should be emphasized by:

   a. **Actions of the leadership** of the firm
   b. **Spreading awareness** and training
   c. **Monitoring**
   d. A process for **dealing with non-compliance**.

2. The firm should establish **policies and procedures designed** to provide it with reasonable assurance that **the firm, its personnel** and (including experts contracted by the firm and network firm personnel) **maintain independence where required by the Code**. Such policies and procedures should enable the firm to:
   a. **Communicate its independence** requirements to its personnel
   b. **Identify and evaluate circumstances and relationships that create threats to independence,** and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if appropriate, to withdraw from the engagement.
3. There should **exist a mechanism in the firm** by which engagement partners provide the firm with **relevant information about client engagements and personnel** of firm promptly **notify firm of circumstances and relationships that create a threat to independence**. Its objective is to ensure that independence requirements are satisfied.
4. At least **annually, the firm should obtain written confirmation of compliance with its policies and procedures** on independence from all firm personnel required to be independent in terms of the requirements of the Code.
5. SQC 1 lays special emphasis on familiarity threat. **Using the same senior personnel on assurance engagements over a prolonged period** may impair the quality of performance of the engagement. The firm should establish criteria for determining the need for **safeguards to address this threat.** In determining appropriate criteria, the firm considers such matters as
   a. The **nature of the engagement**, including the extent to which it involves a matter of public interest and
   b. The **length of service of the senior personnel** on the engagement.
   c. The familiarity threat is particularly relevant in the context of financial statement **audits of listed entities**. For these audits, **the engagement partner should be rotated after a pre- defined period, normally not more than 7 years** (except in cases where audit of listed entities is conducted

by a sole practitioner). To ensure quality control exists in such firms and appropriate reports are issued, there is a process for mandatory peer review of such firms.

E. ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND SPECIFIC ENGAGEMENTS:

1. A firm **before accepting an engagement should acquire vital information** about the client. Such an information should help firm to decide about:

a. Integrity of Client, promoters and key managerial personnel:

i. The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.

ii. The nature of **the client's operations, including its business practices**.

iii. Information concerning **the attitude of the client's principal owners**, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.

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

v. Indications of **an inappropriate limitation** in the scope of work.

vi. Indications that the **client might be involved in money laundering** or other criminal activities.

vii. The **reasons for the proposed appointment of the firm and non-reappointment of the previous firm**.

The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

b. Competence (including capabilities, time and resources) to perform engagement:

i. Firm personnel **have knowledge of relevant industries** or subject matters;

ii. Firm personnel **have experience with relevant regulatory** or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;

iii. The firm has **sufficient personnel with the necessary capabilities** and competence;

iv. **Experts** are available,

v. Individuals **meeting the criteria and eligibility requirements** to perform engagement quality control review are available, where applicable; and

vi. The firm would **be able to complete the engagement within the reporting deadline**.

c. Compliance with ethical requirements.

2. The **firm should obtain such information as it considers necessary** in the circumstances:
   a. Before accepting an engagement **with a new client**,
   b. When deciding whether **to continue an existing engagement**, and
   c. When considering **acceptance of a new engagement with an existing client**.
3. **If there is any conflict of interest between the firm and client**, it should be **properly resolved** before accepting the engagement. Where the firm **obtains information that would have caused it to decline an engagement** if that information had been obtainable earlier, policies and procedures on the continuance of the engagement and the client relationship should include consideration of:
   a. The **professional and legal responsibilities that apply to the circumstances**, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and
   b. The **possibility of withdrawing from the engagement** or from both the engagement and the client relationship:
4. **Policies and procedures on withdrawal from an engagement** or from both the engagement and the client relationship address issues that include the following:
   a. Discussing **with the appropriate level of the client's management** and those charged with its governance **regarding the appropriate action that the firm might take** based on the relevant facts and circumstances.
   b. If the **firm determines that it is appropriate to withdraw**, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and **the reasons for the withdrawal.**
   c. **Considering whether there is a professional, regulatory or legal requirement** for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.

d. **Documenting significant issues, consultations, conclusions** and the basis for the conclusions.

HUMAN RESOURCES:

1. The **firm should establish policies and procedures** designed to provide it with reasonable assurance that it **has sufficient personnel with the capabilities, competence, and commitment** to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements and **to enable the firm or engagement partners to issue reports that are appropriate** in the circumstances.
2. Such policies and **procedures should address relevant HR issues** including:
   a. Recruitment,
   b. Compensation,
   c. Training,
   d. Career development,
   e. Performance evaluation etc.

   There should be emphasis on the continuing professional development of firm's personnel.
3. The firm should **assign responsibility for each engagement** to an engagement partner.
4. The firm should establish policies and procedures requiring that:
   a. The **responsibilities of the engagement partner** are clearly defined and communicated to that partner
   b. The **identity and role of the engagement partner are communicated to key members** of the client's management and those charged with governance.
   c. The **engagement partner has the appropriate capabilities, competence, authority** and time to perform the role and
5. Each engagement team **should be able to carry out its responsibilities with necessary competence and skill**. The firm should **ensure suitable people are available and also groom them for their role**.
6. The firm should **assess performance of their partners and team members keeping in mind their commitment** towards quality.

F. ENGAGEMENT PERFORMANCE:

1. **Consistency in quality of engagement** performance is achieved through briefing of engagement teams of **their objectives, processes for complying with engagement standards,** processes of engagement

supervision and training, methods of reviewing performance of work, appropriate documentation of work performed.

2. **CONSULTATION IN DIFFICULT OR CONTENTIOUS MATTERS:** Consultation should take place in difficult or contentious matters pertaining to an engagement.
   a. **CONCEPT:** Consultation **includes discussion, at the appropriate professional level,** with individuals within or outside the firm who have **specialized expertise, to resolve a difficult or contentious matter**. It helps to **promote quality and improves the application of professional judgment.**
   b. **INTERNAL CONSULTATION:** Consultation procedures require **consultation with those having appropriate knowledge, seniority and experience** within the firm (or outside the firm) on significant technical, ethical and other matters and appropriate documentation and implementation of conclusions resulting from consultations.
   c. **EXTERNAL CONSULTATION:** A firm needing to consult externally, for example, a firm without appropriate internal resources, **may take advantage of advisory services provided by other firms or professional and regulatory bodies**.
   d. **DOCUMENTATION OF RESULTS:** **Complete and proper documentation should be maintained on issues involved** and results of consultation.

3. **ENGAGEMENT QUALITY CONTROL REVIEW [EQC]:**
   a. Significant **judgments made in an engagement should be reviewed** by an engagement quality control reviewer [EQCR] for taking an objective view **BEFORE the report is issued**.
   b. The **extent of the review depends on the complexity** of the engagement and the risk that the report might not be appropriate in the circumstances. The **review DOES NOT reduce the responsibilities of the engagement partner**.
   c. Engagement **quality control review is mandatory for all audits of financial statements of listed entities**. In respect of other engagements, firm should devise criteria to determine cases requiring performance of engagement quality control review.
   d. An engagement quality control review for audits of financial statements of listed entities includes considering the following:
      i. The **engagement team's evaluation of the firm's independence** in relation to the specific engagement.

ii. **Significant risks identified** during the engagement and the **responses** to those risks.

iii. Judgments made, particularly with respect **to materiality and significant risks**.

iv. Whether appropriate consultation has taken place on matters involving **differences of opinion or other difficult or contentious matters, and the conclusions** arising from those consultations.

v. The **significance and disposition of corrected and uncorrected misstatements** identified during the engagement.

vi. The **matters to be communicated to management and those charged with governance** and, where applicable, other parties such as regulatory bodies.

vii. Whether **working papers selected for review reflect the work performed in relation to the significant judgments** and support the conclusions reached.

viii. The appropriateness of the report to be issued.

4. **EQCR:**

   a. **Engagement quality control reviewer** is a partner, other person in the firm (who should be member of ICAI), **suitably qualified external person, or a team made up of such individuals.** In this regard, suitably qualified external person refers **to an individual outside the firm with the capabilities and competence** to act as an engagement partner, for example a partner or an employee (with appropriate experience) of another firm.

   b. In addition, the engagement quality control **reviewer for an audit of the financial statements of a listed entity is an individual** with sufficient and appropriate experience **and authority to act** as an audit engagement partner on audits of financial statements of listed entities.

   c. It is **necessary to maintain objectivity of such reviewer**. Participation in **engagement or making decisions** for engagement team is to be **avoided** at all costs. However, **engagement partner may consult** engagement quality control reviewer during the engagement **so as not to compromise his objectivity and eligibility to perform the role.**

   d. Where the nature and extent of the consultations become significant, **care is taken by both the engagement team and the reviewer** to maintain the reviewer's objectivity. Where this is not possible, another individual within the firm or a suitably qualified external person is **appointed to take on the role of either the engagement quality control reviewer** or the person to be consulted on the engagement.

e. The firm's policies should **provide for the replacement** of the engagement quality control reviewer where **the ability to perform an objective review may be impaired.**

f. **Differences of Opinion:**
   i. There might be **difference of opinion within** engagement team, with those consulted and between engagement partner and engagement quality control reviewer.
   ii. The **report should only be issued after resolution** of such differences.
   iii. In case, **recommendations** of engagement quality control reviewer **are not accepted by engagement partner** and matter is **not resolved** to reviewer's satisfaction, the matter should be **resolved by following established procedures** of firm like by consulting with another practitioner or firm, or a professional or regulatory body.

5. **ENGAGEMENT DOCUMENTATION:**
   a. The firm should establish policies and procedures for engagement teams **to complete the assembly of final engagement files on a timely basis** after the engagement reports have been finalized.
   b. Engagement files should be completed in **not more than 60 days after date of auditor's report in case of audit engagements** and in other cases within the limits appropriate to engagements.
   c. **Where 2 or more different reports are issued** in respect of the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement **files should be considered for each report** as if it were for a separate engagement.
   d. Policies and procedures should be designed **to maintain the confidentiality, safe custody, integrity, accessibility and retrievability** of engagement documentation.
   e. Care should be taken that policies and procedures on **documentation of the engagement quality control review should require documentation** that:

i. The **procedures required by the firm's policies** on engagement quality control review have been performed.
ii. The engagement **quality control review has been completed before the report is issued** and
iii. The **reviewer is not aware of any unresolved mat**ters that would cause the reviewer to believe that the significant judgments the engagement team made and the **conclusions they reached were not appropriate.**

f. Unless otherwise specified by law or regulation, **engagement documentation is the property of the firm.** The firm may, at its discretion, make portions of, or extracts from, engagement **documentation available to clients,** provided **such disclosure does not undermine the validity of the work performed,** or, in the case of assurance engagements, the independence of the firm or its personnel.
g. **Engagement documentation has to be retained for a period of time sufficient to permit those performing monitoring procedures** to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.
h. In the specific case of audit engagements, the **retention period ordinarily is no shorter than 7 years from the date of the auditor's report**, or, if later, the date of the group auditor's report.

G. MONITORING:

1. The firm should ensure that policies and procedures relating to the system of quality control are **relevant, adequate, operating effectively and complied with in practice.** Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including **a periodic inspection of a selection of completed engagements**.
2. Quality control of engagements has to be monitored taking into account following factors:
   a. Deciding whether **quality control system of the firm has been appropriately designed and effectively implemented**.
   b. Examining whether **new developments in the professional standards**, legal and regulatory requirements have been reflected in the quality control policies.
   c. Conducting **monitoring by entrusting responsibility of**

monitoring process to a partner or other persons with sufficient and appropriate experience and authority in the firm.

d. Dealing with **complaints and allegations against the firm or any employees of it of non – compliance with professional standards** or appropriate regulatory requirements by a person within or outside the firm.
e. Taking **appropriate remedial actions against the personnel** who did not conform to quality control policies.
f. Taking **action when deficiencies in the design or operation of the firm's quality control policies** and procedures, or non-compliance with the firm's system of quality control are identified.

SA 220 - QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS

A. INTRODUCTION:

1. **Engagement partner** of a team is **responsible for quality control procedures of a particular audit engagement** in accordance with SA-220. Therefore, SA-220 is premised on the basis that the firm is subject to SQC 1.
2. Within the context of the firm's system of quality control, engagement teams have a **responsibility to implement quality control procedures that are applicable to the audit engagement** and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.
3. Engagement teams are **entitled to rely on the firm's system of quality control**, unless information provided by the firm or other parties suggests otherwise.

B. OBJECTIVE OF AUDITOR AS PER SA 220:

The objective of the auditor is to **implement quality control procedures at the engagement level** that provide the auditor with reasonable assurance that:

1. The **audit complies with professional standards** and regulatory and legal requirements and
2. The **auditor's report issued is appropriate** in the circumstances.

ELEMENTS COVERED UNDER SA-220:

This standard is modelled on lines of SQC 1. It describes **responsibilities of engagement partner** in relation to following matters:

1. **Leadership responsibilities** for quality on audits.
2. Relevant **ethical requirements**.
3. **Acceptance and continuance of client relationships** and audit engagements.
4. **Assignment** of engagement teams.
5. **Engagement performance**.
6. **Monitoring**.

C. LEADERSHIP RESPONSIBILITIES FOR QUALITY ON AUDITS:

1. Leadership responsibility of **an engagement partner is to take responsibility for the overall quality on each audit engagement**, emphasis:
2. The importance to audit quality of:
    a. Performing **work that complies with professional standards** and regulatory and legal requirements.
    b. **Complying with the firm's quality control policies** and procedures as applicable.
    c. **Issuing auditor's reports that are appropriate** in the circumstances and
    d. The **engagement team's ability to raise concerns** without fear of reprisals.
3. The fact **that quality is essential in performing audit** engagements.

D. RELEVANT ETHICAL REQUIREMENTS:

The responsibilities of an engagement partner in relation to ethical requirements in an audit engagement are as under:

1. **Identifying a threat to independence regarding the audit engagement** that safeguards may not be able to eliminate or reduce to an acceptable level.
2. Reporting by engagement partner to the relevant persons **within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat**, or withdrawing from the audit engagement, where withdrawal is legally permitted.

E. ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND AUDIT ENGAGEMENTS:

The responsibility of an engagement partner in this regard in an audit engagement is on lines of SQC which requires the firm should obtain such information as it considers necessary in the **circumstances**

before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client:

1. Information like **integrity of principal owners**,
2. **Competence of engagement team** and consideration of necessary capabilities including time and resources,
3. Compliance with **relevant ethical requirements** and
4. **Significant matters arisen during current or previous audit engag**ement and their implications assist the engagement partner in determining whether the **conclusions reached regarding the acceptance and continuance** of client relationships and audit engagements are appropriate.

F. ASSIGNMENT OF ENGAGEMENT TEAMS:

It should be ensured by engagement partner that the **engagement team and any auditor's experts who are not part of the engagement team,** collectively **have the appropriate competence and capabilities to perform the engagement** in accordance with professional standards and regulatory and legal requirements.

G. ENGAGEMENT PERFORMANCE:

1. Engagement partner has the responsibility for direction, supervision and performance of audit engagement in accordance with professional standards and regulatory and legal requirements.
2. He is responsible for auditor's report being appropriate in circumstances.
3. Further, review of audit documentation before issue of audit report is his responsibility. It has to be ensured that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for issuance of auditor's report.
4. Engagement partner is also responsible for ensuring undertaking appropriate consultation on difficult or contentious matters by engagement team not only within the team but also with others at appropriate level within or outside the firm.

H. ENGAGEMENT QUALITY CONTROL REVIEW:

For audits of financial statements of listed entities, and those other audit engagements, for which the firm has determined that an engagement quality control review is required, the engagement partner shall:

1. Determine that **an engagement quality control reviewer** has been appointed.
2. Discuss **significant matters arising during the audit engagement**,

including those identified during the engagement quality control review, with the engagement quality control reviewer

3. **Not date the auditor's report until the completion** of the engagement quality control review.
4. The engagement **quality control reviewer shall perform an objective evaluation of the significant judgments** made by the engagement team, and the conclusions reached in formulating the auditor's report. This evaluation shall involve:
   a. **Discussion of significant matters** with the engagement partner.
   b. **Review of the financial statements and the proposed auditor's report**.
   c. **Review of selected audit documentation** relating to the significant judgments the engagement team made and the conclusions it reached and
   d. **Evaluation of the conclusions reached in formulating** the auditor's report and consideration of whether the proposed auditor's report is appropriate.
   e. For **audits of financial statements of listed entities**, the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:
      i. The engagement team's **evaluation of the firm's independence** in relation to the audit engagement.
      ii. Whether **appropriate consultation has taken place on matters involving differences of opinion** or other difficult or contentious matters, and the conclusions arising from those consultations.
      iii. Whether **audit documentation selected for review reflects the work performed** in relation to the significant judgments made and supports the conclusions reached.
5. **DIFFERENCES OF OPINION:** If **differences of opinion arise within the engagement team,** with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team **shall follow the firm's policies and procedures** for dealing with and resolving differences of opinion.

I. MONITORING:

An **effective system of quality control includes a monitoring process** designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of **quality control are relevant, adequate, and operating effectively.** The engagement partner shall consider the results of the **firm's monitoring process as evidenced**

in the latest information circulated by the firm and, other network firms and whether deficiencies noted in that information may affect the audit engagement.

J. DOCUMENTATION:

1. **BY ENGAGEMENT PARTNER:** The engagement partner should document following matters pertaining to an audit engagement:
   a. **Issues identified with respect to compliance** with relevant ethical requirements and how they were resolved.
   b. **Conclusions on compliance with independence requirements** that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.
   c. **Conclusions reached regarding the acceptance and continuance** of client relationships and audit engagements.
   d. The **nature and scope of, and conclusions resulting from, consultations undertaken** during the course of the audit engagement.
2. **BY EQC REVIEWER:** Besides, the engagement quality control reviewer shall document, for the audit engagement reviewed, that:
   a. The **procedures required by the firm's policies** on engagement quality control review have been performed.
   b. The engagement quality control **review has been completed on or before the date of the auditor's report.**
   c. The **reviewer is not aware of any unresolved matters** that would cause the **reviewer to believe that** the significant judgments the engagement team made and the conclusions they **reached were not appropriate.**

SQC 1 VS. SA 220- KEY DIFFERENCES IN NATURE, SCOPE AND APPLICABILITY

S.N.	SQC 1	SA 220
1	It applies to **entire firm and fixes the responsibility of firm** to be assumed by CEO or managing partners.	It applies to a **particular audit engagement and engagement partner takes responsibility of the same.**
2	It is applicable to **audits, reviews** of historical financial Information, and **other assurance and related services** engagements.	It is applicable to **audit engagements** only.
3	It relates to setting up of a quality control system	It deals with responsibilities of engagement teams to

	consisting of policies and procedures for firm as a whole.	implement quality control **procedures that are applicable to audit engagements**.
4	It pertains to establishing a system of quality control designed to provide firm with a **reasonable assurance that a firm and its personnel comply with professional standards** and regulatory and legal requirements so that reports issued by firm or engagement partners are appropriate in circumstances.	It is premised on the basis that firm is subject to SQC 1. Therefore, SQC 1 is a sine qua non for applicability of SA 220. It is **within overall context of a firm's system of quality control, engagement teams implement quality control procedures applicable to audit engagements.**

OTHER REVIEW MECHANISMS

PEER REVIEW BOARD:

1. Peer review Board is **constituted by Council of ICAI**. The main objective of Peer review Board is to ensure that, in **carrying out assurance assignments**:
    a. **Technical, professional and ethical standards** including regulatory requirements are complied with by members of ICAI.
    b. **Proper systems are in place including documentation** thereof which amply demonstrate quality of assurance services provided by members.
2. The peer review is **meant for purpose of enhancing quality of professional work** resulting in more reliable and useful audit reports.
3. Peer review means **an examination and review of the systems and procedures to determine whether the same have been put in place by the Practice Unit** for ensuring the quality of assurance services as envisaged by the technical, professional and ethical Standards or any other regulatory requirements.
4. Once a Practice Unit is subjected to Peer review, **its assurance engagement records pertaining to the Peer review period are subject to examination** and review by the Peer Reviewer.
5. On completion of this exercise, **a "peer review certificate" is issued in case of unqualified report** issued by Peer Reviewer. In case of a **qualified report, it is informed to the Practice Unit** that same cannot be issued along with the reasons therefor as well as inform **about the**

due date for conducting a follow-on review as may be decided by the Board.

QUALITY REVIEW BOARD:

1. Quality review Board has been set up by Central government. It **consists of members nominated by Central govt and Council of ICAI.** The functions of QRB are:
   a. To make **recommendations to the Council regarding the quality** of services provided by the members of the Institute;
   b. To **review the quality of services** provided by the members of the Institute including audit services and
   c. To guide the members of the Institute **to improve the quality of services** and adherence to the various statutory and other regulatory requirements;
2. The statutory auditors in **respect of the companies are identified for their audit quality review based upon risk-based approach.** The review is carried out by technical reviewers who are **empanelled by QRB on engagement basis from across the country**.

National Financial Reporting Authority (NFRA): NFRA has been constituted in terms of Section 132(1) of Companies Act,2013. Duties of NFRA also include the following:

a. **Monitor and enforce compliance** with accounting standards and auditing standards.
b. **Oversee the quality of service of the professions** associated with ensuring compliance with such standards and suggest measures for improvement in the quality of service.
c. It has **power to monitor and enforce compliance with accounting standards and auditing standards and oversee the quality of service** under section 132(2) or undertake investigation under section 132(4) of the auditors of certain class of companies. Such **companies include listed companies, insurance companies, banking companies** and other companies as provided for in rule 3 of NFRA Rules,2018.
d. **Overseeing quality** of audit services of listed companies falls under the **purview of NFRA**.
e. **QRB can review quality of audit services** provided by the members of the Institute only in respect of **entities other than those specified under Rule 3 of NFRA Rules, 2018** and those referred to QRB by NFRA under relevant rules.

SA 540 – AUDITING ACCOUNTING ESTIMATES, INCLUDING FAIR VALUE ACCOUNTING ESTIMATES & RELATED DISCLOSURES

A. DEFINITIONS:

ACCOUNTING ESTIMATE: An **approximation of a monetary amount** in the **absence of a precise means of measurement**.

AUDITOR'S POINT ESTIMATE OR AUDITOR'S RANGE: The **amount, or range of amounts**, respectively, **derived from audit evidence** for **use in evaluating management's point estimate.**

MANAGEMENT'S POINT ESTIMATE: The amount **selected by management for recognition or disclosure** in the financial statements as an accounting estimate.

MANAGEMENT BIAS: A **lack of neutrality by management** in the preparation and presentation of information.

ESTIMATION UNCERTAINTY: The **susceptibility of an accounting estimate and related disclosures** to an **inherent lack of precision** in its measurement.

OUTCOME OF AN ACCOUNTING ESTIMATE: The **actual monetary amount** which results **from the resolution of the underlying transaction**(s), event(s) or condition(s) **addressed by the accounting estimate.**

B. AUDITOR'S RESPONSIBILITY /AUDIT PROCEDURES:

1. **RISK ASSESSMENT PROCEDURES AND RELATED ACTIVITIES FOR ACCOUNTING ESTIMATES:** The auditor shall obtain an understanding of the following **for assessment of the risks of material misstatement** for accounting estimates:
   a. The **requirements of the AFRFW**.
   b. **How management identifies those transactions, events and conditions that give rise to accounting estimates.**
   c. The auditor **shall make inquiries of management** about **changes in circumstances** that give rise to new, or the **need to revise existing**, **accounting estimates**.
2. **OBTAINING AN UNDERSTANDING OF HOW MANAGEMENT IDENTIFIES THE NEED FOR ACCOUNTING ESTIMATES:**
   a. **Management has the responsibility to identify a transaction, event or condition requires to make an accounting estimate as per AFRFW**.

b. The **auditors risk assessment procedures assist the auditor** in **identifying** circumstances, or changes in circumstances, that **may indicate a requirement for an accounting estimate**.

c. **Inquiries of management about changes in circumstances** that give rise or revise of A/c Estimates, **for example, inquiries about whether**:
   i. The **entity has engaged in new types of transactions**.
   ii. **Terms of transactions**.
   iii. **Accounting policies relating to accounting estimates** have **changed**.
   iv. **Regulatory or other changes outside the control of management.**
   v. **New conditions or events have occurred**.

d. **MANAGEMENT FAILED TO IDENTIFY AN ESTIMATE:** During the audit, the **auditor may identify transactions**, events and conditions that give rise to the **need for accounting estimates that management failed to identify.** In such a case, the **auditor shall determine** whether **there is a significant deficiency in internal control** with regard to the **entity's risk assessment processes**.

3. **HOW MANAGEMENT MAKES THE ACCOUNTING ESTIMATES:** How management makes the accounting estimates, and **an understanding of the data on which they are based**, including:
   a. **The method**, including where applicable **the model**, used in making the accounting estimate.
   b. **Relevant controls**.
   c. Whether management **has used an expert**.
   d. The **assumptions underlying the accounting estimates**.
   e. Whether **there are any changes in the methods** for making the accounting estimates, and if so, why and
   f. Whether and, if so, **how management has assessed the effect of estimation uncertainty.**

   The auditor **shall review the outcome of accounting estimates included in the prior period financial statements** or their **subsequent re-estimation** for the **purpose of the current period**.

4. **ESTIMATION UNCERTAINTY:** For accounting estimates that give rise to significant risks [High estimation uncertainty] the auditor shall evaluate the following:
   a. How **management has considered alternative assumptions** or outcomes.

b. Whether the **significant assumptions used** by management **are reasonable**.
c. The **appropriate application of the applicable financial reporting framework and**
d. **Management's intent to carry out specific courses** of action and its ability to do so.

ESTIMATION UNCERTAINTY - UNADDRESSED: If, in the auditor's judgment, management has **not adequately addressed the effects of estimation uncertainty** on the accounting estimates that give rise to significant risks, the **auditor shall, if considered necessary**, **develop a range with which to evaluate the reasonableness of the accounting estimate.**

5. **RECOGNITION AND MEASUREMENT CRITERIA – SIGNIFICANT RISK:**

For accounting estimates that give rise to significant risks, the auditor **shall obtain sufficient appropriate audit evidence whether the following are in accordance** with the requirements of the applicable financial reporting framework:

a. **Management's decision** to recognise, or to not recognise, the accounting estimates in the financial statements and
b. The **selected measurement basis** for the accounting estimates.

IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENTS:

1. The auditor shall **evaluate the degree of estimation uncertainty** associated with accounting estimates.
2. The auditor shall determine whether any of those accounting estimate have **high estimation uncertainty give rise to significant risk.**

RESPONSES TO THE ASSESSED RISKS OF MATERIAL MISSTATEMENT:

1. Based on Risk assessment the auditor shall determine:
   a. Whether **management has appropriately applied** the **applicable financial reporting framework** relevant to the accounting estimate and
   b. Whether the **methods for making the accounting estimates are appropriate and have been applied consistently**
   c. If **there are changes in accounting estimates** or in the method used for making those from prior period, are those **appropriate in the present circumstances**.

2. The auditor shall **undertake one or more of the following**, taking in account the nature of the accounting estimates:
    a. **SUBSEQUENT EVIDENCE:** Determine whether **events occurring up to the date of the auditor's report** provide sufficient audit **evidence regarding** the accounting estimate.
    b. **Test checks the data used** by the management for making accounting estimate.
    c. The auditor shall also evaluate whether **the method used for measurement is appropriate** in the circumstances and assumptions made by the management are reasonable. This can be achieved by:
        i. **Testing the extent to which data and assumptions** on which accounting estimate **is based is accurate, complete and relevant.**
        ii. Considering the **source, relevance and reliability of external data.**
        iii. **Recalculating the accounting**.
        iv. **Test checks the effectiveness of the controls** over the estimates used by the management **together with appropriate substantive procedure.**
3. The auditor **shall consider whether specialized skills** or **knowledge** in relation to one or more aspects of the accounting estimates are required in order to obtain sufficient appropriate audit evidence. [**Whether Expert assistance is needed**]

6. EVALUATING THE REASONABLENESS OF THE ACCOUNTING ESTIMATES, AND DETERMINING MISSTATEMENTS:

The **auditor shall evaluate**, based on the audit evidence, whether the accounting estimates in the financial statements **are either reasonable** in the context of the applicable financial reporting framework, or **are misstated**.

C. AUDIT REPORTING & DISCLOSURE:

DISCLOSURES RELATED TO ACCOUNTING ESTIMATES:

a. **AS PER AFRFW:** The auditor shall obtain sufficient appropriate audit evidence about **whether the disclosures in the financial statements related to accounting estimates** are **in accordance with** the requirements of the AFRFW.

b. **ESTIMATION UNCERTAINTY:** For accounting estimates that give rise to significant risks, the auditor **shall also evaluate the adequacy of the disclosure of their estimation uncertainty** in the financial statements in the context of the applicable financial reporting framework

WRITTEN REPRESENTATIONS:

The auditor shall **obtain written representations** from management and, where appropriate, those charged with governance whether **they believe significant assumptions** used in making accounting estimates **are reasonable**.

D. DOCUMENTATION OF ACCOUNTING ESTIMATES:

The audit documentation **shall include:**

a. The **basis for the auditor's conclusions** about the **reasonableness of accounting estimates** and **their disclosure** that give rise to significant risks and
b. **Indicators of possible management bias,** if any.

12. FORENSIC ACCOUNTING

INTRODUCTION:

Forensic Accounting has **established itself as dynamic and strategic tool in combating corruption, financial crimes and frauds through investigations and resolving allegations of fraud** and embezzlement.

"Forensic" means "suitable for use in the court of law". Bologna said that it is the application of financial skills and investigative mentality to unresolved issues, conducted within the context of the rules of evidence.

As an emerging discipline, it **encompasses financial expertise, fraud knowledge** and a sound knowledge and **understanding of business reality and the working of legal system**.

Forensic Accounting can be conducted in order to **prosecute a party for fraud**, embezzlement or other financial claims. In addition, an **audit may be conducted to determine negligence** in addition, an audit may be conducted to determine negligence.

IMPORTANT DEFINITIONS:

FORENSIC: The word forensic comes from the Latin word forensis, meaning "of or before the forum." It is:

1. **Relating to, used in, or appropriate for courts of law** or for public discussion or argumentation.
2. Relating to the **use of science or technology in the investigation** and establishment of facts or evidence in a court of law.

FORENSIC ACCOUNTING: The **integration of accounting, auditing and investigative skills yields the specialty known as Forensic Accounting.**

It is the **application of accounting methods to the tracking and collection of forensic evidence**, usually for investigation and **prosecution of criminal acts such as embezzlement or fraud**.

BOOK DEFINITION:

1. Forensic accounting is the **application of investigative and analytical skills** for the **purpose of resolving financial issues** in a manner that meets standards required by courts of law.
2. Forensic accountants apply special skills in accounting, auditing, finance, quantitative methods, certain areas of the law, research and investigative skills to **collect, analyse and evaluate evidential matter and to interpret and communicate findings.**

RED FLAG:

1. Red flags **are indicators or warning of any impending danger** or inappropriate behavior.

2. Red flag **does not necessarily indicate the existence of fraud** however are **indicators that caution** needs to be exercised while investigating the situations.
3. Red flags are classified in categories such **as financial performance red flag, accounting system red flags, operational red flags and behavioral red flags**.

FORENSIC ACCOUNTING ANALYSIS VS AN STATUTORY AUDIT

The **general public believes that a financial auditor would detect a f**raud if one were being perpetrated during the financial auditor's audit. The truth, however, is that **the procedures for financial audits are designed to detect material misstatements, not immaterial frauds**.

Vast majority of **frauds could not be detected with the use of financial audits.** Reasons include the dependence of financial auditors on a sample and the auditors' reliance on **examining the audit trail versus examining the events and activities behind the documents**. The **latter is simply resource prohibitive in terms of costs and time**.

In comparison, forensic accounting and audit differ in specific ways, as shown below:

	STATUTORY AUDIT	FORENSIC ACCOUNTING
Basic Overview	1. It's a **legal mandate** 2. Conducted **only by a chartered accountant** 3. Measures **compliance with reporting standards** 4. Obtains **reasonable assurance** 5. Expression of an **independent opinion** 6. On **financial statements** 7. As per **ICAI auditing standards**	1. To **support legal cases** a. In **response to an event**. b. Financial investigation c. Finding **used as evidence in court or to resolve disputes** **2. Non – CAs permitted** 3. Report **findings of evidence discovered** 4. Primarily financials 5. ICAI standards
Objective	**True and fair picture**	**Discover facts and evidence**
Focus	Very general – an overall **review of the books of account**	Narrow – **validate transactions and Balances**
Approach	**Control tests** of transactions and **substantive tests** of balances	Focused **testing to confirm Suspicion** / allegation
Target	**Identify material mis –**	Identify / **confirm nature of**

	statements in financial statements	**violation**
Skills	**Testing & checking, analysis**, inquiry & observation	**Scrutiny & analysis, fact – finding**, interviews
Presumption	Professional skepticism, due professional care	Neutrality
Outcome	Audit report opinion (qualification – subject to/except for)	Present evidence to a court of law – they shall judge)!

FORENSIC ACCOUNTING VS OTHER AUDITS

A **forensic accountant professional will often look for indications of fraud** that are not subject to the scope of a financial statement audit. Forensic Accounting has Investigative mentality" however auditing is done with "professional scepticism".

A forensic accountant professional will **often require more extensive corroboration**. A forensic accountant professional may **focus more on seemingly immaterial transactions**.

Sr.No.	Particulars	Other Audits	Forensic Accounting
1.	**Objectives**	Express an opinion as to **'True & Fair' presentation**	**Whether fraud has actually taken** place in books
2.	**Techniques**	**Substantive & Compliance**. Sample based	**Investigative,** substantive or in-depth checking
3.	**Period**	Normally for **a particulars accounting period**.	No **such limitations**
4.	**Verification of stock, Estimation realisable value of assets, provisions, liability etc.**	Relies on **the management certificate/**Management Representation	**Independent/verification of suspected/selected items** where misappropriation in suspected
5.	**Off balance**	Used to **vouch the**	**Regulatory & propriety**

	sheet items (like contracts etc.)	**arithmetic accuracy & compliance** with procedures.	**of these transactions** / contracts are examined.
6.	**Adverse findings if any**	**Negative opinion or qualified opinion** expressed with/without quantification	**Legal determination of fraud impact** and identification of perpetrators depending on scope.

FORENSIC ACCOUNTANT PROFESSIONAL AND LIST OF SERVICES THAT THEY CAN PROVIDE

1. A Forensic Accountant Professional is often **retained to analyze, interpret, summarize and present complex financial and business-related issues** in a manner which is both understandable and properly supported.
2. Forensic Accountants Professional are **trained to look beyond the numbers and deal with the business reality** of the situation.
3. A Forensic Accountant Professional **must initially consider whether his/her firm has the necessary skills and experience** to accept the work.
4. Forensic Accounting is **highly specialized, and the work requires detailed knowledge of fraud investigation** techniques and the legal framework.
5. Forensic Accountant Professional **needs to have an understanding on various frauds** that can be carried off and how evidence need to be collected.
6. Forensic Accountant Professional c**an be engaged in public practice or employed** by insurance companies, banks, police forces, government agencies and other organizations.
7. **FORENSIC ACCOUNTING SERVICES:** An indicative **list of services** that can be provided by the Professional in this area are as follows:
    a. Financial Statement manipulations
    b. Fund diversions/Asset tracing
    c. Anti-Money laundering
    d. Licence Fees/Dues/Tax Evasion
    e. Related party transactions/valuations
    f. Valuations/Estimations of loss/damage
    g. Suspicious transactions under IBC (Insolvency and Bankruptcy Code)

8. AREAS OF SERVICES PERFORMED:

a. **Fraud Detection:** Investigating and analyzing financial evidence, detecting financial frauds and tracing misappropriated funds

b. **Computer Forensics:** Developing computerized applications to assist in the recovery, analysis and presentation of financial evidence.

c. **Fraud Prevention:** Either reviewing internal controls to verify their adequacy or providing consultation in the development and implementation of an internal control framework aligned to an organization's risk profile.

d. **Providing Expert Testimony:** Assisting in legal proceedings, including testifying in court as an expert witness and preparing visual aids to support trial evidence.

GENERAL STEPS INVOLVED IN THE PROCESS OF FORENSIC ACCOUNTING

Initialization
- **Step 1**

Develop the Plan
- **Step 2**

Obtain Relevant Evidence
- **Step 3**

Perform Analysis
- **Step 4**

Reporting
- **Step 5**

Court Proceedings
- **Step 6**

STEP 1: INITIALIZATION

1. It is **vital to clarify and remove all doubts as to the real motive, purpose and utility** of the assignment. It is **helpful to meet the client to obtain an understanding** of the important facts, players and issues at hand.
2. A **conflict check should be carried out** as soon as the relevant parties are established. It is often useful to carry out a **preliminary investigation prior to the development of a detailed plan of action**. This will allow subsequent planning to be based upon a more complete understanding of the issues.

STEP 2: DEVELOP PLAN

This **plan will take into account the knowledge** gained by meeting with the client and carrying out the initial investigation and will **set out the objectives to be achieved and the methodology to be utilized** to accomplish them.

STEP 3: OBTAIN RELEVANT EVIDENCE

1. Depending on the nature of the case, this may **involve locating documents, economic information, assets, a person or company, another exp**ert or proof of the occurrence of an event.
2. In order to gather detailed evidence, the **investigator must understand the specific type of fraud** that has been carried out, and **how the fraud has been committed.**
3. The **evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss** suffered.
4. It is important that the **investigating team is skilled in collecting evidence that can be used in a court case** within the stipulated time period, and in keeping a clear chain of custody until the evidence is presented in court.
5. If any **evidence is inconclusive** or there are gaps in the chain of custody, then **the evidence may be challenged in court**, or even become inadmissible.
6. Investigators **must be alert to documents being falsified, damaged** or destroyed by the suspect(s).

STEP 4. PERFORM THE ANALYSIS

The actual analysis performed will be dependent upon the nature of the assignment and may involve:

1. Calculating **economic damages**.
2. **Summarizing** a large number of transactions.
3. Performing a **tracing of assets**.
4. Performing **present value calcul**ations utilizing appropriate discount rates.
5. Performing a **regression or sensitivity analysis**.
6. Utilizing a **computerized application** such as a spread sheet, data base or computer model; and
7. Utilizing **charts and graphics to explain** the analysis.

STEP 5: REPORTING

1. **Issuing a report is the final ste**p of a forensic accounting. Accountant / Investigators will include **information detailing the fraudulent activity**, if any has been found.
2. The **client will expect a report containing the findings** of the investigation, including a summary of evidence, a **conclusion as to the amount of loss** suffered as a result of the fraud and to identify those involved in fraud.
3. The report may include **sections on the nature of the assignment**, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions.

4. The **report will include schedules and graphics neces**sary to properly support and explain the findings.
5. The report will also discuss **how the fraudster set up the fraud scheme**, and which controls, were circumvented.
6. It is also likely that the **investigative team will recommend improvements to controls within the organization** to prevent any similar frauds occurring in the future.

STEP 6: COURT PROCEEDINGS

The investigation is likely to **lead to legal proceedings against the suspect,** and members of the investigative team will probably be involved in any resultant court case. The evidence **gathered during the investigation will need to be presented at court, and team members may be called** to court to describe the evidence they have gathered and to explain how the suspect was identified.

FORENSIC ACCOUNTING AND INVESTIGATION REPORT REFERRED UNDER FAIS 510

This Forensic Accounting and Investigation Standard (FAIS or "Standard") 510 deals with the **responsibility of the Professional to issue a written report to the stakeholders** at the conclusion of the assignment. Reporting **results of the work procedures completed and the findings** from those procedures, is the concluding part of the assignment. Since one engagement may include multiple assignments, multiple reports may have to be issued, one for each assignment.

1. **WRITTEN REPORT:** The Professional **shall issue a written report which conveys the results of the assignment clearly and accurately**. The findings reported shall be based on evidence gathered which are reliable and relevant.
2. **REPORT ADDRESSEE AND DISTRIBUTION:** The **report shall be addressed to the Primary Stakeholders and shared with other stakeholder(s)** if required or otherwise permissible
3. **FORMAT OR CONTENT OF REPORT:**
   a. While **no fixed form or content of the report is mandated** by this Standard, the **report shall include certain key elements to enable the recipient to understand the purpose of the assignment,** the extent and scope of work performed by the Professional, any limitations, assumptions or disclaimers, the facts and evidence gathered and the conclusions drawn.
   b. Where the **form and content of the report is mandated by the stakeholders**, or specified by the statutory or regulatory

requirements, the **Professional shall report in line with those requirements**, while keeping in mind the key elements.

4. **KEY ELEMENTS OF THE REPORT:** The Professional shall consider the inclusion of the following key elements in the report (indicative list):
   a. **Title, addressee** and distribution list (if any)
   b. **Scope and objectives** of the assignment
   c. **Approach and broad work** procedures undertaken
   d. An **Executive Summary of the results**, covering all important aspects and the essence of the findings
   e. **Reference to use of an expert**, where applicable
   f. The fact that the **assignment has been conducted in accordance with FAIS**, or any material departures therefrom
   g. **List of findings supported by key evidences**, sources of evidences, and other relevant matter;
   h. **Assumptions, limitations** and disclaimers of the assignment
   i. **Conclusions (if any) drawn** from the assessment undertaken.

5. **DISCUSSION OF DRAFT REPORT:**
   a. Where the **mandate of the engagement requires a discussion of the findings with the subject party prior to finalisation**, a summary of the **responses received from them shall be included** in the report.
   b. Further, the **Principles of Natural Justice requires a discussion of the observations with the subject party.** In some cases, this is done by the Primary Stakeholders through their own internal processes (e.g., disciplinary committee, show-cause notice, etc.).
   c. At times, **the Professional is requested to incorporate the discussion of draft findings as part of the interview process** with the subject. Any **response received from them shall be included in the written report** issued by the Professional.

6. **ASSUMPTIONS AND LIMITATIONS:**
   a. The Professional shall **list any relevant assumptions made during the assignment having a significant bea**ring on the subject matter.
   b. In addition, the Professional may **encounter limitations that restrict the methodologies or procedures applied** in carrying out the assignment. Such limitations can be in the form of lack of (or limited) management support, restricted (or denied) access to required records, etc. These **disclaimers would be covered in the report as a key element** of the report.
   c. The report **shall not express an opinion or pass any judgement on the guilt or innocence. Determination of culpability is either a disciplinary process internal** to the organization under review, or a

judicial process **depending on the specific situation** under review.

d. The report can, at best, **highlight the circumstances and facts that may aid a stakeholder decision** or further a civil or criminal investigation.

7. REPORTING TIMELINES: The report **shall be issued within reasonable time** frame as per the engagement terms. The Professional may be required to provide interim reports as per the engagement terms **which can be given to the extent practicable without compromising the progress** of the investigation. Such interim reports are also subject to this Standard.

OVERVIEW OF FORENSIC ACCOUNTING AND INVESTIGATION STANDARDS (FAIS)

1. The Institute of Chartered Accountants of India (ICAI) was formed with many mandates, one of which places a responsibility of "Ensuring Standards of Performance of its Members".
2. In keeping with this obligation, **the ICAI has recently published a full set of standards in the area of forensic science**. These are referred to as the "Forensic Accounting and Investigation Standards (FAIS for short):
    a. The **FAIS are issued to ensure that the ICAI members deliver high quality output** in the area of Forensic Accounting and Investigations.
    b. The Framework Governing Forensic Accounting and Investigations (the "Framework") lays down the **underlying principles and boundaries for undertaking such services.** It aims to **preserve and enhance the quality of practice** of a member of the Institute of Chartered Accountants (ICAI) performing forensic accounting and investigation services.
    c. This Framework **needs to be read in conjunction with the Preface to the Forensic Accounting and Investigation Standards (FAIS).**
3. The main **objectives of the Framework** are to:
    a. Provide **an overall understanding of Forensic Accounting** and Investigations and its key components.
    b. **Outline the manner in which these components come together** in an inter-related cohesive manner when providing such services.
    c. **Maintain and improve the quality** of forensic accounting and investigation services.
4. The Framework **establishes the structure which governs the professions of Forensic Accounting and Investigations**. It is based on the "Definition

of forensic accounting and investigation" and the Code of Ethics forms the foundation of the Framework. It **comprises of 4 components inherent to the process of forensic accounting and investigations**. These components implicitly form part of the FAIS, even though they may not be mentioned explicitly in the particular Standards. Hence, as explained in the Preface, they all are **mandatory in nature, except the Guidance which is recommendatory.**

5. The 4 key components (forming the pillars) of the Framework are:

(i) Basic Principles of Forensic Accounting and Investigations

(ii) Key Concepts.

(iii) Standards on Forensic Accounting and Investigations.

(iv) Guidance.

6. The Forensic Accounting and Investigation Standards (referred to as "FAIS" or the "Standards") at a broad level seek to provide:
    a. The Professionals with the **minimum standards for undertaking forensic accounting and investigation** (FAI) assignments.
    b. The **Users of FAI services with an indication of the quality of service** that can be expected from such engagements.
    c. The **Regulators and Governmental agencies** with an appreciation of what can be expected from FAI services and
    d. To **everyone, guidance on matters of implementation** and related practical issues.
7. The **Standards are intended to be principle-based**, rather than rule based, thereby providing **ample room for professional judgment when applying such principles** to unique situations and under specific circumstances. The unique nature of forensic assignments would necessitate that the **application of forensic accounting and investigative skills,** together with the use of digital forensic tools, may vary depending on the nature of specific engagements.
8. If, for any reason, a **member is unable to comply** with any of the requirements of the FAIS, or if there is a **conflict between the Standards and other mandates**, such as a statutory or regulatory requirement, **the FAI report (or such similar communication) should draw attention to the material departures** therefrom along with appropriate explanation.

9. The FAIS, as and when issued, will be classified, and numbered in a series format.

13. DIGITAL AUDITING AND ASSURANCE

DIGITAL AUDIT AND THE FEATURES OF DIGITAL AUDIT

MEANING: **Digital Audit is placing assurance on the effectiveness of the IT systems** implemented in an organization. **Technology is becoming an integral part of day-to-day business** operations. It is essential that organizations **review their technology-related controls to identify gaps and risks** for continuous improvement and to ensure regulatory compliance. A **strong controls and security position will allow organizations to build trust** with their stakeholders.

KEY FEATURES OF A DIGITAL AUDIT:

1. Digital audit **encourages the auditee to embrace the latest technological advancements and provides confidence to auditee** to stay updated in a constantly evolving environment.
2. A **digital audit improves the quality of opinion**. This consequently leads to a more reliable audit report
3. Digital Audit **leads to savings in time, cost and human effort**. digitally enabled processes can be **operated autonomously 24x7, driving real-time transactions**.
4. Digital Audit **allows to standardize processes and allow controls to be implemented to mitigate risk**.
5. The digital audit will help organization **gain a more comprehensive overview of end-to- end processes** and how technologies are utilized, controlled and optimized against standards set.
6. It can help auditee to **make informed decisions**.

CONSIDERATIONS THAT ORGANISATIONS WHILE USING DIGITAL TECHNIQUES AND AUTOMATION

1. Some considerations that organization should keep in mind while using digital techniques & automation:
   a. **Know what business benefits the organization** wants to achieve with automation
   b. **Think people first and do not underestimate change** is difficult.
   c. **Target the right processes** – this is a key for successful automation.
   d. **Automation is not a standalone solution** and should be part of a broader digitalization strategy.

e. Ensure **the process works and it is standardised before automating**. Bots do not easily adapt to process change.
f. **Automation introduces new challenges** for organization. Don't forget about governance and data security in the risk framework.

2. As auditors **will obtain an understanding of management's implementation and oversight of new technologies**, they also will perform procedures to understand the changes to the company's business, including any changes to the information technology environment. Areas of focus could include understanding of the following:
   a. **New activities or changes to existing processes** due to new technology
   b. **Changes in the way the entity's systems are developed and maintained** and whether these **changes introduce new risks and require new controls to respond** to those risks
   c. The **impact the new technology** as how the organization obtains or generates and uses relevant, **quality information to support the functioning of internal control.**

CONCEPT OF AUDITING DIGITALLY

1. Auditing Digitally is **using advancements in technology for conducting an effective and efficient audit**.
2. There are **new technologies to help capture data, automate procedures, analyse information** and focus on the real risks of the client.
3. The **opportunity is in understanding** how technology can help and then **applying it to the auditing challenges**.
4. **Expectations from an Auditor:**
   a. Audit teams **need to involve the experts on different software applications** and technologies. Having the right level of expertise of new technology (such as RPA, AI, blockchain technology) **allows auditors to provide the highest quality of audit**.
   b. **Investment in digitally upskilling** the people is the real secret to quality technology audit.
   c. Investment in technology across the profession **has largely been focused on developing and using tools to automate and enhance existing processes,** such as data analytics and collaboration and sharing tools, which help to drive quality in audits today. While this will remain core to the role of technology in the audit, there are **more advanced technologies such as AI and drones could have an even bigger impact.** Such

technologies may also play a role in evolving the scope of the audit (e.g., in using data analytics and machine learning to help identify fraud).

d. This **control can be tested and reperformed by the auditor using RPA technology –** BOTs can login into the system and **generate the report and write the output to an Excel file**. Based on the population the **BOT will select the samples** of changes to be tested. Further **BOT will pull the correct file with approved changes** from SharePoint. Then it will perform the testing wherein it will populate the details of approvals (date, approved by) and **identify if changes made without approvals.** Lastly BOT will **summarise the results** for all the selected samples in an excel file.

e. The auditor will then **review the final results file to check if there are any exceptions** (changes made without approvals) noted in the selected samples.

f. Due to the **usage of BOT manual intervention has been reduced**, more accurate results are populated, it **results in saving auditors time as well and exceptions highlighted** can be readily reviewed.

KEY FEATURES OR ADVANTAGES OF AUDITING DIGITALLY:

IMPROVED QUALITY OF AUDITS: The **impact on quality is evident**, through automation, data analytics techniques we can **easily move from sample auditing to full population of transactions being reviewed or re-performed**. This ultimately free up time for **audit teams to analyses the information and better understand** the business they audit. **Technology requires an element of upfront investment, and it can be challenging to implement** with regards to resources and people, but the value once it is up and running is undeniable.

DECREASING HUMAN DEPENDENCY: Using technology **minimizes the manual intervention** which ultimately results in **reducing the risk of manual errors.** Technology helps in streamlining the process of testing for auditors which **decreases the errors which occur from the judgement** of different individuals.

INCREASES TRANSPARENCY: With the technological advancement **transparency has been increased**. New ERPs and tools **have audit trail feature available to trace the transaction** end to end. It helps the management or auditors to review the details like the date on which any change is made, who made the change, what has been changed, all such details are captured and can be used while performing audit.

AUTOMATION AND EASE: **Automating tasks like recording work in repositories, extracting data and sampling** have improved the quality of audit and **reduced the manual error**. Using dashboards (e.g., Power BI) for reporting helps in understanding the position and helps the auditor to form his opinion.

IMPROVED EFFICIENCY: What used to take weeks to learn and programme using deep experts, is **now easily available to auditors after some simple training and digital upskilling.** The **result may be increased efficiency and fewer errors**, but the benefits are wider reaching and personal. This also results in improved retention of talent and confidence.

BETTER RISK ASSESSMENT: With usage of automation and technology in audit, **auditor may focus on the real challenges and assess the potential risk precisely**. It gives time to **auditors to focus on the bigger picture** rather than being involved with repetitive tasks. Dashboards, **visual presentations and other tools helps in understanding where the risk lies** and what all areas need more attention.

CONSIDERATIONS IN AUDITING DIGITALLY

1. **Problems that are trying to be solved**
   Continuously evaluate the emerging technologies and latest tools to see what can benefit the audit. Think about **what would make audit easier or better** and how to measure return on your investment.

2. **A Technology that could help**
   There are a **number of tools available and many vendors** and start-ups using data acquisition, manipulation and visualization tools. Consider **how comfortably these solutions will integrate into current processes and flag** any potential implementation issues early on.

3. **Upskilling people to make best use of the technology available**
   Technology is only as good as the people using it. **Training and development are critical to ensure** teams understand **how and why they are using the technology**. Reluctance to change is obvious, however continuous training help them to get better.

4. **Range of automated solutions:**
   There is a **range of automation solutions, from low to high sophistication, which helps to standardize the repeatable tasks** and optimize the efforts resulting in doing better.

Macros and Scripts	Business Process Automation (BPA)	Robotic Process Automation (RPA)	Intelligent Process Automation (IPA)
Rules-based automation within a specific application	Reengineering existing business processes e.g. workflows	Automating labourintensive, repetitive activities across multiple systems and interfaces	**Combining RPA with artificial intelligence technologies** to identify patterns, learn over time, and optimize workflows Understand Identify Assess

UNDERSTANDING OF THE IT ENVIRONMENT

1. Understanding the **ways in which the entity relies upon IT** and how the IT environment is set up to support the business. This **allows the auditor to better understand where risks might arise** from the entity's use of IT (required as per SA 315).
2. Understanding **how IT is used by the entity helps in identifying controls over the entity's IT processes**.
3. **Assessing the complexity of the IT** environment helps the teams consider **whether to involve IT specialists or experts in the planning and/or execution of the audit**, including initial consideration of whether to include specialists in the complexity assessment.
4. The **auditor's understanding of the automated environment** should include the following:
    a. The **applications that are being used** by the company.
    b. Details of the **IT infrastructure components** for each of the application.
    c. The **organization structure** and governance.
    d. The **policies, procedures and processes** followed.
    e. **Extent of IT integration**, use of service organizations.
    f. IT **risks and controls**.

KEY AREAS FOR AN AUDITOR TO UNDERSTAND IT ENVIRONMENT

Key Areas for an Auditor to Understand IT Environment are as follows:

1. **UNDERSTAND THE FLOW OF TRANSACTION:** The auditor's understanding

of the IT environment **may focus on identifying and understanding the nature and number of the specific IT applications and other aspects** of the IT environment that are relevant to the flows of transactions and processing of information in the information system. **Changes in the flow** of transactions, or information within the information system **may result from program changes to IT applications, or direct changes to data in databases** involved in processing or storing those transactions or information.

2. **IDENTIFICATION OF SIGNIFICANT SYSTEMS:** The **auditor may identify the IT applications and supporting IT infrastructure** concurrently with the **auditor's understanding of how information relating to significant classes of transactions**, account balances and disclosures flows into, through and out the entity's information system.

3. **IDENTIFICATION OF MANUAL AND AUTOMATED CONTROLS:** An entity's system of internal control **contains manual elements and automated elements** (i.e., manual and automated controls and other resources used in the entity's system of internal control). An entity's mix of manual and automated elements varies with the nature and complexity of the entity's use of IT. The **characteristics of manual or automated elements are relevant to the auditor's identification and assessment of the risks** of material misstatement.

4. **IDENTIFICATION OF THE TECHNOLOGIES USED:** The need to **understand the emerging technologies implemented and the role they play** in the entity's information processing or other financial reporting activities and consider whether there are risks arising from their use.
   Given the potential complexities of these technologies, there is an increased likelihood that the **engagement team may decide to engage specialists and/or auditor's experts to help understand** whether and how their use impacts the entity's financial reporting processes and may give rise to risks from the use of IT. Some examples of emerging technologies are:
   - Blockchain, including cryptocurrency businesses (e.g., token issuers, custodial services, exchanges, miners, investors)
   - Robotics
   - Artificial Intelligence
   - Internet of Things
   - Biometrics
   - Drone

5. **ASSESSING THE COMPLEXITY OF THE IT ENVIRONMENT:** Not all applications of the IT environment have the same level of complexity.

The level of complexity for individual characteristics differs across applications. **Complexity of IT Environment is assessed** based on the following factors:

a. **Automation used** in the organization,
b. **Entity's reliance on system** generated reports,
c. **Customization** in IT applications,
d. **Business model** of the entity,
e. Any **significant changes done** during the year and
f. **Implementation** of emerging technologies.

IDENTIFYING THE RISKS ARISING FROM USAGE OF IT

1. **UNAUTHORISED ACCESS TO DATA:** Unauthorized access to data that may **result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transac**tions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.

2. **RISK OF PRIVILAGED ACCESS:** The possibility of **IT personnel gaining access privileges beyond those necessary to perform their assigned duties** thereby breaking down segregation of duties. Unauthorized changes to data in master files.

3. **CHANGES TO DATA:** **Unauthorized changes to IT applications** or other aspects of the IT environment.
4. **UPDATE FAILURES:** **Failure to make necessary update IT applications** or other aspects of the IT environment.

5. Inappropriate **manual intervention**.

6. **DATA LOST:** Data loss or data corruption is a major risk which arises from use of IT. If **appropriate cybersecurity controls and protocols not followed it may lead to loss of sensitive data**, hackers might encrypt your system or illegally break into your system. Risk of fraud can arise if users alter the information or there is a case of physical security breach or theft of sensitive information.

7. **DOWNTIME:** There is a risk of system downtime which is caused by hardware failures, faulty configurations, cyberattacks or power outage. It **means the IT systems will** not be operational or will be unavailable/offline which may hamper the business.

8. **INTEGRATION ISSUES:**

   a. Since companies **uses more than one IT systems to support their business system integration** (means integrating one or more systems) and system compatibility comes in place. However, **system integration and compatibility have some risks.** In case of **system failure in one system may also lead to widespread failure in integrated systems**. Or if the **integration between two systems is not appropriate the end result would be incorrect**.

   b. System **compatibility means sharing compatible hardware, software and operating system** while performing the integration. Compatibility **risks arises if different versions of same software are used**, if the patches are not upgraded which may lead to bugs.

9. **COMPLIANCE RISKS:** With advancement in usage of IT the **risk of regulatory compliances increases.** Any **change in the law, order, guidelines or agreements will impact the business,** its related costs, investments etc.

10. **PERFORMANCE ISSUES:** **Performance Issues arises with the way requests are processed** in the IT systems. **Heavy data load, network usage impacts the application performance** and its responsiveness. To overcome the performance issues of IT systems, **resources or hardware can be added to an existing node, which is known as scaling**. However, **scaling can be expensive therefore an informed decision should be made** in case of adding a hardware or changing the architecture.

IDENTIFYING THE IT DEPENDENCIES IMPACTING THE AUDIT.

Identifying and documenting the entity's IT dependencies in a consistent, clear manner helps to identify the **entity's reliance upon IT**, understand how IT is **integrated into the entity's business** model, identify **potential risks** arising from the use of IT, **identify related IT General Controls and enables us to develop an effective and efficient audit approach**.

How IT dependencies arise

IT Dependencies are created **when IT is used to initiate, authorize, record, process, or report transactions** or other financial data for inclusion in financial statements.

There are five types of IT dependencies as described below:

TYPE	DESCRIPTION
AUTOMATED CONTROLS	Automated controls are **designed into the IT environment to enforce business rules.** For example: a. Purchase order approval via workflow or format checks (e.g., only a particular date format is accepted), b. Existence checks (e.g., Duplicate customer number cannot exist),
REPORTS	System **generated reports are information generated by IT systems**. These reports are often used in an entity's execution of a manual control, including business **performance reviews, or may be the source of entity information used by us when selecting items for testing,** performing substantive tests of details or performing a substantive analytical procedure. E.g. (Vendor master report, customer ageing report)
CALCULATIONS	Calculations are **accounting procedures that are performed by an IT system** instead of a person.
SECURITY	Security including **segregation of duties is enabled by the IT environment to restrict access** to information and to **determine the separation of roles and responsibilities** that could allow an employee to perpetrate and conceal errors or fraud, or to process errors that go undetected.
INTERFACES	Interfaces are **programmed logic that transfer data from one IT system to another**.

AUDITORS UNDERSTANDING OF RESPONDING TO RISKS ARISING FROM IT DEPENDENCIES BY MANAGEMENT OF THE ENTITY

1. When **auditors identify IT dependencies** that are relevant to the entity's flow of transactions and processing of financial information, **they need to understand how management responds to the associated risks** that may arise from them.
2. Management **may implement information technology general controls** (ITGCs) to address risks related to IT dependencies.
3. IT dependencies may **also affect the design of the entity's controls and how they are implemented**.

   Therefore, **auditors consider IT dependencies relevant to audit and evaluate the related risks.** Auditor should **scope in ITGCs to tests when there are IT dependencies** identified in the system. If **the controls**

around IT environment are not implemented or operating effectively it will result in **not relying on ITGCs which means the IT dependencies could not be relied upon**.

The illustration below is an overview of the Control Objectives and controls for each area of General IT Controls:

ACCESS SECURITY OBJECTIVE
To ensure that access to programs and data is authenticated and authorized to meet financial reporting objectives

- **Access requests** to the application **are properly reviewed** and authorized by management
- **Access of terminated user is removed** on a timely basis
- Access rights to applications are **periodically monitored** for appropriateness
- **Transactions of administrative and sensitive generic IDs are monitored**
- **Security policies** are procedures are maintained
- **Access to operating system and database is restricted**.

PROGRAM CHANGE OBJECTIVE
To ensure modified systems continue to meet financial reporting objectives

- **Change Management policy and procedures are maintained**.
- Development, testing and production **environments are segregated for changes to application configurations**
- **Changes are adequately tracked** and recorded.
- Changes to application configurations are adequately **tested and approved before being migrated into production**
- **Emergency changes are approved**.
- **Segregation of duties is maintained** between developer and implementor.

DATA CENTRE AND NETWORK OPERATIONS OBJECTIVE
To ensure production systems are appropriately backed up to meet financial reporting objectives

- Policies and procedures for **data back and recovery is maintained**.
- **Data is appropriately backed up** and recoverable
- **Restoration testing is perfomed**
- Monitoring and complaince of **service level agreements.**
- Batch job scheduled are **monitored for failures and access is restricted**.

AS SESSING CYBER RISKS (INCLUDING REMOTE AUDIT)

1. **MEANING:** A cyber-attack is an **attempt to gain unauthorized access to a computing system or network** with the intent **to cause damage, steal, expose, alter, disable, or destroy data.**
2. Regulators across the globe have placed the topic of cyber risk management under increasing scrutiny, **requiring financial institutions to assess** their cybersecurity program, manage cyber risks, and **enhance resiliency against cyber-attacks.**
3. Most common types of cyber- attacks are:
   a. **MALWARE** : Malware or malicious software is any **program or code that is created with the intent to do harm** to a computer, network or server. Malware is the **most common type of cyberattack**, its subsets are ransomware, fileless Malware trojans, viruses etc.

Type	Description
Ransomware	1. In a ransomware attack, **an adversary encrypts a victim's data and offers to provide a decryption key in exchange for a payment**. 2. Ransomware attacks are **usually launched through malicious links** delivered via phishing emails, **but unpatched vulnerabilities** and policy misconfigurations are used as well.
Fileless Malware	Fileless malware is a type of malicious activity that **uses native, legitimate tools built into a system to execute a cyber-attack**. Unlike traditional malware, fileless malware **does not require an attacker to install any code on a target's system, making it hard to detect**.
Trojan	1. A trojan is malware **that appears to be legitimate software disguised** as native operating system programs or harmless files like free downloads. 2. Trojans are **installed through social engineering techniques** such as phishing or bait websites.
Mobile Malware	Mobile malware is any type of malware **designed to target mobile devices.** Mobile malware is **delivered through malicious downloads,** operating system vulnerabilities, phishing, **smishing, and the use of unsecured Wi-Fi**.

b. **DENIAL-OF-SERVICE (DoS) ATTACKS :**

i. A Denial-of-Service (DoS) attack is a malicious, targeted attack **that floods a network with false requests in order to disrupt business operations**.

ii. In a DoS attack, **users are unable to perform routine and necessary tasks**, such as accessing email, websites, online accounts or other resources that are operated by a compromised computer or network.

iii. While most DoS attacks do not result in lost data and are typically resolved without paying a ransom, they **cost the organization** time, money and other resources in order **to restore critical business operations**.

c. **PHISHING**: Phishing is a type of cyberattack that **uses email, SMS, phone, social media,** and social engineering techniques **to entice a victim to share sensitive information** — such as passwords or account numbers — or to download a malicious file that **will install viruses on their computer or phone**.

Type	Description
Spear Phishing	Spear-phishing is a type of phishing attack that **targets specific individuals or organizations typically through malicious emails**. The goal of spear phishing is **to steal sensitive information** such as login credentials or infect the targets' device with malware.
Whaling	A whaling attack **is a type of social engineering attack specifically targeting senior or C-level executive employees** with the purpose of stealing money or information or gaining **access to the person's computer** in order to execute further cyberattacks.
Smishing	Smishing is a type of fraudulent practice of **sending text messages purporting to be from reputable companies** in order to **induce individuals to reveal personal information**, such as passwords or credit card numbers.
Vishing	Vishing, **a voice phishing attack, is the fraudulent use of phone calls and voice** messages pretending to be from a reputable organization to convince individuals **to reveal private information** such as bank details and passwords.

d. **SPOOFING**: Spoofing is a technique through which a **cybercriminal disguises themselves as a known or trusted source.** In so doing, the adversary is able to **engage with the target and access their systems or devices** with the ultimate goal of stealing information, extorting money or installing malware or other harmful software on the device.

Type	Description
Domain Spoofing	Domain spoofing is a form of phishing where **an attacker impersonates a known business or person with fake website or email domain** to fool people into the trusting them. Typically, the domain appears to be legitimate at first glance, but a closer look will reveal subtle differences.
Email Spoofing	Email spoofing is a type of cyberattack that **targets the businesses by using emails with forged sender addresses**. Because the recipient trusts the alleged sender, they are more likely to open the email and interact with its contents, such as a malicious link or attachment.

e. **IDENTITY-BASED ATTACKS**: When a **valid user's credentials have been compromised and an adversary is pretend to be that user**.

f. **INSIDER THREATS**: When **current or former employees** that pose danger to an organization because they **have direct access to the company network, sensitive data**, and intellectual property (IP), as well as knowledge of business processes, company policies or other information that would help carry out such an attack.

g. **DNS TUNNELING:** DNS Tunneling is a type of cyberattack that **leverages domain name system (DNS) queries and responses to bypass traditional security measures** and transmit data and code within the network. This tunnel gives the hacker a route to unleash malware and/or to extract data, IP or other sensitive information by encoding it bit by bit in a series of DNS responses.

h. **IoT-BASED ATTACKS:** An IoT attack is any cyberattack **that targets an Internet of Things (IoT) device or network.** Once compromised, the hacker can assume control of the device, steal data, or join a group of infected devices.

THE STAGES OF CYBER RISKS

1. **STAGE 1 - ASSESSING THE CYBER RISK:** No organization is completely

immune to a cyber-risk. Different clients will have different levels of risks, even with the same industry. Every organization should **consider at least the common threats**:

a. **Ransomware disabling their organization** (including their plants and manufacturing facilities)
b. Common criminals **using email phishing and hacks for fraud and theft**.
c. **Insiders committing malicious activities or accidental activities** resulting in unintended discourse of information theft and frauds.

2. **STAGE 2 – IMPACT OF CYBER RISK:** Cyber-attack can impact one, two or more types of risks. The **impact of the attack would vary from organization to organization** and most importantly from an attack to attack. Some of the indicative areas can be:
   a. **Regulatory costs**
   b. Business **interruptions causing an operational challenge** for an organization.
   c. **Data loss, reputational loss and litigation**.
   d. **Ransomware** - more common these days where entire systems are encrypted
   e. **Intellectual property theft** which may not only take the competitive advantage, but we may also result in any impairment/impediment charge because of the loss of IP.
   f. **Incident response cost** which could be for investigations & remediations
   g. **Breach of Privacy**, if personal data of a consumer is hacked it could have a significant impact on the organization.
   h. **Fines and penalties**

3. **STAGE 3 – MANAGING THE CYBER RISK**: A strategic approach to cyber risk management can help an organization to:
   a. Gain a **holistic understanding of the cyber risks, threats** facing their organization and other financial institutions
   b. **Assess existing IT and cybersecurity program and capabilities** against the relevant regulatory requirements
   c. **Align cybersecurity and IT transformation initiatives** with strategic objectives and critical risks
   d. Understand **accepted risks & documented compensating controls**

CYBER SECURITY FRAMEWORK

Cybersecurity framework includes how **management is identifying the risk, protecting and safeguarding its assets** (including electronic assets) from the risk. Management preparedness **to detect the attacks, anomalies and responsiveness** to the adverse event.

A. IDENTIFY THE RISK:

1. Auditor has to determine **whether the entity's risk assessment process considers cybersecurity risks**.
2. Entity should **conduct a periodic risk assessment & develop a management strategy** which identifies cybersecurity risks around IT system failure **affecting the entity's primary business or potential loss** of data or inability to access data as required, Risk of unauthorized access to the IT network.
3. The entity should **maintain and periodically reviews an inventory of their information assets**- i.e., Asset Management (e.g., intellectual property, patents, copyrighted material, trade secrets and other intangibles).
4. The entity should **classify and prioritize protection of their information assets based on sensitivity and business value** and periodically reviews the systems connected to the network on which digital assets reside.
5. From the governance perspective management should review how **cybersecurity risks affect internal controls over financial reporting**. In case of adverse attack how management is going to assess the **impact on the recoverability of financial data and impact on revenue recognition**.
6. Management needs **to identify if any established a risk-based cybersecurity program** can be leveraged e.g. (NIST, ISO etc.)
7. To determine overall responsibility for cybersecurity in the business environment **entity should establish roles and responsibilities over cybersecurity** (CISO, CIO).
8. Further the **risk assessment should be discussed** with those charged with governance (e.g., the Audit Committee or Board of Directors).

B. PROTECT THE RISK:

1. Obtained an **understanding of the entity's processes for safeguarding of assets subject to cybersecurity**. Entity monitors whether there has been unauthorized access to electronic assets and any related impact on financial reporting.
2. **Formal training should be conducted** to make the teams aware of the risk associated with cyber- attacks.

3. Entity should **implement effective controls for data security**.
4. Entity should have a **process & procedures in place for identifying material digital/electronic assets** on the balance sheet subject to cybersecurity risk (e.g., intellectual property, patents, copyrighted material, trade secrets) and **prioritizing their protection** based on criticality.

C. DETECT THE RISK:

1. Entity should have controls and procedures that **enable it to identify cybersecurity risks and incidents and to assess and analyse their impact** on the entity's business, evaluate the significance associated with such risks and incidents, and consider timely disclosures.
2. Review entity's processes to monitor and detect security breaches or incidents. If management has implemented **anti-virus in the system to secure it from anomalies or if firewall logs are being continuously monitored** to detect any repetitive attacks.
3. A monitoring process should be established to review how many such events have been denied by the firewall. Monitoring process **should also include if any upgrades or updates** are required to safeguard the systems from vulnerabilities.

D. RESPOND TO THE RISK:

1. In case of **material cybersecurity or data breac**h has been identified **management should capture the details of nature of incident** and how the incident or data breach was identified.
2. Entity should have a **response planning in place to capture the details** of nature of incident and the **same needs to be communicated with those who are ultimately responsible** for this framework and with those charge with governance.
3. The security incident response **plan helps in analysing the impact and severity of the attack** and helps the organisation in taking the appropriate actions.
4. Management should assess Litigation costs, Regulatory investigation costs and **Remediation costs as a part of mitigation process and improvement** management should assess the **future action plans that needs to be taken** to safeguard the organisation from such attacks.

E. RECOVER FROM RISK:

1. Entity should undertake appropriate **actions to recover from the attack and make sure the business is up and running**
2. Once the impact evaluated and communicated with the regulators the **recovery plan needs to be implemented to overcome** the impact.
3. **Necessary improvements** – like patch upgrades, better controls, improved technology in terms of firewall, anti-virus, tools etc. **needs to be implemented** to safeguard the entity.

CONTROL CONSIDERATIONS FOR CYBER RISKS

Apart from having the cyber security policies, procedures, framework and regular assessment in place, **management should have a strong and updated internal controls to ensure they are covered** from cyber risks:

1. CONTROLS AROUND VENDOR SETUP AND MODIFICATIONS:

a. Certain cyber schemes exist in which **changes to bank account or other critical vendor information are requested through email phishing scams** by individuals purporting to be authorized vendor personnel.

b. Entities have **inappropriately dispersed funds** to these individuals and therefore inappropriately **reduced the liability owed to the actual vendor**, resulting in an impact to the financial statements (i.e., loss of cash and related expense)

   i. **Who is responsible for making changes** to vendor master data? Is the process centralized or decentralized?

   ii. Are **other communication channels, such as email, used to request changes** to vendor master data? (If yes, consider if multi-factor authentication is enabled for email).

   iii. What **systems and technologies are used to initiate, authorize and process requests** related to changes to vendor master data

   iv. Are **authentication protocols defined** to verify modifications to vendor master data (e.g., call back procedures, multi-factor authentication)?

2. CONTROLS AROUND ELECTRONIC TRANSFER OF FUNDS:

Cyber schemes pertaining to fraudulent requests for wire transfers are made relating to business transactions and vendor payments, as well as fraudulent requests appearing to come from financial institutions requesting disbursement from customer asset accounts.

a. Are **personnel responsible for wire transfers educated** on the relevant threats and information related to common phishing scams associated with fraudulent requests for wire transfers?

b. Are **authentication protocols defined to verify wire transfer requests** (e.g., call back procedures, dual-authentication procedures)?
c. What **systems and technologies are used to facilitate the request/initiation**, authorization and release of wire transfers?

3. CONTROLS AROUND PATCH MANAGEMENT:

Cyber and ransomware attacks **exploit known security vulnerabilities resulting in the manipulation or the destruction of data**. Exploitations of known security vulnerabilities are often caused by unapplied patches or upgrades.

a. Does the **entity have a patch management program**?
b. Does the **entity run periodic vulnerability scans** to identify missing/unapplied patches?
c. How is the **entity notified of patches by external vendors** (e.g., Microsoft for Windows patches)?

CONCEPT OF REMOTE AUDIT AND WHAT ARE THE CONSIDERATIONS FOR REMOTE AUDIT

Remote audit or virtual audit is when the **auditor uses the online or electronic means to conduct the audit.** It could be **partially or completely virtual, auditor engages using technology to obtain the audit evidence** or to perform documentation review with the participation of the auditee.

Remote auditing plays a vital part, and provide assurance when unprecedented circumstances, like COVID. It provides an opportunity for **organisations and auditors to leverage communication technology tools**. In addition, management perception about remote audits is changing as it provides flexibility in terms of time ensuring that **day-to-day business activities are not impacted, along with the reductions in cost**.

CONSIDERATIONS FOR REMOTE AUDIT: Auditors must **develop tailored strategies to ensure the remote audit meets the requirements** and deliver results equivalent to traditional onsite audits.

1. FEASIBILITY AND PLANNING:

a. **Planning should involve agreeing on audit timelines**, meeting platform (Zoom calls/ Microsoft Teams/Google Meet) to be used for audit sessions, data exchange mechanisms, any access authorization requests.
b. Ensure **feasibility is determining what technology may be used**, if auditors and auditees have competencies and that resources are available.

c. The **execution phases of a remote audit** involve video/tele conferencing with auditees. The **documentation for audit evidence** should be transferred through a document sharing platform.

2. **CONFIDENTIALITY, SECURITY AND DATA PROTECTION:**
   a. To ensure data security and confidentiality, **access to document sharing platform should be sufficiently restricted and secured** by encrypting the data that is sent across the network.
   b. The information, once reviewed and documented by auditor, is **removed from the platform, and stored according to applicable archiving standards** and data protection requirements.
   c. **Auditors should take into consideration legislation and regulations**, which may require additional agreements from both sides (e.g., there will be no recording of sound and images, or authorizations to using people's images).
   d. Auditors **should not take screenshots of auditees as audit evidence**. Any screenshots of documents or records or other kind of evidence should be previously authorized by the audited organization.
   e. In case of **accessing the auditee's IT system auditor should use VPN** (Virtual private network). VPN is a service which creates safe and encrypted online connection. It **prevents unauthorized users to enter into network and allows the users to perform work remotely**.

3. **RISK ASSESSMENT:** The communication from auditor as well as auditees need to clear and consistent, and this becomes crucial during remote audit. The risks **for achieving the audit objectives are identified, assessed and managed**. The **assessment if remote audit would be sufficient to achieve the audit objectives should be done** and documented for each audit involving all members of the audit team and the audited organization representative.

ADVANTAGES AND DISADVANTAGES OF REMOTE AUDIT:

ADVANTAGES	DISADVANTAGES
Cost and time effective: **No travel time and travel costs involved.**	Due to network issues, **interviews and meetings can be interrupted**.
Comfort and flexibility to the audit team as they would be working from home environment,	Limited or no ability to visualize facility culture of the organization, and the body language of the auditees. **Time zone issues could also affect the efficiency** of remote audit session
Time required to gather evidence can spread over several weeks, instead of concentrated into a	The **opportunity to present doctored documents and to omit relevant information** is increased. This may

small period that takes personnel from their daily activities.	call for additional planning, some additional/different audit procedures, Security and confidentiality violation.
Auditor can get first-hand evidence directly from the IT system as direct access may be provided.	**Remote access to sensitive IT systems may not be allowed.** Security aspects related to remote access and privacy needs to be assessed
Widens the selection of auditors from global network of experts.	Cultural challenges for the auditor. **Lack of knowledge for local laws and regulations could impact audit**. Audit procedures like physical verification of assets and stock taking cannot be performed.

EMERGING TECHNOLOGIES IN AUDIT

1. Emerging technologies **are altering the financial reporting environment substantially, and this change is accelerating**. Some examples of emerging technologies are – Data analytics (CAATs (ACL, Alteryx, Power BI, CaseWare), Artificial Intelligence (AI), Robotic Process Automation, and Blockchain). These are **changing the way business gets done, and auditors are leading by transforming their own processes**.
2. As the use of emerging technologies in the financial reporting process increases, it becomes **important for auditor and the client to upskill on the emerging technologies**.
3. Some important considerations for **auditors are to assess the impact of emerging technologies on business and evaluate whether management is properly assessing the impact of emerging technologies on internal control** over financial reporting.
4. **DATA ANALYTIC TECHNIQUES:**
    a. **Generating and preparing meaningful information from raw system dat**a using processes, tools, and techniques is known as Data Analytics.
    b. Audit analytics or audit data analytics involves **analyzing large sets of data to find actionable insights, trends, draw conclusions** and for informed decision making. The use of audit **analytics enables greater efficiencies and more accurate findings** from the review process.
    c. As a result, businesses will be able to **create strategies based on verifiable data and professional assumptions and auditors can**

improve the audit quality. It allows auditors to more effectively audit the large amounts of data held and processed in IT systems in larger clients.

d. Audit analytics helps:
   i. To **discover and analyze patterns**
   ii. **Identifying anomalies**
   iii. **Extract other useful information** in data

CAAT's AND EXAMPLES OF VARIOUS TOOLS OF CAAT's

The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs. It involves use of multiple data analytical tool or visualization tools that can help the auditor **to deep dive into the problem statement and hence increase the audit quality**. This also **minimizes the scope of missing out on key attributes** that might be of a higher risk to the organization and its respective business.

Auditor performing audit analytics can make use of various applications and tools that help them to **analyse large data sets and obtain insights that help them to make the quality of the audit better**. Some of the popular tools used across the industry as part of CAATs are listed below:

1. **ACL:** Audit Command Language (ACL) Analytics is a **data extraction and analysis software used for fraud detection and prevention, and risk management**. It samples large data sets to find irregularities or patterns in transactions that could indicate control weaknesses or fraud.

2. **ALTERYX**:
   a. Alteryx is used to **consolidate financial or operational data to assess controls**. A **fully transparent audit trail of every action** is performed in Alteryx in form of a workflow which makes it easier for the user to **learn as no prior knowledge of coding or scripting is required.**
   b. Alteryx can also be **leveraged to automate analytics and perform Machine Learning to search for patterns indicative of fraud or irregularities** speed up your processes like accounting close, tax filings, regulatory reporting, forecast creation etc.
   c. It can also be **used to automate set procedures that are performed periodically like reconciliations, consolidations,** marketing workflows, system integrations, continuous audits etc.

3. **Power BI**: Power Bi is a business intelligence (BI) platform that **provides nontechnical business users with tools for aggregating, analyzing, visualizing and sharing data.** From audit perspective, such visualization tools can be used to **find the outliers in the population, it**

can also be used for reporting purpose (audit reports) in an interactive dashboard to the higher management.

4. **CaseWare**: CaseWare is a data analysis software & provide tools that helps in **conducting audit and assurance engagements quickly, accurately and consistently**. It shares analytical insights which help in taking **better informed decisions.** It helps in **streamlining processes and eliminating the routine tasks**. Used by accounting firms, governments and corporations worldwide, this trusted platform integrates everything you need to conduct assurance and reporting engagements.

AUTOMATED TOOLS IN AUDIT

Automation and use of technology often requiring auditors to understand and perform procedures on a larger group of systems that **produce information relevant to the production of financial statements**.

Based on managements and auditors' independent risk assessment procedures, the **audit's scope may need to include peripheral systems, as well as testing general IT and application controls** relative to those systems due to the increased use of technology that is relevant to financial reporting.

A. INTERNET OF THINGS [IoT]:

1. IoT is the **concept of connecting any device (cell phones, coffee makers, etc) to the internet**. Key components of IoT are **data collection, analytics, connectivity, and people and process.**
2. IoT **not only changes the business model, but also affects the strategic objectives of the organization.** The risk profile of the entity changes with exposure to new laws and regulations.
3. **AUDIT IMPLICATIONS:**
    a. A **shift to connected devices** and systems may result in **auditors not being able to rely only on manual controls**. Instead, auditors may need to **scope new systems into their audit.** Audit firms may need to **train and upskill auditors to evaluate the design and operating effectiveness** of automated controls.
    b. **Consumer-facing tools that connect** to business environments in new ways can **impact the flow of transactions and introduce new risks for management and auditors** to consider.
    c. Consider **payment processing tools that allow users to pay via credit card** at a retail location through a mobile device.

d. This could create a new path for incoming payments that may rely, in part, on a **new service provider supplying and routing information correctly.** Auditors would need to **consider the volume of those transactions and the processes and controls** related to it.

4. **COMMON RISKS OF IoT:** The key risks associated with IoT, including, **device hijacking, data siphoning, denial of service attacks, data breaches** and device theft.

B. AI (Artificial intelligence):

1. Artificial intelligence (AI) refers to a **system or a machine that can think and learn.** AI systems **utilize data analysis and algorithms to make decisions** based on predictive methods. Complex algorithms are developed to propose decisions based on a pattern or behavior learned over time.

2. **AUDITOR IMPLICATIONS:**
    a. Given the invisible nature of algorithms, **audits must focus on the logical flow of processes.** A review of AI should **ascertain whether unintended bias has been added** to the algorithms.
    b. Auditors should assess **the effectiveness of algorithms and whether their output is appropriately reviewed** and approved.
    c. Because AI is built on software modules, auditors must also consider **cybersecurity and search for possible bugs and vulnerabilities that can be exploited** to impact AI functionality.
    d. Auditors should confirm **their understanding of how the use of AI affects the entity's flows of transactions**, including the generation of reports or analytics used by management. Auditors also should consider whether the AI is **making decisions—or being utilized by management as part of the decision-making process**.
    e. If management **shifts its focus on oversight by relying on AI,** auditors should **understand what shift occurred, how new risks might be addressed,** and whether existing risks may not be getting the same level of attention. Understanding these **changes could drive changes in the audit approach**.

3. **Common risks for AI:** AI comes with list of risks:
    a. Security is one of the key risks – the more data the system uses, from more sources, the **more entry points and connections are formed and the greater the potential risks**.

b. Inappropriate configuration - AI may also be used to diagnose medical conditions. If it is **badly configured or malfunctions, it could harm people before the problem is spot**ted.
c. Data privacy - The data **used and shared should have the necessary explicit consent** from data providers.

C. BLOCKCHAIN:

1. Blockchain is based on **a decentralized and distributed ledger that is secured through encryption.** Each transaction is **validated by the blockchain participants, creating a block of information** that is replicated and distributed to all participants.
2. All blocks are **sequenced so that any modification or deletion of a block disqualifies the information**.
3. **AUDIT IMPLICATIONS:**
   a. Auditors should consider the **appropriate governance and security transactions** around the transactions.
   b. Although blockchain's core security premise rests on cryptography, there are risk factors associated with it. As blockchain **interacts with legacy systems and business partners, concerns** related to insecure application programming interfaces (APIs), data confidentiality and privacy **cannot be ignored**.
   c. **Weak blockchain application** development protocols are something **auditors cannot overlook**.
   d. **Data privacy laws and regulations may be area of concern** as data are communicated across geographic boundaries.
   e. Auditors **must be able to determine whether the data put on blockchain will expose the enterprise to liability for noncompliance** with applicable laws and regulations.

4. **COMMON RISKS FOR BLOCKCHAIN TECHNOLOGY:**
   a. The strengths **of blockchain can also be its weaknesses**. **The inability to reverse transactions and to access data without the required keys** make the system secure, but also mean that organisations **need specific protocols and management processes to ensure that they are not locked out** and have clear contingency plans.
   b. Operating through **network nodes could also expose the organisation to cyber-attacks and data hacks**, so security issues are important.
   c. Auditors should also ensure **that the organisation has the necessary data management processes and complies with**

regulations. The regulatory landscape is still evolving for blockchain, so audit teams **should check that compliance managers are following developments constantly and adapting** processes accordingly.

D. NFT (Non-Fungible Token):

1. NFTs are **digital assets**, e.g., photos, videos, artwork, sports collectibles etc. NFT means something **is unique and cannot be replaced**. Unlike physical money and cryptocurrencies are fungible (means they can be traded or exchanged for one another) NFTs are non-fungible tokens.
2. NFTs contains **the digital signature which make them unique**.
3. NFTs are **tokens used to represent ownership of unique items**.
4. NFTs **allow their creators to tokenize things** like art, collectibles, or even real estate. They **are secured by the blockchain and can only have one official owner at a time**.
5. **No one can change the record of ownership** or copy/paste a new NFT into existence.
6. **Key Features of NFT:**
    a. Digital Asset - NFT is a digital asset that **represents Internet collectibles** like art, music, and games with an authentic certificate created by blockchain technology that underlies Cryptocurrency.
    b. Unique - **It cannot be forged or otherwise** manipulated.
    c. Exchange - **NFT exchanges take place with cryptocurrencies such as Bitcoin** on specialist sites.
7. **Challenges of NFT:** NFTs has its own **challenges like ownership and copyright concerns, security risks, market is not that wide**, online frauds etc. NFT audit considerations includes **comprehensive code review for verifying the safety of a token, valid contract, data privacy** and potential cyber threat.

E. ROBOTIC PROCESS AUTOMATION:

1. RPA is the **automation of the repetitive processes performed by users**. It is a software technology that **emulate humans' actions interacting with digital systems and software**. Process efficiency, customer experience and control effectiveness contributed to RPA.
2. Robotic Process Automation software **bots can interact with any application or system** the same way people do—**except that RPA bots can operate around the clock, nonstop, much faster** and with 100% reliability and precision.

3. **Audit Implications:**
    a. It is of **utmost importance for auditors to understand RPA processes,** which include data extraction, aggregation, sanitization and cleansing. Unless auditors understand these processes, they will not be in a position to initiate an audit
    b. A **comprehensive assurance process might demand review of the source code.** To perform **substantive testing, auditors must have an understanding of the tools used to develop and maintain RPA**. This will be helpful when auditors review logs, configuration controls, privileged access controls and the like. General IT controls are applicable as always.
4. **Common Risks of RPA:**
    a. **Operational and execution risks**: Robots are **deployed without proper operating model.** Buying the wrong tool, making wrong assumptions, taking shortcuts, and jeopardizing security and compliance. **Assigning proper responsibilities, training and clearly stating about changing** roles also can help you reduce operational risk to a great extent.
    b. **Change management risks: Not following the change management implementation** lifecycle, improper and incomplete testing (not covering all scenarios) leads to inaccurate results.
    c. **RPA Strategy Risk:** Setting wrong expectations, improper KPIs, and unrealistic business goals creates an environment of uncertainty. **Management should discuss, and analyse the complete working characteristics, potential, and limitations** of RPA before drafting a robotic process automation.
5. **RPA to check IND AS, IFCoFR and Standards on Auditing:**
    Incorporating Standards on Auditing, IFCoFR, IND AS (para-wise details of | Para reference | Accounting policy | Relevant data to be captured | Relevant calculation to be made | Presentation in financial statements | IFCoFR | Audit procedures as per Standards on auditing |) in **audit practices ensures accurate financial reporting, effective internal controls, and reliable audit procedures**. Leveraging RPA in **conjunction with these frameworks can significantly enhance audit efficiency**, accuracy, and compliance. RPA developers and auditors should **collaborate to align RPA workflows with relevant standards and guidelines**, ultimately improving the effectiveness of audits and enhancing client assurance given below:

CONTROL CONSIDERATIONS OR OBJECTIVES OF AUDITING DIGITALLY

The strength of the **auditing profession is the assessment of risks and controls**. As they **address the challenge of assessing technology risk**, auditors can and should focus on the following control considerations:

1. Auditors should **gain a holistic understanding of changes in the industry and the information technology** environment to effectively evaluate management's process for initiating, processing, and recording transactions and **then design appropriate auditing procedures**.
2. Auditors, should **consider risks resulting from the implementation of new technologies** and how those **risks may differ from those that arise from more traditional, legacy systems**.
3. Auditors should consider **whether digital upskilling or specialists are necessary to determine the impact** of new technologies and **to assist in the risk assessment and understanding of the design**, implementation, and operating effectiveness of controls. E.g., cybersecurity control experts, IT specialists in the team etc.
4. Some examples of technology risks where auditors should test the appropriate controls for relying on the digital systems:
    a. **Reliance on systems or programs that are inaccurately** processing data, processing inaccurate data, or both
    b. **Unauthorized access to data that might result in destruction** of data or improper changes to data, including the recording of unauthorized or non-existent transactions or inaccurate recording of transactions.
    c. The possibility of information technology **personnel gaining access privileges beyond those necessary** to perform their assigned duties, thereby leading to insufficient segregation of duties
    d. **Unauthorized or erroneous changes** to data in master files
    e. **Unauthorized changes to systems** or programs
    f. **Failure to make necessary or appropriate changes** to systems or programs
    g. Inappropriate **manual intervention**
    h. **Potential loss of data or inability to access** data as required
    i. Risks introduced when using **third-party service providers**
    j. **Cybersecurity** risks

KEY STEPS FOR AUDITORS IN A CHANGING TECHNOLOGY ENVIRONMENT

As auditors **obtain an understanding of the impact of technology on a company's business, its systems of internal control, and its financial reporting**, some important reminders include the following:

1. Maintain sufficient **professional skepticism when reviewing management's risk assessment** for new systems.
2. Understand the **direct and indirect effects of new technology and determine how its use** by the entity impacts the auditor's overall risk assessment.
3. Understand **how the technologies impact the flow of transactions**, assess the completeness of the in-scope ICFR systems, and design a sufficient and appropriate audit response.
4. Assess the **appropriateness of management's processes to select, develop, operate, and maintain controls** related to the organization's technology based on the extent the technology is used.

NEXT GENERATION AUDIT

1. The Next Generation Audit is **human-led, tech-powered and data-driven**. It is based on **combining emerging technologies to redefine how audits** are performed.
2. Next Generation Audit aims to the following:

FROM	→	TO
Sampling populations	→	Full population analysis
Multiple datasets	→	One data set
Disconnected tools	→	Integrated ecosystem services
Manual risk assessments	→	Dynamic, data-driven risk assessment
Separated communication	→	Embedded communication
Repetitive tasks	→	High value work and capacity for growth
Manual work	→	Automation
Ad hoc insights	→	Insights from a broader audit

3. We **live in an era of fast technological progress**, with new digital devices, applications, and tools being developed almost on a daily basis. **3D printing, augmented reality (AR) and virtual reality (VR), biotechnology, auditing through drones** (also known as an 'Unmanned Aerial Vehicle' (UAV) and **quantum technology** are some of the most rapidly advancing areas, with many implications for society.

4. **COMMON RISKS:**
    a. Beyond their potential, these **technologies also come with challenges such as public safety, cybersecurity, data privacy**, data protection, lack of standards and technical challenges. Since they often track movements and data, **massive amounts of data are generated about the whereabouts of users**.
    b. It **also raises questions about taxation, jurisdiction, and customer protection**.
    c. Regulators and auditors have to **think of the controls around privacy, data security, governance to make it more regulated**.

NEW TECHNOLOGIES

1. **AUGMENTED REALITY:** The technology **allows users to view the real-world environment** with augmented (added) elements, generated by digital devices. One famous example was Pokémon Go, a game for mobile devices in which players chase imaginary digital creatures (visible on their mobile phones) around physical locations.
2. **VIRTUAL REALITY:** VR goes **a step forward and replaces the real world entirely with a simulated environment, created through digitally generated images, sounds, and even touch and smell**. Using special equipment, such as a custom headset, the user can explore a simulated world or simulate experiences such as flying or skydiving.
3. **METAVERSE:** The **metaverse is the emerging 3-D digital space** that uses virtual reality, augmented reality, and other advanced internet technology **to allow people to have lifelike personal and business experiences online.** It represents a convergence of digital technology to combine and extend the reach and use of Cryptocurrency, Artificial Intelligence (AI), Augmented Reality (AR) and Virtual Reality (VR)
4. **VIRTUAL BANKING AND TRANSACTIONS**: A **forward-thinking financial institution, establishes a presence in the metaverse** to offer virtual banking services. **Users can create virtual bank accounts, access personalized financial dashboards, and perform transactions** using virtual currencies. Customers can seamlessly transfer funds, make virtual purchases, and engage in virtual commerce, all within the immersive environment of the metaverse.
5. **DIGITAL ASSET MANAGEMENT**: A digital asset management company, **recognizes the growing popularity of virtual assets in the metaverse.** They launch a **virtual asset trading platform** within the metaverse, allowing users to buy, sell, and trade NFTs and other digital assets. Investors can diversify their portfolios, participate in virtual

auctions, and even showcase their virtual art collections in virtual galleries. Crypto Investments Ltd. leverages the metaverse's decentralized and secure infrastructure to facilitate transparent and efficient transactions of virtual assets.

6. **VIRTUAL FINANCIAL EDUCATION AND TRAINING**: **A Financial Learning Academy aims to enhance financial literacy using the metaverse**. They **create a virtual classroom environment where participants can attend interactive financial education sessions**. Students can engage in simulated investment activities, learn about budgeting and financial planning, and gain hands- on experience through virtual trading simulations. Financial Learning Academy leverages the immersive nature of the metaverse to provide an engaging and practical financial education platform, preparing individuals for real-world financial challenges.

7. **VIRTUAL MEETINGS AND CONFERENCES**: For a leading industry even an **organisation hosts a virtual conference within the metaverse**. Participants from **around the world can access the conference** through their virtual avatars. They can attend keynote speeches, panel discussions, and networking events in virtual conference halls. Attendees can interact with industry experts, explore virtual exhibition booths, and establish valuable connections in the financial sector. Global Finance Summit leverages the metaverse to create a global and inclusive conference experience, fostering collaboration and knowledge sharing.

   DATA VISUALIZATION AND ANALYTICS: **A company utilizes the metaverse to offer advanced data visualization and analytics tools to financial professionals**. Their virtual analytics platform allows users to visualize complex financial data in interactive and immersive 3D environments. **Users can explore data trends, conduct simulations, and analyze financial performance** through intuitive interfaces within the metaverse. Analytics Solutions Inc. leverages the metaverse's immersive capabilities to enhance data-driven decision-making, enabling financial professionals to gain deeper insights into market trends and make informed investment decisions.

14. SPECIALISED AREAS

There **are 3 separate SAs** for the above specialised areas as under:

1.	SA 800	Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
2.	SA 805	Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
3.	SA 810	Engagements to Report on Summary Financial Statements

SA 800 - SPECIAL CONSIDERATIONS - AUDITS OF FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH SPECIAL PURPOSE FRAMEWORKS

SCOPE OF SA 800 AND CONCEPT OF SPECIAL PURPOSE FRAME WORK

A. SCOPE OF SA 800: SA 800 deals with special considerations applicable in respect of audit of **financial statements prepared in accordance with special purpose framework**. This SA addresses special considerations that are relevant to:

1. The **acceptance of the engagement**
2. The **planning and performance** of that engagement and
3. **Forming an opinion and reporting** on the financial statements
4. **BUT NOT for the purpose of expressing an opinion on the effectiveness** of the entity's internal control.

B. WHAT IS SPECIAL PURPOSE FRAMEWORK

1. SA 800 defines special purpose framework as a **financial reporting framework designed to meet the financial information needs of specific users.** The financial reporting framework **may be a fair presentation framework or a compliance framework**.
2. The **requirements** of the applicable financial reporting framework **determine the form and content of the financial statements** and what constitutes a complete set of financial statements.
3. **GPFW vs SPFW:** Special purpose framework is to be distinguished from general purpose framework. A financial reporting framework designed to meet the common financial **information needs of a wide range of users is known as "General purpose framework"** whereas a financial reporting framework designed to meet the **financial**

information needs of specific users is known as "Special purpose framework."

CONSIDERATIONS WHEN ACCEPTING AN AUDIT OF FINANCIAL STATEMENTS USING SPECIAL PURPOSE FRAMEWORK

1. **NEEDS OF USERS:** In the case of special purpose financial statements, the financial information **needs of the intended users are a key factor in determining the acceptability** of the financial reporting framework applied in the preparation of the financial statements.

2. **ACCEPTABLE ORGANISATION STANDARDS:** The applicable financial reporting framework may encompass the financial reporting standards **established by an organisation that is authorised or recognised to promote standards for special purpose financial statements**.
   In that case, those standards will be presumed acceptable for that purpose if the organisation follows an established and transparent process involving deliberation and consideration of the views of relevant stakeholders.

3. **REGULATORY REQUIREMENT:** Some **laws or regulations may prescribe** the financial reporting framework to be used by management in the **preparation of special purpose financial statements for a certain type of entity**. For example, a regulator may establish financial reporting provisions to meet the requirements of that regulator.
   In the **absence of indications to the contrary**, such a financial reporting framework is **presumed acceptable for special purpose financial statements** prepared by such an entity.

4. **CONFLICT BETWEEN ORG SA's AND REGULATORY REQUIREMENTS:** Where the financial reporting standards referred to above are supplemented by legislative or regulatory requirements, SA 210 requires the **auditor to determine whether any conflicts between the financial reporting standards and the additional requirements exist** and prescribes actions to be taken by the auditor if such conflicts exist.

5. The applicable financial reporting framework **may encompass the financial reporting provisions of a contract or sources other than those described** in the preceding paras. In that case, the acceptability of the financial reporting framework in the circumstances of the engagement is determined by considering **whether the framework exhibits attributes normally exhibited** by acceptable financial reporting frameworks in accordance with the requirements of SA 210.

6. In the case of a special purpose framework, the **relative importance to a particular engagement of each of the attributes** normally exhibited by acceptable financial reporting frameworks is a **matter of professional judgment**.

CONSIDERATIONS WHEN PLANNING AND PERFORMING AN AUDIT OF FINANCIAL STATEMENTS USING SPECIAL PURPOSE FRAMEWORK

1. SA 200 requires the auditor to comply with:
   a. **Relevant ethical requirements**, including those pertaining to independence, relating to financial statement audit engagements, and
   b. All **SAs relevant** to the audit.
2. **COMPLY WITH SA's:** It also requires the **auditor to comply with each requirement of an SA unless,** in the circumstances of the audit, the **entire SA is not relevant** or the requirement is not relevant because it is conditional and the condition does not exist.
3. **DEPART FROM SA's:** In exceptional circumstances, the **auditor may judge it necessary to depart** from a relevant requirement in an SA **by performing alternative audit procedures** to achieve the aim of that requirement.
4. Application of some of the requirements of the SAs in an audit of **special purpose financial statements may require special consideration by the auditor**. **For example:**
   a. In SA 320, **judgments about matters that are material** to users of the financial statements are based on a consideration of the **common financial information needs** of users as a group. In the case of an audit of **special purpose financial statements**, however, those **judgments are based on** a consideration of the financial information **needs of the intended users**.
   b. In the case of **special purpose financial statements**, such as those prepared in accordance with the requirements of a contract, **management may agree with the intended users on a threshold** below which **misstatements identified** during the audit **will not be corrected or otherwise adjusted**. The **existence of such a threshold does not relieve the auditor** from the requirement to determine materiality in accordance with SA 320 for purposes of planning and performing the audit of the special purpose financial statements.

c. SA 260 (Revised) **requires the auditor to determine the appropriate person(s)** within the entity's governance structure with whom to communicate. SA 260 (Revised) notes that, in some cases, all of those charged governance are involved in managing the entity, and the application of the communication requirements is modified to recognize this position.

d. When a complete set of general purpose financial statements is also prepared by the entity, those **person(s) responsible for the oversight of the preparation of the special purpose financial statements may not be the same** as those charged with governance responsible for the oversight of the preparation of those general purpose financial statements.

5. **FORMING AN OPINION:** When forming an opinion and reporting on special purpose financial statements, the **auditor shall apply the requirements in Revised SA 700**.

DESCRIPTION OF THE APPLICABLE FINANCIAL REPORTING FRAMEWORK IN THE AUDITORS REPORT AND ALERTING USERS ON ITS USAGE AND DISTRIBUTION

A. DESCRIPTION IN AUDITORS REPORT:

1. Revised **SA 700** requires the auditor to **evaluate whether** the financial statements adequately refer to or **describe the applicable financial reporting framework**.
2. In the case of financial statements **prepared in accordance with the provisions of a contract**, the auditor shall evaluate whether the financial **statements adequately describe any significant interpretations of the contract** on which the financial statements are based.
3. Revised SA 700 deals with the form and content of the auditor's report. In the case of an auditor's report on special purpose financial statements:

    a. The auditor's report shall also describe **the purpose for which the financial statements are prepared and, the intended users**, or refer to a note in the special purpose financial statements that contain that information and

    b. If **management has a choice** of financial reporting frameworks in the preparation of such financial statements, the **explanation of management's responsibility** for the financial statements shall also make reference to its responsibility for determining that the **applicable financial reporting framework is acceptable** in the circumstances.

B. **ALERTING READERS THAT THE FINANCIAL STATEMENTS:** The **special purpose financial statements may be used for purposes other than those for which they were intended**. For example, a regulator may require certain entities to place the special purpose financial statements on public record. To **avoid misunderstandings, the auditor alerts users of the auditor's report** that the financial statements are prepared in accordance with a special purpose framework and, therefore, **may not be suitable for another purpose**.

C. **RESTRICTION ON DISTRIBUTION OR USE OF AUDITORS REPORT:** In addition to the alert required as discussed above, the **auditor may consider it appropriate to indicate that the auditor's report is intended solely for the specific users**. Depending on the law or regulation applicable, this may be achieved by restricting the distribution or use of the auditor's report. In these circumstances, the paragraph alerting the readers may be expanded to include these other matters, and the heading modified accordingly.

SA 805 - SPECIAL CONSIDERATIONS - AUDITS OF SINGLE FINANCIAL STATEMENTS AND SPECIFIC ELEMENTS, ACCOUNTS OR ITEMS OF A FINANCIAL STATEMENT

SCOPE OF SA 805 AND ITS APPLICABILITY

1. Standards on Auditing (SAs) in the **100-700 series apply to an audit of financial state**ments and are to be **adapted as necessary** in the circumstances **when applied to audits of other historical financial information**.
2. SA **805 deals with special considerations** in the application of those SAs to an **audit of a single financial statement or of a specific element, account or item** of a financial statement.
3. The single financial statement or the specific element, account or item of a financial statement **may be prepared in accordance with a**

general or special purpose framework. If prepared in accordance with a special purpose framework, SA 800 also applies to the audit.

4. SA **805 does not apply to the report of a component auditor** issued as a result of work performed on the financial information of a component at the request of a group engagement team for purposes of an audit of group financial statements.
5. The objective of the auditor, when applying SAs, in such an audit, is **to address appropriately the special considerations** that are relevant to:
   a. The **Acceptance** of Engagement,
   b. **Planning and Performan**ce of Engagement and
   c. **Forming an Opinion** and Reporting
   d. **BUT NOT** for the purpose of expressing an opinion on the **effectiveness of the entity's internal control**.

SINGLE FINANCIAL STATEMENT AND ELEMENT OF A FINANCIAL STATEMENT

SINGLE FINANCIAL STATEMENT [SFSE]: A single financial statement is to be different from a complete set of financial statements AND **includes the related notes ordinarily comprising a summary of significant accounting policies and other explanatory information relevan**t to the **financial statement.**

ELEMENT [SFSE]: "Element of a financial statement" or "element" means an "element, account or item of a financial statement" AND **includes the related notes ordinarily comprising a summary of significant accounting policies and other explanatory information relevant to the financial statement Element**.

CONSIDERATIONS WHEN ACCEPTING AUDIT OF SINGLE FINANCIAL STATEMENT OR ELEMENT THEREOF

1. **SA 200 requires the auditor to comply with all SAs relevant** to the audit. In the case of an audit of a single financial statement or of a specific element of a financial statement, this **requirement applies irrespective of whether the auditor is also engaged to audit** the entity's complete set of financial statements.
2. **PRACTICABILITY:** If the **auditor is not also engaged to audit the entity's complete set of financial statements**, the auditor shall **determine whether the audit of a single financial statement** or of a specific element of those financial statements in accordance with **SAs is practicable.**

3. **COMPLY AS PER SA 200:** SA 200 requires the auditor to comply with
    a. **Relevant ethical requirements**, including those pertaining to independence relating to financial statement audit engagements, and
    b. **All SAs relevant** to the audit.
    c. It also **requires the auditor to comply with each requirement of an SA UNLESS**, in the circumstances of the audit, the entire **SA is not relevant or the requirement is not relevant because it is conditional** and the condition does not exist.

4. **DEPART FROM REQUIREMENT OF THE STANDARD:** In exceptional circumstances, the **auditor may judge it necessary to depart** from a relevant requirement in an SA **by performing alternative audit procedures to achieve** the aim of that requirement.

5. **NOT AUDITED CSFS:**
    a. **Compliance with the requirements of SAs** relevant to the audit of a single financial statement or of a **specific element of a financial statement may not be practicable when the auditor is not also engaged to audit the entity's complete** set of financial statements.
    b. In such cases, the **auditor often does not have the same understanding** of the entity and its environment, including its internal control, as an auditor who also audits the entity's complete set of financial statements.
    c. **The auditor also does not have audit evidence about the general quality** of the accounting records or other accounting information that **would be acquired in an audit of the entity's complete set of financial statements**. Accordingly, the auditor may need further evidence to corroborate audit evidence acquired from the accounting records.
    d. In the case of an **audit of a specific element of a financial statement**, **certain SAs require audit work that may be disproportionate to the element** being audited.
    e. If the **auditor concludes that an audit** of a single financial statement or of a specific element of a financial statement in accordance with **SAs may not be practicable**, the auditor **may discuss with management whether another type of engagement might be more practicable**.

ACCEPTABILITY OF THE FINANCIAL REPORTING FRAMEWORK

1. SA 210 requires the auditor to **determine the acceptability of the financial reporting framework applied in the preparation of the financial statements**. In the case of an audit of a single financial statement or of a specific element of a financial statement, this shall include whether application of the financial reporting framework **will result in a presentation that provides adequate disclosures to enable the intended users to understand the information** conveyed in the financial statement or the element, and the effect of material transactions and events on the information conveyed in the financial statement or the element.
2. A **single financial statement or a specific element** of a financial statement may be prepared in **accordance with an applicable financial reporting framework** that is based on a financial reporting framework **established by an authorised or recognised standards setting organisation** for the preparation of a complete set of financial statements.

   If this is the case, determination of the acceptability of the applicable framework may involve considering whether that framework includes all the requirements of the framework on which it is based that are **relevant to the presentation of a single financial statement or of a specific element of a financial statement that provides adequate disclosures**.

CONSIDERATIONS WHEN PLANNING AND PERFORMING THE AUDIT OF SINGLE FINANCIAL STATEMENT OR ELEMENT

1. **COMPLY WITH ALL RELEVANT SA's:** In **planning and performing the audit of a single financial statement or of a specific element** of a financial statement, the auditor **shall adapt all SAs relevant to the audit as necessary** in the circumstances of the engagement.
2. **USAGE OF EVIDENCE OBTAINED EARLIER:** When **auditing a single financial statement or a specific element of a financial statement in conjunction with the audit of the entity's complete set** of financial statements, the auditor may be **able to use audit evidence obtained** as part of the audit of the entity's complete set of financial statements in the audit of the financial statement or the element.
3. **OBTAIN S&A EVIDENCE:** **SAs, require the auditor to plan and perform** the audit of the financial statement or element **to obtain sufficient**

appropriate audit evidence on which to base the opinion on the financial statement or on the element.

4. **VERIFY INTERRELATED ITEMS:** The **individual financial statements that comprise a complete set of financial statements, and many of the elements** of those financial statements, including their related notes, are interrelated. Accordingly, when auditing a single financial statement or a specific element of a financial statement, the **auditor may not be able to consider the financial statement or the element in isolation**. Consequently, **the auditor may need to perform procedures in relation to the interrelated items to meet the objective** of the audit.
5. **MATERIALITY AND EVALUATION:** The **materiality determined for a single financial statement or for a specific element** of a financial statement **may be lower than the materiality determined for the entity's complete** set of financial statements, **this will affect the nature, timing and extent of the audit** procedures and the evaluation of uncorrected misstatements.

FORM OF OPINION IN CASE OF AUDIT OF SINGLE ELEMENT OR SINGLE FINANCIAL STATEMENT

1. **INCORPORATE IN TERMS OF ENGAGEMENT: SA 210 requires that the agreed terms of the audit engagement include the expected form of any reports** to be issued by the auditor. In the case of an audit of a single financial statement or of a specific element of a financial statement, the **auditor shall consider whether the expected form of opinion is appropriate** in the circumstances.
2. **DEPENDS ON AFRFW:** The form of opinion to be expressed by the auditor In accordance with Revised SA 700:
   a. **FAIR PRESENTATION FRAMEWORK:** When **expressing an unmodified opinion on a complete set** of financial statements prepared in accordance with a fair presentation framework, the auditor's opinion, unless otherwise required by law or regulation, uses one of the following phrases:
      i. The **financial statements present fairly, in all material respects**, in accordance with the applicable financial reporting framework OR
      ii. The **financial statements give a true and fair view** in accordance with the applicable financial reporting framework and
   b. **COMPLIANCE FRAMEWORK:** When **expressing an unmodified opinion on a complete set** of financial statements prepared in

accordance with a compliance framework, the auditor's opinion **states that the financial statements are prepared, in all material respects, in accordance** with the applicable financial reporting framework.

3. **NO EXPLICIT AFRFW FOR SFSE:**
    a. In the case of a **single financial statement or of a specific element of a financial statement,** the applicable financial reporting **framework may not explicitly address the presentation of the financial statement or of the element.** This may be the case when the applicable financial reporting framework is based on a financial reporting framework **established by an authorised or recognised standards setting organisation for the preparation of a complete set** of financial statements.
    b. The auditor **therefore considers whether the expected form of opinion is appropriate** in the light of the applicable financial reporting framework.
4. **FACTORS FOR WORDINGS OF FAIR PRESENTATION:** Factors that may affect the auditor's consideration as to whether to use the phrases "presents fairly, in all material respects", or "gives a true and fair view" in the auditor's opinion include:
    a. Whether **the applicable financial reporting framework is explicitly or implicitly restricted** to the preparation of a complete set of financial statements.
    b. Whether the **single financial statement or the specific element of a financial statement** will:
        i. **Comply fully with each of those requirements of the framework** relevant to the particular financial statement or the particular element, and the presentation of the financial statement or the specific element of a financial statement include the related notes and disclosures.
        ii. If **necessary to achieve fair presentation, provide disclosures beyond those specifically required** by the framework or, in exceptional circumstances, depart from a requirement of the framework.
    c. The auditor's **decision as to the expected form of opinion is a matter of professional judgment.** It may be affected by whether use of the phrases "presents fairly, in all material respects", or

"gives a true and fair view" in the auditor's opinion on a single financial statement or on a specific element of a financial statement **prepared in accordance with a fair presentation framework is generally accepted in the particular jurisdiction**.

FORMING AN OPINION AND REPORTING CONSIDERATIONS FOR AUDIT OF SINGLE SET OF FINANCIAL STATEMENT OR ELEMENT

1. **APPLY SA 700: When forming an opinion and reporting on a single** financial statement or on a specific element of a financial statement, the **auditor shall apply the requirements in Revised SA 700, adapted as necessary** in the circumstances of the engagement.
2. **SAME PERSON AUDITED COMPLETE SET:** If the auditor undertakes an engagement to **report on a single financial statement or on a specific element of a financial statement in conjunction** with an engagement to audit the **entity's complete set** of financial statements, the **auditor shall express a separate opinion for each engagement**.
3. **IF AUDITED SFSE AND AUDITED CSFS ARE PUBLISHED TOGETHER:**
   a. An **audited single financial statement or an audited specific element** of a financial statement may be **published together with the entity's audited complete set** of financial statements.
   b. If the auditor **concludes that the presentation of a single** financial statement or of the specific element of a financial statement **does not differentiate it sufficiently from the complete set** of financial statements, the **auditor shall ask management to rectify** the situation.
   c. The auditor **shall also differentiate the opinion on the single** financial statement or on the specific element of a financial statement **from the opinion on the complete set** of financial statements.
   d. The auditor **shall not issue the auditor's report containing the opinion on the single** financial statement or on the specific element of a financial **statement until satisfied with the differentiation.**

4. **MODIFIED OPNION / EOMP / OMP IN AUDITORS REPORT ON CSFS:**
   a. **MODIFIED OPINION ON CSFS – M.O. ON SFSE:** If the **opinion in the auditor's report on an entity's complete set of financial statements is modified**, or that report **includes an Emphasis of matter paragraph or other matter paragraph**, the auditor shall

determine the **effect t**hat this may have on the **auditor's report on a single** financial statement or on a specific element of those financial statements. When deemed appropriate, the **auditor shall modify the opinion on the single financial** statement or on the specific element of a financial statement, or **include an Emphasis of matter** paragraph or other matter paragraph in the auditor's report, accordingly.

b. **ADVERSE OR DISCLAIER OF OPINION ON CSFS – SAME FOR SFSE:**

   i. If the **auditor concludes that it is necessary to express an adverse opinion** or disclaim an opinion on the **entity's complete set** of financial statements as a whole, **revised SA705 does not permit the auditor to include in the same auditor's report an unmodified opinion on a single financial** statement that forms part of those financial statements or on a specific element that forms part of those financial statements.

   ii. This is because such **an unmodified opinion would contradict the adverse opinion or disclaimer of opinion** on the entity's complete set of financial statements as a whole.

c. **SFSE – MAJOR ITEM OF CSFS:** The auditor **shall not express an unmodified opinion on a single financial statement of a complete set** of financial statements if the **auditor has expressed an adverse opinion or disclaimed an opinion on the complete set** of financial statements as a whole. This is the case even if the auditor's report on the single financial statement is not published together with the auditor's report containing the adverse opinion or disclaimer of opinion. This **is because a single financial statement is deemed to constitute a major portion of those** financial statements.

d. **M.O. ON CSFS – U.M.O. ON SFSE [SFSE IS NOT A MAJOR ITEM]:** If the auditor concludes that **it is necessary to express an adverse opinion or disclaim an opinion on the entity's complete set** of financial statements as a whole **but, in the context of a separate audit of a specific** element that is included in those financial statements, the auditor nevertheless **considers it appropriate to express an unmodified opinion** on that element, the auditor shall only do so if:

   i. The **auditor is not prohibited by law or regulation** from doing so.

ii. That **opinion is expressed in an auditor's report that is not published together** with the auditor's report containing the adverse opinion or disclaimer of opinion and

iii. The specific element **does not constitute a major portion of the entity's complete set** of financial statements.

e. **CHECK ADEQUACY OF PRESENTATION AND DISCLOSURES IN SFSE:** Revised SA 700 requires the auditor, in forming an opinion, to **evaluate whether the financial statements provide adequate disclosures** to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements. In the case of a **single financial statement** or of a specific element of a financial statement, it is important that the financial statement or the element, including the related notes, in view of the requirements of the applicable financial reporting framework, **provides adequate disclosures to enable the intended users to understand the information** conveyed in the financial statement or the element, and the **effect of material transactions and events on the information** conveyed in the financial statement or the element.

f. **REFERENCE IN OMP IN AUDITORS REPORT ON SFSE – MODIFICATION IN CSFS NOT RELATED TO SFSE:** Even when the **modified opinion on the entity's complete set** of financial statements, Emphasis of matter paragraph or Other matter paragraph **does not relate to the audited financial statement or the audited element**, **the auditor may still deem it appropriate to refer to the modification** in an **Other matter paragraph in an auditor's report** on the financial statement or on the element because the auditor judges it to be relevant to the users' understanding of the audited financial statement or the audited element or the related auditor's report.

g. **ITEMISED OPINION ON CSFS:** In the auditor's report on an entity's complete set of financial statements, the expression of a **disclaimer of opinion regarding the results of operations and cash flows**, where relevant, and an **unmodified opinion regarding the state of affairs is permitted** since the disclaimer of opinion is being **issued in respect of the results of operations and cash flows only and not in respect of the financial statements as a whole**.

NOTE: SA 800 and 805 do not override the requirements of the other SAs; nor do they purport to deal with all special considerations that may be relevant in the circumstances of the engagement.

SA 810 - ENGAGEMENTS TO REPORT ON SUMMARY FINANCIAL STATEMENTS

SCOPE OF SA 810 AND CONCEPT OF SUMMARY FINANCIAL STATEMENTS

SA 810 deals with the auditor's responsibilities **when undertaking an engagement to report on summary financial statements derived from financial statements audited in accordance with SAs by that same auditor.**

SUMMARY FINANCIAL STATEMENTS:
Summary financial statements **reflect historical financial information that is derived from financial statements**, **but that contains less detail than the financial statements while still providing a structured representation** consistent with that provided by the financial statements of the entity's economic resources or obligations at a point in time or the changes therein for a period of time.

AUDITORS ACCEPTING AN ENGAGEMENT OF REPORTING ON SUMMARY FINANCIAL STATEMENTS

1. **ENGAGEMENT ACCEPTANCE:** The auditor shall, ordinarily, **accept an engagement to report on summary financial statements** in accordance with this SA only **when the auditor has been engaged to conduct an audit in accordance with SAs** of the financial statements from which the summary financial statements are derived. If the **auditor has not also audited the financial statements from which the summary financial statements are derived**, **the auditor shall not have the necessary knowledge to discharge his responsibilities** in relation to the summary financial statements in accordance with this SA.
2. Before accepting an engagement to report on summary financial statements, the auditor shall:
   a. **DETERMINE ACCEPTABILITY OF APPLIED CRITERIA:**
      i. Applied criteria refer to the **criteria applied by management in the preparation of the summary** financial statements.
      ii. **Management is responsible for the determination of the information that needs** to be reflected in the summary

financial statements so that they are consistent, in all material respects, with or **represent a fair summary** of the audited financial statements.

iii. Because summary financial statements, **by their nature contain aggregated information and limited disclosure, there is an increased risk** that they may not contain the **information necessary so as not to be misleading** in the circumstances.

iv. This **risk increases when established criteria** for the preparation of summary financial statements **do not exist.**

b. Factors affecting the **auditor's determination of the acceptability** of the applied criteria:

i. The **nature** of the entity.

ii. The **purpose of the summary** financial statements.

iii. The **information needs of the intended users** of the summary financial statements and

iv. Whether the **applied criteria will result** in summary financial statements that are **not misleading** in the circumstances.

c. **CRITERIA SIMILAR TO AFRFW:** The **criteria** for the preparation of summary financial statements may be established by **an authorised or recognised stan**dards setting organisation or by law or regulation. Similar to the case of financial statements, as explained in SA 210, in many such cases, the **auditor may presume that such criteria are acceptable.** Where established criteria for the preparation of summary financial statements **do not exist, criteria may be developed by management**, for example, based on practice in a particular industry.

d. **UNACCEPTABLE CRITERIA:**

i. If the auditor **concludes that the applied criteria are unacceptable or is unable to obtain the agreement** of management as discussed above, the **auditor shall not accept the engagement** to report on the summary financial statements, **unless required by law or regulation** to do so.

ii. An engagement **conducted in accordance with such law or regulation does not comply with this SA**. Accordingly, the auditor's report on the summary financial statements

shall not indicate that the engagement was conducted in accordance with this SA.

iii. The auditor shall include **appropriate reference to this fact** in the terms of the engagement. The auditor **shall also determine the effect that this may have on the engagement to audit the financial statements** from which the summary financial statements are derived.

e. **PROPER HEADING:** Adequate disclosure of the summarised nature of the summary financial statements and the identity of the audited financial statements, may, for example, be provided by a title such as "Summary financial statements prepared from the audited financial statements for the year ended March 31, 20XX"

OBTAINING AN AGREEMENT FROM MANAGEMENT REGARDING RESPONSIBILITIES ON SUMMARY FINANCIAL STATEMENTS

1. **OBTAIN THE AGREEMENT OF MANAGEMENT THAT IT ACKNOWLEDGES AND UNDERSTANDS ITS RESPONSIBILITY:**

a. For the **preparation of the summary financial statements** in accordance with the applied criteria.

b. To make the **audited financial statements available** to the intended users of the summary financial statements **without undue difficulty** (or, **if law or regulation provides that the audited financial statements need not be made available** to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements, to **describe that law or regulation in the summary** financial statements)

c. The auditor's evaluation whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty is affected by factors such as whether:

i. The **summary financial statements describe** clearly from whom or where the **audited financial statements are available**.

ii. The audited **financial statements are on public** record.

iii. Management has established a process by which the **intended users** of the summary financial statements **can obtain ready access to the audited financial statements**.

d. To **include the auditor's report** on the summary financial statements in **any document that contains the summary financial statements and that indicates that the auditor has reported** on them.

2. **FORM OF OPINION:** Agree with management on the **form of opinion to be expressed** on the summary financial statements.

PROCEDURES TO BE PERFORMED BY THE AUDITOR FOR EXPRESSING OPINION ON SUMMARY FINANCIAL STATEMENTS

The auditor shall perform the following procedures as the basis for the auditor's opinion on the summary financial statements:

1. **DISCLOSURE ABOUT AFS:** Evaluate whether the **summary financial statements adequately disclose their summarised nature and identify the audited financial statements**.
2. **NOT ACCOMPAIED AFS:** When summary financial statements **are not accompanied by the audited financial statements**, evaluate whether they describe clearly:
   a. From **whom or where the audited financial statements are available** or
   b. The **law or regulation that specifies that the audited financial statements need not be made available to the intended users** of the summary financial statements and **establishes the criteria for the preparation** of the summary financial statements.
3. **PRESENTATION AND DISCLORE OF APPLIED CRITERIA:** Evaluate whether the summary financial statements **are prepared and adequately discloses the applied criteria**.
4. **COMPARE WITH AFS: Compare the summary financial statements with the related information in the audited financial statements** to determine whether the summary financial statements agree with or can be re-calculated from the related information in the audited financial statements.
5. **NECESSARY INFORMATION:** Evaluate, in view of the purpose of the summary financial statements, whether the summary financial statements **contain the information necessary, and are at an appropriate level of aggregation, so as not to be misleading** in the circumstances.
6. **AFS AVAILABLE TO USERS:** Evaluate whether the audited financial statements are available to the **intended users of the summary financial statements without undue difficulty, unless law or regulation**

provides that they need not be made available and establishes the criteria for the preparation of the summary financial statements as discussed already.

FORM OF OPINION ON SUMMARY FINANCIAL STATEMENTS

1. **WORDINGS NOT GIVEN IN LAW:** When the **auditor has concluded that an unmodified opinion on the summary** financial statements is appropriate, the **auditor's opinion shall, unless otherwise required by law or regulation,** use one of the following phrases:
   a. The **summary financial statements are consistent,** in all material respects, with the audited financial statements, in accordance with the applied criteria or
   b. The **summary financial statements are a fair summary** of the audited financial statements, in accordance **with the applied criteria**
2. **LAW CONTAINS WORDINGS:** If **law or regulation prescribes the wording of the opinion on summary** financial statements in terms that are different from those described above, the auditor shall:
   a. **Apply the procedures discussed earlier** and any further procedures necessary to enable the auditor to express the prescribed opinion and
   b. **Evaluate whether users of the summary financial statements might misunderstand** the auditor's opinion on the summary financial statements and, if so, **whether additional explanation** in the auditor's report on the summary financial statements **can mitigate possible misunderstanding**.
   c. If, the auditor **concludes that additional explanation** in the auditor's report on the summary financial statements **cannot mitigate possible misunderstanding**, **the auditor shall not accept the engagement, unless required by law** or regulation to do so.
   d. An engagement conducted in accordance with such law or regulation **does not comply with this SA.** Accordingly, the **auditor's report** on the summary financial statements **shall not indicate that the engagement was conducted in accordance with this SA**.

ELEMENTS OF AUDITOR'S REPORT ON SUMMARY FINANCIAL STATEMENTS

The auditor's report on summary financial statements shall include the following elements: -

1. **TITLE:** A **title clearly indicating** it as the report of an independent auditor
2. **ADDRESSEE:** If the addressee of the summary financial statements is not the same as the addressee of the auditor's report on the audited financial statements, the **auditor shall evaluate the appropriateness of using a different addressee**. Factors that may affect the auditor's evaluation of the appropriateness of the addressee of the summary financial statements include:
    a. The **terms of the engagement**,
    b. The **nature** of the entity, and
    c. The **purpose** of the summary financial statements.
3. **INTRODUCTORY PARAGRAPH:**

a. **REFERENCE TO EACH ITEM OF SUMMARY F/S:** Identifies the summary financial statements on which the auditor is reporting, including the **title of each statement** included in the summary financial statements. When the auditor is aware that the summary financial statements will **be included in a document that contains other information,** the auditor may consider, if the form of presentation allows, identifying the page numbers on which the summary financial statements are presented.
b. **AFS:** Identifies the audited financial statements.
c. **AUDITORS REPORT ON AFS:** Refers to the auditor's report on the audited financial statements, the date of that report, and**, in cases other than where audited financial statements contain modified opinion,** emphasis of matter paragraph and other matter paragraph, **the fact that an unmodified opinion is expressed on the audited financial statements.**
d. **DATE OF SUMMARY IS DIFF FROM AFS:** If the **date of the auditor's report on the summary** financial statements **is later than the date of the auditor's report on the audited financial statements**, states that the summary financial statements and the audited financial statements **do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the audited**

financial statements and

e. **NOT A SUBSTITUTE FOR AFS:** A **statement indicating that the summary financial statements do not contain all the disclosures** required by the financial reporting framework applied in the preparation of the audited financial statements, and **that reading the summary financial statements is not a substitute for reading the audited financial statements.**

4. **MANAGEMENT RESPONSIBILITIES:** A description of management's responsibility for the summary financial statements, explaining that **management is responsible for the preparation of the summary financial statements in accordance with the applied criteria**.
5. **AUDITORS RESPONSIBILITIES:** A statement that the **auditor is responsible for expressing an opinion on the summary financial statements** based on the procedures required by this SA.
6. **OPINION PARA:** A paragraph clearly **expressing an opinion**.
7. **SIGNATURE AND MEMBERSHIP OF AUDITOR:** The **auditor's signature** along with the firm registration number, wherever applicable, and the membership number assigned by the Institute of Chartered Accountants of India. Besides, UDIN is required to be stated.
8. **DATE OF AUDITORS REPORT:** The **date** of the auditor's report

The **auditor shall date the auditor's report on the summary** financial statements **NO EARLIER THAN:**

(i) The **date on which the auditor has obtained sufficient appropriate evidence** on which to base the opinion, including evidence that the summary financial statements have been prepared and those with **the recognised authority have asserted that they have taken responsibility** for them and

(ii) The date of the **auditor's report on the audited financial statements.**

9. **THE PLACE OF SIGNATURE.**

MODIFICATIONS TO THE OPINION, EMPHASIS OF MATTER PARAGRAPH OR OTHER MATTER PARAGRAPH IN THE AUDITOR'S REPORT ON THE AUDITED FINANCIAL STATEMENTS

When the **auditor's report on the audited financial statements contains a qualified opinion, an Emphasis of Matter paragraph, or an Other Matter paragraph, but the auditor is satisfied that the summary financial statements are consistent**, in all material respects, with or are a fair summary of the audited financial statements, in accordance with the applied criteria, the **auditor's report on the summary financial statements shall, also contain** followings:

1. **State that the auditor's report on the audited financial statements contains a qualified opinion**, an Emphasis of Matter paragraph, or an Other Matter paragraph and
2. Describe about:
    a. The **basis for the qualified opinion on the audited financial statements**, and that qualified opinion; or the Emphasis of Matter or the Other Matter paragraph in the auditor's report on the audited financial statements and
    b. The **effect thereof on the summary financial statements**, if any.
3. **ADVERSE OR DISCLAIMER IN AUDITORS REPORT ON AFS:** When the **auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion,** the **auditor's report on the summary financial statements shall,** additionally:
    a. State that the **auditor's report on the audited financial statements contains an adverse opinion or disclaimer of opinion**.
    b. Describe the **basis for that adverse opinion or disclaimer** of opinion; and
    c. State that, as a result of the adverse opinion or disclaimer of opinion, **it is inappropriate to express an opinion on the summary financial statements**.
4. **MODIFIED OPINION ON THE SUMMARY FINANCIAL STATEMENTS:** If **the summary financial statements are not consistent, in all material respects**, with or are not a fair summary of the audited financial statements, in accordance with the applied criteria, and **management does not agree to make the necessary changes, the auditor shall express an adverse opinion** on the summary financial statements.
5. **RESTRICTION ON DISTRIBUTION OR USE OR ALERTING READERS TO THE BASIS OF ACCOUNTING:** When **distribution or use of the auditor's report on the audited financial statements is restricted**, or the auditor's report on the audited financial statements alerts readers that the audited financial statements are prepared in accordance with a special purpose framework, the **auditor shall include a similar**

restriction or alert in the auditor's report on the summary financial statements.

6. **COMPARATIVES:**
    a. Comparatives in the audited financial statements may be regarded as corresponding figures or as comparative financial information. If the **audited financial statements contain comparatives, but the summary financial statements do not**, **the auditor shall determine whether such omission is reasonable** in the circumstances of the engagement. The auditor **shall determine the effect of an unreasonable omission** on the auditor's report on the summary financial statements.
    b. If the summary financial statements **contain comparatives that were reported on by another auditor,** the **auditor's report on the summary financial statements shall also contain the matters that SA 710 requires** the auditor to include in the auditor's report on the audited financial statements.

UNAUDITED SUPPLEMENTARY INFORMATION PRESENTED WITH SUMMARY FINANCIAL STATEMENTS

The auditor shall evaluate whether any unaudited supplementary information presented with the summary financial statements is **clearly differentiated from the summary financial statements**. If the auditor **concludes that the entity's presentation of the unaudited supplementary information is not clearly differentiated** from the summary financial statements, the **auditor shall ask management to change the presentation** of the unaudited supplementary information.

If **management refuses to do so, the auditor shall explain in the auditor's report** on the summary financial statements that such information is not covered by that report.

OTHER INFORMATION IN DOCUMENTS CONTAINING SUMMARY FINANCIAL STATEMENTS

1. The auditor **shall read the other information included in a document** containing the summary financial statements and related auditor's reports to **consider whether there is a material inconsistency between the other information and the summary** financial statements.
2. If the **auditor identifies a material inconsistency, the auditor shall determine** whether the summary financial statements or the other information **needs to be revised**.

3. If, **the auditor becomes aware that the other information needs to be revised**, the auditor shall **discuss the matter** with management.

AUDITOR's RESPONSE IF THE ENTITY NOT INCLUDING AUDITORS REPORT ON SUMMARY FINANCIAL STATEMENTS IN A DOCUMENT CONTAINING SUCH F/S OR AUDITORS HAD NOT AUDITED SUMMARY F/S

1. If the auditor becomes aware that the entity plans to state that the auditor has reported on summary financial statements in a **document containing the summary financial statements, but does not plan to include the related auditor's report, the auditor shall request management to include the auditor's report in the document**.
2. If **management does not do so, the auditor shall determine and carry out other appropriate** actions designed to prevent management from **inappropriately associating the auditor with the summary** financial statements in that document.
3. The auditor may be engaged to report on the financial statements of an entity**, while not engaged to report on the summary financial statements.** If, in this case, the auditor becomes aware that the entity plans to make a statement in a document that refers to the auditor and **the fact that summary financial statements are derived from the financial statements audited by the auditor**, the auditor shall be satisfied that:

   a. The **reference to the auditor is made in the context of the auditor's report** on the audited financial statements and

   b. The **statement does not give the impression that the auditor has reported** on the summary financial statements.

   If **(a) or (b) are not met,** the **auditor shall request management to change the statement** to meet them, or not to refer to the auditor in the document. Alternatively, the entity may engage the auditor to report on the summary financial statements and include the related auditor's report in the document.
4. If **management does not change the statement**, delete the reference to the auditor, or include an auditor's report on the summary financial statements in the document containing the summary financial statements, **the auditor shall advise management that the auditor disagrees with the reference to the auditor, and the auditor shall**

determine and carry out other appropriate actions designed to prevent management from inappropriately referring to the auditor.

TIMING OF WORK AND EVENTS SUBSEQUENT TO THE DATE OF THE AUDITOR'S REPORT ON THE AUDITED FINANCIAL STATEMENTS

NO NEED TO OBTAIN EVIDENCE SUBSEQUENT TO AUDITORS REPORT DATE ON AUDITED F/S:

When the **auditor reports on the summary financial statements after the completion of the audit of the financial statements**, the auditor is **not required to obtain additional audit evidence on the audited financial statements,** or report on the **effects of events that occurred subsequent to the date of the auditor's report on the audited financial statement**s since the summary financial statements are derived from the audited financial statements.

15. RELATED SERVICES

For the **purpose of standardising the procedures to perform non-assurance services**, the AASB of ICAI issued **2 Standards on 2 different services i.e., Standards on Related Services.**

The following standards have been issued under Standards on Related Services:

1. **SRS 4400 Engagements to Perform Agreed-upon Procedures Regarding Financial Information**
2. **SRS 4410 Compilation Engagements**

RELATED SERVICES

1. ASSURANCE ENGAGEMENTS:

a. **"Assurance engagement"** means an **engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence** of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

b. It means that the **practitioner gives an opinion about specific information due to which users of information are able to make confident decisions** knowing well that chance of information being incorrect is diminished.

2. RELATED SERVICES:

a. Not all engagements performed by practitioners are assurance engagements.

b. Other frequently performed engagements **that do not meet the definition of assurance engagements are in the nature of Related Services** and they include:

   i. The **preparation of tax returns** where no conclusion conveying assurance is expressed.

   ii. **Consulting (or advisory) engagements** such as management and tax consulting.

   iii. Engagements covered by **Standards for Related Services, such as agreed-upon procedures engagements and compilations** of financial or other information.

3. AGREED-UPON PROCEDURES: In an engagement to perform agreed-upon procedures, the **auditor is engaged by the client to issue a report**

of factual findings, based on specified procedures performed on specified subject matter of specified elements, accounts or items of a financial statement.

4. **NEED NOT BE AN AUDITOR:** A **person performing related services need not necessarily be the auditor** of the entity's financial statements.

SRS 4400 - ENGAGEMENTS TO PERFORM AGREED UPON PROCEDURES REGARDING FINANCIAL INFORMATION

OBJECTIVE IN ACCORDANCE WITH SRS 4400

1. The **objective of an agreed-upon procedures** engagement is for the auditor **to carry out procedures of an audit nature** to which the auditor and the entity and any appropriate third parties **have agreed and to report on factual findings**.
2. As the **auditor simply provides a report of the factual findings** of agreed upon procedures**, no assurance is provided by him in his report**. Instead, **users of the report assess for themselves the procedures and the findings reported by the auditor and draw their own conclusions** from the work done by the auditor.
3. The report is **usually restricted to those parties that have agreed to the procedures** to be performed since others, **unaware of the reasons for the procedures**, may misinterpret the results.
4. Such **agreed-upon procedures engagements are non-assurance engagements**.

DIFFERENCES BETWEEN AUDIT AND AGREED-UPON PROCEDURES GIVE AN EXAMPLE OF AN AGREED UPON PROCEDURES

A key difference between an audit and agreed-upon procedures relates to assurance.

1. An **audit expresses an opinion and provides assurance** to users.
2. In an agreed-procedures engagement, **only a report of the factual findings of agreed-upon procedures is provided. No assurance is given to users.** Instead, users draw their own conclusions based on factual findings stated in the report.

GENERAL PRINCIPLES OF AN AGREED-UPON PROCEDURES ENGAGEMENT

1. The **auditor should comply with the Code of Ethics,** issued by the Institute of Chartered Accountants of India. Ethical principles governing the auditor's professional responsibilities for this type of engagement **include integrity, objectivity, professional competence and due care, confidentiality, professional conduct and technical standards**.
2. **Independence is not a requirement for agreed-upon procedures** engagement. However, the **terms or objective of the engagement may require the auditor to comply with the independence** requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India.
3. Where **the auditor is not independent, a statement to that effect should be made in the report** of factual findings.

TERMS OF THE ENGAGEMENT IN AN AGREED UPON PROCEDURES

1. The **auditor should ensure with representatives of the entity** and, other specified parties who **will receive copies of the report of factual findings, that there is a clear understanding** regarding the agreed procedures and the conditions of the engagement.
2. **MATTERS TO INCLUDE IN AN ENGAGEMENT LETTER:**
   a. It is in the interests of both the client and the auditor that **the auditor sends an engagement letter documenting the key terms** of the appointment.
   b. An **engagement letter confirms the auditor's acceptance** of the appointment and helps avoid misunderstanding regarding such matters as the **objectives and scope of the engagement, the extent of the auditor's responsibilities** and the form of reports to be issued. Matters that would be included in the engagement letter include:
      i. A **listing of the procedures** to be performed as agreed-upon between the parties
      ii. A **statement that the distribution of the report** of factual findings would be restricted to the **specified parties** who have agreed to the procedures to be performed.
3. **MATTERS TO BE AGREED:** Matters to be agreed include the following:
   a. **Nature of the engagement** including the fact that the procedures performed will not constitute an audit or a review and that accordingly no assurance will be expressed

b. Stated **purpose** for the engagement
c. **Identification of the financial information** to which the agreed-upon procedures will be applied.
d. **Nature, timing and extent** of the specific procedures to be applied
e. **Limitations on distribution of the report of factual findings**. When such limitation would be in conflict with the legal requirements, if any, the auditor would not accept the engagement.

PLANNING AND PROCEDURES IN AN AGREED UPON PROCEDURES

1. **PLAN:** The **auditor should plan the work** so that an effective engagement will be performed.
2. **PROCEDURES AND EVIDENCE:** The auditor **should carry out the procedures agreed-upon and use the evidence obtained as the basis for the report of factual findings**. The procedures applied in an engagement to perform agreed-upon procedures may include:
   a. **Inquiry and analysis**
   b. **Re computation, comparison** and other clerical accuracy checks
   c. **Observation**
   d. **Inspection**
   e. Obtaining **confirmations**

DOCUMENTATION AND REPORTING ASPECTS IN AN AGREED UPON PROCEDURES

The report on an agreed-upon procedures engagement **needs to describe the purpose** and the agreed-upon procedures of the engagement **in sufficient detail to enable the reader to understand the nature and the extent** of the work performed. The report **should also clearly mention that no audit or review** has been performed. The report of factual findings should contain:

ELEMENTS OF THE REPORT IN CASE OF AGREED UPON PROCEDURES
1. **Title**
2. **Addressee** (ordinarily, the appointing authority)
3. **Identification of specific financial or non-financial information** to which the agreed- upon procedures have been applied
4. A statement that the **procedures performed were those agreed-upon** with the recipient

5.	A statement that the **engagement was performed in accordance with the Standard** on Related Services applicable to agreed-upon procedures engagements
6.	Identification of the **purpose for which the agreed-upon procedures** were performed
7.	A **listing of the specific procedures** performed
8.	A **description of the auditor's factual findings** including sufficient details of errors and exceptions found
9.	A statement that the **procedures performed do not constitute either an audit or a review** and, as such, **no assurance is expressed**
10.	A statement that had the **auditor performed additional procedures**, an audit or a review, other matters might have come to light that would have been reported
11.	A statement that the **report is restricted to those parties that have agreed to the procedures** to be performed
12.	A statement (when applicable) that the **report relates only to the elements, accounts, items or financial and non-financial information specified** and that it does not extend to the entity's financial statements taken as a whole
13.	**Date** of the report
14.	**Place of signature** and
15.	**Auditor's signature**

DOCUMENTATION:

The auditor **should document matters which are important in providing evidence** to support the report of factual findings, and evidence that the engagement was carried out in accordance with this SRS and the terms of the engagement.

SRS 4410 – COMPILATION ENGAGEMENTS

SA 4410 AND ITS APPLICABILITY

1. SRS 4410 deals with the practitioner's responsibilities when engaged to assist management with the **preparation and presentation of historical financial information without obtaining any assurance** on that information, and to report on the engagement in accordance with this SRS.
2. It applies to compilation engagements for historical financial information.
3. **Compilation engagements for financial information other than historical financial information**, **and compilation engagements for non-financial information can be performed** under this Standard after necessary adaptation.
4. SQC 1 is applicable to all Engagement Standards. **Since SRS 4410 is also one of Engagement Standards, SQC 1 applies to firms** in respect of firm's compilation engagements too.

COMPILATION ENGAGEMENT AND VARIOUS PURPOSES OF THE SAME

1. **MEANING:** Compilation engagement is an engagement in which a **practitioner applies accounting and financial reporting expertise** to assist management in the **preparation and presentation of financial information** of an entity in accordance with an applicable financial reporting framework and **issues a report**.
2. **CAP WILL ASSIST:** Management may **request a professional accountant in public practice** to assist with the preparation and presentation of financial information of an entity.
3. **NOT AN ASSURANCE ENGAGEMENT:** A compilation engagement **is not an assurance engagement.** A compilation engagement **does not require the practitioner to verify the accuracy or completeness of the information** provided by management for the compilation, or otherwise to gather evidence to express an audit opinion or a review conclusion on the preparation of the financial information.
4. **PURPOSES:** Financial information that is the subject of a compilation engagement may be required for various purposes including:
   a. To **comply with mandatory periodic financial reporting requirements** established in law or regulation, if any or

b. For other purposes including for example:
   i. For management or those charged with governance, **prepared on a basis appropriate for their particular purposes** (such as preparation of financial information for internal use).
   ii. For **periodic financial reporting undertaken for external parties under a contract** or other form of agreement (such as financial information provided to a funding body to support provision or continuation of a grant).
   iii. For **transactional purposes**, for example to support a transaction involving changes to the entity's ownership or financing structure (such as for a merger or acquisition).

OBJECTIVES IN ACCORDANCE WITH SRS 4410

The **practitioner's objectives** in a compilation engagement under this SRS are to:

1. Apply **accounting and financial reporting expertise** to assist management in the preparation and presentation of financial information in accordance with an applicable financial reporting framework based on information provided by management and
2. **Report in accordance** with the requirements of this SRS.

SCOPE OF COMPILATION ENGAGEMENTS

1. The **scope of a compilation engagement will vary depending on the circumstances** of the engagement. However, in every case it will involve assisting management in the **preparation and presentation of the entity's financial information** in accordance with the financial reporting framework, **based on information provided** by management.
2. In some compilation engagements, **management may have already prepared** the financial information itself in a **draft or preliminary form.**
3. **Management retains responsibility for the financial information** and the basis on which it is prepared and presented. That **responsibility includes application by management of the judgment required** for the preparation and presentation of the financial information, including the selection and application of appropriate accounting policies and, where needed, developing **reasonable accounting estimates**.
4. **Different financial reporting frameworks can be used** to prepare and present financial information, ranging from a simple entity-specific

basis of accounting to established financial reporting standards. The financial reporting framework adopted by management to prepare and present the financial information **will depend on the nature of the entity and the intended use of the information**.

ETHICAL REQUIREMENTS IN THE CONTEXT OF COMPLIATION ENGAGEMENTS

1. The **practitioner shall comply with relevant ethical requirements**. In complying with the Code of Ethics, **threats to the practitioner's compliance** with relevant ethical requirements are required to be **identified and appropriately addressed.**
2. Being in nature of non-assurance engage**ment, independence requirements do not apply to compilation engagements.** However, laws or regulations may specify requirements or disclosure rules pertaining to independence.

ENGAGEMENT ACCEPTANCE AND CONTINUANCE IN THE CONTEXT OF COMPILATION ENGAGEMENT

The practitioner **shall not accept the engagement unless the practitioner has agreed the terms** of engagement with management, and the engaging party if different, including:

1. The **intended use and distribution of the financial information**, and any restrictions on either its use or its distribution where applicable
2. **Identification of the applicable financial reporting framework**.
3. The **objective and scope of the compilation** engagement
4. The **responsibilities of the practitioner**, including the requirement to comply with relevant ethical requirements
5. **RESPONSIBILITES OF MANAGEMENT:** The responsibilities of management for:
    a. The financial information, and for the preparation and presentation thereof, in accordance with a financial reporting framework that **is acceptable in view of the intended use of the financial information and the intended users**
    b. **Design, implementation and maintenance of such internal control as management determines is necessary** to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

c. The **accuracy and completeness of the records, documents, explanations** and other information provided by management for the compilation engagement and

d. **Judgments needed in the preparation and presentation** of the financial information, including those for which the **practitioner may provide assistance** in the course of the compilation engagement

6. The **expected form and content** of the practitioner's report.

7. **ENGAGEMENT LETTER:**

a. The **practitioner shall record the agreed terms of engagement** in an engagement letter or other suitable form of written agreement, prior to performing the engagement.

b. On recurring compilation engagements, the practitioner shall evaluate whether circumstances, including **changes in the engagement acceptance considerations, require the terms of engagement to be revised** and whether there is need to remind management of the existing terms of engagement.

PERFORMING THE COMPILATION ENGAGEMENT

1. The **practitioner shall obtain an understanding** of the following matters sufficient to be able to perform the compilation engagement:

a. The **entity's business and operations**, including the entity's accounting system and accounting records and

b. The **applicable financial reporting framework**, including its application in the entity's industry.

2. **COMPILING THE FINANCIAL INFORMATION:**

a. The **practitioner shall compile the financial information using the records, documents**, explanations and other information, including significant judgments, **provided by management**.

b. The **practitioner shall discuss with management**, or those charged with governance as appropriate, **those significant judgments**, for which the practitioner has provided assistance in the course of compiling the financial information.

c. Prior to completion of the compilation engagement, the **practitioner shall read the compiled financial information in light of the practitioner's understanding** of the entity's business and operations, and of the applicable financial reporting framework.

d. If, in the course of the compilation engagement, the **practitioner becomes aware that the records, documents, explanations or other information**, including significant judgments, provided by management for the compilation engagement are incomplete, inaccurate or otherwise unsatisfactory, the **practitioner shall bring that to the attention of management and request the additional or corrected information**.

e. If the practitioner is **unable to complete the engagement because management has failed to provide records,** documents, explanations or other information, including significant judgments, as requested, the **practitioner shall withdraw from the engagement and inform management** and those charged with governance of the reasons for withdrawing.

3. **PROPOSE AMENDMENTS:** If the **practitioner becomes aware during the course** of the engagement that:
    a. The compiled financial information **does not adequately refer to or describe** the applicable financial reporting framework
    b. **Amendments to the compiled financial information are required** for the financial information not to be materially misstated or
    c. The compiled financial information is **otherwise misleading**,

    The practitioner shall propose the appropriate amendments to management in the above cases.

4. **WITHDRAW FROM ENGAGEMENT:**
    a. If **management declines, or does not permit** the practitioner to make the proposed amendments to the compiled financial information, the **practitioner shall withdraw from the engagement and inform management** and those charged with governance of the reasons for withdrawing.
    b. If withdrawal from the engagement is not possible, the practitioner shall determine the professional and legal responsibilities applicable in the circumstances.

5. **OBTAIN ACKNOWLEDGEMENT FROM MANAGEMENT:** The practitioner **shall obtain an acknowledgement from management** or those charged with governance, as appropriate, that they **have taken responsibility for the final version of the compiled financial information**.

6. **COMMUNICATION WITH MANAGEMENT AND THOSE CHARGED WITH GOVERNANCE:** The practitioner **shall communicate with management**

or those charged with governance, as appropriate, on a **timely basis during the course of the compilation engagement**, all matters concerning the compilation engagement that, in the practitioner's professional judgment, are of **sufficient importance to merit the attention of management** or those charged with governance, as appropriate.

PRACTITIONER'S REPORT ON COMPILATION ENGAGEMENT

The practitioner's report is to **clearly communicate the nature of the compilation engagement, and the practitioner's role and responsibilities** in the engagement. The **practitioner's report is not a vehicle to express an opinion or conclusion** on the financial information in any form.

The practitioner's report issued for the **compilation engagement shall be in writing**, and shall include the following elements:

1. **Title**
2. The **addressee(s),** as required by the terms of the engagement
3. A **statement that the practitioner has compiled** the financial information based **on information provided by management**
4. A **description of the responsibilities of management,** or those charged with governance as appropriate, in relation to the compilation engagement, and in relation to the financial information
5. Identification of the applicable financial reporting framework and, if a special purpose financial reporting framework is used**, a description or reference to the description of that special purpose financial reporting framework** in the financial information
6. **Identification of the financial information**, including the title of each element of the financial information if it comprises more than one element, and the date of the financial information or the period to which it relates.
7. A description of the **practitioner's responsibilities in compiling the financial information**, including that the engagement was performed in accordance with this SRS, and that the practitioner has complied with relevant ethical requirements.
8. A **description of what a compilation engagement** entails in accordance with this SRS
9. Explanations that:
   a. Since a **compilation engagement is not an assurance engagement, the practitioner is not required to verify the accuracy or**

completeness of the information provided by management for the compilation and

b. Accordingly, the **practitioner does not express an audit opinion or a review conclusion** on whether the financial information is prepared in accordance with the applicable financial reporting framework.

10. If the financial information is **prepared using a special purpose financial reporting framework**, an explanatory paragraph that:
    a. Describes the **purpose** for which the financial information is prepared and, if necessary, the **intended users, or contains a reference to a note in the financial information** that discloses this information and
    b. Draws the attention of readers of the report to the fact that the financial information is **prepared in accordance with a special purpose framework** and that, as a result, the **information may not be suitable for other purposes**.
11. The **date** of the practitioner's report
12. **The practitioner's signature** and
13. The **place** of signature.

ENGAGEMENT LEVEL QUALITY CONTROL AND DOCUMENTATION IN THE CONTEXT OF COMPILATION ENGAGEMENT

1. **ENGAGEMENT LEVEL QUALITY CONTROL:** The **engagement partner shall take responsibility** for:
    a. The **overall quality of each compilation engagement** to which that partner is assigned and
    b. The engagement being performed in accordance with **the firm's quality control policies and procedures**

2. DOCUMENTATION:

3. The practitioner shall include in the engagement documentation:
    a. **Significant matters arising during the compilation engagement** and how those matters were addressed by the practitioner
    b. A **record of how the compiled financial information reconciles** with the underlying records, documents, explanations and other information, provided by management and
    c. A copy of the **final version of the compiled financial information for which management** or those charged with governance, as

appropriate, has **acknowledged their responsibility, and the practitioner's report**.

d. The practitioner may consider also including in the engagement documentation **a copy of the entity's trial balance, summary of significant accounting** records or other information that the practitioner used to perform the compilation.

16. REVIEW OF FINANCIAL INFORMATION

Standards on Review Engagements **apply where "Review" of financial information is undertaken by the practitioner.** Following Standards on review engagements have been issued in this regard:

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

REVIEW

1. **"Review" is a limited assurance engagement.** Limited assurance is the **level of assurance obtained where engagement risk is reduced to a level that is acceptable** in the circumstances of the engagement, but where **that risk is greater than for a reasonable assurance engagement**, as the basis for expressing a conclusion.
2. **Limited assurance engagement provides lower level of assurance than audit**. It **involves fewer procedures and, gathers sufficient and appropriate** evidence on basis of which limited conclusions can be drawn up.
3. **"Review" is related to financial statements prepared on basis of historical financial information just like an audit.**

REVIEW VS AUDIT

Overview of distinctive areas between Audit and Review:

Audit	Review
Audit is a **type of reasonable assurance engagement** providing reasonable level of assurance.	Review is **a type of limited assurance** engagement providing a **lower level of assurance than reasonable assurance** engagement.
It performs **elaborate and extensive procedures** including tests of controls and substantive procedures.	It performs **fewer procedures primarily focusing on inquiry and analytical** procedures.
It draws **reasonable conclusions** on	It draws **limited conclusions** on the

the basis of sufficient appropriate evidence.	basis of sufficient appropriate evidence.
It provides an **assurance opinion**.	It provides an **assurance conclusion**.
The language of **assurance opinion is positively worded.**	The language of **assurance conclusion is negatively worded**.

SRE 2400 – ENGAGEMENTS TO REVIEW HISTORICAL FINANCIAL STATEMENTS

SCOPE OF SRE 2400

SRE 2400 deals with: –

- The **practitioner's responsibilities** when engaged to perform **a review of historical financial** statements, when the **practitioner is not the auditor of the entity's financial statements** and
- The **form and content of the practitioner's report** on the financial statements.

1. SRE 2400 deals with the **practitioner's responsibilities performing a review of historical financial** statements when the **practitioner is not the auditor of the entity's financial statements**.
2. In a review of financial statements, the **practitioner expresses a conclusion that is designed to enhance the degree of confidence of intended users** regarding the preparation of an entity's financial statements in accordance with an applicable financial reporting framework.
3. Such financial statements **may have been prepared using general purpose framework or special purpose framework**.
4. The practitioner's conclusion **is based on the practitioner obtaining limited assurance**. The practitioner's report includes a **description of the nature of a review engagement as context for the readers of the report** to be able to understand the conclusion.

5. The practitioner **performs primarily inquiry and analytical procedures to obtain sufficient and appropriate evidence** as the basis for a conclusion on the financial statements as a whole.
6. If the practitioner becomes aware of a matter that causes the practitioner to believe the financial **statements may be materially misstated, he/she designs and performs additional procedures,** as he/she considers necessary in the circumstances, to be able to conclude on the financial statements.

OBJECTIVES IN A REVIEW OF FINANCIAL STATEMENTS IN ACCORDANCE WITH SRE 2400

1. **OBTAINED LIMITED ASSURANCE:** The practitioner's objectives in a review of financial statements in accordance with SRE 2400 are as under:
   a. **Obtain limited assurance, primarily by making an inquiry and performing analytical** procedures, about whether the financial statements as a whole are free from material misstatement, thereby enabling the practitioner to express a conclusion on whether anything has come to his attention that causes him **to believe the financial statements are not prepared, in all material respects, in accordance** with an applicable financial reporting framework.
   b. **Report on the financial statements as a whole and communicate,** as required by this SRE.
2. **NOT OBTAINED LIMITED ASSURANCE:**
   In all cases when **limited assurance cannot be obtained and a modified conclusion in the practitioner's report is insufficient** in the circumstances, this SRE requires that the practitioner either to **disclaim a conclusion** in the report issued for the engagement or, where appropriate to **withdraw from the engagement** if withdrawal is possible under applicable law or regulations

COMPLIANCE WITH ETHICAL REQUIREMENTS AND ENGAGEMENT LEVEL QUALITY CONTROL IN THE CONTEXT OF REVIEW ENGAGEMENT

1. **ETHICAL REQUIREMENTS:** The practitioner shall comply with relevant ethical requirements, **including those pertaining to independence and the engagement partner is responsible for overall quality** of each review engagement.

2. **ACCEPTANCE AND CONTINUANCE OF RELATIONSHIP:** Unless required by law or regulation, the practitioner shall not accept a review engagement if:

   a. **NO RATIONALE OR REVIEW ENGAGEMENT IS NOT APPROPRIATE:**

      i. **NO RATIONALE:** The practitioner is **not satisfied that there is a rational purpose for the engagement.** assurance engagements may only be accepted when the engagement exhibits certain characteristics that are conducive to achieving the practitioner's objectives specified for the engagement.

      It may be unlikely that there is a rational purpose for the engagement if, for example, there is a significant limitation on the scope of work or the practitioner suspects association of the practitioner's name with the financial statements in an inappropriate manner.

      Similarly, when the **engagement is intended to meet compliance requirements of relevant law or regulation** and such law or regulation requires the financial statements to be audited, there is **no rational purpose for such a review engagement.**

      ii. **REVIEW ENGAGEMENT NOT APPROPRIATE:** The **practitioner is not satisfied that a review engagement would be appropriate** in the circumstances.

      When the practitioner's preliminary understanding of the engagement circumstances **indicates that accepting a review engagement would not be appropriate,** the practitioner may consider recommending that another type of engagement be undertaken.

   b. **NON-COMPLIANCE WITH ETHICAL REQUIREMENTS:** The practitioner has reason **to believe that relevant ethical requirements,** including independence, will **not be satisfied**.

   c. **NON-AVAILABILITY OF INFORMATION:** The practitioner's preliminary understanding of the engagement circumstances **indicates that information needed to perform the review engagement is likely to be unavailable or unreliable**.

   d. **DOUBTS ABOUT INTEGRITY OF MANAGEMENT:** The practitioner has cause to **doubt management's integrity such that it is likely to affect proper performance** of the review.

e. **LIMITATION ON SCOPE BY MANAGEMENT:** Management or those charged with governance **impose a limitation on the scope of the practitioner's work in the terms of a proposed review engagement** such that the practitioner believes that the limitation will result in the practitioner disclaiming a conclusion on the financial statements.

PRECONDITIONS FOR ACCEPTING A REVIEW ENGAGEMENT

1. **Acceptability of financial reporting framework** applied in preparation of financial statements.
2. **Agreement of management in acknowledging and understanding its responsibility** for preparation of financial statements and internal control.
3. Providing **access to all information to the practitioner for the purpose of review** and unrestricted access to persons within the entity.

POINTS TO BE CONSIDERED PRIOR TO ACCEPTING A REVIEW ENGAGEMENT

The practitioner shall:

1. **ACCEPTABILITY OF FRFW:** Determine whether the financial reporting framework applied in the preparation of the **financial statements is acceptable including, in the case of special purpose financial statements, obtaining an understanding** of the purpose for which the financial statements are prepared and of the intended users.
2. **MANAGEMENT RESPONSIBILITIES:** Obtain the agreement of management that it acknowledges and understands its responsibilities:
    a. For the **preparation of the financial statements in accorda**nce with the applicable financial reporting framework, including, where relevant, their fair presentation.
    b. For such **internal control as management determines is necessary to enable the preparation of financial statements** that are free from material misstatement, whether due to fraud or error and
    c. To provide the practitioner with:
        i. **Access to all information of which management is aware that is relevant** to the preparation of the financial statements, such as records, documentation and other matters.

ii. **Additional information that the practitioner may request** from management for the purpose of the review and

iii. **Unrestricted access to persons within the entity** from whom the practitioner determines it necessary to obtain evidence.

3. If the **practitioner is not satisfied** as to any of the matters set out above as preconditions for accepting a review engagement, the **practitioner shall discuss the matter** with the management or those charged with governance.

4. If **changes cannot be made to satisfy the practitioner as to those matters, the practitioner shall not accept** the proposed engagement **unless required by law or regulation** to do so. An **engagement conducted under such circumstances does not comply with this SRE.** Accordingly, the practitioner **shall not include any reference** within the practitioner's report to the review having been conducted in **accordance with this SRE**.

5. If it is discovered after the **engagement has been accepted that the practitioner is not satisfied as to any of the above preconditions**, the practitioner shall discuss the matter with the management or those charged with governance and shall determine:
   a. Whether the **matter can be resolved**.
   b. Whether it is **appropriate to continue with the engagement** and
   c. **Unrestricted access to persons within the entity** from whom the practitioner determines it necessary to obtain evidence

AGREEING TO THE TERMS OF REVIEW ENGAGEMENT

1. **PRIOR TO PERFORMING THE ENGAGEMENT:** The practitioner **shall agree to the terms of the engagement** with the management or those charged with governance, as appropriate, prior to performing the engagement.

2. **IN WRITING:** The agreed terms of engagement **shall be recorded in an engagement letter** or other suitable form of written agreement.

3. **RECURRING ENGAGEMENTS:** On recurring review engagements, the practitioner shall evaluate whether circumstances, including **changes in the engagement acceptance considerations, require the terms of engagement to be revised** and whether there is a need to remind

management or those charged with governance, as appropriate, of the existing terms of engagement.

4. **CHANGE IN TERMS OF ENGAGEMENT:**
    a. **REASONABLE JUSTIFICATION:** The practitioner **shall not agree to a change in the terms of the engagement where there is no reasonable justification** for doing so. If, prior to completing the review engagement, the practitioner is requested to change the engagement to an engagement for which **no assurance is obtained, the practitioner shall determine whether there is reasonable justification** for doing so.
    b. **NEW TERMS IN WRITING:** If the **terms of engagement are changed during the course** of the engagement, the practitioner and the management or those charged with governance, as appropriate, **shall agree on and record the new terms of engagement in an engagement letter** or any other suitable form of written agreement.

OVERVIEW OF PERFORMING THE REVIEW ENGAGEMENT AFTER ITS ACCEPTANCE IN ACCORDANCE WITH SRE 2400

Determine materiality for financial statements as a whole

Obtain **understanding of entity and applicable financial reporting framework** to identify areas of possible material misstatements

Design and perform **"Inquiry" and "Analytical procedures"**

Perform procedures to **address specific circumstances**

Perform **other procedures, if necessary**, in circumstances

A. MATERIALITY IN A REVIEW OF FINANCIAL STATEMENTS:

1. The practitioner **shall determine materiality** for the financial statements **as a whole and apply this materiality in designing the procedures** and in evaluating the results obtained from those procedures.

2. The **practitioner's judgment about what is material** in relation to the financial statements as **a whole is the same regardless of the level of assurance** obtained by a practitioner as the basis for expressing the conclusion on the financial statements.

3. The practitioner **shall revise materiality for the financial statements as a whole** in the event of **becoming aware of any information during the review** that would have caused the practitioner to have determined a different amount initially.

B. OBTAINING UNDERSTANDING OF THE ENTITY:

The practitioner shall obtain **an understanding of the entity and its environment and the applicable financial reporting framework** to identify areas in the financial statements where **material misstatements are likely to arise** and thereby provide a basis for designing procedures to address those areas.

C. DESIGNING AND PERFORMING PROCEDURES THROUGH INQUIRY AND ANALYTICAL PROCEDURES:

1. In obtaining sufficient appropriate evidence as the basis for a conclusion on the financial statements as a whole, the practitioner shall **design and perform inquiry and analytical** procedures:
   a. **To address all material items** in the financial statements, including disclosures and
   b. To **focus on addressing areas** in the financial statements **where material misstatements are likely to arise.**

2. The requirements relating to designing and performing of inquiry and analytical procedures, and procedures **addressing specific circumstances, are designed to enable the practitioner to achieve the objectives** of this SRE. The circumstances of review engagements vary widely and, accordingly, there may be circumstances where **the practitioner may consider it effective or efficient to design and perform other procedures**.

3. The fact that the practitioner may **deem it necessary to perform other procedures does not alter the practitioner's objective** of

obtaining limited assurance in relation to the financial statements as a whole.

4. The practitioner may consider, **reviewing the accounting records with a view to identifying significant or unusual transactions** that may require specific attention in the review.

5. **INQUIRY:**
   a. In a review, **inquiry includes seeking information from management and other persons within the entity**, as the practitioner considers appropriate in the engagement circumstances.
   b. Inquiries may include matters such as those relating to:
      i. Making of **accounting estimates**,
      ii. Identification of **related parties**,
      iii. About significant, **complex or unusual transactions**,
      iv. **Existence of any actual, suspected or alleged fraud**,
      v. **SUBSEQUENT EVENTS: Events occurring between the date of the financial statements and practitioner's report**,
      vi. Basis for **management's assessment** of the entity's ability to continue as a **going concern**,
      vii. Events or conditions that appear to cast **doubt on the entity's** ability to continue as a **going concern**,
      viii. **CONTINGENCIES: Material commitments, contractual obligations** or contingencies that have affected or may affect the entity's financial statements including disclosures and **material non-monetary transactions or transactions for no consideration in the financial reporting** period under consideration.
   c. **NON-FINANCIAL INFORMATION:** The practitioner may also **extend inquiries to obtain non-financial data if appropriate.** Depending on the engagement circumstances, inquiries may also include inquiries about:
      i. **Actions taken at meetings of owners, those charged with governance and committees** thereof, and proceedings at other meetings, if any, that affect the information and disclosures contained in the financial statements.
      ii. **Communications the entity has received, or expects** to receive or obtain, from regulatory agencies.

iii. **Matters arising in the course of applying other procedures**.

d. **Evaluating the responses provided by the management** is integral to the inquiry process.

e. When performing further inquiries in relation to identified inconsistencies, the practitioner considers the **reasonableness and consistency of management's responses in light of the results obtained from other procedures**, and the practitioner's knowledge and understanding of the entity and the industry in which it operates.

6. **ANALYTICAL PROCEDURES:** In designing analytical procedures, the practitioner shall consider **whether the data from the entity's accounting system and accounting records are adequate for the purpose** of performing the analytical procedures.

"INQUIRY" AND "ANALYTICAL PROCEDURES" ITS IMPORTANCE IN REVIEW

1. **WHY INQUIRY:**

a. **Evidence obtained through inquiry is often the principal source** of evidence about management intent.

b. **INFORMATION ABOUT MANAGEMENT INTENTS:** However, information available to support management's intent may be limited. In that case:

i. **Understanding management's past history** of carrying out its stated intentions,

ii. Management's **stated reasons for choosing a particular course of action**, and

iii. Management's **ability to pursue a specific course of action** may provide relevant information to corroborate the evidence obtained through inquiry.

c. **SKEPTICISM IN EVALUATING RESPONSE:** Application of **professional scepticism in evaluating responses** provided by management is important to enable the practitioner to evaluate whether there are any matters that would cause **the practitioner to believe the financial statements may be materially misstated**.

d. Performing inquiry procedures also **assists the practitioner in obtaining or updating the practitioner's understanding of the entity** and its environment, to be able to identify areas where material misstatements are likely to arise in the financial statements.

2. **WHY ANALYTICAL PROCEDURES:** In a review of financial statements, performing analytical procedures assists the practitioner in:
   a. Obtaining or updating the practitioner's **understanding of the entity** and its environment, including to be able to **identify areas where material misstatements** are likely to arise in the financial statements.
   b. Identifying **inconsistencies or variances from expected trends**, values or norms in the financial statements such as the level of congruence of the financial statements with key data, including key performance indicators.
   c. Providing **corroborative evidence in relation to other inquiries or analytical procedures** already performed.
   d. **Serving as additional procedures** when the practitioner becomes aware of matters that cause the practitioner to believe that the financial statements **may be materially misstated.**
   e. Various methods may be used to perform **analytical procedures ranging from performing simple comparisons to performing complex analysis** using statistical techniques. The practitioner may, for example:
      i. Apply analytical procedures to **evaluate the financial information underlying the financial statements and assessment of results** for consistency with expected values.
      ii. **Expectations may be developed by the practitioner on information** obtained from relevant sources like information regarding the industry in which entity operates.

PROCEDURES TO ADDRESS SPECIFIC CIRCUMSTANCES IN CASE OF REVIEW ENGAGEMENT

1. **RELATED PARTIES:** During the review, the practitioner shall remain alert for:
   a. **Arrangements or information** that may indicate the **existence of related party** relationships or transactions that the management has **not previously identified or disclosed** to the practitioner.

b. If the practitioner **identifies significant transactions outside the entity's normal course** of business during the course of review, the practitioner shall **inquire with the management about the nature of those transactions, possible involvement of related parties** and the business rationale (or lack thereof) of those transactions.

2. **FRAUD AND NON-COMPLIANCE WITH LAWS OR REGULATIONS:** When there is an **indication that fraud or non-compliance with laws or regulations, or suspected fraud** or non-compliance with laws or regulations, has occurred in the entity, the practitioner **shall communicate that matter to the appropriate level** of senior management or those charged with governance as appropriate and **request management's assessment of the effects, on the financial statements**.

   The practitioner has to consider the effect, of management's assessment of the effects of fraud or non-compliance with laws or regulations communicated to him on his conclusion on the financial statements and **on his report and determine whether there is a responsibility to report the occurrence or suspicion of fraud or illegal acts** to a party outside the entity.

3. **GOING CONCERN:** A review of financial statements includes **consideration of the entity's ability to continue as a going concern**. If, during the performance of the review, the practitioner **becomes aware of events or conditions that may cast significant doubt** about the entity's ability to continue as a going concern, the practitioner shall:

   a. **Inquire of management about plans for future actions** affecting the entity's ability to continue as a going concern and about the feasibility of those plans, and also **whether management believes that the outcome of those plans will improve** the situation regarding the entity's ability to continue as a going concern.

   b. **Evaluate the results of those inquiries,** to consider whether management's responses provide a sufficient basis to:

   c. **Continue to present the financial statements on the going concern basis if the applicable** financial reporting framework includes the assumption of an entity's continuance as a going concern or

   d. **Conclude whether the financial statements are materially misstated, or are otherwise misleading** regarding the entity's ability to continue as a going concern and

e. **Consider management's responses in light of all relevant information** of which the practitioner is aware as a result of the review.

4. **USE OF WORK PERFORMED BY OTHERS:** In performing the review, it may be necessary for the **practitioner to use work performed by other practitioners, or the work of an individual or organization possessing expertise** in a field other than accounting or assurance. If the practitioner uses work performed by another practitioner or an expert in the course of performing the review, the **practitioner shall take appropriate steps to be satisfied that the work performed is adequate** for the practitioner's purposes.

5. **REVIEW OF GROUP FINANCIAL STATEMENTS:** When the practitioner **is engaged to review the financial statements** of a group of entities, the planned nature, timing and extent of the procedures for the review **are directed at achieving the practitioner's objectives** for the review engagement in **accordance with this Standard but in the context of the group** financial statements.

ADDITIONAL PROCEDURES WHEN THE PRACTITIONER BECOMES AWARE THAT THE FINANCIAL STATEMENTS MAY BE MATERIALLY MISSTATED

1. If the practitioner **becomes aware of matters** that causes the practitioner to believe that the financial statements **may be materially misstated**, the practitioner shall design and perform **additional procedures sufficient** to enable the practitioner to:
   a. **Conclude that the matter(s) is not likely** to cause the financial statements as a whole to be **materially misstated or**
   b. Determine that **the matter(s) causes the financial statements as a whole to be materially misstated**.
2. The **practitioner's response in undertaking additional procedures** with respect to an item the practitioner has cause to believe may be **materially misstated** in the financial statements will vary, **depending on the circumstances**, and is a matter for the practitioner's professional judgment.
3. **Additional procedures focus on obtaining sufficient appropriate evidence to enable the practitioner to form a conclusion on matters** that the practitioner believes may cause the financial statements to be materially misstated. The procedures may be:
   a. **Additional inquiry or analytical procedures,** for example, being performed in greater detail or being focused on the affected

items (i.e., amounts or disclosures concerning the affected accounts or transactions as reflected in the financial statements); or

b. **Other types of procedures**, for example, substantive test of details or external confirmations.

REVIEW PROCEDURES RELATED TO SUBSEQUENT EVENTS IN THE CONTEXT OF REVIEW ENGAGEMENT

1. **SUBSEQUENT EVENTS:** If the **practitioner becomes aware of events occurring between the date of the financial statements and the date of the practitioner's report that require adjustment of, or disclosure in, the financial statements**, the practitioner **shall request management to correct those misstatements**.
2. **AMENDING THE FINANCIAL STATEMENTS: The practitioner has no obligation to perform any procedures** regarding the financial statements after the date of the practitioner's report. However, if, **after the date of the practitioner's report but before the date the financial statements are issued, a fact becomes known to the practitioner** that, had it been known to the practitioner at the date of the practitioner's report, may have **caused the practitioner to amend the report**, the practitioner shall:
    a. **Discuss the matter with management** or those charged with governance, as appropriate
    b. **Determine whether the financial statements need amendment** and
    c. If so, inquire **how management intends to address the matter** in the financial statements.

3. **MANAGEMENT NOT AMENDING THE F/S:** If **management does not amend** the financial statements in circumstances where the **practitioner believes they need to be amended**, and the practitioner's **report has already been provided to the entity**:
    a. **NOTIFY NOT TO ISSUE F/S:** The practitioner **shall notify management** and those charged with governance **not to issue the financial statements to third parties** before the necessary amendments have been made.
    b. **TAKE APPROPRIATE ACTIONS:** If the financial statements **are nevertheless subsequently issued without the necessary amendments**, the practitioner shall take **appropriate actions to prevent reliance** on the practitioner's report.

OBTAINING WRITTEN REPRESENTATIONS IN THE CONTEXT OF REVIEW ENGAGEMENTS

1. **NOT A SUBSTITUTE FOR EVIDENCE:** **Written representations are an important source of evidence** in a review engagement. If **management modifies or does not provide the requested written representations**, it may alert the practitioner to the **possibility that one or more significant issues may exist**.
2. Further, a request for written, rather than oral, representations in many cases **may prompt management to consider such matters more rigorously, thereby enhancing the quality** of the representations.
3. **REGARDING RESPONSIBILITES OF MANAGEMENT:** The practitioner shall request management to provide a **written representation that management has fulfilled its responsibilities** described in the agreed terms of engagement. The written representation shall include that:
    a. Management **has fulfilled its responsibility for the preparation of financial statements** in accordance with the applicable financial reporting framework, including where relevant their fair presentation, and
    b. Has **provided the practitioner with all relevant information and access to information** as agreed in the terms of the engagement and
    c. All **transactions have been recorded and are reflected** in the financial statements.

    If **law or regulation requires management to make written public statements** about its responsibilities, and the practitioner determines that such statements provide some or all of the representations required above, **the relevant matters covered by such statements need not be included in the written representation**.
4. **REPRESENTATIONS RELATED TO DISCLOSURES:** In addition to the written representations required under this SRE, the practitioner may **consider it necessary to request other written representations about the financial statements**. These may be needed, for example, to complete the practitioner's evidence with respect to certain items or disclosures reflected in the financial statements where the practitioner **considers such representations to be important in forming a conclusion on the financial statements** on either a modified or unmodified basis.

5. **REPRESENTATION ON ADDITIONAL MATTERS:** The practitioner shall also request management's written representations that management has disclosed to the practitioner:
   a. The **identity of the entity's related parties and all the related party relationships** and transactions of which management is aware.
   b. **Significant facts relating to any frauds or suspected frauds** known to management that may have affected the entity.
   c. Known **actual or possible non-compliance with laws and regulations** for which the effects of non-compliance affect the entity's financial statements.
   d. **All information relevant to use of the going concern assumption** in the financial statements.
   e. That **all events occurring subsequent to the date of the financial statements** and for which the applicable financial reporting framework requires adjustment or disclosure, have **been adjusted or disclosed.**
   f. **Material commitments, contractual obligations or contingencies** that have affected or may affect the entity's financial statements, including disclosures.
   g. **Material non-monetary transactions or transactions for no consideration** undertaken by the entity in the financial reporting period under consideration.
6. **NOT PROVIDING REPRESENTAION:**
   a. If **management does not provide** one or more of the requested written representations, the practitioner shall:
      i. **Discuss the matter with management** and those charged with governance, as appropriate.
      ii. **Re-evaluate the integrity of management, and evaluate the effect** that this may have on the reliability of representations (oral or written) and evidence in general; and
      iii. **Take appropriate actions**, including determining the possible effect on the conclusion in the practitioner's report in accordance with this SRE.
   b. **DISCLAIM OR WITHDRAW:** The practitioner **shall disclaim a conclusion on the financial statements, or withdraw from the**

engagement if withdrawal is possible under applicable law or regulation, as appropriate, if:

i. **NOT RELIBLE:** The practitioner **concludes that there is sufficient doubt about the integrity of management** such that the written representations are not reliable or

ii. **NOT PROVIDED:** **Management does not provide the required representations in respect of its responsibilities** for preparation of financial statements and recording of all transactions in financial statements.

EVALUATING EVIDENCE OBTAINED FROM THE PROCEDURES PERFORMED IN THE CONTEXT OF REVIEW ENGAGEMENT

1. The practitioner **shall evaluate whether sufficient appropriate evidence** has been obtained from the procedures performed and, if not, the practitioner **shall perform other procedures** judged by the practitioner to be necessary in the **circumstances to be able to form a conclusion** on the financial statements.
2. In some circumstances, the practitioner may not have obtained the evidence that the practitioner **had expected to obtain through the design of primarily inquiry and analytical proced**ures and procedures addressing specific circumstances.
3. In these circumstances, the **practitioner considers that the evidence obtained** from the procedures performed is **not sufficient and appropriate to be able to form a conclusion** on the financial statements.
4. The practitioner may:
   a. **Extend the work performed** or
   b. **Perform other procedures judged** by the practitioner to be necessary in the circumstances.
5. Where **neither of these is practicable in the circumstances**, the **practitioner will not be able to obtain sufficient appropriate evidence** to be able to form a conclusion and is required by this SRE to **determine the effect on the practitioner's report,** or on the practitioner's ability to complete the engagement, for example, if a member of management is unavailable at the time of the review to respond to the practitioner's inquiries on significant matters.
6. If the **practitioner is not able to obtain sufficient appropriate evidence** to form a conclusion, the practitioner **shall discuss with management**

and those charged with governance, as appropriate, the **effects such limitations have on the scope of the review**.

7. **Inability to perform a specific procedure does not constitute a limitation** on the scope of the review if the practitioner is able to obtain sufficient appropriate evidence by performing other procedures.
8. **Limitations on the scope of the review imposed by management may have other implications** for the review, such as for the practitioner's consideration of areas where the financial statements are likely to be **materially misstated**, and engagement continuance.

FORMING THE PRACTITIONER'S CONCLUSION ON THE FINANCIAL STATEMENTS IN THE CASE OF A REVIEW ENGAGEMENT

1. In forming conclusion, the practitioner shall also consider the impact of:
   a. **Uncorrected misstatements identified during the review,** and in the previous year's review of the entity's financial statements, on the financial statements as a whole
   b. **Qualitative aspects of the entity's accounting practices**, including indicators of possible bias in management's judgments.
2. If the **financial statements are prepared using a fair presentation framework**, the practitioner's consideration shall also include:
   a. The **overall presentation, structure and content** of the financial statements in accordance with the applicable framework and
   b. Whether **the financial statements, including the related notes**, appear to represent the **underlying transactions and events in a manner that achieves fair presentation** or gives a true and fair view, as appropriate, in the context of the financial statements as a whole.
3. The practitioner's conclusion on the financial statements, whether **unmodified or modified, shall be expressed in the appropriate form** in the context of the financial reporting framework applied in the financial statements.

UNMODIFIED CONCLUSION IN THE PRACTITIONERS REPORT IN CASE OF REVIEW ENGAGEMENT

1. **UNMODIFIED CONCLUSION:** The practitioner **shall express an unmodified conclusion** in the practitioner's report on the financial

statements as a whole when the practitioner has obtained **limited assurance to be able to conclude** that nothing has come to the practitioner's attention that causes the practitioner **to believe that the financial statements are not prepared, in all material respects**, in accordance with the applicable financial reporting framework.

2. When the **practitioner expresses an unmodified conclusion**, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:
    a. **FAIR PRESENTATION FRAMEWORK:** "Based on our review, **nothing has come to our attention** that causes us to believe that the financial statements do not give a true and fair view (or do not present fairly, in all material respects), in accordance with the applicable financial reporting framework,".
    b. **COMPLIANCE FRAMEWORK:** "Based on our review, nothing has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework,".

MODIFIED CONCLUSION IN THE PRACTITIONERS REPORT IN CASE OF REVIEW ENGAGEMENT

1. **MODIFIED CONCLUSION:** The practitioner **shall express a modified conclusion** in the practitioner's report on the financial statements as a whole when:
    a. The **practitioner determines, based on the procedures performed** and the evidence obtained, that the financial statements are materially misstated or
    b. The practitioner is **unable to obtain sufficient and appropriate evidence in relation to one or more items** in the financial statements that are material in relation to the financial statements as a whole.
2. **MMS IN FINANCIAL STATEMENTS:** If the practitioner determines that the financial statements are materially misstated, the practitioner shall express:
    a. A **qualified conclusion, when the practitioner concludes that the effects** of the matter(s) giving rise to the modification **are material, but not pervasive** to the financial statements or

b. An **adverse conclusion**, when the effects of the matter(s) giving rise to the modification are **both material and pervasive** to the financial statements.

3. **HEADINGS OF CONCLUSION PARA:** When the practitioner **modifies the conclusion expressed** on the financial statements, the practitioner shall:

   a. Use **the heading "Qualified Conclusion," "Adverse Conclusion" or "Disclaimer of Conclusion," as appropriate**, for the conclusion paragraph in the practitioner's report and

   b. Provide a **description of the matter giving rise to the modification**, under an appropriate heading (for example, "Basis for Qualified Conclusion," "Basis for Adverse Conclusion" or "Basis for Disclaimer of Conclusion," as appropriate) in a separate paragraph in the practitioner's report immediately before the conclusion paragraph (referred to as the basis for conclusion paragraph).

4. **WORDINGS OF CONCLUSION PARA IN CASE OF QUALIFIED OPINION:** When the **practitioner expresses a qualified conclusion** on the financial statements because of a material misstatement, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:

   a. **FAIR PRESENTATION FRAMEWORK:** "Based on our review, **except for the effects of the matter(s) described in the Basis for Qualified Conclusion** paragraph, **nothing has come to our attention** that causes us to believe that the financial statements do not give a true and fair view (or do not present fairly, in all material respects), in accordance with the applicable financial reporting framework," (for financial statements prepared using a fair presentation framework) or

   b. **COMPLIANCE FRAMEWORK:** "Based on our review, **except for the effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention** that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework," (for financial statements prepared using a compliance framework).

5. **WORDINGS OF CONCLUSION PARA IN CASE OF ADVERSE CONCLUSION:** When the practitioner **expresses an adverse conclusion on the financial**

statements, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:

a. **FAIR PRESENTATION FRAMEWORK:** "Based on our review, due to the significance of the matter(s) described in the **Basis for Adverse Conclusion paragraph, the financial statements do not give a true and fair view** (or do not present fairly, in all material respects), in accordance with the applicable financial reporting framework,"or

b. **COMPLIANCE FRAMEWORK:** "Based on our review, due to the significance of the matter(s) **described in the Basis for Adverse Conclusion paragraph, the financial statements are not prepared, in all material respects**, in accordance with the applicable financial reporting framework,".

6. **BASIS FOR CONCLUSION PARA:** In the basis for conclusion paragraph, in relation to **material misstatements that give rise to either a qualified conclusion or an adverse conclusion**, the practitioner shall:

    a. **Describe and quantify the financial effects** of the misstatement if the material misstatement relates to specific amounts in the financial statements (including quantitative disclosures), unless impracticable, in which case the practitioner shall so state;

    b. **Explain how disclosures are misstated** if the material misstatement relates to narrative disclosures or

    c. Describe the **nature of omitted information if the material misstatement relates to the non- disclosure of information** required to be disclosed. Unless prohibited by law or regulation, the practitioner **shall include the omitted disclosures where practicable** to do so.

    MEANING OF NARRATIVE DISCLOSURES: Narrative accounting disclosures are an integral part of the corporate financial reporting package. They are **deemed to provide a view of the company "through the eyes of management"**. The narratives represent management's construal of corporate events and are largely discretionary.

PRACTITIONERS CONCLUSION ON REPORTING IN CASE OF INABILITY TO OBTAIN SUFFICIENT AND APPROPRIATE EVIDENCE IN A REVIEW ENGAGEMENT

1. **UNABLE TO OBTAIN EVIDENCE:** If the practitioner is **unable to form a conclusion on the financial statements due to the inability to obtain sufficient appropriate and evidence**, the practitioner shall:
    a. **Express a qualified conclusion** if the practitioner concludes that the **possible effects on the financial statements of undetected misstatements**, **could be material but not pervasive** or

    b. **Disclaim a conclusion** if the practitioner concludes **that the possible effects on the financial statements of undetected misstatements**, **could be both material and pervasive.**

2. **WITHDRAW FROM ENGAGEMENT:** The practitioner s**hall withdraw from the engagement** if the following conditions are present:
    a. Due to a **limitation on the scope of the review imposed by management** after the practitioner has accepted the engagement, the practitioner is unable to obtain sufficient appropriate and evidence to form a conclusion on the financial statements.
    b. The practitioner has determined that the **possible effects on the financial statements of undetected misstatements are material and pervasive and Withdrawal is possible** under applicable law or regulation.

3. **WORDINGS OF QUALIFIED CONCLUSION PARA:** When the practitioner expresses a **qualified conclusion** on the financial statements **due to inability to obtain sufficient and appropriate evidence,** the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:

    a. **FAIR PRESENTATION FRAMEWORK:** "**Based on our review, except for the possible effects of the matter(s) described in the Basis for Qualified Conclusion** paragraph, **nothing has come to our attention** that causes us to believe that the financial statements **do not give a true and fair view** (or do not present fairly, in all material respects) in accordance with the applicable financial reporting framework," or
    b. **COMPLIANCE FRAMEWORK:** "**Based on our review, except for the**

possible effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements **are not prepared, in all material respects, in accordance** with the applicable financial reporting framework,".

4. **WORDINGS OF DISCLAIMER OF CONCLUSION PARA:** When **disclaiming a conclusion** on the financial statements the practitioner shall state in the conclusion paragraph that:
    a. Due to the **significance of the matter(s) described in the Basis for Disclaimer of Conclusion paragraph,** the **practitioner is unable to obtain sufficient appropriate evidence** to form a conclusion on the financial statements and
    b. Accordingly, the **practitioner does not express a conclusion** on the financial statements.
5. **BASIS FOR CONCLUSION PARA:** In the basis for conclusion paragraph, in relation to either the qualified conclusion **due to inability of obtaining sufficient and appropriate evidence** or when the practitioner disclaims a conclusion, the **practitioner shall include the reason(s) for the inability to obtain sufficient** and appropriate evidence.

ELEMENTS OF PRACTITIONER'S REPORT ON A REVIEW ENGAGEMENT

The practitioner's report for the review engagement shall be in writing and shall contain the following elements:

1. **TITLE:** A title, which shall clearly indicate that it is the report of an independent practitioner for a review engagement
2. **ADDRESSEE:** The addressee(s), as required by the circumstances of the engagement
3. **INTRODUCTORY PARAGRAPH:**
    a. **Identifies the financial statements reviewed**, including identification of the title of each of the statements contained in the set of financial statements and the date and period covered by each financial statement
    b. **Refers to the summary of significant accounting policies** and other explanatory information and
    c. States that the financial statements **have been reviewed**
4. **MANAGEMENT RESPONSIBILITIES:** A description of the **responsibility of**

management for the preparation of the financial statements, including an explanation that management is responsible for:

a. Their **preparation in accordance with the applicable financial reporting** framework including, where relevant, their fair presentation;
b. Such **internal control as management determines is necessary to enable the preparation of financial statements** that are free from material misstatement, whether due to fraud or error;

IF THE FINANCIAL STATEMENTS ARE SPECIAL PURPOSE FINANCIAL STATEMENTS:

a. A description of the **purpose for which the financial statements are prepared and, the intended users,** or reference to a note in the special purpose financial statements that contains that information; and
b. If **management has a choice** of financial reporting frameworks in the preparation of such financial statements, a **reference within the explanation of management's responsibility** for the financial statements to management's responsibility for **determining that the applicable financial reporting framework is acceptable** in the circumstances

5. **PRACTITIONERS RESPONSIBILTIES:**

1. A **description of the practitioner's responsibility to express a conclusion** on the financial statements including reference to this SRE and, where relevant, applicable law or regulation.
2. **A description of a review of financial statements and its limitations, and the following statements:**
   a. A **review engagement under this SRE is a limited assurance** engagement.
   b. The practitioner performs procedures, **primarily consisting of making inquiries of management and others within the entity,** as appropriate, and applying analytical procedures, and evaluates the evidence obtained and
   c. The procedures performed in a **review are substantially less than those performed in an audit conducted in accordance** with Standards on Auditing (SAs), and, accordingly, **the practitioner does not express an audit opinion** on the financial statements.
3. **A paragraph under the heading "Conclusion" that contains:**
   a. The **practitioner's conclusion on the financial statements as a whole** as appropriate and

b. A **reference to the applicable financial reporting framework** used to prepare the financial statements.

4. **When the practitioner's conclusion on the financial statements is modified:**
   a. A paragraph under the appropriate heading that contains the **practitioner's modified conclusion as appropriate** and
   b. A paragraph, under an appropriate heading, that provides **a description of the matter(s) giving rise to the modification**

5. A reference to the practitioner's obligation under this SRE to comply with relevant ethical requirements

6. **THE DATE OF THE PRACTITIONER'S REPORT:** The practitioner shall date the report no earlier than the date on which the practitioner has **obtained sufficient appropriate evidence as the basis for the practitioner's conclusion** on the financial statements, including being satisfied that:
   a. All the statements that **comprise the financial statements under the applicable financial reporting framework**, including the related notes where applicable, have been prepared and
   b. Those with the **recognized authority have asserted that they have taken responsibility** for those financial statements.

7. The **PRACTITIONER'S SIGNATURE** and

8. The **PLACE OF SIGNATURE**

INCLUSION OF EMPHASIS OF MATTER AND OTHER MATTER PARAGRAPHS IN THE PRACTITIONER'S REPORT IN CASE OF A REVIEW ENGAGEMENT

1. **EMPHASIS OF MATTER PARA:**
    a. **MEANING:** The practitioner **may consider it necessary to draw users' attention to a matter presented or disclosed** in the financial statements that, in the practitioner's judgment, is of such importance that it is **fundamental to users' understanding of the financial statements.** Such paragraph **shall refer only to the information presented or disclosed in the financial statements.**
    b. **NO MMS:** In such cases, the practitioner shall include an Emphasis of Matter paragraph in the practitioner's report, provided the **practitioner has obtained sufficient appropriate evidence to conclude that the matter is not likely to be materially misstated** as presented in the financial statements.
    c. **PLACING OF EOMP IN REPORT:** The practitioner shall include an Emphasis of Matter paragraph **immediately after the paragraph that contains the practitioner's conclusion on the financial statements** under the heading "Emphasis of Matter," or other appropriate heading.
2. **OTHER MATTER PARA:** If the practitioner **considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements** that, in the practitioner's judgment, is relevant to users' understanding of the review, the practitioner's responsibilities or the practitioner's report and this is **not prohibited by law or regulation, the practitioner shall do so** in a paragraph in the practitioner's report with the heading **"Other Matter" or other appropriate heading.**

OTHER REPORTING RESPONSIBILITIES IN THE PRACTITIONER REPORT IN CASE OF REVIEW ENGAGEMENT

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS: A practitioner may be requested **to address other reporting responsibilities in the practitioner's report on the financial statements that are in addition to the practitioner's responsibilities** under this SRE to report on the financial statements. In such situations, those other reporting responsibilities shall be **addressed by the practitioner in a separate section** in the practitioner's report headed **"Report on Other Legal and Regulatory Requirements,"** or otherwise as appropriate to the context of the section, following the section of the report headed "Report on the Financial Statements."

DOCUMENTATION BY PRACTITIONER IN CASE OF REVIEW ENGAGEMENT

The preparation of **documentation for the review provides evidence that the review was performed** in accordance with this SRE along with **legal and regulatory requirements where relevant** and a sufficient and appropriate record of the basis for the practitioner's report.

The practitioner shall document the following:

1. The **nature, timing, and extent of the procedures performed** to comply with this SRE and applicable legal and regulatory requirements. While documenting the nature, timing and extent of procedures performed as required in this SRE, the practitioner shall record: a. **Who performed the work and the date such work** was completed and b. Who **reviewed the work performed for the purpose of quality control** for the engagement, and the period and extent of the review.
2. **Results obtained from the procedures**, and the practitioner's conclusions formed on the basis of those results and
3. **Significant matters arising during the engagement, the practitioner's conclusions** reached thereon, and significant professional judgments made in reaching those conclusions.
4. The practitioner shall also document **discussions with the management, those charged with governance**, and others as relevant to the performance of the review of significant matters arising during the engagement, including the nature of those matters.
5. If, in the course of the engagement, the **practitioner identified information that is inconsistent with the practitioner's findings regarding significant matters** affecting the financial statements, the practitioner shall **document how the inconsistency was addressed.**

SRE 2410 - REVIEW OF INTERIM FINANCIAL INFORMATION PERFORMED BY THE INDEPENDENT AUDITOR OF THE ENTITY

SRE 2410 deals with the **auditor's professional responsibilities** when the auditor **undertakes an engagement to review the interim financial information** of an audit client and on the form and content of the report.

INTERIM FINANCIAL INFORMATION

Interim financial information is financial information that is **prepared and presented in accordance with an applicable financial reporting framework** and comprises either a complete or a condensed set of **financial statements for a period that is shorter than the entity's financial year**.

OBJECTIVE OF AN ENGAGEMENT TO REVIEW INTERIM FINANCIAL INFORMATION IN ACCORDANCE WITH SRE 2410

1. The objective of an engagement to **review interim financial information is to enable the auditor to express a conclusion** whether, on the basis of the review, **anything has come to the auditor's attention that causes the auditor to believe that the interim financial information is not prepared,** in all material respects, in accordance with an applicable financial reporting framework.
2. The auditor **makes inquiries and performs analytical** and other review procedures in order to **reduce to a moderate level risk of expressing an inappropriate conclusion** when the interim financial information is materially misstated.
3. The objective of a **review of interim financial information differs significantly from that of an audit conducted in accordance with Standards on Auditing (SAs).** A review of interim financial information **does not provide a basis for expressing an opinion on whether the financial information gives a true and fair view**, or is presented fairly, in all material respects, in accordance with an applicable financial reporting framework.
4. A review, in contrast to an audit, is **not designed to obtain reasonable assurance** that the interim financial information is free from material misstatement.

5. A review **consists of making inquiries, primarily of persons responsible** for financial and accounting matters, and applying analytical and other review procedures.
6. A review may **bring significant matters affecting the interim financial information** to the auditor's attention, but **it does not provide all of the evidence** that would be required in an audit.

AGREEING THE TERMS OF THE ENGAGEMENT

The **auditor and the client should agree on the terms** of the engagement. The agreed terms of the engagement are ordinarily recorded in an engagement letter. Such communication helps to avoid misunderstandings regarding:

1. The **nature** of the engagement
2. The **objective and scope of the review**,
3. **Management's responsibilities**,
4. The **extent of the auditor's responsibilities**, the assurance obtained, and
5. The **nature and form** of the report.

UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT INCLUDING ITS INTERNAL CONTROL IN A REVIEW OF INTERIM FINANCIAL STATEMENTS BY THE AUDITOR

1. The **AUDITOR should have an understanding of the entity and its environment**, including its internal control, as it **relates to the preparation of both annual and interim financial** information, **sufficient to plan and conduct the engagement** so as to be able to:
    a. Identify the **types of potential material misstatement** and consider the likelihood of their occurrence and
    b. Select the **inquiries, analytical and other review procedures** that will provide the **auditor with a basis for reporting** whether anything has come to the auditor's attention that causes the auditor to believe that the interim financial information is not prepared, in all material respects, in accordance with the applicable financial reporting framework.
2. **RECURRING AUDITOR:**
    a. **EVIDENCE OBTAINED IN EARLIER AUDITS:** The auditor who has audited the entity's **financial statements for one or more**

annual periods has obtained an understanding of the entity and its environment, including its internal control, as it relates to the preparation of annual financial information that was sufficient to conduct the audit.

b. **UPDATE THE EVIDENCE:** In planning a review of interim financial information, the **auditor updates this understanding**.

c. **ICS DIFF FROM ANNUAL F/I:** The auditor also **obtains a sufficient understanding of internal control as it relates to the preparation of interim financial information** as it may **differ from internal control as it relates to annual financial information**.

3. **PROCURES TO OBTAIN THE UNDERSTANDING:** Some of the procedures performed by the auditor **to update the understanding of the entity and its environment**, including its internal control, ordinarily include the following:

   a. **Reading the documentation, to the extent necessary, of the preceding year's audit and reviews of prior interim period(s)** of the current year and corresponding interim period(s) of the prior year, to enable the auditor to identify matters that may affect the current-period interim financial information.

   b. Considering **any significant risks, including the risk of management override of controls**, that were identified in the audit of the prior year's financial statements.

   c. **Reading the most recent annual and comparable prior period** interim financial information.

   d. **Considering materiality with reference to the applicable financial reporting framework** as it relates to interim financial information to assist in determining the nature and extent of the procedures to be performed and evaluating the effect of misstatements.

   e. Considering **the nature of any corrected material misstatements and any identified uncorrected immaterial misstatements** in the prior year's financial statements.

   f. Considering **significant financial accounting and reporting matters** that may be of continuing significance such as material weaknesses in internal control.

g. Considering **the results of any audit procedures performed** with respect to the current year's financial statements. [PRIOR TO THE DATE OF REVIEW]

h. Considering the **results of any internal audit performed** and the subsequent actions taken by the management.

i. Inquiring of management about **the results of management's assessment of the risk** that the interim financial information may be materially misstated as a result of fraud.

j. Inquiring of management about the **effect of changes in the entity's business activities**.

k. Inquiring of management about **any significant changes in internal control and the potential effect of any such changes** on the preparation of interim financial information.

l. Inquiring of management of the **process by which the interim financial information has been prepared and the reliability** of the underlying accounting records to which the interim financial information is agreed or reconciled.

4. **NEW AUDITOR:** In order to plan and conduct a review of interim financial information**, a recently appointed auditor, who has not yet performed an audit of the annual financial statements** in accordance with SAs, should obtain an **understanding of the ent**ity and its environment, including of its internal control, as it **relates to the preparation of both annual and interim financial information.**

5. **COMMUNICATION WITH COMPONENT AUDITORS:** Besides, **the auditor determines the nature of the review procedures,** if any, to be performed for components and, where applicable, **communicates these matters to other auditors involved in the review**.

INQUIRIES, ANALYTICAL AND OTHER REVIEW PROCEDURES IN THE CONTEXT OF REVIEW OF INTERIM FINANCIAL INFORMATION

1. A review ordinarily **does not require tests of the accounting records** through inspection, observation or confirmation. **Procedures** for performing a review of interim financial information **are ordinarily limited to making inquiries, primarily of persons responsible** for financial and accounting matters, and **applying analytical and other review procedures**, rather than corroborating information obtained concerning significant accounting matters relating to the interim financial information.

2. The **auditor's understanding of the entity and its environment** including its internal control, the **results of the risk assessments relating to the preceding audit** and the auditor's consideration of materiality as it relates to the interim financial information, **affects the nature and extent of the inquiries made, and analytical and other review** procedures applied.
3. The auditor ordinarily performs the following procedures:

   a. **READING THE MINUTES:** Reading the minutes of the meetings of shareholders, those charged with governance, and other appropriate committees to **identify matters that may affect the interim financial information, and inquiring about matters dealt with at meetings** for which minutes are not available that may affect the interim financial information.

   b. **UNADJUSTED ITEMS IN PRECEEDING YEAR**: **Considering the effect, of matters giving rise to a modification of the audit** or review report, accounting adjustments or **unadjusted misstatements**, at the time of the previous audit or reviews.

   c. **OTHER AUDITORS: Communicating, where appropriate, with other auditors** who are performing a review of the interim financial information of the reporting entity's significant components.

   d. **INQUIRIEIS WITH MANAGEMENT:** Inquiring of members of management responsible for financial and accounting matters, and others as appropriate about the following:

      1. Whether the interim financial information **has been prepared and presented in accordance** with the applicable financial reporting framework.

      2. Whether there have been **any changes in accounting principles** or in the methods of applying them.

      3. Whether any **new transactions have necessitated the application of a new accounting principle**.

      4. Whether the interim financial information **contains any known uncorrected misstatements.**

      5. **Unusual or complex situations that may have affected** the interim financial information, such as a business combination or disposal of a segment of the business.

6. **Significant assumptions that are relevant to the fair value measurement** or disclosures and management's intention and ability to carry out specific courses of action on behalf of the entity.
7. Whether **related party transactions have been appropriately accounted** for and disclosed in the interim financial information.
8. **Significant changes in commitments** and contractual obligations.
9. S**ignificant changes in contingent liabilities** including litigation or claims.
10. **Compliance with debt covenants**.
11. Matters about which **questions have arisen in the course of applying the review** procedures.
12. Significant **transactions occurring in the last several days of the interim period** or the first several days of the next interim period. [CUTT-OFF]
13. **Knowledge of any fraud or suspected fraud** affecting the entity **involving management, employees who have significant roles** in internal control or others where the fraud could have a material effect on the interim financial information.
14. **Knowledge of any allegations of fraud, or suspected fraud,** affecting the entity's interim financial information **communicated by employees, former employees, analysts, regulators, or others**.
15. **Knowledge of any actual or possible non-compliance with laws and regulations** that could have a material effect on the interim financial information.
16. **Applying analytical procedures to the interim financial information** designed to identify relationships and individual items that **appear to be unusual and that may reflect a material misstatement** in the interim financial information.
17. **Reading the interim financial information, and considering whether anything has come to the auditor's attention** that causes the auditor to believe that the interim financial information is not prepared, in all material respects, in accordance with the applicable financial reporting framework.

e. **CONCURRENT REVIEW ALONG WITH F/S:** The auditor **may perform many of the review procedures before or simultaneously with the entity's preparation** of the interim financial information.

For example, it may be practicable to update the understanding of the entity and its environment, including its internal control, and begin reading applicable minutes before the end of the interim period.

f. **EARLY DAYS OF THE INTERIM PERIOD:** Performing some of the **review procedures earlier in the interim period also permits early identification and consideration** of significant accounting matters affecting the interim financial information.

g. **CONCURRENTLY WITH AUDIT:** The **auditor performing the review** of interim financial information is also **engaged to perform an audit of the annual financial statements** of the entity. For convenience and efficiency, the auditor may decide to perform certain audit procedures **CONCURRENTLY with the review** of interim financial information.

h. **LITIGATIONS AND CLAIMS:**

1) A review of interim financial information **ordinarily does not require corroborating the inquiries about litigation or claims**. It is, ordinarily not necessary to send an inquiry letter to the entity's lawyer.
2) **Direct communication with the entity's lawyer with respect to litigation or claims may, be appropriate** if a matter comes to the auditor's attention that causes the auditor to question whether the interim financial information is not prepared, in all material respects, in accordance with the applicable financial reporting framework, and the **auditor believes the entity's lawyer may have pertinent information**.

i. **RECONCILE WITH ACCOUNTING RECORDS:** The auditor may obtain evidence that the interim financial information **agrees or reconciles with the underlying accounting records** by tracing the interim financial information to:

1) The accounting records, such as **the general ledger, or a consolidating schedule** that agrees or reconciles with the accounting records and
2) Other **supporting data in the entity's records** as necessary.

j. **INQUIRING ABOUT SUBSEQUENT EVENTS:** The auditor should inquire whether **management has identified all events up to the date of the review report** that may require adjustment to or disclosure in the interim financial information. It is **not necessary for the auditor to perform other procedures to identify events occurring after the date** of the review report.

k. **GOING CONCERN:** The auditor should inquire **whether management has changed** its assessment of the entity's **ability to continue as a going concern**. When, as a result of this inquiry or other review procedures, the **auditor becomes aware of events or conditions** that may cast significant doubt on the entity's ability to continue as a going concern, the auditor should:

   1) Inquire of management as to its **plans for future actions** such as:
      i. Its **plans to liquidate assets, borrow money or** restructure debt, reduce or delay expenditures, or increase capital based on its going concern assessment
      ii. The **feasibility** of these plans, and
      iii. Whether management believes **that the outcome of these plans will improve** the situation and

      It is **not ordinarily necessary for the auditor** to corroborate the **feasibility of management's plans and whether the outcome of these plans** will improve the situation.

   2) **Consider the adequacy of the disclosure about such matters** in the interim financial information.

l. **ADDITIONAL INQUIRIES:** When a matter comes to the auditor's attention that leads the auditor to question whether a material adjustment should be made for the interim financial information to be prepared, in all material respects, in accordance with the applicable financial reporting framework, the **auditor should make additional inquiries or perform other procedures to enable the auditor to express a conclusion** in the review report.

   For example, if the auditor's review procedures lead the auditor to question whether a significant sales transaction is recorded in accordance with the applicable financial reporting framework, the auditor performs additional procedures sufficient to resolve the auditor's questions, such as **discussing the terms of the transaction with senior marketing and accounting personnel, or reading the sales contract**.

EVALUATION OF MISSTATEMENTS IDENTIFIED IN A REVIEW ENGAGEMENT OF INTERIM FINANCIAL INFORMATION

1. The auditor should evaluate, individually and in the aggregate, **whether uncorrected misstatements that have come to the auditor's attention are material** to the interim financial information.
2. Misstatements which come to the auditor's attention, including inadequate disclosures, are evaluated individually and in the aggregate to determine **whether a material adjustment is required to be made to the interim financial information** for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework.
3. The **auditor exercises professional judgment in evaluating the materiality of any misstatements** that the entity has not corrected.

OBTAINING MANAGEMENT REPRESENTATIONS IN A REVIEW OF INTERIM FINANCIAL STATEMENTS

The auditor should obtain written representation from management that:

(a) It acknowledges its **responsibility for the design and implementation of internal control** to prevent and detect fraud and error
(b) The interim financial information is **prepared and presented in accordance with the applicable financial reporting framework**
(c) It believes the **effect of those uncorrected misstatements aggregated by the auditor** during the review **are immaterial, both individually and in the aggregate**, to the interim financial information taken as a whole. A summary of such items is included in or attached to the **written representations**
(d) It has disclosed to the **auditor all significant facts relating to any frauds** or suspected frauds known to management that may have affected the entity
(e) It has disclosed to the **auditor the results of its assessment of the risks** that the interim financial information may be materially misstated as a result of fraud
(f) It has disclosed to the **auditor all known actual or possible non-compliance with laws and regulations whose effects are to be considered** when preparing the interim financial information; and
(g) It has disclosed to the **auditor all significant events that have occurred subsequent to the balance sheet date and through to the date of the review report** that may require adjustment to or disclosure in the interim financial information.

AUDITOR'S RESPONSIBILITY FOR ACCOMPANYING INFORMATION [OTHER INFORMATION] IN A DOCUMENT CONTAINING REIVEWED INTERIM FINANCIAL STATEMENTS

1. **READ THE OTHER INFORMATION:** The auditor **should read the other information that accompanies the interim financial information** to consider whether any such information is **materially inconsistent with the interim financial** information.
2. **MATERIAL INCONSISTENCY:** If the auditor **identifies a material inconsistency,** the auditor considers **whether the interim financial information or the other information needs to be amended**.
   a. **MMS IN INTERIM FINANCIAL INFORMATION:** If **an amendment is necessary** in the interim financial information and **management refuses** to make such amendment, the **auditor considers the implications** for the review report.
   b. **MMS IN OTHER INFORMATION:** If an **amendment is necessary in the other information and management refuses** to make such amendment, the auditor considers including in the review report **an additional paragraph describing the material inconsistency, or taking other actions, such as withholding the issuance** of the review report or withdrawing from the engagement.
   c. If a matter comes to the **auditor's attention that causes the auditor to believe that the other information appears to include a material misstatement** of fact, the auditor should **discuss the matter** with the entity's management.
3. **OTHER INFORMATION NOT RELATED TO FINANCIAL INFORMATION:**
   a. While reading the other information for the purpose of identifying material inconsistencies, an **apparent material misstatement of fact may come to the auditor's attention** (i.e., information, not related to matters appearing in the interim financial information, that is incorrectly stated or presented). When discussing the matter with the entity's management, **the auditor considers the validity of the other information and management's responses** to the auditor's inquiries, whether valid differences of judgment or opinion exist and whether to request management to consult with a qualified third party to resolve the apparent misstatement of fact.

b. If an **amendment is necessary to correct a material misstatement of fact and management refuses** to make the amendment, the auditor considers taking further action as appropriate, such as **notifying those charged with governance and obtaining a legal advice.**

COMMUNICATION OF MATTERS TO MANAGEMENT OR TCWG THAT REQUIRES ADJUSTMENT IN INTERIM FINANCIAL INFORMATON IN THE CONTEXT OF REVIEW UNDER SRE 2410

1. **COMMUNICATE TO APPROPRIATE LEVEL OF MANAGEMENT:** When, as a result of performing the review of interim financial information, a matter comes to the auditor's attention that causes the auditor to believe that it is **necessary to make a material adjustment to the interim financial information** for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework, the **auditor should communicate this matter as soon as practicable to the appropriate level** of management.
2. **COMMUNICATE TO TCWG:** When, in the auditor's judgment, **management does not respond appropriately within a reasonable period** of time, the auditor **should inform those charged with governance**.
3. **MANNER OF COMMUNICATION:** The communication is made as soon as practicable, either **orally or in writing**. The auditor's decision whether to communicate orally or in writing is affected by factors such as:
    a. The **nature**,
    b. **Sensitivity and significance** of the matter to be communicated and
    c. The **timing** of such communications.
    d. If the information is **communicated orally, the auditor documents** the communication.
4. **TCWG NOT REPONDED – MODIFIED REPORT:** When, in the auditor's judgment, those charged with governance **do not respond appropriately within a reasonable period**, the auditor should consider:
    a. Whether to **modify the report or**
    b. The **possibility of withdrawing** from the engagement and
    c. The **possibility of resigning from the appointment** to audit the annual financial statements.

5. **COMMUNICATION OF FRAUD:**
    a. When, as a result of performing the review of interim financial information, a matter comes to the auditor's attention that causes the **auditor to believe in the existence of fraud or noncompliance by the entity with laws and regulations**, **the auditor should communicate the matter as soon as practicable to the appropriate level** of management.
    b. The determination of which level of management is the appropriate one is affected by the likelihood of collusion or the involvement of a member of management. The auditor also considers **the need to report such matters to those charged with governance and considers the implication** for the review.
6. **GOVERNANCE MATTERS TO TCWG:**
    a. The auditor should **communicate relevant matters of governance interest** arising from the review of interim financial information with those charged with governance.
    b. As a result of performing the review of the interim financial information, the auditor may become aware of **matters that in the opinion of the auditor are both important and relevant to those charged with governance in overseeing the financial reporting** and disclosure process. The auditor communicates such matters to those charged with governance.

REVIEW REPORT ON INTERIM FINANCIAL INFORMATION

The auditor should issue a written report that contains the following:

Content of Written Report:
1. **TITLE:** An appropriate title. 2. **ADDRESSEE:** An addressee, as required by the circumstances of the engagement. 3. **INTRODUCTORY PARA:** Identification of the interim financial information reviewed, including identification of the title of each of the statements contained in the complete or condensed set of financial statements and the date and period covered by the interim financial information. 4. **MANAGEMENT RESPONSIBILITIES:** a. **FPFW:** If the interim financial information **comprises a complete set of general-purpose financial statements** prepared in

accordance with a financial reporting framework **designed to achieve fair presentation, a statement that management is responsible** for **the preparation and fair presentation** of the interim financial information in accordance with the applicable financial reporting framework.

b. **CFW:** In other circumstances, a statement that **management is responsible for the preparation and presentation of the interim financial information** in accordance with the applicable financial reporting framework.

5. **AUDITORS RESPONSIBILITIES:**

a. A statement that the **auditor is responsible for expressing a conclusion** on the interim financial information based on the review.

b. A statement that the **review** of the interim financial information was conducted in **accordance with Standard on Review Engagements** (SRE) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity," and

c. a statement that that such a **review consists of making inquiries, primarily of persons responsible for financial and accounting matters**, and applying analytical and other review procedures.

d. A statement that **a review is substantially less in scope than an audit conducted in accordance with Standards on Auditing and consequently does not enable the auditor to obtain assurance** that the auditor would become aware of all significant matters that might be identified in an audit and that accordingly no audit opinion is expressed.

6. **CONCLUSION PARA:**

a. **FPFW:** If the interim financial information comprises a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation, **a conclusion** as to whether anything has come to the auditor's attention that causes the auditor to believe that the **interim financial information does not give a true and fair view, or does not present fairly, in all material respects**, in accordance with the applicable financial reporting framework.

b. **CFW:** In other circumstances, **a conclusion** as to whether anything has come to the auditor's attention that causes the auditor **to believe that the interim financial information is not** prepared, in all material respects, in accordance with the applicable financial reporting framework

7. **DATE:** The date of the report.
8. **PLACE:** Place of Signature.
9. **SIGNATURE AND MRN:** The auditor's signature and membership number assigned by the Institute of Chartered Accountants of India (ICAI).
10. **FRN:** The Firm's registration number of the member of the Institute, wherever applicable, as allotted by ICAI

Besides, **UDIN has also to be generated and stated for review engagement** as it is also in nature of an assurance engagement. U**DIN has to be stated for engagements performed in accordance with SRE 2400 or SRE 2410**

DEPARTURE FROM THE APPLICABLE FINANCIAL REPORTING FRAMEWORK FOR PREPARATION AND PRESENTATION OF INTERIM FINANCIAL INFORMATION

1. MODIFIED CONCLUSION:

a. The auditor **should express qualified or adverse conclusion** when a matter has come to the auditor's attention **that causes the auditor to believe that a material adjustment should be made to the interim financial information** for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework.

b. If **matters have come to the auditor's attention that cause the auditor to believe** that the interim financial information is or may be **materially affected by a departure from the applicable financial reporting framework, and management does not correct** the interim financial information, the **auditor modifies the review report**.

2. MANNER OF MODIFICATION:

a. The **modification describes the nature of the departure** and, **states the effects** on the interim financial information.

b. If the information that the auditor believes is **necessary for adequate disclosure is not included** in the interim financial information, the auditor **modifies the review report** and, includes the necessary information in the review report.

c. The **modification to the review report is ordinarily accomplished by adding an explanatory paragraph** to the review report **and qualifying the conclusion**.

3. **ADVERSE CONCLUSION:** When the **effect of the departure is so material and pervasive** to the interim financial information that the auditor **concludes a qualified conclusion is not adequate** to disclose the misleading or incomplete nature of the interim financial information, the auditor **expresses an adverse conclusion.**

LIMITATION ON SCOPE IN CASE OF REVIEW OF INTERIM FINANCIAL INFORMATION

1. **MEANING OF LIMITATION ON SCOPE:** A **limitation on scope ordinarily prevents the auditor from completing the review**. When the auditor is unable to complete the review, the auditor **should communicate, in writing, to the appropriate level of management** and to those charged with governance the reason why the review cannot be completed and **consider whether it is appropriate to issue a report**.
2. **LIMITATION ON SCOPE IMPOSED BY MANAGEMENT:**
   a. **DO NOT ACCEPT AN ENGAGEMENT:** The auditor **does not accept an engagement to review** the interim financial information if the auditor's **preliminary knowledge of the engagement circumstances indicates** that the auditor would be unable to complete the review because there will be a **limitation on the scope** of the auditor's review imposed by the management of the entity.

   b. **LIMITATION AFTER ACCEPTING ENGAGEMENT:**
      i. If, after **accepting the engagement, management imposes a limitation** on the scope of the review, the **auditor requests the removal of that limitation**.

      ii. If **management refuses to do so,** the auditor is unable to complete the review and express a conclusion. In such cases, **the auditor communicates, in writing, to the appropriate level** of management and those charged with governance the reason why the review cannot be completed.

   c. If a matter **comes to the auditor's attention** that causes the auditor to believe that a **material adjustment to the interim financial information is necessary** for it to be prepared, in all material respects, in accordance with the applicable financial reporting framework, the **auditor communicates** such matters.

d. The auditor also **considers the legal and regulatory responsibilities**, including whether there is a requirement for the auditor to issue a report. If there is such a requirement, the **auditor disclaims a conclusion, and provides in the review report the reason why the review cannot be completed**.

3. OTHER LIMITATIONS ON SCOPE:

a. A limitation on scope may occur **due to circumstances other than a limitation on scope imposed by management.** In such circumstances, the **auditor is ordinarily unable to complete the review and express a conclusion**. There may be, however, some rare circumstances where the limitation on the scope of the **auditor's work is clearly confined to one or more specific matters** that, while material, are **not in the auditor's judgment pervasive** to the interim financial information.

b. In such circumstances, the **auditor modifies the review report** by indicating that, **except for the matter which is described in an explanatory paragraph** to the review report, the review was conducted in accordance with this SRE, and by qualifying the conclusion.

c. The auditor may **have expressed a qualified opinion** on the audit of the latest annual financial statements **because of a limitation on the scope of that audit**. The auditor considers whether that limitation on scope still exists and, if so, the implications for the review report.

GOING CONCERN AND SIGNIFICANT UNCERTAINTIES IN A REVIEW OF INTERIM FINANCIAL INFORMATION AS PER SRE 2410

1. **EOMP:** If, as a result of inquiries or other review procedures, **a material uncertainty relating to an event or condition comes to the auditor's attention** that may cast significant doubt on the entity's **ability to continue as a going concern, and adequate disclosure is made** in the interim financial information the auditor **modifies the review report by adding an emphasis** of matter paragraph.

2. **UNCERTAINITY IN PRIOR PERIOD:**

   a. The auditor may have **modified a prior audit or review report by adding an emphasis of matter paragraph to highlight a material** uncertainty relating to an event or condition that may cast significant doubt on the entity's ability to continue as a going concern.

b. **COTINUE TO EXIST IN CURRENT REVIEW:** If the **material uncertainty still exists and adequate disclosure is made in the interim financial** information, the auditor **modifies the review report on the current interim financial information** by adding a paragraph to highlight the continued material uncertainty.

c. **MODIFIED CONCLUSION:** If a material uncertainty that **casts significant doubt about the entity's ability to continue as a going concern is not adequately disclosed** in the interim financial information, **the auditor should express a qualified or adverse conclusion**, as appropriate. The report should include specific reference to the fact that there is such a material uncertainty.

OTHER CONSIDERATIONS IN A REVIEW OF INTERIM FINANCIAL INFORMATION BY THE AUDITOR

1. **REVIEW REPORT CUM INTERIM F/I SHALL BE TOGETHER:**
   a. The **terms of the engagement include management's agreement** that where any document containing interim financial information indicates that such information has been reviewed by the entity's auditor, the **review report will also be included in the document**.

   b. **NOT INCLUDED REVIEW REPORT:** If management **has not included the review report in the document, the auditor considers seeking legal advice** to assist in determining the appropriate course of action in the circumstances.

   c. **MODIFIED REVIEW REPORT NOT INCLUDED ALONG WITH INTERIM F/I:** If the **auditor has issued a modified review report and management issues the interim financial information without including** the modified review report in the document containing the interim financial information, the **auditor considers seeking legal advice** to assist in determining the appropriate course of action in the circumstances, and **the possibility of resigning from the appointment** to audit the annual financial statements.

2. **READ IN CONJUCTION WITH LATEST AUDITED F/S:**
   a. Interim financial information **consisting of a condensed set of financial statements does not necessarily include all the information** that would be included in a complete set of

financial statements, but may rather present an explanation of the events and changes that are significant to an **understanding of the changes in the state of affairs and performance** of the entity since the annual reporting date. This is **because it is presumed that the users of the interim financial information will have access to the latest audited financial statements**, such as is the case with listed entities.

b. In other circumstances, the **auditor discusses** with management the need for such interim financial information **to include a statement that it is to be read in conjunction with the latest audited financial statements**.

c. In the absence of such a statement, the auditor considers whether, **without a reference to the latest audited financial statements, the interim financial information is misleading** in the circumstances, and the implications for the review report.

DOCUMENTATION IN A REVIEW ENGAGEMENT OF INTERIM FINANCIAL INFORMATION BY AUDITOR

The auditor should **prepare review documentation that is sufficient and appropriate** to provide a basis for the auditor's conclusion and to **provide evidence that the review was performed in accordance with this SRE and applicable legal and regulatory** requirements

17. PROSPECTIVE FINANCIAL INFORMATION AND OTHER ASSURANCE SERVICES

An **assurance engagement may relate to examination of subject matters other than examination of financial statements** prepared on basis of "historical financial information".

In such type of assurance engagements, **examination may relate to prospective financial information or to providing assurance regarding non-financial matters** like design and operation of internal control in an entity.

The level of assurance provided by these Standards on Assurance Engagements is moderate.

Following Standards on Assurance Engagements have been issued:
SAE 3400 The Examination of Prospective Financial Information
SAE 3402 Assurance Reports on Controls at a Service Organisation
SAE 3420 Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

SAE 3400 – THE EXAMINATION OF PROSPECTIVE FINANCIAL INFORMATION

PROSPECTIVE FINANCIAL INFORMATION

1. **"Prospective financial information"** is financial information based on:
    a. **Assumptions about events that may occur in the future** and
    b. Possible actions by an entity.
2. It is highly subjective in nature and its preparation **requires the exercise of considerable judgment**. Prospective financial information can be in the form of:
    a. a forecast,
    b. a projection,
    c. or a combination of both (for example a 1-year, forecast plus a 5-year, projection.)
3. SAE 3400 provides guidance on engagements **to examine and report on prospective financial information including examination procedures** for best-estimate and hypothetical assumptions.
4. Examination of prospective financial **information need not necessarily be performed by statutory auditor** of the entity's financial statements.

FORECAST AND PROJECTION. GIVE AN EXAMPLE

A. FORECAST: Forecast means Prospective Financial Information prepared on the basis of:

1. **Assumptions as to future events** which management expects to take place and
2. The actions management expects to take as of the date the information is prepared.

Best- estimate assumptions: An assumption that reflects **anticipated experience with no provision for risk of adverse deviation**.

B. PROJECTION: Prospective Financial Information prepared on the basis of:

1. **Hypothetical assumptions about future events** and management actions which are not necessarily expected to take place, such as when some entities are in a start-up phase or are considering a major change in the nature of operations; or
2. A mixture of best-estimate and hypothetical assumptions (imagined or suggested)

SCOPE OF SAE-3400

1. The purpose of this Standard on Assurance Engagement (SAE) is **to establish standards and provide guidance on engagements** to examine and **report on prospective financial information** including examination procedures for best-estimate and hypothetical assumptions.
2. This SAE **does not apply to the examination of prospective financial information expressed in general or narrative terms**, such as that found in management's discussion and analysis in an entity's annual report, though many of the procedures outlined herein may be suitable for such an examination.
3. Further, the **principles laid down in the other Standards** on Auditing, issued by the Institute of Chartered Accountants of India, **should be used by the auditor, to the extent practicable**, in applying this SAE.
4. The **term "auditor"** is used throughout this SAE when describing **services involving examination of prospective financial information.** Such reference is not intended to imply that a member performing such services need necessarily be the statutory auditor of the entity's financial statements.

NATURE OF ASSURANCE REGARDING PROSPECTIVE FINANCIAL INFORMATION

SPECULATIVE: Prospective financial **information relates to events and actions that have not yet occurred and might not occur.** While **evidence may be available to support the assumptions** on which the prospective financial information is based, such **evidence is itself generally future-oriented** and, therefore, **speculative in nature,** as **distinct from the evidence ordinarily available** in the examination of historical financial information.

Therefore, an **opinion as to whether the results shown** in the prospective financial information **will be achieved cannot be expressed.**

RESPONSIBILITY OF MANAGEMENT IN PREPARATION AND PRESENTATION OF PROSPECTIVE FINANCIAL INFORMATION

Management is responsible for the preparation and presentation of the prospective financial information including the:

1. Identification and disclosure of Prospective Financial Information;
2. Explaining the basis of forecast;
3. Underlying assumptions.

ASSOCIATION OF PROFESSIONAL ACCOUNTANTS WITH PROSPECTIVE FINANCIAL INFORMATION

1. **NEED FOR CA's:** Traditionally, the attest function performed by a Chartered Accountant in practice has been in relation to "historical financial information". Recognizing the professional skill and competence of Chartered accountants, varied stakeholders like banks, financial institutions and **prospective investors intend to place greater reliance on reports** of projected cash flow and profitability statements **examined and signed by Chartered accountants**.
2. **CODE OF ETHICS:**
    a. **PROHIBITS:** Clause 3 of the Second Schedule to the Chartered Accountants Act, 1949 states that that a chartered accountant in practice shall be **deemed to be guilty of professional misconduct,** if **he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions** in a manner which **may lead to the belief that he vouches for the accuracy** of the forecast.
    b. **EXCEPTION TO PROHIBITION:** The above clause does not preclude a Chartered accountant from associating his name with prospective financial statements. A chartered accountant **can participate in the preparation of profit or financial forecasts and can review them,** provided **he indicates clearly** in his report:
        i. The **sources of information**,
        ii. The **basis of forecasts and also the major assumptions made** in arriving at the forecasts and so long
        iii. Statement that **he does not vouch for the accuracy of the forecasts**.
3. The **same also applies to projections made on the basis of hypothetical assumptions about future events** and management actions which are

not necessarily expected to take place so long as vouching for the accuracy of the projection is not made.

DUTIES OF MEMBER WHO IS EXAMINING THE PROSPECTIVE FINANCIAL INFORMATION

In an engagement to examine prospective financial information, the **auditor should obtain sufficient appropriate evidence** as to whether:

1. **Management's best-estimate assumptions** on which the prospective financial information is based **are not unreasonable** and, in the case of hypothetical assumptions, such assumptions are **consistent with the purpose of the information**.
2. The prospective financial information is **properly prepared on the basis of the assumptions**.
3. The prospective financial information is **properly presented and all material assumptions are adequately disclosed,** including a clear indication as to whether they are best-estimate assumptions or hypothetical assumptions and
4. The prospective financial information **is prepared on a consistent basis with historical financial statements, using appropriate accounting principles**.

While examining prospective financial information, principles laid down in other Standards on Auditing should be applied to the extent practicable.

ACCEPTANCE OF ENGAGEMENT BY AUDITOR IN RELATION TO PROSPECTIVE FINANCIAL INFORMATION

1. Before accepting an engagement to examine prospective financial information, the auditor would consider the following precautions, amongst other things:
    a. The **intended use** of the information;
    b. Whether the **information will be for general or limited distribution**.
    c. The **nature of the assumptions**, that is, whether they are best estimates or hypothetical Assumptions.
    d. The **elements to be included** in the information and
    e. The **period covered** by the information.
2. The **auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic** or when the

auditor believes that the prospective financial information will be **inappropriate for its intended use**. The auditor should consider the extent to which reliance on the entity's historical financial information is justified. Like in other engagements, it is necessary that terms of engagements should be agreed with client by sending an engagement letter.

EXAMINATION PROCEDURES FOR PROSPECTIVE FINANCIAL INFORMATION

When determining the nature, timing and extent of examination procedures, the following matters should be considered such as:

Examination Procedures	1. The **knowledge obtained** during any previous engagements
	2. Management's competence regarding the preparation of prospective financial information
	3. The **likelihood of material misstatement**
	4. The extent to which the prospective financial information is affected by the **management's judgment**
	5. The **sources of information** considered by the management for the purpose, their adequacy, **reliability of the underlying data, including data derived from third parties**, 6. Such as **industry statistics,** to support the assumptions
	7. The stability of entity's business and
	8. The **engagement team's experience with the business and the industry** in which the entity operates and with reporting on prospective financial information

In performing these procedures, **source and reliability of the evidence supporting management's best-estimate assumptions needs to be assessed**. Such evidence may be available from varied sources like entity's budgets, debt agreements, industry publications etc.

When **hypothetical assumptions are used, all significant implications** of such assumptions should **have been taken into consideration**.

ASSESSING PRESENTATION AND DISCLOSURE OF PROSPECTIVE FINANCIAL INFORMATION

1. When assessing the presentation and disclosure of the prospective financial information and the underlying assumptions, in addition to the specific requirements of any relevant statutes, regulations as well as the relevant professional pronouncements, it needs to be considered whether:

    a. The presentation of prospective financial information **is informative and not misleading**.

    b. The **accounting policies are clearly disclosed in the notes** to the prospective financial information.

    c. If there is **any change in the accounting policy** of the entity from that disclosed in the most recent historical financial statements, whether **reason for the change and the effect of such change** on the prospective financial information **has been adequately disclosed**.

    d. The **assumptions are adequately disclosed in the notes** to the prospective financial information. It needs to be clear whether assumptions represent management's best-estimates or are hypothetical and, when assumptions are made in areas that are material and are **subject to a high degree of uncertainty, this uncertainty and the resulting sensitivity of results needs to be adequately disclosed**.

    e. The date as of which the prospective financial information was prepared is disclosed. **Management needs to confirm that the assumptions are appropriate as of this date**, even though the underlying information may have been accumulated over a period of time.

    f. The basis of establishing points in a **range is clearly indicated and the range is not selected in a biased or misleading manner** when results shown in the prospective financial information are expressed in terms of a range and

AUDITORS REPORT ON EXAMINATION OF PROSPECTIVE FINANCIAL INFORMATION

The report for an examination of prospective financial information should contain the following:
1. **Title**
2. **Addressee**
3. **Identification** of the prospective financial information
4. **Reference to the Standards** on Auditing applicable to the examination of prospective financial information
5. Statement that **management is responsible** for the prospective financial information including the underlying assumptions
6. When applicable, a **reference to the purpose and/or restricted distribution** of the prospective financial information
7. Statement that the **examination procedures included examination, on a test basis, of evidence supporting the assumptions**, amounts and other disclosures in the forecast or projection
8. Statement of **negative assurance** as to whether the assumptions provide a reasonable basis for the prospective financial information
9. **Opinion as to whether the prospective financial information is properly prepared** on the basis of the assumptions and is presented in accordance with the relevant financial reporting framework
10. **Appropriate caveats concerning the achievability of the results** indicated by the prospective financial information
11. **Date** of report (which should be the date procedures have been completed)
12. **Place** of signature and
13. **Signature**.

SUCH A REPORT WOULD INCLUDE THE FOLLOWING DISCLAIMERS:

1. State whether, based on the examination of the evidence supporting the assumptions, anything **has come to attention, which causes the belief that the assumptions do not provide a reasonable basis** for the prospective financial information.
2. Express an opinion as to whether the prospective financial information **is properly prepared on the basis of the assumptions and is presented in accordance** with the relevant financial reporting framework.
3. State that:
    a. **Actual results are likely to be different from the prospective**

financial information since anticipated events frequently do not occur as expected and the variation could be material. Likewise, when the prospective financial information is expressed as a range, it would be stated that there can be **no assurance that actual results will fall within the range** and

b. In the case of a projection, the prospective financial information **has been prepared for (intended use), using a set of assumptions** that include hypothetical assumptions about future events and management's actions that are not necessarily expected to occur. Consequently, **readers are cautioned that the prospective financial information should not be used for purposes other than the abovementioned intended** use.

AUDITOR'S REPORTS WHEN THE PRESENTATION AND DISCLOSURE OF THE PROSPECTIVE FINANCIAL INFORMATION IS NOT ADEQUATE

1. **P & D NOT ADEQUATE:** When it is believed that the **presentation and disclosure** of the prospective financial information **is not adequate**:
   a. A **qualified or adverse opinion in the report** on the prospective financial information **should be expressed** or
   b. **Withdrawal from engagement** should be made as appropriate.

   An example would be **where financial information fails to disclose adequately** the consequences of any assumptions, which are **highly sensitive**.
2. **ASSUMPTIONS ARE NOT REASONABLE:** When it is believed that **one or more significant assumptions do not provide a reasonable basis** for the prospective financial information prepared on the basis of best-estimate assumptions or that one or more significant assumptions do not provide a reasonable basis for the prospective financial information given the hypothetical assumptions:
   a. An **adverse opinion setting out the reasons** in the report on the prospective financial information should be expressed, or
   b. **Withdrawal from the engagement** should be made.
3. **UNABLE TO APPLY AUDIT PROCEDURES:** When the **examination is affected by conditions that preclude application of one or more procedures** considered necessary in the circumstances, either:
   a. **Withdrawal** from the engagement or

b. **Disclaimer of the opinion and describing the scope limitation** in the report on the prospective financial information is considered.

DOCUMENTATION:

Matters, which are important in providing evidence to support report on examination of prospective financial information, and **evidence that such examination** was carried out in accordance with this **SAE should be documented**.

SAE 3402 - ASSURANCE REPORTS ON CONTROLS AT A SERVICE ORGANISATION

SAE 3402 deals with **assurance engagements undertaken by a professional accountant** in public practice **to provide a report for use by user entities** and their **auditors on the controls at a service organization that provides a service to user entities** that is likely to be relevant to user entities' internal control as it relates to financial reporting.

It **complements SA 402,** in that reports prepared in accordance with this SAE are capable of providing appropriate evidence under SA 402.

SCOPE OF SAE 3402

1. **SAE 3402 applies only when the service organization is responsible** for, or otherwise able to make an assertion about, the suitable design of controls. It **does not deal with assurance engagements:**
    a. To report only on **whether controls at a service organization operated as described** or
    b. To report **only on controls at a service organization other than those related to a service** that is likely **to be relevant to user entities' internal control** as it relates to financial reporting (for example, controls that affect user entities' production or quality control).

SERVICE ORGANISATION AND WHY CONTROLS OF A SERVICE ORGANISATION ARE IMPORTANT TO USER ENTITIES INTERNAL CONTROLS RELEVANT TO FINANCIAL REPORTING

SERVICE ORGANISATION: **Service organization refers to a third-party organization** (or segment of a third-party organization) that **provides services to user entities** that are likely to be **relevant to user entities internal control** as it relates to financial reporting.

USER ENTITY: User entity refers to **an entity that uses a service organization**.

IMPORTANCE OF CONTROLS AT S.O.:

1. Controls related to a service organization's operations and compliance objectives **may be relevant to a user entity's internal control as it relates to financial reporting**. Such controls may pertain to assertions about presentation and disclosure relating to account balances, classes of transactions, or disclosures, or may **pertain to**

evidence that the user auditor evaluates or uses in applying auditing procedures.

For example, a company has **outsourced its payroll processing functions to a service organization**. The service organization is responsible for the accurate preparation of payrolls and timely remittance of statutory dues to government authorities on behalf of the company.

Payroll processing service organization's controls **related to the timely remittance of payroll deductions to government authorities may be relevant** to the company (user entity) as late remittances could result in interest and penalties resulting in liabilities for the user entity.

2. "Controls at the service organization" includes **aspects of user entities' information systems maintained by the service organization,** and may also include aspects of one or more of the other components of internal control at a service organization.

   For example, such controls at a service organization **may include aspects of a service organization's control environment, monitoring, and control activities** when they relate to the services provided. **It does not, however, include controls at a service organization that are not related to the achievement of the control objectives** stated in the service organization's description of its system, for example, controls related to the preparation of the service organization's own financial statements.

3. The **determination of whether controls at a service organization related** to operations and compliance are likely to be relevant to user entities' internal control as it relates to financial reporting is **a matter of professional judgment,** having regard to the control objectives set by the service organization and the suitability of the criteria.

USER AUDITOR AND SERVICE AUDITOR. OBJECTIVES OF SERVICE AUDITOR

USER AUDITOR: User auditor refers **to an auditor who audits and reports on the financial statements of a user entity**.

SERVICE AUDITOR: Service auditor refers to a professional accountant in public practice who, **at the request of the service organization, provides an assurance report on controls at a service organization**.

OBJECTIVES OF SERVICE AUDITOR:

The objectives of the service auditor are as per SAE 3402:

1. To obtain reasonable assurance about whether, in all material respects, based on suitable criteria:
    a. The **service organization's description of its system** fairly presents the system as designed and **implemented throughout the specified period** (or in the case of a type 1 report, as at a specified date)
    b. The **controls related** to the control objectives stated in the service organization's description of its system **were suitably designed throughout the specified period** (or in the case of a type 1 report, as at a specified date)
    c. Where included in the scope of the engagement, the **controls operated effectively to provide reasonable assurance that the control objectives** stated in the service organization's description of its system were achieved throughout the specified period. (Type 2 Report)
2. To report on the matters in (a) above in accordance with the service auditor's findings.

TYPE 1 AND TYPE 2 REPORTS

Type 1 report is a report that comprises:	**Type 2 report is a report that comprises:**
1. The **service organization's description of its system**. 2. A **written assertion by the service organization** that, in all material respects, and based on suitable criteria: a. The description fairly presents the **service organization's system** as designed and **implemented at the specified date** b. The **controls related to the control objectives** stated in the service organization's description of its system were **suitably designed as at the specified date** and	1. The **service organization's description of its system**. 2. A **written assertion by the service organization** that, in all material respects, and based on suitable criteria: a. The description fairly presents the service organization's system as designed and implemented **THROUGHOUT THE SPECIFIED PERIOD**. b. The controls related to the control objectives stated in the service organization's description of its system were suitably **designed throughout THE SPECIFIED**

3. A service auditor's assurance report that conveys **reasonable assurance** about the matters referred to in (2)	**PERIOD** and c. The controls related to the control objectives stated in the service organization's description of its system **operated effectively throughout the specified period** and 3. A service auditor's assurance report that: a. Conveys **reasonable assurance** about the matters in (2) and b. Includes a description of **the tests of controls and the results** thereof.
Type 1 report is a report on the **description and design of controls at a service organization** whereas **Type 2 report** is a report on the **description, design and OPERATING EFFECTIVENESS** of controls at a service organization.	

ENGAGEMENT OF ASSURANCE ON SERVICE ORGANIZATIONS SYSTEMS

1. **COMPLIANCE WITH ETHICAL REQUIREMENTS:** The service auditor **shall comply with relevant ethical requirements, including those pertaining to independence,** relating to assurance engagements.
2. **COMMUNICATION WITH APPROPRIATE MANAGEMENT AND TCWG:**
   a. The service **auditor shall inquire of, request representations from, communicate** with, or otherwise interact with the service organization wherever required.
   b. The service auditor **shall determine the appropriate persons** within the service organization's management or governance structure **with whom to interact**.
3. **ACCEPTANCE AND CHANGES IN TERMS OF ENGAGEMENT:**
   a. Before, accepting such an engagement, it has to be **ensured by service auditor that necessary capabilities and competence** to carry out such engagement are possessed by him.
   b. It also needs to be ensured that the **criteria to be applied by the service organization to prepare the description of its system** will

be suitable and **available to user entities and their auditors** and

c. The scope of the engagement and the service organization's description of its system **will not be so limited that they are unlikely to be useful to user entities and their auditors**.

d. If the service organization **requests a change in the scope of the engagement before the completion of the engagement**, the service auditor shall be **satisfied that there is a reasonable justification for the change.**

4. **ASSESSING OF SUITABILITY OF THE CRITERIA: The service auditor shall assess whether the service organization has used suitable criteria** in preparing the description of its system, **in evaluating whether controls are suitably designed**, and, in the case of a type 2 reports, in evaluating whether controls are **operating effectively**.
5. **DETERMINATION OF MATERIALITY:** When planning and performing the engagement, the service auditor **shall consider materiality with respect to the fair presentation** of the description, the suitability of the design of controls and, in **the case of a type 2 report, the operating effectiveness** of controls.
6. **OBTAINING AN UNDERSTANDING OF THE SERVICE ORGANIZATION'S SYSTEM:** The service Auditor shall obtain an **understanding of the service organization's system**, including controls that are included in the scope of engagement.
7. **OBTAINING EVIDENCE REGARDING THE DESCRIPTION:** The service auditor shall **obtain and read the service organization's description** of its system and evaluate whether those aspects of the description included in the **scope of engagement** are fairly presented.
8. **OBTAINING EVIDENCE REGARDING THE DESIGN OF CONTROLS:** The service auditor shall **determine which of the controls at the service organization are necessary to achieve** the control objectives stated in the service organization's description of its system and shall assess **whether those controls were suitably designed**.
9. **OBTAINING EVIDENCE REGARDING OPERATING EFFECTIVENESS OF CONTROLS:** When providing **a type 2 report, the service auditor shall test those controls** that the service auditor has determined are necessary to achieve the control objectives stated in the service organization's description of its system, and **assess their operating effectiveness throughout the period.**

10. **UNDERSTANDING THE INTERNAL AUDIT FUNCTION:** If the service organization has an internal audit function, the service auditor shall obtain an understanding of the nature of the **responsibilities of the internal audit function** and of the activities performed in order to determine whether **the internal audit function is likely to be relevant to the engagement** in order for the service auditor to use specific work of the internal auditors.

11. **ASKING FOR WRITTEN REPRESENTATIONS:** The service auditor shall request the service organization **to provide written representations**:
    a. That **reaffirm the assertion accompanying the description** of the system
    b. That it has **provided the service auditor with all relevant information and access** agreed to and
    c. That it has **disclosed to the service auditor** any of the following of which it is aware:
        1) **Non-compliance with laws and regulations, fraud, or uncorrected deviations** attributable to the service organization that may affect one or more user entities.
        2) **Design deficiencies** in controls
        3) Instances where controls have not operated as described and
        4) Any **events subsequent to the period covered by the service organization's** description of its system up to the **date of the service auditor's assurance report** that could have a significant effect on the service auditor's assurance report.

12. **SUBSEQUENT EVENTS:** The **service auditor shall inquire whether the service organization is aware of any events subsequent to the period** covered by the service organization's description of its system **up to the date of the service auditor's assurance report** that could have a **significant effect on the service auditor's assurance report**.

ELEMENTS OF ASSURANCE REPORT BY SERVICE AUDITOR

The service auditor's assurance report shall include the following basic elements:

1. **TITLE:** A title that clearly indicates the report is an independent service auditor's assurance report.
2. **AN ADDRESSEE**
3. **INTRODUCTORY PARA:** Identification of:

a. The service organization's description of its system, and the service organization's assertion, which includes the matters for a **type 2 report, or for a type 1 report**.

b. Those parts of the service organization's description of its system, if any, **that are not covered by the service auditor's opinion**.

c. If the description refers to the **need for complementary user entity controls, a statement that the service auditor has not evaluated** the suitability of design or operating effectiveness of complementary user entity controls, and that the control objectives stated in the service organization's description of its system **can be achieved only if complementary user entity controls are suitably designed or operating effectively**, along with the controls at the service organization.

d. If **services are performed by a subservice organization, the nature of activities performed by the subservice organization** as described in the service organization's description of its system.

e. **CRITERIA: Identification of the criteria**, and the party specifying the control objectives.

f. A statement that the report and, in the case of a **type 2 report, the description of tests of controls are intended only for user entities** and their auditors, who have a sufficient understanding to consider it, along with other information including information about controls operated by user entities themselves, **when assessing the risks of material misstatements of user entities'** financial statements.

4. **S.O. RESPONSIBILITIES:** A statement that the service organization is responsible for:

   a. Preparing the description of its system, and the accompanying assertion, including the **completeness, accuracy and method of presentation of that description and that assertion**.

   b. Providing **the services covered by the service organization's description** of its system.

   c. **Stating the control objectives** (where not identified by law or regulation, or another party, for example, a user group or a professional body) and

   d. **Designing and implementing controls to achieve the control**

objectives stated in the service organization's description of its system.

5. **SERVICE AUDITORS' RESPONSIBILITIES:**
   a. A statement that the service auditor's responsibility is to **express an opinion on the service organization's description, on the design of controls** related to the control objectives stated in that description and, in the case of a **type 2 report, on the operating effectiveness of those controls,** based on the service auditor's procedures.
   b. A statement that the engagement was performed in accordance with SAE 3402, "Assurance Reports on Controls at a Service Organization," which requires that the **service auditor comply with ethical requirements and plan and perform procedures** to obtain reasonable assurance about whether, in all material respects, the service organization's description of its system is **fairly presented and the controls are suitably designed and, in the case of a type 2 report, are operating effectively**.
   c. A summary of the service auditor's procedures to obtain reasonable assurance and a statement of the service **auditor's belief that the evidence obtained is sufficient and appropriate to provide a basis for the service auditor's opinion**, and, in the case of a **type 1 report**, a statement that the **service auditor has not performed any procedures regarding the operating effectiveness of controls** and therefore **no opinion is expressed thereon**.
   d. A statement of the limitations of controls and, in the case of a **type 2 report, of the risk of projecting to future periods any evaluation of the operating effectiveness** of controls.
6. **OPINION OF SERVICE AUDITOR:** The service auditor's opinion, expressed in the positive form, on whether, in all material respects, based on suitable criteria:

i. In the case of a type 2 report: -	ii. In the case of a type 1 report: -
a. The description fairly presents the service organization's system that had been **designed and implemented throughout the specified period**; **b.** The controls related to the	**a.** The description fairly presents the service organization's system that had been **designed and implemented as at the specified date** and **b.** The controls related to the

control objectives stated in the service organization's description of its system were **suitably designed throughout the specified period**; and **c.** The controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description **were achieved, operated effectively throughout the specified period**.	control objectives stated in the service organization's description of its system **were suitably designed as at the specified date**.

7. **DATE OF REPORT:** The date of the service auditor's assurance report, which shall be **NO earlier than the date on which the service auditor has obtained sufficient appropriate evidence** on which to base the opinion.
8. **SIGNATURE:** The report should be signed by the practitioner.
9. **THE PLACE OF SIGNATURE:** **T**he report should name specific location, which is ordinarily the city where the report is signed.

ADDITIONAL MATTERS REQUIRING REPORTING IN TYPE 2 REPORT:

1. In the case of a **type 2 report,** the service auditor's assurance **report shall include a separate section after the opinion,** or an attachment, that describes **the tests of controls that were performed and the results of those tests.**
2. In describing the tests of controls, the service auditor **shall clearly state which controls were tested, identify whether the items tested represent all or a selection of the items** in the population, and indicate the **nature of the tests in sufficient detail to enable user auditors to determine the effect** of such tests on their risk assessments.
3. If **deviations have been identified**, the **service auditor shall include the extent of testing** performed **that led to identification of the deviations** (including the sample size where sampling has been used), and the **number and nature of the deviations** noted.

4. The service auditor shall **report deviations even if, on the basis of tests performed**, the service auditor has concluded that the related control objective was achieved

MODIFIED OPINIONS IN THE SERVICE AUDITORS ASSURANCE REPORT

MODIFIED OPINION: If the service auditor concludes that:

1. The service organization's **description does not fairly present**, in all material respects, the system as designed and implemented.
2. The controls related to the control objectives stated in the description **were not suitably designed, in all material respects**.
3. In the case of a **type 2 report, the controls tested**, which were those necessary to provide reasonable assurance that the control objectives stated in the service organization's description of its system were achieved, did **not operate effectively, in all material respects** or
4. The service auditor is **unable to obtain sufficient appropriate evidence**,

The **service auditor's opinion shall be modified**, and the service auditor's assurance report shall contain a **clear description of all the reasons** for the modification.

DOCUMENTATION:

The service auditor shall prepare **documentation that is sufficient to enable an experienced service auditor, having no previous connection** with the engagement, to understand:

1. The **nature, timing, and extent of the procedures** performed to comply with this SAE and applicable legal and regulatory requirements
2. The **results of the procedures** performed, and the evidence obtained and
3. **Significant matters arising during the engagement**, and the **conclusions** reached thereon and significant **professional judgments** made in reaching those conclusions

SAE 3420 Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

SA 3420 deals with reasonable assurance engagements undertaken by a practitioner to report on the responsible party's compilation of pro forma financial information included in a prospectus.

It applies where such **reporting is required by securities law or regulation of the security excha**nge in the jurisdiction in which the prospectus is to be issued.

PROFORMA FINANCIAL INFORMATION

1. Pro forma financial information refers to **financial information shown together with adjustments to illustrate the impact of an event or transaction** on unadjusted financial information **as if the event had occurred or the transaction had been undertaken at an earlier date** selected for purposes of the illustration. This is achieved by **applying pro forma adjustments** to the unadjusted financial information.
2. The Pro forma financial information is, normally, **used in the offer documents to demonstrate the effect of a transaction on the financial statements** of a company as if those transactions had occurred at an earlier date.
3. The Pro forma financial information **may take the form of Statement of Profit and Loss and Balance Sheet to illustrate how the transactions might have affected** the assets, liabilities and earnings of the Issuer.
4. They also **include notes in relation to the significant aspects** of the transactions, assumptions used to prepare the Pro forma financial information and the adjustments made.
5. Pro forma financial information **does not represent the entity's actual financial position**, financial performance, or cash flows.

OBJECTIVES IN ACCORDANCE WITH SA 3420

The objectives of the practitioner in accordance with SA 3420 are:

1. To obtain reasonable assurance about whether the pro forma financial information has been compiled, in all material respects, by the **responsible party on the basis of the applicable criteria** and
2. **To report in accordance with the practitioner's findings**.

COMPILATION OF PRO FORMA FINANCIAL INFORMATION

The compilation of pro forma financial information **involves the responsible party gathering, classifying, summarising and presenting financial information**.

Steps involved in this process include:

1. **Identifying the source of the unadjusted financial information** to be used in compiling the pro forma financial information, **and extracting the unadjusted financial information** from that source
2. **Making pro forma adjustments** to the unadjusted financial information for the purpose for which the pro forma financial information is presented and
3. **Presenting the resulting pro forma financial information** with accompanying disclosures.

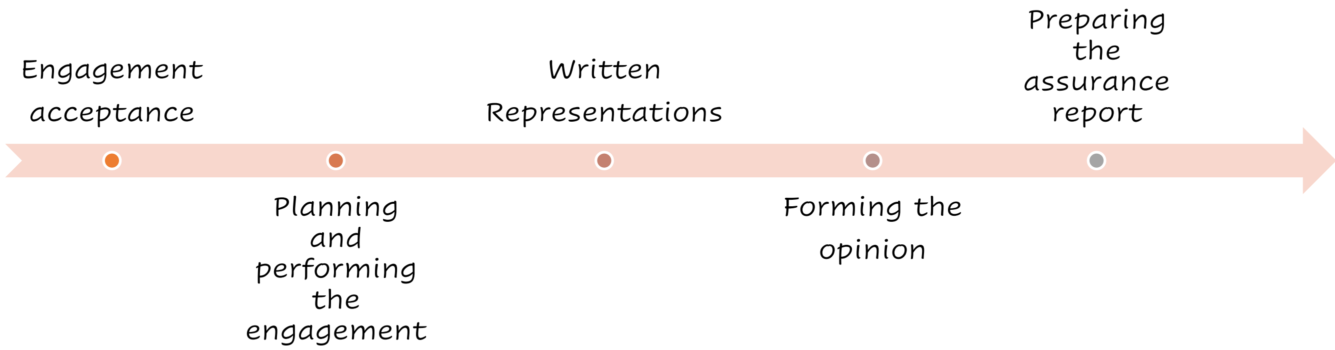
NATURE OF THE PRACTITIONER'S RESPONSIBILITY IN AN ENGAGEMENT OF REPORT ON PROFORMA FINANICAL INFORMATION UNDER SAE 3420

1. The **practitioner has no responsibility to compile the pro forma financial information** for the entity. Such responsibility rests with the responsible party.
2. The practitioner's sole responsibility is to **report on whether the pro forma financial information has been compiled**, in all material respects, by the responsible party on the **basis of the applicable criteria**.
3. It is a reasonable assurance engagement to report on the compilation of pro forma financial information **involving performing the procedures to assess whether the applicable criteria used by the responsible party in the compilation** of the pro forma financial information provide a **reasonable basis for presenting the significant effects directly attributable** to the event or transaction.

"Applicable criteria" are criteria used by the responsible party when compiling the pro forma financial information. **Criteria may be established by an authorized or recognized standard-setting organization** or by law or regulation.

Where established **criteria do not exist, they will be developed by the responsible party**.

STEPS INVOLVED IN REPORTING ON PROFORMA FINANCIAL INFORMATION



A. ENGAGEMENT ACCEPTANCE: Before agreeing to accept an engagement to report on whether pro forma financial information included in a prospectus has been compiled, in all material respects, on the basis of the applicable criteria, the **practitioner shall consider matters** stated below:

1. Determine that the **practitioner has the capabilities and competence** to perform the engagement
2. On the basis of a preliminary knowledge of the engagement circumstances and discussion with the responsible party, **determine that the applicable criteria are suitable and that it is unlikely that the pro forma financial information will be misleading for the purpose** for which it is intended.
3. Evaluate the **wording of the opinion prescribed by the relevant law or regulation**, if any, to determine that the practitioner will likely be able to express the opinion so prescribed based on performing the procedures specified in this SAE
4. Where the **sources from which the unadjusted financial information and any acquiree or divestee financial information have been extracted** have been **audited or reviewed and a modified audit opinion or review conclusion has been expressed**, or the report contains an Emphasis of Matter paragraph, consider whether or not the relevant law or regulation permits the use of, or reference in the practitioner's report to**, the modified audit opinion or review conclusion or the report containing the Emphasis of Matter paragraph** with respect to such sources
5. If the entity's **historical financial information has never been audited** or reviewed, consider whether the **practitioner can obtain a sufficient understanding of the entity and its accounting and**

financial reporting practices to perform the engagement

6. If the event or **transaction includes an acquisition and the acquiree's historical financial information has never been audited** or reviewed, consider whether the **practitioner can obtain a sufficient understanding of the acquiree and its accounting and financial reporting** practices to perform the engagement and

7. Obtain the agreement of the responsible party that it acknowledges and understands its responsibility for:

   a. **Adequately disclosing and describing the applicable criteria** to the intended users if these are not publicly available

   b. **Compiling the pro forma financial information** on the basis of the applicable criteria and

   c. Providing the practitioner with:

      i. **Access to all information** (including, when needed for purposes of the engagement, information of the acquiree(s) in a business combination), such as records, documentation and other material, **relevant to evaluating whether the pro forma financial information has been compiled,** in all material respects, on the basis of the applicable criteria.

      ii. **Additional information that the practitioner may request** from the responsible party for the purpose of the engagement.

      iii. **Access to those within the entity and the entity's advisors from whom the practitioner determines it necessary to obtain evidence** relating to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria and

      iv. When needed for purposes of the engagement, **access to appropriate individuals within the acquiree(s) in a business combination**

B. PLANNING AND PERFORMING THE ENGAGEMENT:

1. **CRITERIA EVALUATION:** The practitioner shall assess **whether the applicable criteria are suitable,** as required by the Framework for Assurance Engagements

2. **MATERIALITY:** When planning and performing the engagement, the

practitioner shall **consider materiality with respect to evaluating** whether the pro forma financial information has been **compiled, in all material respects**, on the basis of the applicable criteria.

3. An **understanding of how the responsible party has compiled** the pro forma financial Information and other engagement circumstances.
4. **SOURCES OF UNADJUSTED F/I:**
   a. The practitioner **shall obtain evidence about the appropriateness of the source** from which the unadjusted financial information has been extracted.
   b. **If there is no audit or review report on the source** from which the unadjusted financial information has been extracted, the practitioner shall **perform procedures to be satisfied that the source is appropriate**.
   c. The practitioner shall obtain evidence about **the appropriateness of the pro forma adjustments.**
5. In **relation to unadjusted financial information**, Pro forma adjustments include:
   a. Adjustments to unadjusted financial information that illustrate the **impact of a significant event or transaction** as if the event had occurred or the transaction had been **undertaken at an earlier date selected for purposes** of the illustration and
   b. Adjustments to unadjusted financial information that **are necessary for the pro forma financial information to be compiled on a basis consistent** with the applicable financial reporting framework of the reporting entity and its accounting policies under that framework.
6. **PRESENTATION:** The practitioner **shall evaluate the presentation** of pro forma financial information.
7. **OTHR INFORMATION:** The practitioner **shall read the other information included in the Prospectus containing** the pro forma financial information **to identify material inconsistencies**, if any, with pro forma financial information.

C. WRITTEN REPRESENTATIONS: The practitioner shall request written representations from the responsible party that:

1. In compiling the pro forma financial information, the **responsible party has identified all appropriate pro forma adjustments necessary**

to illustrate the impact of the event or transaction at the date or for the period of the illustration and

2. The pro forma financial information has been compiled, in all material respects, **on the basis of the applicable criteria**.

D. OPINION:

1. **UNMODIFIED OPINION:** The practitioner shall **express an unmodified opinion** when the practitioner concludes that the pro forma financial information has been **compiled**, in all material respects, by the responsible party **on the basis of the applicable criteria**.
2. **MODIFIED OPINION:**

    a. **LAW DO NOT PERMIT MODIFIED OPINION:** Where the **relevant law or regulation precludes publication of a prospectus that contains a modified opinion** with regard to whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria and the **practitioner concludes that a modified opinion is nevertheless appropriate** in accordance with the Framework for Assurance Engagements, the **practitioner shall discuss the matter with the responsible party**.

If the **responsible party does not agree to make the necessary changes**, the practitioner shall:

- **Withdraw** from the engagement or
- Consider **seeking legal advice**.

    b. **LAW PERMITS MODIFIED OPINION:** Where the **relevant law or regulation may not preclude publication of a prospectus that contains a modified opinion** with regard to whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria and **the practitioner determines that a modified opinion is appropriate** in accordance with the Framework for Assurance Engagements, the **practitioner shall apply the requirements** in the Framework for Assurance Engagements regarding modified opinions.

3. **EMPHASIS OF MATTER PARAGRAPH:**
   a. In some circumstances, the **practitioner may consider it necessary to draw the user's attention to a matter presented** or disclosed in the pro forma financial information or the accompanying explanatory notes. This would be the case when, in the practitioner's opinion, the **matter is of such importance that it is fundamental to the user's understanding** of whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria.
   b. In such circumstances, the practitioner **shall include an Emphasis of Matter paragraph** in the practitioner's report provided that the practitioner has obtained sufficient appropriate evidence that the matter **does not affect whether the pro forma financial information** has been compiled, in all material respects, on the basis of the applicable criteria.
   c. Such a paragraph shall refer **only to information presented or disclosed in the pro forma financial Information** or the accompanying explanatory notes.
4. **PREPARING THE ASSURANCE REPORT:**
   The practitioner's report shall include the following basic elements:

Basic elements of Assurance Report
a. A **title** that clearly indicates that the report is an independent assurance report b. An **addressee(s)**, as agreed in the terms of engagement c. **Introductory paragraphs that identify:** i. The pro forma financial information ii. The **source from which the unadjusted financial information has been extracted** and whether or not an audit or review report on such a source has been published iii. **The period covered by, or the date of, the pro forma** financial information and iv. A **reference to the applicable criteria on the basis of which the responsible party has performed the compilation** of the pro forma financial information, and the source of the criteria d. A statement that the **responsible party is responsible for compiling the pro forma financial information** on the basis of the applicable criteria

e. **A description of the practitioner's responsibilities, including statements that:**

   i. The **practitioner's responsibility is to express an opinion** about whether the pro forma financial information has been **compiled, in all material respects, by the responsible party on the basis** of the applicable criteria

   ii. For purposes of this engagement, the **practitioner is not responsible for updating or reissuing any reports or opinions on any historical financial information** used in compiling the pro forma financial information, **nor has the practitioner, in the course of this engagement, performed an audit or review of the financial information** used in compiling the pro forma financial information and

   iii. The **purpose of pro forma financial information included in a prospectus** is solely to **illustrate the impact of a significant event or transaction on unadjusted financial information of the entity** as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration. Accordingly, the **practitioner does not provide any assurance that the actual outcome** of the event or transaction at that date would have been as presented

   iv. A **statement that the engagement was performed** in accordance with SAE 3420, 'Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus', which **requires that the practitioner comply with ethical requirements and plan and perform procedures** to obtain reasonable assurance about whether the responsible party has compiled, in all material respects, the pro forma financial information on the basis of the applicable criteria

   v. **Statements that**:

      1) A reasonable assurance engagement to report on whether the pro forma financial information has been compiled, in all material respects, **on the basis of the applicable criteria involves performing procedures to assess whether the applicable criteria used by the responsible party** in the compilation of the pro forma financial information **provide a reasonable basis for presenting the significant effects directly attributable to the event or transaction** and to obtain sufficient appropriate evidence about whether:

The **related pro forma adjustments give appropriate effect** to those criteria and

The pro forma financial information reflects the **proper application of those adjustments to the unadjusted financial information**

2) The procedures selected depend on **the practitioner's judgment, having regard to the practitioner's understanding of the nature of the entity**, the event or transaction in respect of which the pro forma financial information has been compiled, and other relevant engagement circumstances and

3) The **engagement also involves evaluating the overall presentation** of the pro forma financial information

f. **OPINION**: Unless otherwise required by law or regulation, **the practitioner's opinion using one of the following phrases,** which are regarded as being equivalent:

   i. The pro forma financial information **has been compiled, in all material respects**, on the basis of the applicable criteria or

   ii. The pro forma financial information **has been properly compiled on the basis stated**.

g. The **practitioner's signature**

h. The **date of the report** and

i. The **place of signature**.

DOCUMENTATION

As in case of all assurance engagements, **documentation has to be ensured by the practitioner** while performing engagement under SAE 3420.

18. SUSTAINABLE DEVELOPMENT GOALS (SDG) & ENVIRONMENT, SOCIAL AND GOVERNANCE (ESG) ASSURANCE

Sustainability is a concept **related to the development** of products, goods and services that involves **meeting our present needs without compromising the ability of future generations to fulfil their own needs.**

Sustainability as a concept recognises that the environment is an exhaustible resource. Therefore, it is important **to use the environment and its resources rationally and protect it** for the good of the Earth, our environment, humanity, and all living things.

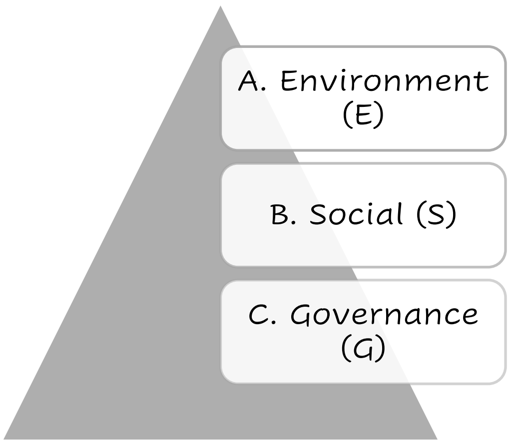
SUSTAINABLE DEVELOPMENT AS PER BRUNDTLAND REPORT AND THE 3 PILLARS OF SUSTAINABILITY

The concept of sustainable development is **named after the Brundtland report, which reports sustainable consumption in developed countries.**

SUSTAINABLE DEVELOPMENT:

"Sustainable development is **development that strives to meet the needs of developing countries seeking to achieve a more sustainable world**. Sustainable development addresses the needs of the **present moment without compromising current and future generations** to meet their own sustainable lifestyles."

3 PILLARS OF SUSTAINABLE DEVELOPMENT: Sustainable development can be applied to corporate policy in the business world as it encompasses following **3 pillars of sustainability**:



A. ENVIRONMENT (E):

1. Environmental stands for **corporate climate policies, energy use, waste, pollutions, natural resource conservation, and treatment of animals**.
2. It includes the **natural resources that every entity absorbs** for its functioning like that of coal, electricity, water and so on.
3. **Processing this energy into products / services which will leave behind certain waste**s like that of carbon emissions, water discharges, e-wastes and so on.

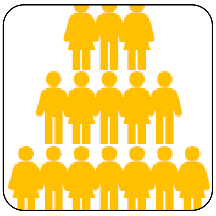
B. SOCIAL (S):

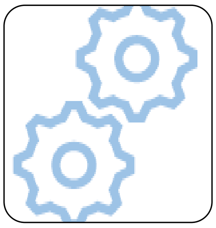
1. It addresses the **relationships the entity has and the reputation it fosters with people and institutions** in the communities where you do business and the value chain involved.
2. It **further includes labour relations, diversity, and inclusions**. Every company operates within a broader and diverse society.

C. GOVERNANCE (G):

1. It is the **internal system of practices, controls, and procedures entity adopts** in order to govern itself, **make effective investment decisions,** comply with the law, and meet the needs of all stakeholders.
2. Every entity, which is **itself a legal creation, requires governance**.

The above pillars include the following elements as under:





ENVIORNMENT

Climate Change:

•Carbon Emissions
•Product Carbon FootPrints
•Financing Enviornmental Impact
•Climate Change Vulnerability

Natural Resources:

•Water Stress
•Bio-diversity & land use
•Raw Material sourcing

Pollution & Waste:

•Toxic emission and waste
•Packing Material and waste
•E-Waste

Enviornment Opportunity:

•Clean Tech
•Green Building
•Renewable nergy

SOCIAL

Human Capital:

•Labour Management
•Health & Safety
•Human Capital Development
•Supply Chain Labour Standards

Product Liability:

•Product Safety & Quality
•Chemical Safety
•Financial Product Safety
•Privacy and Data Security
•Responsible Investment

Stakeholders Opposition:

•Controversial Sourcing

Social Opportunity:

•Access to Communication
•Access to Finance
•Access to Health Care
•Opportunities in Nutrition & Health

GOVERNANCE

Corporate Governance:

•Broad Diversity
•Executive Pay
•Ownership
•Accounting

Corporate Behaviour

•Business Ethics
•Anti - Competitve Practices
•Corruption & Instability
•Financial system and stability
•Tax Transparency

APPROACH OF REPORTING ON ESG:

1. Environmental, Social and Governance (ESG) reporting is all about **disclosure of information, data, metrics that explain the added value in these 3 areas**.
2. ESG reporting can be both **quantitative and qualitative** in nature.
3. Qualitative reports **tend to describe a company's strategy or policy** around the relevant topics, while a **quantitative approach includes metrics, and key performance indicators** (KPIs) linked to each area in order to measure progress against goals and report on achievements.
4. Naturally, a **mixed approach that makes use of both qualitative and quantitative** information tends to add the maximum value to the quality of disclosures

SUSTAINABLE DEVELOPMENT GOALS

1. In 2015, **Sustainable Development was adopted by all United Nations** Members states to provide a blueprint, which mentioned the Sustainable Development Goals (SDGs).
2. There were **17 SDGs which are considered as an urgent** call for action by all countries, whether developed or developing countries.
3. They recognized that by ending **poverty and other deprivations** must go hand in hand with strategies that **improve health and education**, reduce inequality, and spur economic growth – all **while tackling climate change and working to preserve our oceans and forests**.
4. Today, **the Division for Sustainable Development Goals** (DSDG) in the United Nations Department of Economic and Social Affairs (UNDESA) **provides substantive support and capacity building for the SDGs and their related thematic issues** including water, energy, climate, oceans, urbanization, transport, science and technology, the Global Sustainable Development Report (GSDR), partnerships and Small Island Developing States.
5. SDG plays a key role in the **evaluation of UN systemwide implementation of the 2030 Agenda** and on advocacy and outreach activities relating to the SDGs.
6. In order to make the 2030 Agenda a reality, broad ownership of **the SDGs must translate into a strong commitment by all stakeholders** to implement the global goals. DSDG aims to help facilitate this engagement.
7. Following are the 17 SDGs:

1	No Poverty	10	Reduced Inequalitites
2	Zero Hunger	11	Sustainable Cities & Communitites
3	Good Health & Well Being	12	Responsible Consumption & Production
4	Quality Education	13	Climate Action
5	Gender Equality	14	Life Below Water
6	Clean Water & Sanitization	15	Life on Land
7	Affordable & Clean Energy	16	Peace, Justice & Strong Institutions
8	Decent Work & Economic Growth	17	Partnership for the Goals
9	Industry Innovation & Infrastructure		

GLOBAL TRENDS IN SUSTAINABLE REPORTING

The **mandatory reporting requirements** are mostly associated with **the public sector or government- run companies, large corporations, multi-national business conglomerates, and listed companies** in the stock exchanges. **Sector-specific, and thematic reporting provisions** are also becoming more common.

The most **widely used framework** in the world is the **Global Reporting Initiative (GRI) Sustainability Reporting Standards** having 93% of the **world's largest 250 corporations** report on their sustainability performance through GRI.

It is used in **over 100 countries to report** sustainability. This independent international organization is **based in Amsterdam, the Netherlands, and has operational hubs in Brazil, China, Colombia, India, South Africa, and the United States**.

The GRI Sustainability Reporting Standards are developed with true multi-stakeholder contributions and rooted in the public interest.

1. **GLOBAL REPORTING INITIATIVE (GRI):** helps the organizations **to report on economic, environmental, and social impacts.** The general disclosures which are required to be reported under this standard are Economic, Environment and Social. This report is addressed to all the stakeholders of the entity.
2. **CARBON DISCLOSURE PROJECT (CDP):** captures the **environmental performance data** which is related to **GHG emissions, water, forests, and supply chain.** Major details required to be reported are climate change, Forest, and Water security. This report is addressed to all the investors, buyers, and other stakeholders of the entity.
3. **INTERNATIONAL INTEGRATED REPORTING FRAMEWORK (IIRC):** has established **guiding principles and content elements** in order to allow the companies **to produce integrated reports.** This report consists of **Organisational overview, Governance structure, Business model,** risks and opportunities, strategy, performance, outlook etc.
4. In September 2020, these framework & standard setting institutions came together to show a commitment to working towards a **COMPREHENSIVE CORPORATE REPORTING SYSTEM.**
5. The intent of the collaboration was:
   a. Joint market guidance on how **the frameworks & standards can be applied** in a complementary and additive way.
   b. Joint vision **of how these elements could complement financial**

generally accepted accounting principles (Financial GAAP) and serve as a natural starting point for progress towards a more coherent, comprehensive corporate reporting system.

c. Joint commitment to **drive towards this goal, through an ongoing programme of deeper collaboration** between the 5 institutions and stated willingness to engage closely with other interested stakeholders.

6. In November 2021, **the IFRS Foundation Trustees published a revised Constitution** and a Feedback Statement that responds to the feedback from Exposure Draft Proposed Targeted Amendments to the IFRS Foundation Constitution to **Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards**.

7. International investors with global investment portfolios are increasingly calling for high quality, transparent, reliable, and comparable reporting by companies on climate and other environmental, social and governance (ESG) matters.

8. **On 3 November 2021**, the IFRS Foundation Trustees announced the creation of a new standard- setting board—**THE INTERNATIONAL SUSTAINABILITY STANDARDS BOARD (ISSB)—**to help meet this demand.

   The intention is for the **ISSB to deliver a comprehensive global baseline** of sustainability-related disclosure standards **that provide** investors and other capital market participants with **information about companies' sustainability-related risks and opportunities** to help them make informed decisions.

9. **TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (TCFD):** It was created in 2015 by the Financial Stability Board (FSB) with the goal of helping companies create consistent climate-related disclosures. Unlike GRI, which works on a wide range of organizations, TCFD **is targeted at companies that predominantly handle financial-related interests, such as banks and insurance firms.**

10. The Climate Disclosure Standards Board (CDSB) was an international group of business and committed to making climate-rated disclosures in the mainstream global corporate reporting.

    The CDSB framework was formed to help organizations to disclose climate related risks and opportunities. The CDSB framework has also set out an approach on for reporting environmental information.

11. The ISSB has taken the technical guidance for developing IFRS Sustainability Disclosure Standards.

12. The **Value Reporting Foundation (VRF)** is a non-profit organization which was a result of the **merger between SASB Foundation and the International Integrated Reporting Council (IIRC).**

13. The International Accounting Standards Board (IASB) and the ISSB has agreed to work together in order **to build an Integrated Reporting Framework**.

14. The International Sustainability Standards Board (ISSB) in March 2022 launched a consultation on its **first 2 proposed standards—one on climate-related disclosures and one on general sustainability-related disclosures**.

    The proposed standards, when finalised, would form a comprehensive global baseline of sustainability-related disclosures designed to meet the information needs of investors in assessing enterprise value.

IFRS S1: The **proposed requirements** in the Exposure Draft
IFRS S2: Climate-related Disclosures (Climate Exposure Draft) build upon the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) and incorporate industry-based disclosure requirements derived from the Sustainability Accounting Standards Board (SASB) Standards.

INTEGRATED REPORTING

There **are 6 Cs of Integrated Reporting** – also known as 6 capitals:

1. **FINANCIAL CAPITAL:**
   a. **Pool of funds that is available to the organization for use** in the production of goods or provision of services.
   b. **Obtained through financing,** such as debt, equity, or grants, or generated through operations or investments.
2. **MANUFACTURED CAPITAL:**
   a. **Seen as human-created, production-oriented** equipment and tools.
   b. **Available to the organization for use in the production** of goods or the provision of services, including buildings, equipment, infrastructure (such as roads, ports, bridges & waste, and water treatment plants).
3. **NATURAL CAPITAL:**
   a. **Is an input to the production** of goods or the provision of services.
   b. An **organization's activities also impact,** positively or negatively, on natural capital.

c. **Includes water, land**, minerals and forests, biodiversity, and **ecosystem health**.

4. **HUMAN CAPITAL: People's skills and experience, their capacity**, and motivations to innovate, including their:
   a. **Alignment with and support of the organization's governance** framework & ethical values such as its recognition of human rights.

   b. **Ability to understand and implement** an organization's strategy.

   c. **Loyalties and motivations for improving** processes, goods, and services, including their ability to lead and to collaborate.

5. **SOCIAL CAPITAL:**

   a. **Institutions and relationships established** within and between each community, group of stakeholders and other networks to **enhance individual and collective well-being**.

   b. Includes:
      1) **Common values** and behaviour.

      2) **key relationships, the trust and loyalty** that an organization has developed and strives to build and protect with customers, suppliers, and business partners.

      3) An **organization's social license** to operate.

6. **INTELLECTUAL CAPITAL:**
   a. **Key element in an organization's future earning** potential, with a tight link and contingency between investment in R&D, innovation, human resources, and external relationships, which can determine the organization's competitive advantage.

   b. **Asia Pacific region continues to dominate in presenting sustainability data** in annual reports. Approximately with 60% of Companies reporting in 2022. Integrated reporting is strong in the Middle East.

GLOBAL SCENARIO ON SUSTAINABLE REPORTING IN VARIOUS COUNTRIES

March 2021

Sustainable Finance Disclosures Regulation **(SFDR) go into effect for asset managers and financial advisors operating in EU**

April 2021

European commission adopts the CSRD proposal, which will require **large companies to report** on social and environmental impacts starting in 2024

October 2021

GRI standards updated

November 2021

IFRS Foundation announces the formation of its global reporting standardization initiative through the ISSB UK Financial conduct authority releases sustainability requirements disclosure paper

December 2021

The **European commission published the first delegated act** on sustainable activities for the first two environmental objectives of the EU territory

February 2022

The **EU adopts a proposal for a directive on Corporate Sustainability Due Diligence** with Rules for companies to respect human rights and the environment in their global value chains

March 2022

US SEC annouces climate change disclosure proposal ISSB exposure draft for public commentary

April 2022

European Financial Reporting Advisory Board issues exposure draft of the European Sustainbility Reporting Standard (ESRS) for public commentary

June 2022

China's voluntary guidance for Enterprise ESG disclosures takes effect

EVOLUTION OF ESG IN INDIA

In India, the Ministry of Corporate Affairs **(MCA) took the initiative to guide the corporates towards responsible conduct and a sustainable future** by issuing Corporate Social Responsibility Voluntary Guidelines in December 2009.

Its ultimate **goal was to integrate sustainability into business practices and into decision making process.**

The MCA further **issued additional guidelines**, known as the "National Voluntary Guidelines on Social, Environmental, and Economic Responsibilities of Business, 2011" (NVGs), **emphasising the importance of corporate entities' environmental, social, and economic responsibilities**, as well as the need to integrate them into business practices and investment decision making processes.

2009 – 'CORPORATE SOCIAL RESPONSIBILITY VOLUNTARY GUIDELINES 2009'

MCA issued CSR voluntary guidelines for the businesses to add value to the operations and contribute towards the long-term sustainability of the business. The most important element of these was to encourage the **corporates to focus on Ethical functioning, Rights and welfare** of workers, Human Rights, Environmental development and taking social development activities.

2011 – 'NATIONAL VOLUNTARY GUIDELINES ON SOCIAL, ENVIRONMENTAL AND ECONOMIC RESPONSIBILITIES OF BUSINESS'

In July 2011 '**National Voluntary Guidelines** on Social, Environmental and Economic Responsibilities of Business' came which contained comprehensive principles **to be adopted by companies as part of their business practice**.

2012 – SEBI MANDATES TOP 100 LISTED COMPANIES TO FILE BUSINESS RESPONSIBILITY REPORT

Top **100 listed companies by market capitalization were required to file Business Responsibility Report (BRR).** This report was in line with the ESG principles.

2015 – BRR BECAME PART OF SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

SEBI vide Circular no. CIR/CFD/CMD/10/2015 dated November 04, 2015, had prescribed the format for the Business Responsibility Report (BRR) in respect of reporting on ESG (Environment, Social and Governance) parameters by listed entities in line with clause (f) of sub regulation (2) of regulation 34 of SEBI(LODR) Regulations 2015. Top **500 listed companies by market capitalization were required to file Business Responsibility Report (BRR)**.

2017 – SEBI RECOMMENDED INTEGRATED REPORTING FOR TOP 500 LISTED COMPANIES

On 6 February 2017, **SEBI issued a circular advising top 500 listed companies which are required to prepare BRR to adopt IR on a voluntary basis** from the financial year 2017-18.

2019 - NATIONAL GUIDELINES ON RESPONSIBLE BUSINESS CONDUCT (NGRBC) 2018

MCA revised the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 (NVGs) and **formulated the National Guidelines on Responsible Business Conduct (NGRBC)**.

2019 – BRR BECAME MANDATORY FOR TOP 1,000 LISTED COMPANIES

As per SEBI (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2019, with effect from December 26, 2019, the **annual report of the top 1,000 listed entities based on market capitalization shall contain a business responsibility report** as per clause (f) of sub regulation (2) of regulation 34 of Listing Regulations.

2021 – NEW REPORTING REQUIREMENTS ON ESG PARAMETERS CALLED THE BUSINESS RESPONSIBILITY AND SUSTAINABILITY REPORT (BRSR).

Under notification no. SEBI/LAD-NRO/GN/2021/22 dated **May 05, 2021, SEBI introduced new reporting** requirements on ESG parameters called the **Business Responsibility and Sustainability Report (BRSR)**.

The **BRSR seeks disclosures from listed entities on their performance against the 9 principles** of the 'National Guidelines on Responsible Business Conduct' (NGBRCs) and reporting under each principle is divided into essential and leadership indicators.

The **essential indicators are required to be reported on a mandatory basis** while **the reporting of leadership indicators is on a voluntary basis.** Listed entities should endeavour to report the leadership indictors also.

The BRSR is intended towards having quantitative and standardized disclosures on ESG parameters to enable comparability across companies, sectors, and time.

2009 National Voluntary Guidelines (NVGs) *(MCA issued NVGs on corporate social responsibility)*	2012 Business Responsibility Report (BRR) *The top 100 listed companies file BRR based on NVGs along with their annual reports*	2014 Corporate social responsibility (CSR) *CSR is mandated, and CSR Rules come into force*	2015 Extension to top 500 listed companies for filing BRR	2017 Integrated Reporting (IR) *IR may be adopted on a voluntary basis from FY 2017–18 by the top 500 companies which are required to prepare BRR*	2019 - National Guidelines on Responsible Business Conduct (NGRBC) released - Extension to the top 1,000 listed companies for filing BRR	2021 Business Responsibility and Sustainability Report (BRSR) *Introduction of BRSR in May 2021*	2022 Mandatory reporting of top 1,000 listed companies to file BRSR along with the annual reports

INITIATIVES BY ICAI RELATING TO BRSR

1. In Feb 2020, **ICAI constituted Sustainability Reporting Standards Board** (SRSB). Mission of the SRSB is to take **appropriate measures to increase awareness and implement measures** towards responsible business conduct, **developing audit guidance for Integrated Reporting**
2. ICAI, encouraged by SEBI, introduced **India's first award** to celebrate the business practice of Integrated Reporting, **internationally acknowledged as the emerging best practice** in corporate reporting
3. ICAI has also started a Certificate Course on Sustainable Development Goals (SDGs), Business Responsibility Reports (BRR), Integrated Reporting (IR) & also proposed an ICAI Executive Development Program on Business Responsibility Reporting (BRR)
4. In last 2 years, ICAI has issued following publications:
    a. Standard on Assurance Engagements (SAE 3410) – **Assurance Engagements on Greenhouse Gas Statements**
    b. Background Material on BRSR (revised 2021)
    c. Sustainable Development Goals – Accountants creating sustainable World – Parts 1 covering SDGs 1 to 5
    d. Sustainable Development Goals – Accountants creating sustainable World – Parts 1 covering SDGs 6 to 11
    e. Sustainable Development Goals – Accountants creating sustainable World – Parts 1 covering SDG 11 to 17
    f. FAQs on Sustainability Reporting – Heart of Good Governance
    g. Sustainability Reporting Maturity Model (SRMM) – Version 1.0

BUSINESS RESPONSIBILITY AND SUSTAINABILITY REPORT (BRSR)

Reporting under **BRSR is mandatory from financial year 2022-23.** However, disclosure was voluntary in financial year 2021-22.
The reporting questionnaire is divided into 3 sections:

1. **SECTION A – GENERAL DISCLOSURES:**

    This section contains the **details of the listed companies, its products, services,** operations, employee related details, its holding, subsidiary, associate companies etc.

2. **SECTION B – MANAGEMENT PROCESS AND DISCLOSURES:**

    It contains questions **related to policy and management processes, governance, leadership**, and oversight.

3. **SECTION C – PRINCIPLE-WISE PERFORMANCE DISCLOSURES:**

   Companies are required to **report upon Key performance indicators (KPIs) in alignment with the 9 principles of the NGRBC.** The section **classifies KPIs into 2 categories** that companies are required to report upon:

   - **ESSENTIAL INDICATORS** (Mandatory disclosures)
     This would include **data on training programs conducted, environmental data on energy,** emissions, water, waste management etc.

   - **LEADERSHIP INDICATORS** (Optional disclosures)
     It would include **life cycle assessments, details of conflict management policy, additional data**, on biodiversity, energy consumptions, supply chain managements etc.

9 PRINCIPLES OF BRSR

The **9 principles in BRSR are categorized** into the ESG components of Environment, Social and Governance **with 2 of the nine in Environment, 3 in social and 4 in Governance.**

PRINCIPLE 1 – ETHICS, TRANSPARENCY AND ACCOUNTABILITY:

The first principle **emphasizes that the business decisions in an organisation should be open to disclosure and accessible** to the relevant interested parties.
The essence of the core elements associated with the first principle are:

1. **POLICIES AND PROCEDURES:** The entities' **governing structure should develop policies, procedures, and practices for their offices,** factories, and work areas, ensuring that ethics is not compromised.
2. **The information** relating to the policies, procedures, and practices along with the performance should be **made available to the stakeholders**.
3. In case of adverse effects, more **care has to be taken for transparent disclosures**.
4. The **entities in the value chain should be encouraged to adopt these principles** by the governance structure.
5. **NON-COOPERATIVE WITH VIOLATING ENTITIES:** The entities should **proactively respond to the outside entities that violate the 9 principles** of the BRSRs. This includes their suppliers, distributors, sub-

contractors, or regulatory officers that may engage with the business concern.

PRINCIPLE 2 – SAFE AND SUSTAINABLE GOALS AND SERVICE:

The entities should **make sure that their goods, services, and the operations result in better life for the consumers and end-users.**

The essence of the core elements associated with the second principle is:

1. When a product is designed by the entity, the **production methods and technologies** have to be devised in such a way so as **to minimize the resource usage** to make it sustainable.
2. The entities are also **responsible to educate and make aware** their consumers and clients about their rights.
3. The entities should take **measures that reduce the over exploitation of the nature's resources** by consuming sustainably and encourage methods for reduce, reuse and recycling of the resources.

PRINCIPLE 3 – PROMOTE WELL-BEING OF ALL EMPLOYEES INCLUDING THOSE IN THE VALUE CHAIN:

The third principle **relates to all the initiatives an entity has to take for the benefit of its employees** from the point of view of their dignity, health, well-being.

The essence of the core elements associated with the principle is:

1. The entity should **ensure compliance with all regulatory requirements** as far as employees are concerned.
2. The entities are **to respect the dignity of employee as a human being and should not restrict their freedom** of associations, unions, and other participatory mechanism for collective bargaining of their rights and redressal of issues they face at the workplace.
3. The entities **should prevent all kinds of child labour, bonded labour,** and any other forms of involuntary labour.
4. The entities should **have a system in which the work-life balance** of the employees is not compromised.
5. The businesses **have to ensure timely payment** of the worker's wages and compensation.
6. The payment of the **wages has to be as per the living wages,** that can take care of the basic needs and provide economic security to the employees.
7. The entities are **responsible to create** a workplace and work environment that is **safe, hygienic, and comfortable for people to work** for long durations.
8. The **skill development, career development and training** of the workforce is another responsibility of the entities employing them.
9. The **creation of a workplace which is free of harassment and violence** is also a responsibility of the entity.

PRINCIPLE 4 - RESPECT FOR STAKEHOLDERS' INTERESTS AND RESPONSIVENESS:

The concept of interested party or stakeholders to a business has been a point of discussion in all the regulatory and voluntary systems that relate to the **management system of any organisation, be it related to the quality, environment or the occupational health and safety of the workers**. The essence of the core elements associated with the principle is:

1. The entities **have to be transparent and communicate with the stakeholders about the impacts of their operations and business decisions** on the people and the nature. The policies, decisions, and the impact of the operations of the organisation to the stakeholders have to be disclosed transparently with no ambiguity on the extent of the issues.
2. The entities have to systematically **determine the context of their**

operation and identify their interested parties.

3. The entities should **fairly share the benefits to the stakeholders** or give an opportunity to them to benefit from the operations in an equitable manner.

PRINCIPLE 5 - RESPECT AND PROMOTE HUMAN RIGHTS:

The concept of human rights is a vast topic that covers a wide variety of violence and belligerent abusive issues faced by people. It refers to the **human rights issues that happen directly or indirectly due to the operation of the business**.

The essence of the core elements associated with the principle are:

1. The entities should **have a clear understanding of the human rights and various ways by which human rights can be violated** from the perspective of the Constitution of India, national laws and policies and the content of International Bill of Human Rights.
2. The entities when developing their management systems, should **integrate the human rights element into their policies**, procedures, and practices.
3. Businesses should **recognize and respect the human rights of all relevant stakeholders and groups within and beyond the workplace,** including that of communities, consumers, and vulnerable and marginalized groups.

PRINCIPLE 6 – PROTECTION AND RESTORATION OF ENVIRONMENT:

The **6th principle looks at the environmental responsibility as a basic requirement for the economic prosperity and sustainability**.

The core elements associated with the principle are:

1. The entities should have policies, procedures, and **practices in place to assess and rectify impacts to the environment.** This should cover the whole life cycle of the product.
2. The entities have to **make use of natural and manmade resources in an optimum manner** to ensure their sustainability by taking feedback from the stakeholders.
3. The entities have **to measure their performance relating to the prevention of pollution**, destruction of forests, waste generation, energy use, land use, etc.
4. The entities have to **contribute towards climate change resilience in**

line with India's commitment to various international mechanisms such as, Paris Agreement and National Action Plans for Climate Change.

5. The entities should **explore the comparison of its activities with industry best practices** to reduce, reuse and recycle/ recover materials, resources.
6. The companies have **to look out for avenues by which they can improve their performance** towards various environmental responsibilities.

PRINCIPLE 7 – INFLUENCE ON PUBLIC AND REGULATORY POLICY:

The 7th principle of influencing the policy formulation positively recognizes that the **businesses operate within the framework of statutory and legislative policies** of the governing authority.

The principle further highlights that:

1. The core elements of BRSR are to have **met holistically** when the organisation go ahead with their **contributions to policy formulation and policy advocacy.**
2. The collective associations such as, the **trade groups and industry chambers have to be utilized** when moving ahead with the policy advocacy and formulation.
3. The role in policy advocacy by the organisation should be in such a way that it **encourages fair competition and prevents human rights abuses**.

PRINCIPLE 8 – PROMOTE INCLUSIVE GROWTH AND EQUITABLE DEVELOPMENT:

This can work only with close participation and collaboration amongst the entities, authorities, the civil associations contributing to **one another for a better livelihood, and assistance to the marginalized communities**.

The core elements of the 8th principle are:

1. The entities should have systems in place to **identify and address impacts of their activities on the social, cultural, and economic aspects** of the people. This includes business created issues like, land acquisition and use and construction activities for new facilities.
2. The entities should **review, measure, and track the adverse impacts** of their activities on the society and environment and make action

plans to mitigate them adequately.

3. The entities should make **efforts to bring up creative products, technologies, and business concerns that help the marginalized communities** to have well-being and a better quality of life.
4. Entities when designing their CSR activities should review the local and regional development **priorities to help the marginalized groups** and communities.
5. The entities should take care **to ensure that business induced displacement or relocation of communities does not happen,** and in unavoidable cases, should make sure to have mutually agreed, participative, and informed negotiations to provide fair compensation to the affected people.
6. All forms of **intellectual property and traditional knowledge should get the deserved respect** from the organisation, and efforts should be made to ensure that benefits derived from their knowledge are shared equitably.

PRINCIPLE 9 – PROVIDE VALUE TO THE CONSUMERS IN A RESPONSIBLE MANNER:

The **primary purpose of any business is to create or provide useful products and services to the customer** in exchange of reasonable profits.

The core elements associated with the principle are:

1. Entities should put in **their efforts to reduce the negative impacts of their products and services** on consumers, natural environment, and society at large.
2. When conceptualizing, designing, and marketing their products, the organisation **should not in any manner prevent the freedom of choice and fair competition**.
3. The entities should **transparently and accurately disclose all kinds of adverse impacts** to the user, planet, society, on the biodiversity from their products.
4. When handling customer data, the **right to privacy of the customer needs to be maintained**.
5. Entities should **inform the customers on the safe and responsible ways of usage,** reuse, recycling, and disposal of their products, and ways to eliminate over-consumption.
6. When advertising about their products, the organisations should ensure that **misleading and confusing information is not exposed to the customers** about their products or its usage.

7. Business enterprises should **make available transparent and accessible grievance redressal and feedback management** system for their customers to raise their voices or to seek clarifications.

8. Entities, when in the business of **providing essential goods and services (e.g., Utilities), should enable universal access,** including to those whose services have been discontinued for any reason, in a non-discriminatory and responsible manner.

Allignment of BRSR Principles with SDGs

Principles/ SDGs	P1	P 2	P 3	P 4	P 5	P 6	P 7	P 8	P 9
SDG 1			✓	✓				✓	
SDG 2		✓				✓	✓	✓	✓
SDG 3			✓					✓	
SDG 4			✓					✓	✓
SDG 5			✓	✓	✓			✓	
SDG 6		✓				✓		✓	
SDG 7		✓				✓	✓		
SDG 8		✓	✓		✓			✓	
SDG 9		✓					✓		
SDG 10		✓					✓		
SDG 11			✓	✓			✓	✓	
SDG 12		✓				✓			✓
SDG 13		✓				✓	✓	✓	
SDG 14		✓				✓	✓	✓	✓
SDG 15		✓				✓	✓	✓	✓
SDG 16	✓		✓	✓	✓			✓	
SDG 17	✓						✓	✓	

ASSURANCE IN BRSR

1. SEBI has currently **started with the top 1,000 listed companies**, in the **near future remaining listed companies would also need to comply** with the provisions of BRSR.

2. BRSR is expected to be used as a **single means for disclosing sustainability related information** in India. This **would be the main**

document which the stakeholders, investors would review and do industry analysis.

3. Hence, **assurance in this reporting becomes more critical**.

4. ESG audit would be a process that would help the companies **to evaluate the environmental and social risks for the Company**'s products, services, operations etc. Conducting an **ESG audit also helps businesses look at their supply-chain risks**, risk management capabilities and transparency with shareholders.

5. ICAI has recently issued **Standard on Sustainability Assurance Engagements (SSAE) 3000**

6. **Assurance Engagements on Sustainability Information**

   a. This Standard deals with **assurance engagements on an entity's sustainability information.** This is an umbrella standard applicable to all assurance engagements on Sustainability information.

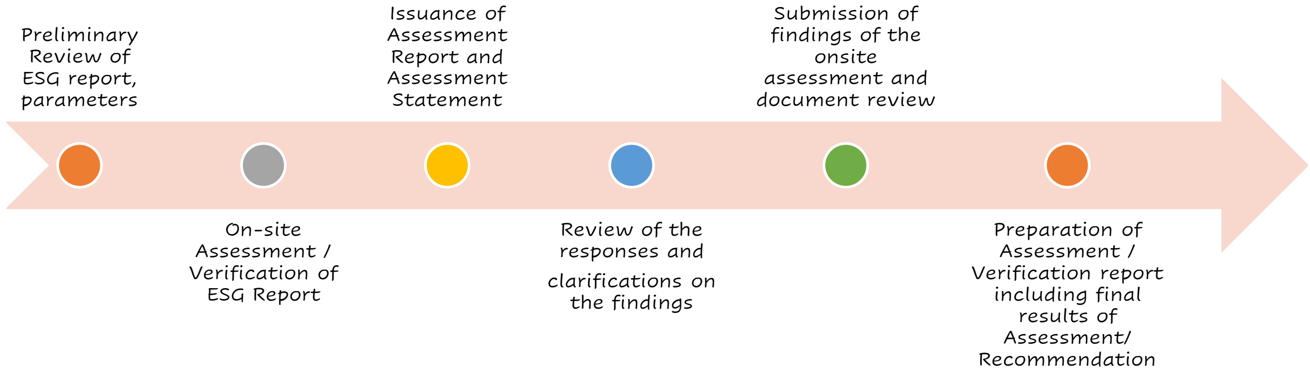
   b. The intended users of this Standard include:
      i. Assurance providers providing **assurance on sustainability information**.
      ii. **Entities seeking to engage a professional auditor**.
      iii. Regulators, investors, and other **users of Sustainability Reporting data**.

   c. This Standard applies for assurance engagements which pertain **to providing reasonable or limited assurance on sustainability information**.

   d. The effective date of application of SSAE 3000 is as follows:
      i. **Voluntary basis** for assurance reports covering periods ending on **31st March 2023**.
      ii. **Mandatory basis** for assurance reports covering periods ending **on or after 31st March 2024.**

7. ICAI has also issued **SSAE 3410, Assurance Engagements on Greenhouse Gas Statements** which deal with assurance engagements on an **entity's sustainability information including assurance of BRSR.**

8. Methodology to provide assurance on BRSR:



SOCIAL AUDIT STANDARDS

1. The Sustainability Reporting Standards Board (SRSB) of the ICAI has **recently issued Social Audit Standards (SAS 100 to 1600)**.
2. These Standards **aim to provide the Social Auditor with the necessary guidance in relation to independent impact assessment** engagement of Social Enterprises engaged in various areas and the **audit steps and procedures that should be applied while conducting the social impact assessment**.
3. The Standard **sets out the minimum requirements to be followed** while conducting impact assessment.
4. Laws or regulations may establish additional requirements which should be followed, as applicable.

Following SASs are issued:

SAS	Particulars
100	Eradicating hunger, poverty, malnutrition and inequality
200	Promoting health care including mental healthcare, sanitation and making available safe drinking water
300	Promoting Education, Employability, and Livelihoods
400	Promoting Gender Equality, Empowerment of Women and LGBTQIA+ communities
500	Ensuring environmental sustainability, addressing climate change including mitigation and adaptation, forest and wildlife conservation
600	Protection of national heritage, art and culture
700	Training to promote rural sports, nationally recognised sports, Paralympic sports and Olympic sports
800	Supporting incubators of social enterprises
900	Supporting other platforms that strengthen the non-profit

	ecosystem in fundraising and capacity building
1000	**Promoting Livelihoods for rural and urban poor including enhancing income of Small and Marginal Farmers and workers in the non-farm sector**
1100	**Slum area development, affordable housing and other interventions to build sustainable and resilient cities**
1200	**Disaster Management, including Relief, Rehabilitation and Reconstruction Activities**
1300	**Promotion of financial inclusion**
1400	**Facilitating Access to Land and Property Assets for disadvantaged Communities**
1500	**Bridging the digital divide in internet and mobile phone access, addressing issues of misinformation and data protection**
1600	**Promoting welfare of migrants and displaced persons**

ROLE OF AUDITOR - CONSIDERATION OF CLIMATE RELATED RISKS IN AN AUDIT OF FINANCIAL STATEMENTS

1. The role of the auditor is **to obtain reasonable assurance** about whether the financial statements as a whole are **free from material misstatement**, whether due to fraud or error, to enable auditor to report whether the financial statements **are prepared and presented fairly, in all material respects**, in accordance with the applicable financial reporting framework.

2. In developing the understanding of an entity, the auditor should **include the consideration of climate- related risks and how these risks may be relevant** to the audits. The climate-related risks could **be more relevant in certain sectors** or industries, e.g., banks and insurance, energy, transportation, materials and buildings, agriculture, food, and forestry products.

3. Many investors and stakeholders are seeking information **from auditor's reports about how climate- related risks were addressed in the audit.** With this increased user focus on climate change, auditor need to be aware of, and may face, increasing pressure for transparency about climate matters in our auditor's reports. The **auditor's reports must follow the requirements of applicable auditing standards**.
4. The auditor's report is a **key mechanism of communication to users** about the audit that was performed. In addition to the audit opinion, it provides information about auditor's responsibilities and, when

required, an **understanding of the matters of most significance in our audit and how they were addressed**.

5. In some circumstances, it may warrant **inclusion of an Emphasis of matter paragraph to draw attention to disclosures** that are of fundamental importance to users' understanding of the financial statements. The auditor should also determine whether the **entity has appropriately disclosed relevant climate-related information in the financial statements** in accordance with the applicable financial reporting framework e.g., Indian Accounting Standards or Accounting Standards, when relevant before considering climate-related matters in the auditor's report.
6. The **auditor should also read the other information for consistency with information disclosed** in the financial statements and information that may be publicly communicated to stakeholders outside the financial statements, **such as management report narratives in the annual report, press releases, or investor updates.** This is a **requirement under ISA 720 and SA 720,** The Auditor's Responsibilities Relating to Other Information.