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CA Final & CA Inter Audit

Abki Baar Audit Mei Exemption Paaar!



CA Ankush Chirimar
AIR 5,6,32

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Notes*

Brief about Author

- All India Ranker at all 3 levels of CA
- Scored 95 Marks in Audit - Highest marks in history of ICAI till Nov 23
- Articleship at KPMG, Mumbai in Statutory Audit Domain
- Industrial Training at DBS Bank

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Companies (Auditor's Report) Order (CARO), 2020

Applicability - Every co. including foreign co. **except** -

<ul style="list-style-type: none"> • 1 Person Co. • Insurance co. • Banking co. • Small co. • Section 8 Co. 	<ul style="list-style-type: none"> • Private co., not being subsidiary or holding co. of public co., having - • Paid up capital & reserves & surplus not > Rs 1 crore as on B/S date & • Total borrowings not > Rs. 1 crore from any bank or financial institution at any point of time during FY & • Total revenue (including discontinuing operation) not > Rs 10 crore as per FS
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CARO shall **not apply** to report on **Consolidated FS except** clause (xxi) of para 3

Para 3 - Matters to be included in auditor's report

(i) PPE & Intangible Assets

- (a) (A) Whether co. is maintaining **proper records** showing full particulars, including quantitative details of **PPE**
- (B) Whether co. is maintaining proper records showing full particulars of **intangible assets**
- (b) Whether PPE is **physically verified** by Mgt at **reasonable intervals**, whether **material discrepancies** were noticed & if so, whether same is properly dealt with in BOA
- (c) Whether **title deeds** of all immovable properties (other than leased properties) disclosed in FS are **held in name of co., if not**, provide details thereof in format below -

Description of Property	Gross carrying Value	Held in name of	Whether promoter, director or their relative or employee	Period held	Reason for not being held in name of co. (also indicate if in dispute)
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- (d) Whether co. has **revalued** its PPE or intangible assets during year & if so, whether revaluation is done by **Registered Valuer**. Specify amount of change, if **change is 10% or more** in aggregate of net carrying value of **each class** of PPE or intangible assets
- (e) Whether any **proceedings** are initiated or pending against co. for holding **benami property** & if so, whether co. has **appropriately disclosed** details in its FS

(ii) Inventory

- (a) Whether **physical verification** of inventory is conducted at reasonable **intervals** by Mgt & whether coverage & procedure of verification is appropriate, whether any **discrepancies of 10% or more** in aggregate for **each class** of inventory were noticed & if so, whether they are properly dealt with in BOA
- (b) Whether at any time of year, co. was **sanctioned working capital limits > Rs. 5 crores**, in aggregate, from banks or financial institutions on basis of security of current assets, whether **quarterly statements** filed by co. are as per BOA, if not, give details

(iii) Loans, Investments, Guarantee & Security - Whether co. has made investments in, provided guarantee or security or loans or advances, secured or unsecured, to co., firms, LLPs or other parties, if so -

- (a) Whether co. has provided loans or advances, or guarantee, or security **to other entity [not applicable to co. whose principal business is to give loans]**, if so, indicate - **Aggregate amount**

during year & **balance outstanding** at B/S date for loans or advances & guarantees or security to

(A) Subsidiaries, joint ventures & associates

(B) Other parties

- (b) Whether investments, guarantees, security & terms & conditions of loans & advances & guarantees are **not prejudicial to co.'s interest**
- (c) For loans & advances, whether **schedule of payment** of principal & interest is stipulated & whether **receipts are regular**
- (d) If amount is **overdue**, state total amount overdue for **> 90 days** & whether **steps** are taken by co. **for recovery** of principal & interest
- (e) Whether loan or advance granted which has fallen due during year, is **renewed or extended or fresh loans** granted **to settle overdues** of existing loans given to same party, if so, specify **aggregate amount** of such dues & **% of aggregate to total loans** or advances granted during year [**not applicable to co. whose principal business is to give loans**]
- (f) Whether co. has granted loans or advances either **repayable on demand or without specifying period of repayment**, if so, specify aggregate **amount, %** to total loans granted, aggregate amount of loans granted to **Promoters, RP**

(iv) **Loans, Investments, Guarantee & Security** - For loans, investments, guarantees, & security, whether **sections 185 & 186** of Co. Act are complied, if not, provide details thereof

(v) **Deposits** - For deposits/deemed to be deposits accepted by co., whether **directives of RBI & Sections 73 to 76** of Co. Act are complied, if not, nature of contraventions be stated. Order of Co. Law Board/RBI/etc is complied with or not

(vi) **Cost Records** - Whether maintenance of cost records is **specified by CG u/s 148** of Co. Act & whether such records are maintained

(vii) Statutory Dues

- (a) Whether co. is **regular** in depositing undisputed statutory (govt) dues & if **not, outstanding** statutory dues for **> 6 months from due date as on last day** of FY, shall be indicated
- (b) Where statutory dues are not deposited **due to dispute**, then **amount & forum** where dispute is pending shall be mentioned (mere representation to dept shall not be treated as dispute)

(viii) **Income Tax** - Whether **transactions not recorded** in BOA are **disclosed as income** in Income tax assessments, if so, whether unrecorded income is properly recorded in BOA during year

(ix) Loans & Borrowings

- (a) Whether co. has **defaulted in repayment** of borrowings or interest to lender, if yes, period & amount of default to be reported as per format below -

Nature of borrowing	Name of lender (lender wise details to be provided in case of banks, financial institutions & Govt)	Amount not paid on due date	Whether principal or Interest	No. of days delay or unpaid	Remarks, if any
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- (b) Whether co. is declared **wilful defaulter** by any bank or financial institution or other lender

- (c) Whether term **loans were applied for purpose** obtained, if **not**, **amount** of loan diverted & **purpose** for which it is used to be reported
- (d) Whether **funds** raised on **short term** basis are **utilised for long term** purposes, if yes, **nature** & **amount** to be indicated
- (e) Whether co. has taken any **funds to meet obligations** of its **subsidiaries, associates or joint ventures**, if so, details with nature of such transactions & amount in each case
- (f) Whether co. has raised loans on **pledge of securities held** in its **subsidiaries, joint ventures or associate** co., if so, give details & report if co. has **defaulted in repayment** of such loans

(x) IPO

- (a) Whether money raised by way of IPO or FPO (including debt) during year were **applied for purpose** raised, if **not**, **details** with default & **subsequent rectification**, if any, be reported
- (b) Whether co. has made any **preferential allotment or private placement** of shares or convertible debentures (fully, partially or optionally) during year & if so, whether **Section 42 & 62** of Co. Act are complied with & **funds** raised are **used for purpose raised**, if not, provide details for amount & nature of non-compliance

(xi) Fraud

- (a) Whether any fraud **by co. or** any fraud **on co.** is **noticed or reported** during year, if yes, nature & amount involved is to be indicated
- (b) Whether any report **u/s 143(12)** of Co. Act is filed by auditors in **Form ADT-4 with CG**
- (c) Whether auditor has considered **whistle-blower complaints** received during year by co.

(xii)Nidhi Company

- (a) Whether Nidhi co. has complied with **Net Owned Funds to Deposits in ratio of 1:20**
- (b) Whether Nidhi co. is maintaining **10% unencumbered term deposits**
- (c) Whether there is any **default in payment of deposits** or interest & if so, details

(xiii) Related Party - Whether all transactions with RP are as per **Sections 177 & 188** of Co. Act & details are disclosed in FS, etc., as required by applicable a/cing standards

(xiv) Internal Audit

- (a) Whether co. has IAF as per **size & nature of business**
- (b) Whether **reports of IA** for audit period were **considered by statutory auditor**

(xv)Non-Cash Transactions - Whether co. has entered into non-cash transactions **with directors or persons connected with him** & if so, whether **Section 192** of Co. Act is complied

(xvi) RBI - Core Investment Companies (CIC)

- (a) Whether co. is **required to be registered u/s 45-IA** of RBI Act & if so, whether registration is obtained
- (b) Whether co. has conducted any **NBFC or HFC activities without valid Certificate of Registration** from RBI

- (c) Whether co. is **CIC**, if so, whether it continues to **fulfil criteria** of CIC & if co. is **exempted or unregistered CIC**, whether it continues to fulfil such criteria
- (d) Whether **Group has > 1 CIC**, if yes, indicate **number** of CICs which are part of Group

(xvii) **Cash Losses** - Whether co. has incurred cash losses **in FY & in immediately preceding FY**, if so, state amount of cash losses

(xviii) **Statutory Auditor Resignation** - Whether there is any resignation of statutory auditors during year, if so, whether auditor has taken into consideration **concerns raised by outgoing auditors**

(xix) **Going Concern** - On basis of financial ratios, ageing & expected dates of realisation of financial assets & payment of financial liabilities, other info, auditor's knowledge of Mgt plans, whether auditor is of opinion that **no material uncertainty exists** as on date of audit report that co. is **capable of meeting its liabilities** existing at date of B/S as & when they **fall due within period of one year from B/S date**

(xx) **CSR**

- (a) Whether, for **other than ongoing projects**, co. has transferred **unspent** amount to **Fund specified** in Schedule VII to Co. Act **within 6 months of expiry of FY** as per section 135 (CSR)
- (b) Whether any amount remaining **unspent** in CSR, for **ongoing project**, is transferred to **special a/c** as per section 135

(xxi) **Consolidated FS (CFS)** - Whether there are any **qualifications or adverse remarks** by auditors **in CARO reports of companies included in CFS**, if yes, indicate details of co. & **para numbers** of CARO report containing qualifications or adverse remarks

Reasons to be stated for unfavourable or qualified answers

- Where answer to any of questions above, is unfavourable or qualified, auditor's report shall also **state basis** for such **unfavourable or qualified** answer
- Where auditor is **unable to express** any **opinion** on any matter, his report shall indicate such fact with **reasons** as to why it is not possible for him to give his opinion

Duty of Auditor to Inquire on following matters – 143(1)

- a. Whether **loans** & advances made by co. are **properly secured** & whether terms are **prejudicial to interests** of co./members
- b. Whether **transactions** of co. represented **merely by book entries are prejudicial** to interests of co.
- c. Where co. **not being** investment co. or banking co., **whether assets** of shares, debentures & other securities are **sold at price less than purchase price**
- d. Whether **loans** & advances by co. are **shown as deposits**
- e. Whether **personal expenses** are charged to revenue a/c
- f. Where it is stated in books that **shares** are allotted **for cash**, whether cash has **actually been received** & if not, whether BOA is correct & not misleading
- Auditor should **make report** to members **only if** he finds **answer** to any of above matters **in adverse**
- Matters having **adverse effect on co.** mentioned in auditors' report shall be **read before co. in general meeting** & shall be open to **inspection** by any member of co.

Duty to audit report – 143(3) - Report under "**Report on Other L&R Requirements**" shall state -

- a. Whether he has **obtained all info** which to best of his knowledge & belief were necessary for audit & if not, details & effect of info on FS
- b. Whether **proper BOA as required** by law are kept by co. & proper **returns** are received **from branches** not visited by him
- c. Whether **report on branch** office audited by other person is sent to him & **manner** in which **he has dealt** with it in preparing his report
- d. Whether co.'s **B/S & P/L are in agreement with BOA** & returns
- e. Whether **FS** comply with **a/cing standards**
- f. Observations of auditors on **transactions having adverse effect** on co.
- g. Whether any **director is disqualified** u/s 164(2)
- h. Any adverse remark for **maintenance of a/cs**
- i. Whether co. has **adequate internal financial controls** in place & **operating effectiveness** of such controls - This clause shall **not apply to Private** co. -
 - (i) Which is **one person co. or small** co. or
 - (ii) having **turnover < Rs. 50 crores** as per latest Audited FS & having aggregate **borrowings** from banks or financial institutions or any corporate **at any point of time** during FY **< Rs. 25 crores**
- j. **Other matters** as prescribed under **Rule 11**, namely -
 - (i) Whether co. has disclosed **impact of pending litigations** on its financial position
 - (ii) Whether co. has made **provision for material foreseeable losses** on long term contracts
 - (iii) Whether there is any **delay in transferring amounts** to Investor Education & Protection Fund
 - (iv)(a) Whether Mgt has represented that **no funds are invested** by co. in any other person ("**Intermediaries**") with understanding that Intermediary shall invest in other persons **on behalf of co.** ("**Ultimate Beneficiaries**")
 - (b) Whether Mgt has represented that **no funds are received** by co. from any person ("**Funding Parties**") with understanding that co. shall invest in other persons **on behalf of Funding Party** ("**Ultimate Beneficiaries**")
 - (c) Nothing has come to auditor's notice that **representations** under above clauses **contain MM**
 - (v) Whether **dividend** declared/paid is **as per section 123**
 - (vi) Whether co. has used **a/cing software** for maintaining BOA having feature of **recording audit trail** & same was **operated throughout year** for all transactions & that it was **not tampered** & is preserved by co.
 - (vii) Statement as to whether **remuneration paid to directors** is as per this Act

Duty to report on frauds – Section 143 (12)

- **Reporting to CG** - If auditor has **reason to believe** that fraud involving **individually** amount of **Rs 1 crore or more**, was committed in co. by its **officers or employees**, he shall report to CG as below
 - (a) Auditor shall report to **Board** or Audit Committee **immediately** but **not later than 2 days** of his knowledge of fraud, seeking their **reply within 45 days**
 - (b) On receipt of such reply, he shall forward his report & reply along with his comments on such reply **to CG within 15 days from receipt of reply**
 - (c) If auditor **fails to get any reply** Board or Audit Committee within 45 days, he shall forward his **report to CG** with note containing details of his report that was earlier forwarded to Board or Audit Committee for which he has not received reply
 - (d) Report shall be sent **to Secretary, Ministry of Corporate Affairs** in **sealed cover** by Registered Post with Acknowledgement Due or by Speed Post **followed by e-mail** confirming same
 - (e) Report shall be **on letter-head of auditor** containing address, e-mail & contact number & be signed by auditor with his seal & indicating his **Membership Number** &
 - (f) Report shall be in **Form ADT-4**
- **Reporting to Audit Committee or Board** - If fraud involves **less than Rs 1 crore**, then auditor shall report matter to audit committee or Board **immediately but not later than 2 days** of his knowledge of fraud specifying - **Nature** of Fraud with description, Approximate **amount** involved & **Parties** involved
- **Disclosure in Board's Report** - Co. whose auditors have **reported frauds** to audit committee or Board, but **not to CG** (i.e. <1crore), shall disclose details in Board's report - **Nature** of Fraud with description, Approximate **Amount** involved, **Parties** involved (if remedial **action not taken**) & Remedial **actions taken**
- **Confidentiality** shall **not** be regarded as **contravened** by reason of fraud reporting by auditor if it is done **in good faith**
- **Fraud reporting** shall also apply, mutatis mutandis, to **cost auditor & secretarial auditor** If any auditor does **not comply** with Section 143(12), he shall be liable to **penalty of Rs 5 lakh in case of listed co. & Rs. 1 lakh in case of other co.**
- Auditor is also required to **report fraud** under **clause (xi) of CARO, 2020**

Duty to state reason for qualification in report - Where any matters required to be included in report is **answered in negative or with qualification**, report shall **state reasons**



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Risk Assessment & Internal Control

Risk Assessment

Audit risk is risk of expressing **inappropriate** audit **opinion** on **FS** that are **materially misstated**

Audit Risk has 2 Components

1. **ROMM** - Risk that **MM** may **exist** in **FS** **before** start of **audit**. It has **2 components** -
 - **Inherent Risk** - **Susceptibility** of assertion to **misstatement** that could be **material**, individually or when aggregated, **assuming** that there are **no related controls**

Risks of particular concern to auditor include -

- **Technological developments** making product obsolete
- **Declining industry** with business failures
- **Lack of sufficient working capital**
- High value **inventory**
- **A/cing estimates** having significant measurement **uncertainty**
- **Complex calculation** might be misstated
- **Control Risk** - Risk that **ICS** will **not prevent or detect & correct**, **misstatement** that could be **material**, individually or when aggregated. Some **control risk will always exist** due to inherent limitations of ICS
- 2. **Detection Risk** - Risk that **auditor** will **not detect misstatement** that could be **material**, individually or when aggregated. Detection risk bears **inverse relationship** to **ROMM**

Audit Risk = ROMM X Detection Risk
Audit Risk = Inherent X Control X Detection Risk

Objective of audit is to **reduce audit risk** to **acceptably low level**

Materiality & Audit Risk

Materiality is **inversely related** with Audit Risk
 They are **considered throughout audit**

Steps for Risk Identification

- Assess **significance of risk & its impact**
- Document **assertions effected**
- Consider **impact** of risk on **each assertion**
- Consider **unique characteristics** of risk
- Identify **significant risks** requiring separate attention & response by auditor
- Determine **likelihood** for risk to **occur** & its **impact** on procedures
- Enquire & document **Mgt's response**
- Consider **nature of ICS** in place & its **effectiveness** in mitigating risks
- Consider **existence** of particular characteristics (**inherent risks**) that need to be addressed in designing FAP

Indicators of Possible Potential Misstatements

- Recording - Inaccurate -
 - Capturing of Source docs
 - Processing of transactions
 - Adjustments in subsidiary ledgers
- Existence -
 - Fictitious / unauthorised / duplicated transactions entered
 - Source docs overstated/duplicated
- Completeness -
 - Transactions not identified
 - Source docs not prepared/captured
- Cut-Off - Transactions occurring in a period are recorded in another period

Risk-based Audit Approach

This approach **analyses audit risks**, sets **materiality** thresholds based on audit risk analysis & develops **audit programmes** allocating larger portion of resources to **high-risk areas**

Steps for Risk Based Audit

- **Risk Assessment** - Assessing ROMM in FS
- **Risk Response** - Designing & performing FAP that respond to assessed risks
- **Reporting** - Issuing appropriate report based on findings

<p>Risk Assessment Steps</p> <ul style="list-style-type: none"> • Performing client acceptance procedures • Planning overall engagement • Performing RAP to understand business • Assessing ROMM in FS • Making informed assessment of ROMM • Identifying significant risks that require special audit consideration • Identifying IC & assessing design & implementation • Communicating material weaknesses in design & implementation of IC to Mgt & TCWG 	<p>Risk response - Matters to consider -</p> <ul style="list-style-type: none"> • Need to perform FAP to address Mgt override of controls • Need to perform specific procedures to address "significant risks" • Existence of IC that could reduce need for substantive procedures • Assertions that cannot be addressed by substantive procedures alone • Need to incorporate element of unpredictability in procedures • Substantive AP that could reduce need for other procedures
<p><u>Internal Control System (ICS)</u></p>	
<ul style="list-style-type: none"> • ICS means all policies & procedures adopted by entity to assist in achieving its objective of ensuring orderly & efficient conduct of its business, including <ul style="list-style-type: none"> ○ Adherence to Mgt policies ○ Safeguarding of assets ○ Accuracy & completeness of records ○ Timely preparation of reliable financial info ○ Prevention & detection of fraud & error <p><u>When obtaining evidence about effective operation of IC, Auditor considers -</u></p> <ul style="list-style-type: none"> • How they were applied • Consistency with which they were applied • By whom they were applied 	<p>Objectives of ICS for A/cing System are</p> <ul style="list-style-type: none"> • All transactions are promptly recorded to permit preparation of financial info • Transactions are executed through Mgt authorization • Assets are verified at reasonable intervals & appropriate action is taken for discrepancies • Assets are safeguarded from unauthorized access, use or disposition <p>Basic objectives of a/cing control system are</p> <ul style="list-style-type: none"> • Ensure All transactions are - Real, Recorded, Properly Valued, Recorded Timely, Properly Classified & Disclosed, Properly Posted & Properly Summarized • If reply to all above answer is positive, auditor is justified to limit his a/c balance tests
<p>Limitations of IC - IC can provide entity with only reasonable assurance due to -</p> <ul style="list-style-type: none"> • Potential for human error due to carelessness & misunderstanding of instructions • Possibility of circumvention of IC through collusion with employees or external parties • Possibility that person responsible for IC could abuse that responsibility • Fact that most IC are not directed at transactions of unusual nature • Manipulations by Mgt for transactions & judgements in preparation of FS 	<p>ICS comprises Administrative Control & A/cing Controls. Internal Checks & Internal Audit are important constituents of A/cing Controls</p> <ol style="list-style-type: none"> 1. Internal Check System (SOD) - Objectives- <ul style="list-style-type: none"> • To protect integrity of business by proper scrutiny & check • To increase efficiency of staff • To avoid & minimize errors & fraud • To prevent & avoid misappropriation of cash & falsification of a/c • To detect error & frauds with ease • To locate responsibility area where actual fraud & error occurs

<ul style="list-style-type: none"> Mgt's consideration that cost of IC does not exceed expected benefits <p>Structure of IC - Control policies & procedures -</p> <ul style="list-style-type: none"> Authorization of Transaction SOD - Transaction processing is allocated to diff persons so that no 1 person can complete transaction from start to finish or work of 1 person is made complimentary to work of another person. Following is segregated - <ul style="list-style-type: none"> Execution of transactions Authorization of transactions Maintenance of records & docs Physical custody of assets Rotation of duties of personnel is also desirable Independent Checks Adequacy of Records & Docs - A/cing controls should ensure that - <ul style="list-style-type: none"> Transactions are promptly recorded at correct amounts Transactions are executed as per Mgt's authorization Records of assets & its location should be maintained to physically verify them periodically Assets should be protected from unauthorized access, use or disposition Transactions should be classified in appropriate a/c & period Recording of transaction should facilitate maintaining accountability for assets Transaction should be recorded to facilitate preparation of FS as per AFRF Accountability & Safeguarding of Assets 	<p><u>Effectiveness of efficient system of internal check depends on following -</u></p> <ul style="list-style-type: none"> Division of Work - SODs Standardization Clarity of Responsibility Appraisal <p>General condition pertaining to internal check -</p> <ul style="list-style-type: none"> No single person should have complete control over important aspect of business Every employee's action should come under review of another person Staff duties should be rotated so that they do not perform same function for long time Person having physical custody of assets must not be permitted to have access to BOA There should exist a/cing control for assets & there should be periodical inspection For inventory taking, trading should be suspended & it should be done by staff of diff sections of org Mechanical devices should be used to prevent loss of cash Every staff should be encouraged to go on leave at least once a year Budgetary control should be exercised & wide deviations should be reconciled Financial & admin powers should be distributed very judiciously among diff officers & should be reviewed periodically Procedures for periodical verification & testing of a/cing records should be there <p>2. Internal Audit - Refer Chapter on IA</p>
<p>Components of IC</p> <p>1. Control Environment - Elements -</p> <ul style="list-style-type: none"> Participation by TCWG Mgt's philosophy & operating style <u>Communication & enforcement of integrity & ethical values</u> - Effectiveness of controls cannot rise above integrity & ethical values of people who create & monitor them. Integrity & ethical behavior are product of entity's ethical & behavioral standards, how they are communicated, & how they are reinforced in practice. It includes Mgt actions to eliminate or mitigate incentives prompting 	<p>Techniques of evaluation of IC</p> <p>1. Questionnaire</p> <p>It is set of ques for evaluation of effectiveness of control & detection of weaknesses. It is to be filled by co. executives who are in charge of various areas. However, It may take long time to be filled & there is possibility of questionnaire being misplaced. Therefore, auditor arranges meetings with executives & gets answers filled by them. They are answered as 'Yes', 'No' or 'Not applicable'. "No" answer will reflect weakness</p>

<p>personnel to engage in dishonest, illegal, or unethical acts through policy statements & codes of conduct</p> <ul style="list-style-type: none"> • Commitment to competence • Organizational structure • Assignment of authority & responsibility • Human resource policies <p>2. Entity's RAP - includes - How Mgt -</p> <ul style="list-style-type: none"> • Identifies business risks • Estimates their significance • Assesses likelihood of their occurrence • Decides actions to respond to them <p>Risks can arise or change due to following -</p> <ul style="list-style-type: none"> • Rapid growth • Expanded foreign operations • New a/cing pronouncements • Changes in operating environment • Corporate restructurings • New business models, products, or activities • New personnel • New technology • New or revamped IS <p>3. Control Activities</p> <ul style="list-style-type: none"> • Performance reviews - Analyses of actual performance v/s budgets, forecasts, & prior period performance • Info processing - 2 types of IS control activities are - <ul style="list-style-type: none"> ○ <u>Application controls</u> - Apply to processing of individual applications. E.g. checking arithmetical accuracy of records, reviewing a/c balances, edit checks, numerical sequence checks, follow-up of exception reports ○ <u>General IT-controls</u> - Policies & procedures that relate to many applications & supports effective functioning of application controls. E.g. program change controls, restricting access to data, controls over implementation of new packaged software & system software restricting access to system utilities • Physical controls - includes - <ul style="list-style-type: none"> ○ Physical security of assets ○ Authorization for access to data ○ Periodic counting & comparison with amounts in records 	<p><u>Basic assumptions about elements of good control in IC questionnaire are -</u></p> <ul style="list-style-type: none"> • Orgs permitting extensive division of responsibilities • Employees of a/cing function are not assigned any custodial function • No single person has responsibility of completing transaction all by himself • Work performed by 1 person comes under review of another in routine • There should always be evidence to identify person who has done work • Certain procedures used by most businesses are essential in achieving reliable IC. This is time-tested assumption • There is proper documentation & recording of transactions • For 1st year of audit, issue of questionnaire is necessary. For subsequent years, auditor may request client to confirm whether there is any change in ICS. However, auditor may issue questionnaire irrespective of any change every 3rd year <p>2. Check List</p> <p>It is series of instructions or ques on IC which auditor must follow or answer. When instruction is performed, auditor initials space opposite instruction. If it is ques, answer 'Yes', 'No' or 'Not Applicable' is entered opposite ques</p> <p><u>E.g. of Check List</u> - Has Auditor checked that cashier -</p> <ul style="list-style-type: none"> • Is not responsible for opening mails • Does not authorise ledgers • Does not authorise expenditure or receipt • Does not sign cheques • Takes his annual leave regularly • Balances cash book everyday • Verifies physical cash balance with book figure daily • Prepares monthly bank reconciliations • Holds no other funds or investment • Holds no unnecessary balance in hand • Does not pay money without looking into compliance with authorization • Has provided proper security or executed fidelity bond
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<ul style="list-style-type: none"> • SODs <p>4. Info System for FR & Communication - includes methods & records that -</p> <ul style="list-style-type: none"> • Identify & record all transactions • Measure value of transactions for recording proper monetary value in FS • Determine time period in which transactions occurred for recording in proper a/cing period • Describe transactions in detail to permit proper classification for FR • Present properly transactions & disclosures in FS <p>5. Monitoring of Controls - considering whether controls are operating as intended & that they are modified as appropriate for changes in conditions</p> <p>Review of ICS - Enables Auditor -</p> <ul style="list-style-type: none"> • To locate areas of weakness in system so that procedures can be adjusted to meet situation • To formulate his opinion for reliance to place on system itself • If auditor is already aware of IC, he may just review changes in intervening period. However, comprehensive review in such cases must be made at interval of 3 years • Review of IC is to be done before finalisation of audit programme. However, if size of operations is small, review can be done with other audit procedures as well <p><u>Revision in Audit Programme is needed when -</u></p> <ul style="list-style-type: none"> • Any change in ICS in IC questionnaire • Any further weakness noted in IC • Any instance where system is not followed 	<p>Diff b/w Questionnaire & Check list</p> <ul style="list-style-type: none"> • Questionnaire contains large number of detailed ques but check list contains ques for main control objective under review • In Questionnaire, ques are answered by co. executives. In check list, same are answered by auditor/auditor staff • 'No' in Questionnaire indicates weakness but not its significance. In check list, specific statement is required if weakness is material <p>3. Flow chart</p> <p>It is graphic presentation of IC & is drawn to show controls in each section. It provides most concise & comprehensive way for reviewing IC. It gives bird's eye view of system. It is most effective way of presenting state of IC</p> <p><u>Flow chart can provide neat picture of activities of dept involving flow of docs & activities. It shows -</u></p> <ul style="list-style-type: none"> • At what point document is raised internally or received from external sources • Number of copies in which document is raised or received • Intermediate stages through which document pass • Distribution of docs to various sections • Checking authorization & matching at stages • Filing of docs • Final disposal by sending or destruction <p><u>For drawing flow chart to incorporate narration, it is useful to know -</u></p> <ul style="list-style-type: none"> • Point for originating flow of transaction • Docs & flow of transaction, number of copies, distribution • Books maintained & details & its sources • There exists alternative possibility
<p>IC Assessment & Evaluation - Key components to assess & evaluate control environment /Standard Operating Procedures (SOPs) elements -</p> <ul style="list-style-type: none"> • Enterprise Risk Mgt • Info Technology based Controls • Segregation of Job Responsibilities - SODs • Job Rotation in Sensitive Areas • Delegation of Financial Powers Document 	<p>Reporting to Client on IC Material Weaknesses through letter of weakness or Mgt letter -</p> <ul style="list-style-type: none"> • Letter lists down area of weaknesses & offers suggestions for improvement • This letter serves as valuable reference document for Mgt for purpose of revising system & its strict implementation • Letter serves to minimize legal liability in case of major loss from weakness in IC

	<ul style="list-style-type: none"> • Indicate that it discusses only weaknesses which have come to attention of auditor & his audit does not determine adequacy of IC • By writing above letter, auditor is not relieved from reporting weaknesses by qualifications if defects are not corrected to his satisfaction considering materiality of weaknesses
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International IC Frameworks

<p>Integrated Framework issued by Committee of Sponsoring Organizations of Treadway Commission (COSO Framework)</p> <ul style="list-style-type: none"> • It includes 17 principles with 5 components - control environment, risk assessment, control activities, info & communication, & monitoring • It lists 3 categories of objectives - <ul style="list-style-type: none"> ○ Reporting Objectives - related to internal & external reporting to stakeholders ○ Operations Objectives - related to effectiveness & efficiency of operations & safeguarding assets against loss ○ Compliance objectives - relating to compliance with applicable L&R • Limitations of IC - Framework acknowledges limitations of IC 	<p>Sarbanes-Oxley Act - Section 404 (USA) It mandates that all publicly-traded co. must establish IC & must document, test those controls to ensure their effectiveness. It was followed up with constitution of PCAOB. SEC rules & PCAOB standard require that -</p> <ul style="list-style-type: none"> • Mgt perform assessment of IC over FR including testing design & operating effectiveness of controls • Mgt include in annual report, assessment of IC over FR • External auditors provide 2 opinions as part of single audit of co. - <ul style="list-style-type: none"> ○ Independent opinion on effectiveness of IC over FR ○ Traditional opinion on FS
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<p>Guidance on Assessing Control published by Canadian Institute of CAs (CoCo) Criteria of Control (CoCo) has objective of improving organisational performance & decision making with better controls, risk mgt & corporate governance. It includes 20 criteria for effective control in 4 areas -</p> <ul style="list-style-type: none"> • Purpose (direction) • Commitment (identity & values) • Capability (competence) • Monitoring & Learning (evolution) 	<p>Guidance for Directors on Combined Code, published by Institute of CAs in England & Wales (known as Turnbull Report) - Key principles are -</p> <ul style="list-style-type: none"> • Board should maintain ICS to safeguard shareholders' investment & co.'s assets • Directors should, at least annually, conduct review of effectiveness of ICS & report to shareholders that they have done so. Review should cover all controls • Co. not having IAF should, from time to time, review need for having IAF
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<p>Control Objectives for Information and Related Technology (COBIT) It is created by ISACA (Info Systems Audit & Control Association) for IT governance & Mgt. COBIT has 34 high-level processes covering 210 control objectives categorized in 4 domains - Planning & organization, Acquisition & Implementation, Delivery & Support & Monitoring & Evaluation</p>
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Internal Audit (IA)

<p>IA provides independent assurance on effectiveness of IC & risk mgt processes to enhance governance & achieve organizational objectives. It is not confined to financial transactions only & include review of operational activities as well</p> <p><u>Objectives & Scope of IAF as per SA 610 include</u></p> <ul style="list-style-type: none"> • Governance • Risk mgt • Examination of financial & operating info • Review of operating activities • Monitoring of IC • Review of compliance with L&R - not managing compliance & engaging with regulators <p>Who can be Appointed as IA?</p> <ul style="list-style-type: none"> • Either CA or CMA (whether in practice or not) or other professional as decided by Board • May or may not be employee of co. • IA must have authority to investigate every organizational activity 	<p>Applicability - As per section 138 of Co. Act, 2013, following co. are required to appoint IA -</p> <ul style="list-style-type: none"> • Every listed co. • Every unlisted public co. having - <ul style="list-style-type: none"> ○ O/s deposits of Rs. 25 crores or more at any point of time during preceding FY ○ Paid up share capital of Rs. 50 crores or more during preceding FY or ○ Outstanding borrowings from banks or public financial institutions exceeding Rs. 100 crores at any point of time during preceding FY or ○ Turnover of Rs. 200 crores or more during preceding FY or • Every private co. having - <ul style="list-style-type: none"> ○ Outstanding borrowings from banks or public financial institutions exceeding Rs. 100 crores at any point of time during preceding FY ○ Turnover of Rs. 200 crores or more during preceding FY or <p>If existing co. fulfils any criteria, it shall comply within 6 months of applicability</p>
<p>As per SIA 210, Activities performed by IAF to achieve its objectives are</p> <ul style="list-style-type: none"> • Define plan, scope & methodology of IAF • Plan, acquire & review performance & training of professional staff • Identify, engage & manage external experts • Oversee & monitor audits, their proper planning, execution & reporting • Develop & maintain quality evaluation & improvement program • Communicate with all key stakeholders regarding achievement of objectives 	<p>For A/cing function, IA responsibilities include</p> <ul style="list-style-type: none"> • At all times, IA must enjoy independent status • Not to involve in performance of executive functions to protect objective outlook • To operate independently of a/cing staff • To ascertain adequacy of ICS & provide safeguards for misappropriation of assets • To observe facts & bring them to notice of authorities who would never know them • To associate closely with mgt & keep knowledge up to date for important events
<p>Mgt Functions</p> <ul style="list-style-type: none"> • In case of Co. covered u/s 138 - Audit Committee or Board, with Mgt & Chief of IA, is responsible to formulate objectives of IA • In case of other Co. - those who appoint IA are responsible for same 	<p>Scope of IA's work includes review of</p> <ul style="list-style-type: none"> • ICS & Procedures <ul style="list-style-type: none"> ○ Assessing design & operational efficiency & effectiveness of ICS ○ Considering limitations of IC

Approach to Prepare IA Plan

IA should, with **TCWG**, including **audit committee**, develop plan for **each IA engagement**

IA plan should cover both financial & operational activities considering -

- **Effort involved** in IA for particular process
- Coverage of **all auditable areas** within time
- **Risk** underlying business process
- **Risk Appetite** of org
- **Value** that IA can provide to org

Integrity, Objectivity & Independence of IA

1. Integrity - IA shall be **honest, truthful** & have high integrity. He shall be **fair** in all his **dealings** & **avoid all conflicts** of interest & not derive personal benefit from his position
2. Objectivity - IA shall conduct his work in **highly objective manner**. He shall **not allow bias** to override his objectivity
3. Independence - IA shall be **free from** any undue **influences**. Independence shall be **both in mind & in appearance**. Chief IA must administratively **report to CEO/MD/CFO**

Quality of IA - Specialised Knowledge & Expertise

- Special expertise to **evaluate mgt control systems**
- **Understanding** of **mgt techniques** & ability to deal with **people**
- IA must **provide assurance** to mgt that **confidentiality** will be maintained
- **A/cing & financial expertise** for his duties
- **Understanding** of **a/cing software**, ERP used by org with knowledge of IT controls
- **Evaluate both financial & operational controls** having good knowledge of operations of org
- Good knowledge of **commerce, laws, taxation, costing, economics, quantitative methods & EDP systems**

Steps while Performing IA

1. **Obtain knowledge of Business** - Conduct **meetings with BOD & Key mgt** to obtain understanding of business docs, **IT IS & Regulatory** landscape
2. **Perform Audit Planning**
 - Audit **scope** must be **approved** by Audit **Committee & BOD**

- **Custodianship & Safeguarding of Assets**

- Review control for **intangible assets**
- Verifying **existence** of assets
- Ensuring **all assets** are **fully accounted**
- Review **SODs**

- **Compliance with Policies & Regulations**

- **Org Structure** - To ascertain if it is in **line with objectives** of entity -

- Examine **org chart** to find out if it is **simple & economical**
- Review **manner** in which **activities** of entity **are grouped** for managerial control
- Examine **reasonableness of span of control** of each executive
- Where **dual responsibilities** cannot be avoided, **primary** one should be specified
- See that **responsibilities** of managerial staff at **headquarters do not overlap** with chief executives at **operating units**
- Review **adequate SODs** is considered in org structure
- Finally, evaluate process of **managerial development** in entity

- **Relevance & Reliability of Info**

- **Accomplishment of Goals & Objectives**

- **Utilisation of Resources**

- Check if **proper operating standards** are established
- Review **methods** of **establishing operating standards**
- They should be **detailed** enough & personnel should be able to **evaluate their performance**
- Where there is **wide divergence** b/w actual performance & standards, **reasons** are considered

IA Report

If IA knows actual or suspected **fraud or misappropriation of assets**, he should bring same **immediately to attention of mgt**

Reporting of IA has 2 stages -

- At **end** of particular **audit**, Report covering specific part of entity is prepared by IA

<ul style="list-style-type: none"> Once approved, IA must share detailed Audit Plan with KMP Conduct opening meeting with key stakeholders before start of audit & share IS Access required to perform audit Detailed plan must be prepared by manager & approved by Head of IA/Chief IA <p>3. Gather required info</p> <ul style="list-style-type: none"> Perform checks to ensure correctness & integrity of info received <p>4. Perform audit checks - AP, Sampling, Audit Evidence, Documentation</p> <p>5. Reporting of IA Issues</p> <ul style="list-style-type: none"> Prepare draft report of IA issues. Mgt Action Plan should be agreed with timelines Review actions taken by mgt as agreed during previous audits Circulate Final Report & present his findings to Audit Committee 	<p>highlighting key observations. It is also shared with local & executive mgt, as agreed</p> <ul style="list-style-type: none"> On periodic basis (normally quarterly), at close of plan period, comprehensive report of all IA activities covering entity is prepared by Chief IA & submitted to highest governing authority responsible for IA, generally Audit Committee SIA deals with only 1st type of reports <p>Key Elements of IA Report</p> <ul style="list-style-type: none"> Overview of objectives, scope & approach of audit Fact that IA is conducted as per SIA Nature of assurance from observations Executive summary of key observations covering all important aspects Summary of corrective actions required <p>No IA report shall be issued in final form unless written draft of report was previously shared with auditee</p>
<p>Content & Format of IA Report include</p> <ul style="list-style-type: none"> Audit Scope performed Audit Period Covered Executive Summary Summary of critical findings Detailed audit findings with elaboration on business impact & its root cause Rating of issues (high/low) as per rating criteria approved by Audit Committee Audit recommendation to improve control environment & address finding Response received from responsible authority containing action plan <p>Documentation</p> <ul style="list-style-type: none"> Copies of draft & final IA reports, cross referenced to specific observations Mgt action plans may be counter signed by respective mgt personnel 	<p>Follow-up</p> <p>Chief IA is responsible for monitoring closure of prior audit issues through implementation of action plans, in form of "Action Taken Report of previous audits" which includes -</p> <ul style="list-style-type: none"> Reference to previous audit reporting containing issues Any critical audit finding that require immediate action Implementation of Action agreed by Mgt with date Status of action taken by Mgt Residual risk & rating for unimplemented action Audit findings not implemented for long period <ul style="list-style-type: none"> If no follow-up action is taken by Mgt within reasonable time, IA should draw mgt's attention to it & ascertain reasons If mgt has accepted his recommendations & initiated action, he should periodically review implementation of recommendations & highlight recommendations which are not implemented fully or partly

Basis	Internal Audit	External Audit
Users of Report	Top Mgt & EA	Stakeholders
Reporting	Weakness in IC & effectiveness of operational activities	Truthfulness & fairness of FS
Examination	Adequacy of operational controls of Org	Accuracy & Validity of FS
Performed by	Independent IAF within org or by external body	Independent body which is not part of org
Appointment	By Audit Committee or BOD	By Members
Status of Auditor	Can be employee of Co.	Mandatorily not employee of Co.

<p>Relationship B/w IA & EA</p> <ul style="list-style-type: none"> • IA is statutory requirement u/s 138 of Co. Act • Scope & objective of IA are dependent upon size & structure of entity. There is lot of overlap b/w work of IA & EA • Work done by IA has important bearing on work performed by EA • It is obligatory for EA to examine scope & effectiveness of IA's work • Independence of IA is important factor for determining effectiveness of his audit • EA should evaluate IAF to extent it is relevant in determining NTE of procedures 	<p>If EA uses IA to Provide Direct Assistance, EA shall include in Audit Documentation</p> <ul style="list-style-type: none"> • Written agreements from authorized representative of entity & IAs • Evaluation of existence & significance of threats to objectivity & competence of IAs • Basis for decision for nature & extent of work performed by IAs • Who reviewed work performed & date & extent of review • Working papers of IAs who provided direct assistance on audit
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<p>Audit Trail Audit Trail (or Edit Log) is visible trail of evidence to trace info contained in reports back to original input source. They are chronological record of changes made to data</p> <p>Records maintained as audit trail may include</p> <ul style="list-style-type: none"> • When changes were made i.e., date & time • Who made change i.e., User Id • What data was changed i.e., reference <p>Audit Trail includes IC to ensure that</p> <ul style="list-style-type: none"> • Audit trail feature is not disabled or deactivated • Access to audit trail is disabled or restricted & access logs are maintained • User IDs are assigned to each individual & that is not shared • Changes to configurations of audit trail are authorized & logs of changes are maintained • Periodic backups of audit trails are taken & archived as per statutory period 	<p>Factors responsible for high employee attrition rate are</p> <ul style="list-style-type: none"> • Unbearable behaviour of Senior Staff • Job Stress & work life imbalance • Wrong policies of Mgt • Limited opportunities for promotion • Low monetary benefits • Lack of labour welfare schemes • Safety factors
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Group Audits

CFS Mandatory under Co. Act, 2013

- As per Section **129(3)**, if co. has **subsidiaries, associates & joint ventures**, it shall prepare **CFS**. Preparation, adoption & audit of Parent's FS shall, **mutatis mutandis, apply to CFS**
- CFS shall be **approved by BOD** & laid before **AGM** with standalone FS along with **statement** containing salient **features of Subsidiaries** FS in Form **AOC-1**
- CFS shall be prepared as per Schedule III & A/cing Standards. However, co. **not required** to prepare **CFS** under **A/cing Standards**, shall comply with **Schedule III**

Exemptions from Preparing CFS

Auditor shall **satisfy** that **exclusion** falls within below **categories**. He shall verify that **reasons** for exclusion are **given in CFS**. If entity is **excluded** from CFS for **reasons other** than those allowed by AFRF, consider its **effect on report**

1. **As per Ind As 110, Investment entity** need not present CFS if it **measures all** subsidiaries at **FVTPL**. Investment entity -
 - **Obtains** funds from investors for providing **investment mgt services**
 - **Commits** to its investors that it **invest funds solely** for returns from **capital appreciation, investment income, or both &**
 - **Measures** performance of **substantially all** of its investments on **FV basis**
 - However, **Parent** of investment entity shall **consolidate all entities** that it controls (including through investment entity), **unless parent itself is investment entity**
2. **As per AS 21, 2 reasons** for exclusion -
 - **Relationship** is intended to be **temporary** (If intention exists on **date of acquisition**)
 - Component operate under **severe long-term restriction** which significantly **impair** its **ability to transfer funds** to parent
3. **As per Co. Act**, following co. is exempted -
 - It is wholly or partially-owned **subsidiary** & all its **other members**, including not entitled to vote, are **intimated in writing** & proof of delivery of intimation is available with co., **do not object** to co. not presenting CFS &

Responsibility of Parent/Holding Co. for CFS

- **Identifying components** & its financial info
- **Identifying RP** & RP transactions for reporting
- Obtaining **accurate & complete** financial info from components
- **Identifying segments** for segmental reporting
- Making appropriate **consolidation adjustments**
- **Harmonization** of **a/cing policies** & framework
- **GAAP conversion**

Mgt Representations (WR)

- **Completeness** of **components** included in CFS
- **Identification** of **RP** & RP transactions
- **Appropriateness & completeness** of permanent & current period **consolidation adjustments**
- **Identification** of reportable **segments**
- **Parent** acknowledges its **responsibility** for true & fair **presentation of CFS** as per AFRF
- Parent mgt has **approved CFS**

Responsibility/Objectives of Auditor of CFS

- He should **validate requirement** of preparation of **CFS** as per AFRF
- To **satisfy** that **CFS** are prepared **as per AFRF**
- To **enable** himself to express **opinion** on **true & fair** view of CFS
- To **enquire** into matters specified u/s **143(1)**
- To **report** on matters u/s **143(3) & rule 11**

For Materiality for CFS, auditor should consider

- Computing **materiality for group** as whole which shall be used to **assess** appropriateness of consolidation **adjustments**
- Computing **materiality** for each **component & communicating** to **component auditor** for true & fair view on CFS
- Using materiality for group level to determine **if component's FS are material** to group
- Obtaining **confirmations** from **component auditors** like independence & disclosures
- While considering **modifications** of **component auditor** in his report on standalone FS, parent

<ul style="list-style-type: none"> Co. securities are not listed or are not in process of listing, in or outside India & Its ultimate or any intermediate holding co. files CFS with Registrar <p>E.g. Co. purchases >50% stake in subsidiary & sells its stake in next year</p> <ul style="list-style-type: none"> If AS Co. - Then it is not required to prepare CFS as per AS 21, but required to give disclosures as per Schedule III If Ind As Co - Required to make CFS as per Ind As 110 which states "Consolidation of investee shall begin from date investor obtains control & cease when he loses control" Assume Ind As Co. if not given in Ques 	<p>auditor should comply with SA 600 considering materiality</p> <p>De facto control</p> <ul style="list-style-type: none"> It means investor with less than majority voting rights has practical ability to direct relevant activities unilaterally (E.g. Control over composition of BOD) If there is De facto control then auditor shall verify Parent's assessment of having control in component & how it controls composition of BOD. He shall also verify Board's minutes, shareholder agreements of parent, agreements with component of parent providing any technology or know how, enforcement of statute etc.
<p>To check completeness of all components included in CFS, auditor should</p> <ul style="list-style-type: none"> Review his working papers for prior years for known components Identify changes in shareholding during reporting period Make Mgt inquiries to identify new components or component leaving CFS Review parent's procedures for identification of components Review investments of parent & its components for shareholding in other entities Review joint ventures & joint arrangements Review other arrangements of parent not included in CFS Review statutory records of parent <p>Diff Reporting Periods</p> <ul style="list-style-type: none"> FS of component shall be of same reporting date as of parent. If not practicable, adjustments shall be made for transactions occurring b/w Components & Parent's FS date Diff b/w reporting dates shall not be more than 6 months for AS & 3 months for Ind As In case of changes in reporting periods of components having material effect on CFS, auditor shall ensure that entity discloses changes & manner of treatment in CFS 	<p>Consolidation Methods</p> <ul style="list-style-type: none"> As per AS - FS of parent & its subsidiaries are combined on line-by-line basis by adding items of assets, liabilities, income, expenses & cash flows & then calculations of goodwill or capital reserve, NCI & consolidation adjustments are made as per AS 21. Investments in associates is reported using Equity Method as per AS 23. Jointly controlled entity using proportionate consolidation method as per AS 27 As per Ind As <ul style="list-style-type: none"> FS of parent & its subsidiaries are combined as per Ind AS 110 on line-by-line basis by adding items of assets, liabilities, income, expenses & cash flows Goodwill/Capital Reserve & NCI is determined as per Ind AS 103 Business combinations under common control is accounted using pooling of interest method as per Ind AS 103 Consolidation Adjustments are made as per Ind AS 110 Investment in associate & joint venture is reported using Equity Method (Ind As 28) Interests in joint operation is reported as part of SFS of entity as per Ind AS 111 For business combination in stages, acquirer shall remeasure its previously held equity interest in acquiree at acquisition-date FV & recognise result in P/L or OCI as per Ind AS 103

<p>Permanent Consolidation Adjustments Those adjustments that are made only on 1st occasion or subsequently when there is change in shareholding of entity. They are -</p> <ul style="list-style-type: none"> • Determination of goodwill or capital reserve - Goodwill of 1 subsidiary can be netted off with capital reserve of another subsidiary if permitted by AFRF. Auditor shall verify that gross amounts of goodwill & capital reserves are disclosed in notes to CFS • Determination of amount of equity attributable to minority/NCI <p>Procedures for Above - Auditor shall</p> <ul style="list-style-type: none"> • Verify that calculations are appropriate • He shall pay attention to determination of pre-acquisition reserves of components • He shall examine whether pre-acquisition reserves are allocated appropriately b/w parent & minority/NCI • He shall verify changes in these adjustments due to subsequent acquisition/disposal of shares in components 	<p>Current Period Consolidation Adjustments Those adjustments that are made in a/cing period for which consolidation is done. They relate to elimination of intra-group transactions including -</p> <ul style="list-style-type: none"> • Intra-group interest paid & received etc • Intra-group indebtedness • Unrealised intra-group profits on assets acquired from/to subsidiaries • Record deferred taxes on profits elimination • Adjustments of deferred tax due to temporary diff from intragroup transactions • Adjustment for harmonising diff a/c policy • For foreign component, adjustments to convert component's FS to GAAP of CFS • Adjustments for subsequent events - For Non-adjusting events, FS shall disclose - <ul style="list-style-type: none"> ○ Nature of event ○ Estimate of financial effect or statement that such estimate cannot be made • Adjustments for effects of events occurring b/w Components FS date & date of report on CFS when Reporting Dates are diff • Determination of movement in equity attributable to NCI since date of acquisition of subsidiary - this can be negative as well
<p>Adjustments for CFS are made in memorandum records kept by parent, which are reviewed by auditor. Apart from this, auditor shall</p> <ul style="list-style-type: none"> • Verify intra group transactions are eliminated • Verify adjustments for deferred tax • Verify CFS is prepared using uniform a/cing policy • Verify adjustments made to harmonise diff a/cing policies including conversion of GAAP • Verify that adequate disclosures are made as per AS 21 in CFS of application of diff a/cing policies if it was impracticable to harmonize them but not allowed as per Ind AS 110 • Verify calculation of minorities/NCI • Verify that income & expenses of subsidiary are included in CFS from date it gains control until date when entity ceases control 	<p>Disclosures in CFS CFS shall not merely repeat disclosures from separate FS. It need to give disclosures relevant to CFS only</p> <p><u>Following info is required to be disclosed in CFS separately for parent & each of its components -</u></p> <ul style="list-style-type: none"> • Amount of net assets & net assets as % of consolidated net assets • Amount of share in P/L & % share in P/L as % of consolidated P/L • Amount in OCI & as % of Consolidated OCI <p>Following disclosures given in separate FS of parent/subsidiary, need not be included in CFS</p> <ul style="list-style-type: none"> • Disclosure required under MSME Act • Source of bonus shares • Unutilised money from issue & if invested • Statement of investments • Expenses in foreign currency for royalty, know-how, professional fees & others

<p>While Auditing CFS, Auditor make plans for</p> <ul style="list-style-type: none"> • Understanding group structure & group-wide controls • Understanding a/cing policies of parent & its components including consolidation process • Determining NTE of procedures based on ROMM • Determining extent of use of other auditor's work • Coordinating work to be performed 	<ul style="list-style-type: none"> • Value of import on CIF basis for raw material, component, spare part & capital goods • Value of imported & indigenous raw materials, spare parts & components consumed • Earnings in foreign currency classified as - <ul style="list-style-type: none"> ○ Export of goods on F.O.B. basis ○ Royalty, know-how, professional fees ○ Interest & dividend ○ Other income with nature • Amount remitted in foreign currency for dividends
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Reporting

<p>When Parent's Auditor is also Auditor of all its Components - He shall report -</p> <ul style="list-style-type: none"> • Whether principles for preparation & presentation of CFS as in AS are followed. If deviation, he shall consider SA 705 so that users of CFS are aware of such deviation • Auditor shall issue report expressing opinion whether CFS give true & fair view of state of affairs & of financial results of Group • Where CFS includes cash flow statement, he shall also give his opinion on true & fair view of cash flow statements 	<p>When Parent's Auditor is not Auditor of all its Components</p> <ul style="list-style-type: none"> • Auditor shall consider SA 600 • As per SA 706, if auditor makes reference to other auditors in Other Matter Para, report on CFS shall disclose magnitude of portion of FS audited by other auditors by stating aggregate rupee amounts or % of total assets, revenues & cash flows of components not audited by parent's auditor before giving effect to consolidation adjustments • Such Reference is not qualification of opinion but rather indication of divided responsibility b/w auditors of parent & its subsidiaries
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<p>When Components Auditor Reports on FS under A/cing Framework Diff than Parent's</p> <ul style="list-style-type: none"> • Parent perform conversion of components' FS from its framework to CFS's framework. Conversion adjustments are audited by principal auditor to ensure that financial info of components is suitable & appropriate • Component may alternatively prepare FS on basis of parent's a/cing policies, as in group a/cing manual which contains all a/cing policies & disclosure requirements, consistent with CFS's FRF • In above approach, parent auditors shall determine compliance of Group a/cing policies with Parent's GAAP to ensure that Component FS will be directly usable for CFS, eliminating need for auditing by auditor. Principal auditor can then decide whether to rely on components' report & refer it in report on CFS 	<p>When Components Auditor Reports under Auditing Framework Diff than Parent's</p> <ul style="list-style-type: none"> • Audits of FS, including CFS, are performed under auditing standards generally accepted in India (Indian GAAS) • To maintain consistency of auditing framework & for parent auditor to rely & refer to other auditor's report in his report on CFS, components' FS shall also be audited under framework in line with Indian GAAS <p>Components Not Audited</p> <ul style="list-style-type: none"> • Parent auditor shall consider unaudited components in evaluating possible modification to his report on CFS as auditor is not able to obtain SAE for such amounts/balances • He shall evaluate both qualitative & quantitative factors on possible effect of unaudited amounts as per SA 705
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CA Ankush Chirimar
AIR 5,6,32

*Free Revision
Videos &
Notes*

Brief about Author

- All India Ranker at all 3 levels of CA
- Scored 95 Marks in Audit - Highest marks in history of ICAI till Nov 23
- Articleship at KPMG, Mumbai in Statutory Audit Domain
- Industrial Training at DBS Bank

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PSU Audit

<ul style="list-style-type: none"> • Govt audit is performed by independent constitutional authority - Comptroller & Auditor General (C&AG), through Indian Audit & A/c Dept • Article 148 of Constitution - Appointment of C&AG by President. Removal of C&AG only on ground of proven misbehaviour/incapacity • Article 151 - Audit reports of C&AG on a/c of CG/SG shall be submitted to President/Governor of State who shall lay them before Parliament/State Legislative Assemblies • C&AG Act, 1971, prescribes that C&AG shall hold office for term of 6 years/upto age of 65 years, whichever is earlier. He can resign at through letter addressed to President • <u>C&AG audits below org</u> - <ul style="list-style-type: none"> ○ All CG & SG depts & offices ○ Public commercial org controlled by CG & SG ○ Non-commercial autonomous bodies & authorities owned/controlled by CG/SG ○ Authority substantially financed by CG/SG • <u>Audit of Govt Co. (Commercial Audit)</u> - Co. whose 51% or more equity is held by Govt is Govt Co & also includes subsidiary of Govt Co. • Their Auditors are appointed by C&AG, who gives directions for conducting audit & auditor shall submit report which include directions of C&AG, action taken & its impact on FS of co. • C&AG can also comment/supplement audit reports - which shall be treated in same manner as Audit Report. • He may also conduct supplementary audit (within 60 days of receiving audit reports) & test audit 	<p>Audit Boards constituted by Indian Audit & A/c Dept have no separate legal entity & work under control of C&AG</p> <p>Action on Audit Reports - Scrutiny of Annual A/c & Audit Reports will be done by below Committees (instead of Parliament) -</p> <ul style="list-style-type: none"> • <u>Public A/c Committee (PAC)</u> - Satisfy that - <ul style="list-style-type: none"> ○ Moneys were disbursed legally to which they were applied ○ Expenses was authorised ○ Re-appropriation is made as per provisions ○ It examine statement of a/c of autonomous & semi-autonomous bodies, whose audit is conducted by C&AG either under directions of President/by Parliament • <u>Estimates Committee</u> - Examine estimate to - <ul style="list-style-type: none"> ○ Examine if money is laid out within limit ○ Report what economies, improvements in org, efficiency may be affected ○ Suggest alternative policies ○ Suggest form to present estimates to Parliament ○ It does not comment on policy approved by Parliament, but if evidenced that particular policy is not leading to desired results/is waste, it shall bring it to notice of House • <u>Committee on Public Undertakings (COPU)</u> - It exercises same control on PSU as PAC exercises over Govt depts. Functions are to - <ul style="list-style-type: none"> ○ Examine autonomy & efficiency of PSU ○ Examine reports & a/cs of PSU ○ Examine reports of C&AG on PSUs ○ Exercise functions of PAC & Estimates Committee as not covered above
<p>C&AG's Role as 'friend, philosopher & guide' -</p> <ul style="list-style-type: none"> • His Reports form basis of Committees' working, though they are not prohibited from examining issues not in his Reports • He scrutinises notes which Ministries submit to Committees 	<p>Basic Elements of PSU Audits</p> <p>1. 3 parties</p> <ul style="list-style-type: none"> • <u>Auditor</u> - Supreme Audit Institution (SAI) - C&AG & Indian Audit & A/c Dept. Seniors

<ul style="list-style-type: none"> Financial Committees present Report to Parliament/State Legislature with observations & recommendations For Audit Reports, which could not be discussed in detail by Committees, written answers are obtained from Dept & incorporated in Reports to ensure that Audit Report is not taken lightly by Govt <p>Principles of PSU Audits - 2 groups</p> <ul style="list-style-type: none"> <u>General Principles</u> - Ethics & Independence, Professional Judgement, due care & skepticism, Quality Control, Audit Team Mgt & Skill, Audit Risk, Materiality, Documentation, Communication <u>Principles of Audit Process</u> - Planning, Conducting, Reporting & Follow-up <p>Financial Audit - conducted to</p> <ul style="list-style-type: none"> Express audit opinion on FS Enhance confidence of users in FS 	<p>of SAI representing C&AG in state are called Accountants General</p> <ul style="list-style-type: none"> <u>Responsible Party</u> - Auditable entities & TCWG of auditable entities are responsible for subject matter info <u>Intended Users</u> - Person for whom auditor prepares report <p>2. Subject matter, criteria & subject matter info.</p> <ul style="list-style-type: none"> <u>Subject matter</u> - Info that is measured/evaluated against criteria <u>Criteria</u> - Benchmarks used to evaluate subject matter <u>Subject matter info</u> - Outcome of evaluating subject matter against criteria <p>3. Types of engagement</p> <ul style="list-style-type: none"> <u>Attestation Engagements</u> - Responsible party measures subject matter against criteria & presents subject matter info, on which auditor gathers SAAE to express conclusion <u>Direct Reporting Engagement</u> - Auditor evaluates subject matter against criteria Financial audits are always attestation engagements. Performance & compliance audits are direct reporting engagements
<p>Compliance Audit It is independent assessment of whether subject matter comply with applicable criteria</p> <p><u>It is concerned with</u> -</p> <ul style="list-style-type: none"> <u>Regularity</u> - Adherence of subject matter to formal criteria from L&R <u>Propriety</u> - Observance of general principles for ethical conduct of public officials <p><u>Perspective of Compliance Auditing</u> - conducted either -</p> <ul style="list-style-type: none"> In relation with audit of FS or Separately as individual compliance audit or In combination with performance auditing 	<p>Comprehensive Audit - <u>issues examined are</u> -</p> <ul style="list-style-type: none"> Is there any poor project planning? Are systems of project formulation & execution sound? Inadequacies? Are cost control measures adequate & inefficiencies/wastages? Are purchase policies adequate? Piling up of inventory? How is overall capital cost of project compared with approved planned costs? Substantial increases? If enterprise has adequate system of repairs & maintenance? Does enterprise have R&D programs? Have planned production outputs been achieved? Under-utilisation of capacity? Has planned rate of return been achieved? Are procedures effective & economical?

<p><u>Compliance Audit Process</u></p> <ul style="list-style-type: none"> • General principles & Annual Compliance Audit Plan • Planning Compliance Audit • Performing Audit & Gathering Evidence • Evaluating Evidence & Forming Conclusions • Reporting 	
<p><u>Performance Audit</u></p>	
<p>It is objective & systematic examination of evidence for providing independent assessment of performance of Govt, program, activity to provide info to improve public accountability & facilitate decision-making to initiate corrective action</p> <p><u>It assists TCWG to improve performance through examination of whether -</u></p> <ul style="list-style-type: none"> • Decisions by legislature/executive are efficiently & effectively implemented • Tax payers have received value for money <p><u>Performance Audits address issues of -</u></p> <ol style="list-style-type: none"> 1. <u>Economy</u> - It is minimising cost of resources used for activity, considering appropriate quantity, quality & at best price 2. <u>Efficiency</u> - It is input-output ratio. It is achieved when output is maximised at minimum of inputs/input is minimised for any given quantity & quality of output <p><u>Auditing efficiency considers whether -</u></p> <ul style="list-style-type: none"> • Objectives of public sector programs are met cost-effectively • Sound procurement practices are followed • Resources are properly protected & maintained • Human, financial & other resources are efficiently used • Optimum resources are used to produce appropriate quantity & quality of goods • PSUs & activities are efficiently managed, regulated & executed • Efficient operating procedures are used 	<p>Steps for Planning Performance Audit</p> <ul style="list-style-type: none"> • <u>Understanding Entity/Program</u> - Auditor uses following sources for understanding entity - <ul style="list-style-type: none"> ○ Past audits ○ Docs of entity ○ Legislative Docs ○ Policy Docs ○ Media coverage ○ Academic/special research • <u>Defining Objectives & Scope of Audit</u> • <u>Determining Audit Criteria</u> - They are standards used to determine whether program meets expectations. It may be obtained from - <ul style="list-style-type: none"> ○ Policies, standards, directives & guidelines ○ Procedure manuals of entity ○ Criteria used by same/other entities in similar programs ○ Independent expert opinion & know how ○ New scientific knowledge & reliable info ○ General mgt & subject matter literature & research papers • <u>Deciding Audit Approach</u> - There is no uniform audit approach that is applicable to all performance audits. Some methods are - <ul style="list-style-type: none"> ○ Analysis of procedures ○ Analysis of results ○ Quantitative analysis ○ Use of existing data ○ Case studies ○ Surveys • <u>Developing Audit Questions</u>

3. Effectiveness - It is extent to which **objectives are achieved** & relationship b/w **intended & actual impact** of activity.

Performance audit may -

- Assess **effectiveness** of program
- Determine extent to which **program achieves desired** level of **results**
- Assess whether **objectives** of public sector program are **proper, consistent** & suitable
- Assess **compliance with L&R** of program
- Assess whether observed social & economic **impact** are **due to policy/other causes**
- Identify ways of making programs **more effective**
- Assess whether **program complements/duplicates** other programs
- Determine whether **mgt has considered alternatives** for meeting desired results

- Assessing Audit Team Skills & whether Outside Expertise required - Accountant may **use work of expert**, he is **responsible for opinion** in report

- Preparing Audit Design Matrix - It highlights **data collection & analysis** method & type & sources of evidence required to support audit opinion. **It includes** - Audit Objective, Audit Questions, Audit Criteria, Evidence, Data Collection & Analysis Method

- Establishing Time Table & Resources

- Intimation of Audit Program to Audit Entities

Propriety Audit

- It is **verification** on tests of **public interest, commonly accepted customs & standards of conduct**
- In propriety audit, auditors try to bring out cases of **improper, avoidable/infructuous** (wasteful) expenses **even** though it is in **conformity with L&R**

Propriety principles are that -

- **Expenses** is **not** prima facie **more than** occasion **demands** & that every official exercises **same** degree of **vigilance** for expenses **as person of ordinary prudence** would exercise for his own money
- Authority exercises its **power** of sanctioning expenses which will **not directly/indirectly** be for its **own advantage**
- Funds are **not** utilised for **benefit** of **particular person/group** of persons
- Apart from agreed remuneration, **no other avenue** is kept open to **indirectly benefit employees**

Functions of Auditor for Propriety Audit are to -

- See that **all expenses** are properly **planned**
- See that **size** & channels of expenses are **rightful** & give **maximum results**
- **Appraise** whether expenses are likely to **give optimum result**
- Examine **actions & decisions of mgt** that they are as per public interests
- See that any **substitute plan of action** can bring improvement & return

Propriety Audit - Problems - It has **inherent element of subjectivity** because it is very **difficult to establish standards** of public interest, commonly accepted customs, standards for conduct

Audit Report of C&AG - presented to Parliament in several parts consisting -

- **Introduction** containing general **review of results** of Govt co.
- **Resume** of **co. auditors' reports** submitted by them under directions of C&AG & **comments**
- Results of **comprehensive appraisals** of selected undertakings conducted by **Audit Board**
- **Significant results** of audit of undertakings **not appraised** by Audit Board



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Brief about Author

- All India Ranker at all 3 levels of CA
- Scored 95 Marks in Audit - Highest marks in history of ICAI till Nov 23
- Articleship at KPMG, Mumbai in Statutory Audit Domain
- Industrial Training at DBS Bank

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SDG & ESG Assurance

<p>Sustainability Reporting is practice of reporting publicly on economic, environmental & social impacts & its contributions - positive or negative - towards sustainable development (SD). It is info that co. provides about its performance to outside world on regular basis in structured way. It is comprehensive mechanism of measuring & disclosing sustainability data with performance indicators & mgt disclosures</p> <p><u>Expected Benefits</u> -</p> <ul style="list-style-type: none"> • It helps entities to focus on long-term value creation, by addressing ESG issues • Investing in social & environmental issues will improve business continuity • It helps stakeholders to understand orgs performance v/s sustainability & impacts 	<p>Concept of SD is named after Brundtland report</p> <p>3 pillars of sustainability & their elements</p> <ol style="list-style-type: none"> 1. <u>Environment (E)</u> - Climate Change, Natural Resources, Pollution & Waste & Environment Opportunity 2. <u>Social (S)</u> - Human Capital, Product Liability, Stakeholder Opposition & Social Opportunity. It addresses relationships with people & institution in community of your business 3. <u>Governance (G)</u> - Corporate Governance & Corporate Behaviour. It is internal system of practices, controls, & procedures entity adopts to govern itself <p>ESG reporting can be quantitative (metrics, KPIs) & qualitative (strategy, policy) in nature</p>
<p>SD GOALS Division for SD Goals in UN Dept of Economic & Social Affairs provides substantive support</p> <p><u>Following are 17 SD Goals</u> - No Poverty; Reduced Inequalities; Zero Hunger; Sustainable Cities & Communities; Good Health & Well Being; Responsible Consumption & Production; Quality Education; Climate Action; Gender Equality; Life Below Water; Clean Water & Sanitization; Life on Land; Affordable & Clean Energy; Peace, Justice & Strong Institutions; Decent Work & Economic Growth; Partnership for Goals; Industry Innovation & Infrastructure</p> <p>Co. contribute to above goals through innovative solutions</p>	<p>Global Trends in Sustainable Reporting</p> <ul style="list-style-type: none"> • Mandatory reporting for public sector co., large co., MNC conglomerates & listed co • Most widely used framework in world is Global Reporting Initiative Sustainability Reporting Standards having 93% of world's largest 250 co. report on their sustainability performance through GRI. This independent international org is based in Amsterdam, Netherlands <ol style="list-style-type: none"> 1. <u>Global Reporting Initiative</u> - economic, environmental & social impacts 2. <u>Carbon Disclosure Project</u> - GHG emissions, water, forests & supply chain 3. International integrated reporting framework
<p>6 Cs of Integrated Reporting</p> <ol style="list-style-type: none"> 1. <u>Financial Capital</u> - Pool of funds available to org for production of goods or services. Obtained via financing (debt, equity, or grants)/generated via operations/ investments 	<p>United Kingdom UK ESG disclosures for annual reporting apply to listed co. or co. turnover exceeding £500 million or co. having > 500 employees</p>

<p>2. <u>Human Capital</u> - People's skills & experience, capacity & motivations, including -</p> <ul style="list-style-type: none"> • Alignment with org's governance framework & ethical values • Ability to understand & implement org's strategy • Loyalties & motivations for improving processes, goods & services <p>3. <u>Intellectual Capital</u> - Key element in org's future earning potential, investment in R&D, innovation, HR & external relationships</p> <p>4. <u>Natural Capital</u> - Input to production of goods or services. Org's activities also impact natural capital. Includes water, land, minerals & forests, biodiversity, & ecosystem health</p> <p>5. <u>Social Capital</u> - Institutions & relationships b/w community, stakeholders & networks to enhance individual & collective well-being. Includes -</p> <ul style="list-style-type: none"> • Common values & behaviour • Key relationships, trust & loyalty • Org's social license to operate <p>6. <u>Manufactured Capital</u> - Seen as human-created, production equipment & tools. Available for production of goods/services</p>	<p>Business Responsibility & Sustainability Report (BRSR) Applicable to Top 1,000 Listed Co.</p> <p><u>3 sections</u> -</p> <p>A. <u>General Disclosures</u> - Details of listed co., its products, services, holding, subsidiary etc</p> <p>B. <u>Mgt Process & disclosures</u> - Governance & Leadership</p> <p>C. <u>Principle-wise performance disclosures</u> - 2 Categories KPIs</p> <ul style="list-style-type: none"> • Essential indicator (Mandatory disclosure) - Less efforts - E.g. membership of org • Leadership indicator (Optional disclosure) - More efforts - E.g. inputs in meetings <p>Methodology to provide assurance on BRSR</p> <ul style="list-style-type: none"> • Preliminary Review of ESG report • On-site Assessment/Verification of ESG Report • Submission of findings of on-site assessment & doc review • Review of responses & clarifications on findings • Preparation of Assessment/Verification report including final results • Issuance of Assessment Report & Statement
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9 Principles of BRSR
2 of Environment, 3 of Social & 4 of Governance

<p>Principle 1 - Ethics, Transparency & Accountability - core elements -</p> <ul style="list-style-type: none"> • Entities' governing structure shall develop policies ensuring that ethics is not compromised • Info of policies shall be made available to stakeholders • Entities in value chain shall adopt these principles • Entities shall proactively respond to outside entities that violate 9 principles of BRSR • For adverse effects, give more transparent disclosures 	<p>Principle 3 - Promote well-being of all employees including those in value chain - core elements -</p> <ul style="list-style-type: none"> • Entities shall prevent child, bonded & involuntary labour • Entities shall respect dignity of employee as human being & not restrict their freedom of associations • Entities shall ensure that work-life balance is not compromised • Skill & career development & training of workforce is responsibility of entities • Entities shall ensure timely payment of wages • Payment of wages shall be as per living wages providing basic needs & economic security
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<p>Principle 2 - Safe & Sustainable Goods & Services - core elements -</p> <ul style="list-style-type: none"> • Entities shall reduce over exploitation of resources by methods of reduce, reuse & recycle • Entities shall educate & aware its consumers & clients about their rights • When product is designed in way to minimize resource usage to make it sustainable 	<ul style="list-style-type: none"> • Entities shall create safe, hygienic, & comfortable workplace • Creation of workplace that is free of harassment & violence is responsibility of entity • Entity shall comply with all regulatory requirements of employees
<p>Principle 4 - Respect for stakeholders' interests & responsiveness - core elements -</p> <ul style="list-style-type: none"> • Entities shall determine their operation & identify interested parties • Entities shall be transparent & communicate with stakeholders about impacts of operations & business decisions on people & nature • Entities shall fairly share benefits to stakeholders 	<p>Principle 5 - Respect & promote human rights - core elements -</p> <ul style="list-style-type: none"> • Entities shall have understanding of human rights & ways by which human rights can be violated • Entities when developing Mgt systems, shall integrate human rights element into policies • Businesses shall recognize & respect human rights of all relevant stakeholders
<p>Principle 6 - Protection & restoration of Environment - core elements -</p> <ul style="list-style-type: none"> • Entities shall contribute for climate change resilience as per India's commitment • Entities shall use natural & manmade resources in optimum manner • Entities shall compare its activities with industry best practices to reduce, reuse & recycle resources • Entities shall measure performance for prevention of pollution, waste generation etc • Entities shall look ways to improve performance for environment responsibilities • Entities shall have policies to assess & rectify impacts to environment 	<p>Principle 7 - Influence on Public & Regulatory Policy</p> <ul style="list-style-type: none"> • Core elements to have met when org go ahead with contributions to policy formulation & advocacy • Collective associations like trade groups & industry chambers be utilized for policy advocacy & formulation • Role in policy advocacy shall encourage fair competition & prevent human rights abuses
<p>Principle 8 - Promote Inclusive Growth & equitable development - core elements -</p> <ul style="list-style-type: none"> • Entities shall identify & address impacts of its activities on social, cultural & economic aspects of people • Entities shall review adverse impacts & make action plans to mitigate them • Entities shall ensure that displacement of communities does not happen & in unavoidable 	<p>Principle 9 - Provide value to consumers in responsible manner - core elements -</p> <ul style="list-style-type: none"> • When designing & marketing products, org shall not prevent freedom of choice & fair competition • Entities shall transparently disclose adverse impacts to user, planet, society, on biodiversity from products • Entity shall reduce negative impacts of products on people, environment & society

<p>cases, provide fair compensation to affected people</p> <ul style="list-style-type: none"> • Entities shall bring creative products to help marginalized communities with well-being & better quality of life • Entities when designing CSR activities shall help marginalized communities • All forms of intellectual property & traditional knowledge shall get respect from org 	<ul style="list-style-type: none"> • When advertising products, orgs shall ensure that misleading & confusing info is not exposed to customers • When handling customer data, right to privacy shall be maintained • Entities providing essential goods & services shall enable universal access • Entities shall inform customers on safe ways of usage, reuse, recycling & disposal of products & eliminate over-consumption • Entities shall have transparent & accessible grievance redressal & feedback system
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Assurance in BRSR

Standard on Sustainability Assurance Engagement (SSAE) **3000** - **Assurance Engagement on Sustainability Info** - providing reasonable or limited assurance
 SSAE **3410**, Assurance Engagements on **Greenhouse Gas Statements**

Intended users of SSAE 3000 -

- **Assurance providers** providing assurance on sustainability info
- **Entities** seeking to **engage** professional auditor
- Regulators, investors & other **users of Sustainability Reporting data**

Effective date of application of SSAE 3000 is -

- **Voluntary** basis for period ending on **31st March 2023**
- **Mandatory** basis for period ending on/after **31st March 2024**

Role of Auditor - Consideration of Climate related Risks in Audit of FS

- Role of auditor is to obtain **reasonable assurance** whether **FS are free from MM** due to fraud/error
- While **understanding** entity, he shall consider **climate risks** & how they are **relevant to audits**
- Many **investors** are seeking **info** from auditor's **reports** about **how climate-related risks were addressed** in audit. With this increased focus on climate change, **auditor** may face increasing **pressure for transparency** about **climate matters** in auditor's reports
- Auditor's **report** provides info about auditor's responsibilities & **understanding of matters of most significance** in audit
- In some circumstances, it **may include EOM para** to draw **attention to disclosures** having fundamental importance to users' understanding of FS
- Auditor shall determine whether entity has **appropriately disclosed relevant climate-related info** in FS as per **AFRF**
- Auditor shall also **read other info** for **consistency** with info disclosed in FS & info **publicly communicated to stakeholders** outside FS as per **SA 720**



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CA Final & CA Inter Audit

Abki Baar Audit Mei Exemption Paaar!



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AIR 5,6,32

*Free Revision
Videos &
Notes*

Brief about Author

- All India Ranker at all 3 levels of CA
- Scored 95 Marks in Audit - Highest marks in history of ICAI till Nov 23
- Articleship at KPMG, Mumbai in Statutory Audit Domain
- Industrial Training at DBS Bank

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Digital Auditing & Assurance

<p>Digital Audit Placing assurance on effectiveness of IT systems implemented in org</p> <p>Consideration & Challenges of Digital Audit</p> <ul style="list-style-type: none"> Automation should be part of broader digitalization strategy Don't forget about governance & data security in risk framework Target right processes for successful automation Ensure process works & is standardised before automating Think people first & do not underestimate change is difficult Know what business benefits org wants to achieve <p>Advantages of Digital Audit</p> <ul style="list-style-type: none"> Improved Risk Assessment Better Analytics Enhanced Effectiveness & Efficiency Better Audit Quality Lower Costs 	<p>Key Features of Digital Audit</p> <ul style="list-style-type: none"> It help to create future for digital strategy It encourages auditee to accept latest technological advancements & provides confidence to stay updated It allows to standardize processes & controls to mitigate risk It leads to savings in time, cost & human effort leading towards more productive tasks It helps org gain more comprehensive overview of end-to-end processes It helps auditee to make informed decisions It improves quality of opinion leading to more reliable audit report <p>Areas of Focus of auditors to obtain understanding of mgt's implementation of new technologies include</p> <ul style="list-style-type: none"> New activities or changes to existing processes due to new technology Changes in way entity's systems are developed & maintained Impact new technology has on functioning of IC
<p>Auditing Digitally Using advancements in technology for conducting effective & efficient audit</p> <p>Considerations in Auditing Digitally</p> <ul style="list-style-type: none"> What problems are you trying to solve? Which technology can help you? How will you upskill your people to make best use of technology available? Range of automated solutions 	<p>Key Features/Advantages of Auditing Digitally</p> <ul style="list-style-type: none"> Better risk assessment Improved Efficiency Increases Transparency Improved Quality of Audits Decreasing human dependency Automation & Ease
<p>Understand IT/Automated Environment include</p> <ul style="list-style-type: none"> Org structure & governance Policies, procedures & processes followed Details of IT infrastructure components for each application IT risks & controls Applications being used by co. Extent of IT integration, use of service orgs 	<p>Key Areas for Auditor to Understand IT Environment</p> <ul style="list-style-type: none"> Identification of technologies used Identification of Significant Systems Assessing complexity of IT environment Understand flow of transaction Identification of Manual & Automated Control

<p>Risks arising from use of IT</p> <ul style="list-style-type: none"> • Unauthorized access to data • Unauthorized changes to IT applications • Failure to make necessary update to IT • Data loss/corruption is major risk which arises from use of IT • Inappropriate manual intervention • Possibility of IT personnel gaining access privileges beyond necessary • There is risk of system downtime due to hardware fails, cyberattacks or power outage • Since co. uses > 1 IT systems, system integration & system compatibility risks • With increase in usage of IT, risk of regulatory compliances increases • Performance Issues arises with way requests are processed in IT systems 	<p>5 types of IT dependencies</p> <ul style="list-style-type: none"> • Interfaces - They are programmed logic that transfer data from 1 IT system to another • Security - It is enabled by IT environment to restrict access to info through SODs • Automated Controls - They are designed into IT environment to enforce business rules. E.g. format checks, existence checks & reasonableness checks • Calculations - They are a/c'ing procedures performed by IT system instead of person • Reports - System generated reports are info generated by IT systems <p>IT general controls addresses risks of IT dependencies</p>
<p>Cyber Risk It is an attempt to gain unauthorized access to network to damage, steal, alter or destroy data</p> <p>Most common types of cyber-attacks are</p> <ul style="list-style-type: none"> • Malware - Malicious software is program created to do harm to computer. It is most common cyber-attack, <u>its subsets are</u> - <ul style="list-style-type: none"> ○ Mobile Malware - It targets mobile devices ○ Fileless Malware - It uses native tools built in system for cyber-attack. It not require attacker to install code on target's system ○ Trojan - It appears to be legitimate software disguised as native operating system/harmless files like free downloads ○ Ransomware - Adversary encrypts victim's data & provide decryption key for payment • Phishing - It uses email, SMS, phone, social media to tempt victim to share sensitive info <ul style="list-style-type: none"> ○ Spear Phishing - It targets specific individuals or orgs through malicious emails ○ Whaling - It is social engineering attack, targets senior/C-level executive employee ○ Vishing - Voice phishing is fraudulent use of phone calls & voice messages pretending to be from reputable org ○ Smishing - Fraudulent practice of sending texts pretending to be from reputable co. 	<p>3 Stages of Cyber Risk</p> <ol style="list-style-type: none"> 1. Assessing cyber risk <ul style="list-style-type: none"> • Ransomware disabling their org • Common criminals using email phishing & hacks for fraud & theft • Insiders committing malicious activities resulting in unintended disclosure of info 2. Impact of cyber risk <ul style="list-style-type: none"> • Data loss, reputational loss & litigation • Breach of Privacy, if personal data of consumer is hacked • Incident response cost for investigations & remediations • Ransomware - more common where entire systems are encrypted • Regulatory costs • Fines & penalties • Business interruptions causing operational challenge for org • Intellectual property theft to take competitive advantage 3. Managing cyber risk to <ul style="list-style-type: none"> • Gain holistic understanding of cyber risks • Understand accepted risks & documented compensating controls • Assess existing IT & cybersecurity against regulatory requirements • Align cybersecurity & IT initiatives with objectives & risks

<ul style="list-style-type: none"> • Spoofing - In this, cybercriminal disguises themselves as known or trusted source <ul style="list-style-type: none"> ○ <u>Domain Spoofing</u> - Attacker impersonates known person with fake website/email ○ <u>Email Spoofing</u> - It targets businesses by using emails with forged sender addresses • Identity-Based Attacks - When valid user's credentials are compromised & adversary pretend to be that user • Denial-of-Service Attacks - It is malicious, targeted attack that floods network with false requests to disrupt business operations • Insider Threats - When current/former employees pose danger to org due to having direct access to co. • DNS Tunneling - It leverages domain name system (DNS) queries & responses to bypass traditional security measures • IoT-Based Attacks - It targets Internet of Things (IoT) device or network 	<p>Cyber Security Framework includes</p> <ul style="list-style-type: none"> • <u>Identify risk</u> - Entity shall conduct periodic risk assessment & develop mgt strategy to identify cybersecurity risks • <u>Detect risk</u> - Entity shall have controls to identify cybersecurity risks & to assess & analyse their impact • <u>Respond to risk</u> - Entity shall have response planning to capture details of incident & communicate it with TCWG • <u>Protect risk</u> - Entity shall implement effective controls for data security • <u>Recover from risk</u> - Entity shall undertake appropriate actions to recover from attack & make sure business is up & running
<p>Control considerations for Cyber Risks</p> <ol style="list-style-type: none"> 1. Control around vendor setup & modification <ul style="list-style-type: none"> • Are there authentication protocols to verify modifications to vendor master data? • Who is responsible for making changes to vendor master data? • What systems are used to process requests for changes to vendor master data? • Are other communication channels used to request changes to vendor master data? 2. Controls around electronic transfer of funds <ul style="list-style-type: none"> • Are there authentication protocols to verify wire transfer requests? • What systems are used to process wire transfers? • Are personnel responsible for wire transfers educated on threats & phishing scams? 3. Controls around patch mgt <ul style="list-style-type: none"> • Does entity have patch mgt program? • Does entity run vulnerability scans to identify missing patches? 	<p>Remote Audit/Virtual Audit It is when auditor uses online means for audit</p> <p>Considerations for remote audit</p> <ul style="list-style-type: none"> • <u>Feasibility & Planning</u> - Agreeing audit timelines, meeting platform used for audit • <u>Confidentiality, Security & Data Protection</u> - Access to doc sharing platform shall be restricted & secured by encrypting data • <u>Risk assessment</u> - Assessment if remote audit will be sufficient to achieve audit objectives <p>Advantages</p> <ul style="list-style-type: none"> • Wide selection of auditor from global expert • First-hand evidence directly from IT system • Time to gather evidence can spread for week • Comfort & flexibility to audit team • Cost & time effective <p>Disadvantages</p> <ul style="list-style-type: none"> • Remote access to sensitive IT systems may not be allowed • Opportunity to present doctored docs & to omit relevant info is increased • Limited or no ability to visualize facility culture of org & body language of auditees • Meeting is interrupted due to network issues

<ul style="list-style-type: none"> How is entity notified of patches by external vendors? 	<ul style="list-style-type: none"> Cultural challenges for auditor
<p>Emerging technologies in Audit - Data Analytics It is generating & preparing meaningful info from raw data using processes, tools & techniques. Data analytics methods used in audit are called Computer Assisted Auditing Techniques or CAATs.</p> <p>E.g. of tests performed using CAATs</p> <ul style="list-style-type: none"> Existence of records Data completeness Data consistency Verify calculations Identify exceptions Identify errors Duplicate payments A/cs exceeding authorized limit 	<p>Popular tools used as part of CAATs are</p> <ul style="list-style-type: none"> <u>Audit Command Language</u> - It samples large data to find irregularities indicating control weaknesses or fraud <u>Power BI</u> - It is business intelligence platform that provides non-technical users with tools for analysing & sharing data & finding outliers <u>Alteryx</u> - Fully transparent audit trail of every action is performed in Alteryx in form of workflow <u>CaseWare</u> - It is data analysis software & provide tools to conduct audit quickly, accurately & consistently

Automated Tools in Audit

<p>Internet of Things It is concept of connecting any device to internet</p> <p><u>Audit Implications</u> - Auditors may need to scope new systems into audit. Audit Firms may need to train & upskill auditors to evaluate design & operating effectiveness of automated controls</p> <p><u>Common risks</u> - Device hijacking, data siphoning, denial of service attacks, data breaches & device theft</p>	<p>AI (Artificial intelligence) It is system or machine that can think & learn</p> <p><u>Auditor Implications</u> - Review of AI shall ascertain whether unintended bias is added to algorithms. Auditors shall assess effectiveness of algorithms & whether its output is reviewed & approved</p> <p><u>Common risks</u> - Security, Inappropriate configuration & Data privacy</p>	<p>Robotic Process Automation It is automation of repetitive processes performed by users</p> <p><u>Audit Implications</u> - Auditors shall understand RPA processes including data extraction & cleansing to initiate audit. Auditors shall also understand tools used to develop & maintain RPA</p> <p><u>Common Risks of RPA</u> - Operational & execution risks, Change mgt risks & RPA Strategy Risk</p>
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<p>Blockchain It is based on decentralized & distributed ledger that is secured through encryption</p> <p><u>Audit Implications</u> - Auditors shall consider appropriate governance & security around transactions. Weak blockchain application development is something auditors cannot overlook. Auditor must determine whether data</p>	<p>NFT (Non-Fungible Token) It means something is unique & cannot be replaced. They are digital assets, e.g., photos, videos etc. They represent ownership of unique items. They are secured by blockchain & can only have 1 official owner at time</p> <p><u>Key Features of NFT</u> -</p> <ul style="list-style-type: none"> Digital Asset Unique
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put on blockchain will expose enterprise to **liability for non-compliance** with L&R

- **Exchange** - NFT exchanges take place with cryptocurrencies on **special sites**

Common risks - Auditors shall ensure that org has **necessary data mgt processes** & complies with regulations. He shall check that **compliance managers** are **following regulatory developments** constantly & adapting accordingly

Challenges of NFT - **Ownership & copyright** concerns, **security** risks, market is not that wide, **online frauds** etc.

Control Considerations or Objectives of Auditing Digitally

- Auditors shall gain **holistic understanding of changes** in industry & IT environment
- Auditors shall consider **risks resulting from** implementation of **new technologies**
- Auditors shall consider whether **digital upskilling or specialists** are necessary to determine impact of new technologies

E.g. of technology risks where auditors shall test controls for relying on digital systems

- **Unauthorized access to data** leading to destruction/improper changes to data
- **Unauthorized changes** to data in master files
- **Unauthorized changes** to systems/programs
- **Failure** to make **necessary changes** to systems/programs
- Potential **loss of data** or inability to access data
- Inappropriate **manual intervention**
- Possibility of **IT personnel gaining access privileges** beyond necessary
- Reliance on **systems/programs processing inaccurate data** or inaccurately processing data

Next Generation Audit

It is human-led, tech-powered & data-driven. It is based on **combining emerging technologies** to redefine how audits are performed

E.g. of Emerging Technologies Available for Next Generation Audit

- | | |
|---|---|
| <ul style="list-style-type: none"> • <u>Drone Technology</u> - Drones have great payload capacity for carrying sensors & cameras, thus they can photograph & physically examine count of fixed assets & inventory • <u>Augmented reality</u> - It allows users to view real-world environment with augmented (added) elements, generated by digital devices. E.g. Pokémon Go • <u>Virtual reality</u> - It replaces real world entirely with simulated environment, through digital images, sounds & even touch & smell | <ul style="list-style-type: none"> • <u>Metaverse</u> - It is emerging 3D digital space that uses VR, AR & other advanced internet technology to allow people to have lifelike personal & business experiences online <p><u>Potential application of metaverse in financial domain are</u></p> <ul style="list-style-type: none"> • Virtual Banking & Transaction • Digital Asset Mgt • Virtual Financial Education & Training • Virtual Meetings & Conference • Data Visualization & Analytics |
|---|---|

Common Risks associated with Next Generation Audit

Public safety, cybersecurity, data privacy, data protection, lack of standards & technical challenges. Since they track movements, **massive data is generated for whereabouts of users**. Regulators & auditors have to think of **controls around privacy, data security, governance** to make it more regulated



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Due Diligence, Investigation & Forensic Accounting

Due Diligence

<ul style="list-style-type: none"> • It is process of investigation, performed by investors, into details of potential investment like examination of operations & mgt & verification of material facts • It can be conducted by non-CA as well. E.g. - Bank granting loan, Corporate Restructuring, Venture Capital Financing & Public Offerings 	<p>Diff B/w Due Diligence & Audit</p> <ul style="list-style-type: none"> • Audit is independent examination of FS to express opinion • Due diligence is examination of potential investment to confirm all material facts of prospective business opportunity. It reviews financial & non-financial records
<p>Importance/Reasons of Due Diligence</p> <ul style="list-style-type: none"> • To confirm if business is what it appears to be • Identify potential 'deal killer' defects in target co. & avoid bad business transaction • To gain info for valuing assets & warranties & negotiating price concessions • To verify that transaction complies with investment/acquisition criteria 	<p>Classification of Due Diligence</p> <ul style="list-style-type: none"> • Commercial/Operational Due Diligence • Personnel Due Diligence • Tax Due Diligence • <u>Financial Due Diligence</u> - Unless its scope is wide enough to cover all aspects, it shall not be confused with overall due diligence. It commences only after price is agreed • Info System Due Diligence • Legal Due Diligence • Environmental Due Diligence
<p>Scope of Financial due diligence/Individual Areas of Verification</p> <ul style="list-style-type: none"> • Brief history of target co. & background of its promoter • Mgt & employees • Review of FS • Statutory Compliance • A/cing policies • <u>Cash flow</u> - Can co. meet its cash requirements internally, check - <ul style="list-style-type: none"> ○ Is co. able to honour its commitments to its trade payables, to banks, to government & other stakeholders? ○ How well is co. able to turn its trade receivables & inventories? ○ How well does it deploy its funds? ○ Are there any funds lying idle or is co. able to reap maximum benefits out of available funds? ○ What is investment pattern of co. & are they easily realisable? • Taxation 	<p>Hidden Liabilities</p> <ul style="list-style-type: none"> • Co. may not show any show cause notices, which have not matured into demands, as contingent liabilities • Co. may have given "Letters of Comfort" to banks, may not be disclosed in B/S as these are not "guarantees" • Tax liabilities under DT & IDT • Long pending sales tax assessments • Pending final assessments of customs duty • Future lease liabilities • Unresolved labour litigations • Agreement to buy back shares at stated price <p>Work Approach to Due Diligence/Assessing Business FV involves</p> <ul style="list-style-type: none"> • Assessing business 1st hand by site visit • Working through due diligence process with investor • Reviewing & reporting on FS of target co.

<ul style="list-style-type: none"> Financial Projection 	<ul style="list-style-type: none"> Helping prepare offer based on completion of due diligence
<p>Over-Valued Assets</p> <ul style="list-style-type: none"> Uncollected/uncollectable receivables Obsolete, slow non-moving inventories valued above NRV Litigated assets & property Underused or obsolete PPE impaired due to fall in market value Intangible assets of no value Investments carried at cost though realizable value is much lower Investments carrying very low rate of return 	<p>How to Conduct Due Diligence</p> <ul style="list-style-type: none"> Start with open mind. Identify trouble spots & ask for explanations Take risk mgt approach Get best team of people. Hire due diligence experts Get help in all areas to get 360-degree view Talk to customers, suppliers & employees Prepare comprehensive report detailing compliances & substantive risks

<p>Contents of Due Diligence Report</p>		
<ul style="list-style-type: none"> Executive Summary Introduction Background of Target co. Brief history of co. 	<ul style="list-style-type: none"> Objective of due diligence Terms of reference & scope of verification Assessment of financial liabilities Assessment of valuation of assets 	<ul style="list-style-type: none"> Assessment of net worth Assessment of operating results Assessment of taxation & statutory liabilities SWOT Analysis Comments on future projections

Investigation

It is **systematic & in-depth examination** to establish fact or to evaluate specific situation

Basis	Investigation	Audit
Objective	Establishing a fact or happening or assessing particular situation	Verify whether FS give true & fair view of state of affairs & financial results
Nature	Voluntary in nature. Requires detailed study & examination of facts	Mandatory for co. Involves tests checking to draw evidences for expressing opinion
Evidence	It seeks conclusive evidence	Mainly concerned with prima- facie evidence
Appointing Agency	Even 3rd party can appoint Investigator	Owner /shareholders of Co.
Reporting	To person for whom investigation is done	To owners of entity
Inherent Limitations	No inherent limitation owing to nature of engagement	Suffers from inherent limitation
Periodicity	Not limited by rigid time frame. May cover several years	Either quarterly, half-yearly or yearly basis
Observance of A/cing Principles	Analytical in nature & requires thorough mind to observe, collect & evaluate facts	Governed by compliance with GAAPs, audit procedures & disclosure requirements
Scope	Governed by statute or may be non-statutory	Wide and for statutory audit, determined by provisions of law

<p>Steps in Investigation</p> <ul style="list-style-type: none"> • Determination of objectives & scope of investigation • Formulation of investigation programme • Examination of records referring appropriate evidence • Analysis & interpretation of findings • Preparation of report & drawing conclusions <p>Important issues while preparing report</p> <ul style="list-style-type: none"> • Report shall not contain anything which is not relevant • Relevant facts & conclusions be linked with evidence • Report shall state nature, objective & scope of assignment • Report shall also state restrictions/limitations imposed by client • Bases & assumptions made shall be explicitly stated • Every word used shall be properly considered so that possibility of arriving at different meaning can be minimized • Report shall be in para form with headings • Opinion of investigator shall appear in final para of report 	<p>Special Issues in Investigations</p> <ul style="list-style-type: none"> • <u>Whether 100% or selective verification</u> - Depends on case. If cash defalcated - examine all cash vouchers. If checking profitability of concern - verify on selective basis • <u>If Investigator can rely audited FS</u> - If investigation due to doubt in audited FS - no reliance. If FS not audited by qualified CA - check & verify FS. In other cases, agree with client in writing • <u>If investigator requires assistance of expert</u> - He shall get written consent of client • <u>Investigation out of disputes & conflicting claims</u> - Investigator shall remain above disputes & be alert as info may be prejudiced. He shall keep interest of all parties in view • <u>Basis of opinion</u> - Investigator shall not issue speculative opinion. He shall restrict his opinion to established facts. If books & records are incomplete - not express opinion or qualify opinion with reasons • <u>Futuristic statements</u> - Even if appointing party is willing to obtain futuristic statement, investigator shall refuse to be futuristic. He may assume that trend will continue in arriving at present value of business • <u>Retaining working papers</u> - Investigator shall retain working papers. He shall take WR to give evidence in court of law to support his figures
<p>To study economic & financial position of business, consider</p> <ul style="list-style-type: none"> • Adequacy of fixed & working capital for growth of business? • What will be trend of sales & profits in future? • Whether profit expected in future will yield adequate return on capital? • Whether business is operating at 100% capacity or improvements are required? 	<p>In assessing future maintainable turnover, consider</p> <ul style="list-style-type: none"> • <u>Marketability</u> - Extend sales into new markets or fully exploited? • <u>Trend</u> - Sales are increasing consistently or fluctuating? • <u>Political & economic considerations</u> - Govt policies extending market to other countries? • <u>Competition</u> - Effect on business of products at cheaper price?
<p>In assessing value of Trade Receivables, consider</p> <ul style="list-style-type: none"> • Whether Provision for Bad Debts is made in years of sales instead of in year of writing off 	<p>In assessing working capital requirements in future, consider</p> <ul style="list-style-type: none"> • Has ratio of inventory to turnover increasing? • Are trade payables being paid promptly or there is backlog?

<ul style="list-style-type: none"> • Debts shall be classified according to their age • Length of credit period or excessive discounts allowed 	<ul style="list-style-type: none"> • What will be effect on inventory, trade receivables & payables, if turnover is increased or new products are introduced?
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Types of Investigation
Statutory - Discussed in SPOM Set A
Non-statutory - Discussed Below

<p>Investigation for Bank Giving Loan to Co.</p> <ul style="list-style-type: none"> • Purpose of loan & how borrower will invest amount of loan • Schedule of repayment of loan submitted by borrower • History of growth & development of co. during past 5 years • Financial standing & reputation for business integrity • Whether co. is authorised by MOA/AOA to borrow money for purpose specified • Whether loan was applied to other Bank & if so, reasons for rejection <p>Steps to investigate profitability of business for judging accuracy of schedule of repayment</p> <ul style="list-style-type: none"> • Prepare condensed income statement from P/L for last 5 years • Compute below ratios separately - <ul style="list-style-type: none"> ○ Sales to Average Inventories held ○ Sales to Fixed Assets ○ Sales to Book Debts ○ Equity to Fixed Assets ○ Equity to Long Term Loans ○ Current Assets to Current Liabilities ○ Quick Assets to Quick Liabilities ○ Return on Capital Employed • Enter in separate part of statement break-up of annual sales product-wise <p>Steps for verification of assets & liabilities of borrower co.</p> <ul style="list-style-type: none"> • Fixed assets • Inventory • <u>Trade Receivables</u> - segregated as - <ul style="list-style-type: none"> ○ Debts for which credit period has not expired ○ Debts due within 6 months 	<p>Investigation of Frauds</p> <p><u>Types of Frauds</u> - Fraudulent Financial Reporting, Mis-appropriation of Assets & Corruption</p> <p>Corporate Frauds</p> <ul style="list-style-type: none"> • Advance Sales Billing • Shell/Dummy Co. Schemes • Money-Laundering Activities <p>Fraud at Operational Level Employees</p> <ul style="list-style-type: none"> • Tampering of Cheques/ Drafts/ On-line payments/ receipts • Off Book Frauds • Cash Misappropriation • Teeming & Lading • Fraudulent Disbursements • Expense Reimbursement Schemes • Payroll Fraud • Commission Schemes <p>Indicators of Fraud</p> <ul style="list-style-type: none"> • Discrepancies in A/cing Records including incorrect/non-recording • Conflicting or missing evidence including missing/altered docs • Unacceptable mgt responses like denial of access, undue time pressure, unusual delays in providing info • Other indications like A/cing Policies in variance with Industry etc. <p>Fraud Diamond - 4 Elements of Fraud</p> <ul style="list-style-type: none"> • <u>Incentive</u> - I want to, or have need to, commit fraud • <u>Rationalization</u> - I have convinced myself that this fraudulent behaviour is worth risks • <u>Opportunity</u> - There is weakness in system that right person could exploit
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<ul style="list-style-type: none"> ○ Debts due but not recovered for over 6 months • Investments • Secured & Unsecured Loans • Provision of Taxation • Other Liabilities • Insurance • Contingent Liabilities 	<ul style="list-style-type: none"> • <u>Capability</u> - I have necessary abilities to be right person to pull it off <p>Factors affecting Auditor ability to detect fraud</p> <ul style="list-style-type: none"> • Seniority of individuals involved • Skilfulness of perpetrator • Degree of collusion involved • Frequency & extent of manipulation • Relative size of amounts manipulated <p>Read Forms of Money Embezzlement from ICAI SM Page No. 17.49</p>
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Investigation on behalf of Incoming Partner - Steps	
<ul style="list-style-type: none"> • History of inception & growth of firm • Knowledge about specialisation of firm • Study composition & quality of key personnel • Reasons for offer of admission to new partner should be ascertained • Study provisions of deed of partnership 	<ul style="list-style-type: none"> • Scrutiny of profitability of firm over years • Examination of asset & liability position • Appraisal of capital employed & rate of return • Manner of computation of goodwill on admission & retirement

Investigation for Person Proposing to Buy Business	
<p><u>For proprietorship or partnerships -</u></p> <ul style="list-style-type: none"> • Reasons for sale & effect on turnover & profits • If bulk sales are made to small number of customers, profitability will be shaken on withdrawing their support • Length of lease of premises, its renewal or extension • Unexpired period of patents owned by vendors • Valuation of goodwill to determine if that appearing in book is less or more • Age of present managerial staff & prospects of continuing service under new proprietorship 	<p><u>If business belongs to limited co. - Additional Matters</u></p> <ul style="list-style-type: none"> • Authorised & Issued capital of co. • If there is uncalled liability on shares • If capital is divided into diff classes - rights attached to each class • Particulars of dividends paid in past & in arrear • If there are mortgages on assets appearing in co.'s books • Price at which shares are being offered

Forensic Accounting

- Forensic means suitable for **use in court of law**
- Forensic A/cing - **Integration of a/cing, auditing & investigative** skills
- Red Flag - **Indicators of danger** or inappropriate behaviour

Basis	Other Audits	Forensic Accounting
Objectives	Express opinion on 'True & Fair' presentation	Whether fraud has actually occurred in books

Techniques	Substantive & Compliance. Sample based	Investigative, substantive or in-depth checking
Period	Normally for a particular a/cing period	No such limitations
Verification of stock, Estimation of realizable value of assets	Relies on Mgt certificate/ Mgt Representation	Verification of selected items where misappropriation is suspected
Off balance sheet items	Used to vouch arithmetic accuracy & compliance with procedures	Regulatory & propriety of these transactions are examined
Adverse findings	Negative/qualified opinion is expressed with/without quantification	Legal determination of fraud & identification of perpetrators depending on scope
List of Forensic A/cing Services <ul style="list-style-type: none"> • Fund diversions/Asset tracing • Related party transactions/valuations • Suspicious transactions under IBC • Anti-Money laundering • Licence Fees/Dues/Tax Evasion • Valuations/Estimations of loss/damage 		Forensic Professional is often involved in <ul style="list-style-type: none"> • Computer Forensics • Fraud Prevention • Fraud Detection • Providing Expert Testimony
Forensic A/cing Process <ol style="list-style-type: none"> 1. Initialization 2. Develop Plan 3. Obtain Relevant Evidence 4. <u>Perform analysis</u> - involves <ul style="list-style-type: none"> • Summarizing large number of transactions • Performing present value calculations using discount rates • Performing regression/sensitivity analysis • Performing tracing of assets • Calculating economic damages • Using computerized application like spread sheet • Using charts & graphics to explain analysis 5. Reporting 6. Court proceedings 		Format/Content/Elements of Report <ul style="list-style-type: none"> • Title, addressee & distribution list • Scope & objectives of assignment • Approach & broad procedures undertaken • Executive Summary of results • Reference to use of expert • Fact that assignment is conducted as per Forensic A/cing & Investigation Standard (FAIS) • List of findings supported by evidences & its sources • Assumptions, limitations & disclaimers of assignment • Conclusions drawn from assessment • Summary of responses received from entity over draft report
4 components of FAIS Framework are <ul style="list-style-type: none"> • Basic Principles of FAI • Key Concepts • Standards on FAI • Guidance <p>1st 3 are Mandatory</p>		FAIS seek to provide <ul style="list-style-type: none"> • Professionals with minimum standards for undertaking FAI • Users with expected quality of service • Regulators & Govt with what can be expected from FAI services • To everyone, guidance on implementation & practical issues • It is principle-based, rather than rule based



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Brief about Author

- All India Ranker at all 3 levels of CA
- Scored 95 Marks in Audit - Highest marks in history of ICAI till Nov 23
- Articleship at KPMG, Mumbai in Statutory Audit Domain
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Bank Audit

<p>Banks' distinguishing characteristics</p> <ul style="list-style-type: none"> • Custody of large volumes of monetary items • Transactions requiring complex a/c'ing & ICS • Operation through wide network of geographically dispersed branches • Transactions initiated at 1 location, recorded & managed at another location • Direct Initiation & completion of transactions by customer without intervention by bank • Regulatory requirements by Govt 	<p>Special audit considerations in banks due to</p> <ul style="list-style-type: none"> • Scale of operations & significant exposures within short period of time • Effect of regulatory requirements • Continuing development of new products • Extensive dependence on IT of transactions • Particular nature of risks in transactions <p>Legal Framework</p> <ul style="list-style-type: none"> • Banking Regulation Act, 1949 • State Bank of India Act, 1955 • Reserve Bank of India Act, 1934 • Companies Act, 2013 • Info Technology Act, 2000 • Prevention of Money Laundering Act, 2002
<p>Form & Content of FS</p> <ul style="list-style-type: none"> • Form A of 3rd Schedule to Banking Regulation Act, 1949 for B/S & Form B for P/L • Ind AS is deferred by RBI for all Scheduled Commercial Banks (SCBs) presently 	<p>Audit & Appointment of Auditor</p> <p>Nationalised or Public sector banks appoints 4 or more CA firms as Statutory Central Auditors (SCAs) & 1 CA firm as Statutory Branch Auditors (SBAs)</p>
<p style="text-align: center;">Appointment letter sent by banks to SCAs contains</p> <ul style="list-style-type: none"> • Procedural requirements to be complied in accepting assignment • Period of appointment • Particulars of other central auditors • Particulars of previous auditors <ul style="list-style-type: none"> • Statement of division of work among joint auditors in nationalised banks • Scope of assignment including special reports in addition to main report • For SBAs, appointment letter is same as above except for other auditor & work division 	
<p style="text-align: center;">Appointing Authority</p> <ul style="list-style-type: none"> • Banking co. - AGM Shareholders • Nationalised bank - BOD 	<ul style="list-style-type: none"> • For Both, approval of RBI is required
<p>Conducting Audit - Stages</p> <ol style="list-style-type: none"> 1. <u>Initial Considerations</u> <ul style="list-style-type: none"> • Acceptance & Continuance • Terms of Audit Engagements • Communication with Previous Auditor 2. <u>Understanding</u> <ul style="list-style-type: none"> • Understanding Bank & Its Environment • Understand Bank's A/c'ing Process 	<p>Special Considerations in IT Environment</p> <p><u>Bank shall share below info with auditors -</u></p> <ul style="list-style-type: none"> • Overall IT policy, structure & environment • Data processing & interface under systems • Data integrity & security • MIS reports generated & their periodicity • Major exception report & generation process • Process of generating info for FS disclosures

<ul style="list-style-type: none"> • Understanding Risk Mgt Process - <u>Effective Risk Mgt System Requires</u> - <ul style="list-style-type: none"> ○ Oversight by TCWG ○ Identification & monitoring of risks ○ Control activities ○ Monitoring activities ○ Reliable Info Systems <p>3. <u>Risk Assessment</u></p> <ul style="list-style-type: none"> • Identifying & Assessing ROMM • Assess Specific Risks • Assess Risk of Fraud <p>4. <u>Execution</u></p> <ul style="list-style-type: none"> • Engagement Team Discussions • Prepare response to Assessed Risks • Establish Overall Audit Strategy <p>5. <u>Reporting</u> - Discussed Later</p>	<p>Key security control aspects that auditor addresses in computerised bank</p> <ul style="list-style-type: none"> • Verify changes are authenticated • Verify charges calculated manually are properly accounted & authorised • Ensure system prevents unauthorised amendments to programmes • Verify SODs ensured in granting access • Ensure authorised, accurate & complete data is available for processing • Verify if access controls match with responsibilities
<p>General ICs</p> <ul style="list-style-type: none"> • Work of 1 person shall be checked by another • Staff shall be shifted from 1 position to another frequently & without prior notice • All bank forms kept in possession of officer & another officer shall verify them • Signature book kept with responsible officer & access allowed only to authorised officers • Mail opened by responsible officer. Sign on letters checked by officer with sign book • Arithmetical accuracy of books shall be proved independently every day 	<p>Loans & Advances ICs</p> <ul style="list-style-type: none"> • Bank make advances only after satisfying as to creditworthiness of borrowers • Sufficient margin shall be kept against securities to cover decline in value • All securities received & returned by responsible officer & in custody of 2 officers • All securities are registered in name of bank • All a/cs kept within drawing power & sanction limit. Additional temporary limit, for max 20% of existing limit & max 90 days • Operation in each a/c shall be reviewed at least once every year
<p>Cash ICs</p> <ul style="list-style-type: none"> • Cash in joint custody of 2 responsible officer • Cash shall be test-checked daily • Actual cash in hand shall agree with balance in Day Book every day • High value cash receipts & payments shall be verified by higher officer • Payments shall be made only after vouchers are approved by authorised officer • Cashier shall have no access to customer's a/cs & Day Book 	<p>Credit Card Operations ICs</p> <ul style="list-style-type: none"> • Effective screening of applications with good credit assessments • Strict control over storage & issue of cards • System whereby merchant confirms unutilised limit before accepting card • System of prompt reporting by merchants of all settlements accepted by them • Reimbursement to merchants only after verification of acceptance of cards • All reimbursement immediately charged to customer's a/c

<p>Internal Audit & Inspection – RAP includes</p> <ul style="list-style-type: none"> • Identification of inherent business risks in activities of branches • Assessment of effectiveness of control for monitoring inherent risks (Control risk) • Assessment of level of risk areas & overall business risk & control risk • Drawing up risk matrix considering factors 	<p>Clearings ICs</p> <ul style="list-style-type: none"> • Auditor shall check whether sign of drawer of cheque is verified by staff • Under Cheque Truncation System, electronic image of cheque is transmitted to paying branch through clearing house • Branch shall call/email customer for cheque of Rs. 5 lakhs & above for inward clearings • Unpaid cheques shall be sent to customers
<p>Compliance with CRR & SLR requirements – Procedures</p> <ul style="list-style-type: none"> • Obtain understanding of circulars of RBI, regarding composition of DTL • Request branch auditors to send weekly trial balance as on Friday to be consolidated at HO • Examine, on test basis, DTL consolidations • <u>Items excluded from liabilities in DTL are -</u> <ul style="list-style-type: none"> ○ Recoveries from borrowers for bad debts ○ Un-adjusted deposits lying in link branches for agency business to extent not adjusted ○ Margins held & kept in sundry deposits ○ Amounts received in INR for import bills & held in sundry deposit pending final rates ○ Paid up capital, reserve, credit balance in P/L, loan from RBI & refinance from EXIM bank, NHB, SIDBI & NABARD • <u>Items included in liabilities in DTL are -</u> <ul style="list-style-type: none"> ○ Net credit bal in branch adjustment a/cs ○ Borrowings from abroad by Indian banks needs to be considered at gross level ○ Reconciliation of Nostro a/cs with Mirror A/cs needs to be scrutinized carefully 	<p>Special-purpose Certificates of Investments – Procedures</p> <ul style="list-style-type: none"> • Banks shall get their investments under PMS separately audited by external auditors • Examine if bank is maintaining separate a/cs for investment in own Investment A/c, in PMS clients' a/c & on behalf of other constituents • Banks shall do half-yearly reviews as of 30th Sep & 31st March of investment portfolio • IA shall do concurrent audit of treasury transactions & its report shall be submitted to CMD once every month <p>Auditor obtains evidence about following while auditing advances</p> <ul style="list-style-type: none"> • Advances are outstanding on date of B/S • Advances represent amounts due to bank • Amounts due to bank are appropriately supported by loan docs • There are no unrecorded advances • Stated basis of valuation of advances is appropriate & recoverability is recognized • Advances are disclosed as per a/cing policies
<p>Evaluation of ICs over Advances – Procedures</p> <ul style="list-style-type: none"> • Examine area of credit appraisal & verify if procedure for credit worthiness are followed • Examine all necessary loan docs are executed after sanction but before disbursals • Examine existence & valuation of securities • Review operations of a/cs & adverse features • Examine if system for review of advances is being followed • Review whether drawing power is calculated on basis of stock statements 	<p>Substantive Audit Procedures for Advances</p> <ul style="list-style-type: none"> • Examine all large advances & others on sample • Verify correctness of master data in CBS • Verify completeness & accuracy of interest • Carry out appropriate AP • Examine a/cs adversely commented by concurrent auditors/RBI • Examine quick/early mortality a/cs (which became NPA within 12 months of its sanction)

<p>Recoverability of Advances – Procedures</p> <ul style="list-style-type: none"> • Review periodic statements submitted by borrowers • Review latest FS of borrowers • Review reports on inspection of security • Review auditor's reports for borrowers having credit facilities beyond cut-off limit 	<p>A/cs regularized near B/S date</p> <ul style="list-style-type: none"> • If regularised before B/S date through genuine source, a/c not be treated as NPA • If subsequent to repayment, branch provided further funds to borrower, carefully assess if repayment was out of genuine source/not • Where a/c indicates inherent weakness, it shall be deemed as NPA
<p>Drawing Power Calculation</p> <ul style="list-style-type: none"> • Ensure that drawing power is calculated as per extant guidelines of BOD • Special consideration to reporting of sundry creditors & stocks under LCs/guarantees • DP is calculated carefully for working capital advances for construction business • Stock audit shall be done for all a/cs having exposure of more than stipulated limit 	<p>A/cs with temporary deficiencies</p> <ul style="list-style-type: none"> • Not classify as NPA merely due to temporary deficiencies like non-availability of DP based on latest stock statement, balance outstanding exceeding limit temporarily & non-renewal of limits on due date • Stock statements for determining drawing power shall not be older than 3 months otherwise irregular
<p>Govt Guaranteed Advances</p> <ul style="list-style-type: none"> • If Govt guaranteed advance becomes NPA, then for income recognition, interest shall not be accounted unless realized & for asset classification, in case of CG Guarantee, treated as NPA only when CG repudiates its guarantee, when invoked & in case of SG Guarantee, treated as NPA if overdue for > 90 days • If bank has not invoked CG Guarantee though overdue for long, reason reported in LFAR <p>Agricultural Advances NPA as per crop season decided by State Level Bankers' Committee depending on duration of crop - short term (if overdue for > 2 crop seasons)/ long term (if overdue for > 1 crop season)</p> <p>Basel III accord aims at</p> <ul style="list-style-type: none"> • Improving bank's ability to absorb shocks from stress • Improving risk mgt & governance • Strengthening transparency & disclosure 	<p>Sale/Purchase of NPAs – Examine</p> <ul style="list-style-type: none"> • Asset sold shall be NPA for at least 2 years • Policy of BOD for procedures & valuation • Assets are sold/purchased "without recourse" only i.e entire credit risk is transferred • NPA are sold at cash basis only • Subsequent to sale of NPA, bank does not have any risk for sold NPAs • Not purchase NPA which it had originally sold <p><u>For sale of NPA, ensure -</u></p> <ul style="list-style-type: none"> • On sale, NPA is removed from books of bank • If sale is at price below net book value (NBV), shortfall is debited to P/L • If sale is for value higher than NBV, excess provision is not reversed but utilised to meet shortfall on sale of other NPAs <p><u>For purchase of NPAs, verify -</u></p> <ul style="list-style-type: none"> • For capital adequacy, banks assign 100% risk weights to NPAs purchased • NPA purchased is subjected to provisioning requirements as per classification • Recovery from NPA purchased is 1st adjusted against acquisition cost & extra as profit

<ul style="list-style-type: none"> • Tier I capital consists share capital & disclosed reserves & it's highest quality capital as it is fully available to cover losses • Tier II capital consists certain reserves & subordinated debt. Its Loss absorption capacity is lower than Tier I 	<p>Capital Risk Adequacy Ratio (CRAR) $\frac{\text{Eligible Total Capital} \times 100}{\text{Risk weighted assets \& off B/S items}}$</p> <p>Minimum CRAR required - 9%</p>
<p>Current & saving a/cs - Procedures</p> <ul style="list-style-type: none"> • Verify on sample basis CASA opened during year for KYC • Verify bal in individual a/cs on sample basis • Check interest on test check basis • Examine if balance confirmation is obtained periodically, examine on sampling basis • Ensure debit bal in current a/c are not netted out with liabilities but shown as advances • Inoperative/dormant a/cs when there are no transactions for over period of 2 years. Verify on sample basis 	<p>Disclosure Requirement for Contingent Liabilities</p> <ul style="list-style-type: none"> • Other items where bank is contingently liable • Claims against bank not acknowledged as debt • Liability for partly paid investments • Acceptances, endorsement & other obligation • Guarantees given on behalf of constituents • Liability for outstanding forward exchange derivative contracts
<p>For Contingent Liability, Auditor shall obtain Mgt representation that</p> <ul style="list-style-type: none"> • 'All off B/S transaction' is accounted in BOA • Above are entered with due procedure • Above are supported by underlying docs • All year end contingent liability are disclosed • Disclosed contingent liabilities do not include crystallised liabilities like loss/expense • Estimated financial effect of contingent liability is based on best estimate (AS 29) 	<p>Contingent Liabilities - Procedures</p> <ul style="list-style-type: none"> • Ensure system that non-fund-based facilities are extended only to regular constituents • Verify if bank has extended non-fund facility to other than its regular customers • Verify for LCs for import of goods, payment to suppliers is based on shipping docs • Review if comfort letters issued are considered as contingent liabilities • Ascertain if a/cing system provides maintenance of adequate records • Test completeness of recorded obligations
<p>Auditor's Report For nationalised bank, Report to CG includes -</p> <ul style="list-style-type: none"> • Whether, in auditor's opinion, B/S exhibit true & fair view of affairs of bank • Whether P/L shows true balance of P/L • If transactions of bank were within powers • If return received from branch are adequate • In case auditor called for explanation, whether it is given & if it is satisfactory • Other matter to be brought to notice of CG <p>For unaudited branches, number of branches, quantification of advances, deposits, interest income & expense is disclosed in audit report</p>	<p>Reports & certificates</p> <ul style="list-style-type: none"> • Report on adequacy & operating effectiveness of IFC over FR • Long form audit report • Report on compliance with SLR requirements • Report on compliance for implementation of recommendations of Ghosh Committee for frauds & of Jilani Committee on IC • Report on instances of adverse credit-deposit ratio in rural areas • Authentication of capital adequacy ratio • Asset liability Mgt • Certificate on Corporate Governance for listed banks

Long Form Audit Report (LFAR)	
<ul style="list-style-type: none"> It is to be given by SCAs & SBAs SBAs LFAR is in form of questionnaire where comments are provided & submitted to SCAs LFAR is submitted by SCAs to Mgt after consolidation at HO level 	<ul style="list-style-type: none"> LFAR is submitted to ACB indicating action taken for irregularity & copy of LFAR & agenda, with Board views, is submitted to RBI within 60 days of LFAR submission by SCAs
Scope of Concurrent Audit	
<ul style="list-style-type: none"> Cash Investments Deposits 	<ul style="list-style-type: none"> Advances Foreign Exchange House Keeping
Foreign Exchange - Procedures	Advances - Procedures
<ul style="list-style-type: none"> Check FCNR if debit & credits are permissible Ensure balances in Nostro a/cs in diff foreign currencies are within limit Ensure verification/reconciliation of Nostro & Vostro a/c transactions/balances Check if inward/outward remittance are properly accounted Check foreign bills negotiated under LCs Examine extension & cancellation of forward contracts for foreign currency 	<ul style="list-style-type: none"> Ensure advances are sanctioned properly as per delegated authority Ensure securities are received Ensure post disbursement supervision & follow-up is proper Verify if misutilisation & diversion of funds Check if letters of credit issued are within delegated power & for genuine transactions Check bank guarantees are properly worded Ensure follow-up of overdue bills of exchange
Appointment of Concurrent Auditors	Reporting Systems of Concurrent Auditors
<ul style="list-style-type: none"> Option of bank's own staff or external auditors is at discretion of banks If own officials, they shall be experienced, well trained & senior & independent of branch where audit is to be conducted ACB of bank shall decide maximum tenure of external auditors which shall not be >5 years continuously & for branch/units not > 3 years If external firms are appointed & serious omissions or commissions are noticed in their working their appointments may be cancelled & reported to RBI & ICAI 	<ul style="list-style-type: none"> Proper reporting of findings. Quarterly review submitted to ACB Zone-wise reporting of findings & annual report of audit shall be submitted to ACB Before submission discuss important issues Minor irregularities rectified in timely manner. Serious irregularities shall be reported to HOs for immediate action Fraud immediately reported to Inspection & Audit Dept (HO) & Chief Vigilance Officer & Branch Managers (unless he is involved) Follow-up on report be given high priority
MCQ Points	
<ul style="list-style-type: none"> RBI requires SCAs to verify compliance with SLR requirements of 12 odd dates in diff months of fiscal year not being Fridays Pay special attention to credit & debit entries in reconciliation statement provided by RBI remaining unresponded for > 15 days 	<ul style="list-style-type: none"> <u>Non-Banking Assets Acquired in Satisfaction of Claims</u> - recorded at lower of net book value of advance or NRV of asset acquired All commercial banks (excluding RRBs & LABs) shall follow 'Stress Testing framework' Non-Resident (External) Rupee a/c opened by NRIs & persons of Indian origin & Non-

- Balances with banks **outside India converted** into INR at **exchange rates as on B/S date**
- Investments are **classified as NPA** when interest/principal is **overdue for > 90 days**
- A/cs where **limits are not reviewed within 180 days** from due date/date of sanction, shall be **treated as NPA**
- Asset **classification** to be **borrower wise** & not facility wise - All facilities granted to borrower will be treated as NPA
- **Fixed assets** is **classified** into Premises & Other Fixed Assets
- **Banking co.** is **prohibited** from holding any **acquired immovable property** for period **exceeding 7 years** from date of acquisition, **except** for its **own use**

- **Resident Ordinary Rupee** a/c opened by all NRs. NRE a/c is repatriable & NRO a/cs are not repatriable except for all current income
- For **bulk deposits** (>= **Rs. 2 crores** for SCBs), **verify correct rate of interest** is offered
- Deposits designated in foreign currencies - **Interest** is paid on basis of **360 days** in year
- **Inter-office** transactions are **not borrowings**
- Circular for **recommendations** of **Committee** on Legal Aspects of **Bank Frauds** is applicable to all SCBs (**excluding RRBs**)
- **Remuneration** of **Concurrent Auditor** For external firms is **fixed by ACB**
- **Bulk Paper of Security Paper** is to be written off **over time**

NBFC

Definition of NBFC

- A **financial institution** which is co.
- A **non-banking institution** which is co. & having **principal business** receiving of deposits
- Other non-banking institution as RBI may, with **previous approval of CG**, specify
- Co. will be treated as NBFC when its **financial assets** constitute **> 50% of total assets (netted off by intangible assets)** & **income** from financial assets constitute **> 50% of gross income** as per last audited FS & will be required to be **registered as NBFC** by RBI

U/s **45-IA** of RBI Act, **no NBFC** is allowed to commence business **without** -

- **RBI certificate of registration (CoR)**
- Having **net owned fund of Rs. 10 Crores (2 crores for P2P, AA, & NBFCs with no public funds & no customer interface)**

Co. exempted from registration under RBI

- **Housing Finance** (regulated by NHB)
- **Merchant Banking Co.** (SEBI)
- **Stock Exchanges** (SEBI)
- Co. engaged in **stock-broking** (SEBI)
- **Venture Capital Fund Co.** (SEBI)
- **Nidhi Co.** (MCA, GOI)
- **Insurance Co.** (IRDA)
- **Chit Co.** (Chit Funds Act)
- Specified **Micro Finance Co.**
- **Mutual Benefit Co**
- **Securitisation & Reconstruction Co.**
- **CIC** which is not Systemically Important
- **Alternative Investment Fund**
- **CIC** with **asset** size of < Rs 100 crores & those with asset size of Rs 100 crores & above but **not accessing public funds**

NBFCs are categorized as

- **Deposit & Non-Deposit** accepting NBFCs
- **Non deposit taking NBFCs** into **systemically important** & **non-systemically important (NBFC-ND-SI & NBFC-ND)** &
- By kind of **activities**, they conduct as -
 - Investment & Credit Co. (**ICC**)
 - Infrastructure Finance Co. (**IFC**)

Scale Based Regulation - 4 Layers

- Base Layer (BL) - Comprise of
 - **NBFC-ND** below **asset of Rs 1000 crores**
 - **Below NBFCs (always in BL)** -
 - **Peer to Peer Lending (NBFC-P2P)**
 - **A/c Aggregator (NBFC-AA)**
 - **NOFHC**

- Systemically Important CIC (**CIC-ND-SI**)
- Infrastructure Debt Fund (**IDF-NBFC**)
- Micro Finance Institution (**NBFC- MFI**)
- Factors (**NBFC Factors**)
- Non-operative financial holding (**NOFHC**)

Diff B/w Banks & NBFCs

- NBFC **cannot accept demand deposits**, some NBFCs can accept Term Deposits
- NBFCs are **not part of payment & settlement system & cannot issue cheques**
- Deposit insurance facility of **DICGC is not available** to depositors of NBFCs, unlike banks
- **No Minimum Exposure to Priority Sector** required by NBFCs

Capital Requirements

- Every NBFC-D & NBFC-ND-SI shall maintain **minimum capital ratio of 15%**
- **Tier I** capital (other than for MFI & IDF) at any point of time, shall **not be < 10%**
- NBFCs lending for **gold jewellery** (such loans comprising **50% or more of financial assets**) shall maintain **minimum Tier I capital of 12%**

Risk Weights for Assets

- Cash & bank, FDs, certificates of deposits with banks, Approved Securities, Loans fully secured against deposits held, Loans to staff, Income tax deducted at source, Advance tax paid, Interest due on Govt securities, Fund based claims on CG, Direct loan & investment in SG securities & CG guaranteed claims - **0%**
- **Bonds** of public sector banks & **SG guaranteed** claims, not in default/are in default for **<= 90 days** - **20%**
- All assets covering **PPP & post commercial operations** date infrastructure projects over year of commercial operation - **50%**
- **Rest All** - **100%**

- NBFCs **not** availing **public funds** & not having any **customer interface**

- **Middle Layer (ML)** - Consist of
 - **All NBFC-Ds**, irrespective of asset size,
 - **NBFC-ND** with **asset >= Rs 1000 crores**
 - Standalone Primary Dealers (**SPDs**)
 - Infrastructure Debt Fund (**IDF-NBFCs**)
 - **CIC**
 - Housing Finance Co. (**HFCs**)
 - Infrastructure Finance Co. (**NBFC-IFCs**)
- **Upper Layer (UL)** - NBFCs **identified by RBI** warranting enhanced regulatory requirement. **Top 10 eligible NBFCs** in terms of their **asset size** shall always reside in upper layer
- **Top Layer (TL)** - It will ideally remain empty unless there is **substantial increase** in **potential systemic risk** from specific NBFC
- **Note**
 - NBFC-D, CIC, IFC & HFC will be included in ML or UL (& not in BL). SPD & IDF-NBFC will always remain in ML
 - ICC, MFI, Factors & Mortgage Guarantee Co. can be in any layers
 - Govt NBFCs shall be in BL/ML not in UL
- All references to NBFC-ND means BL & NBFC-D & NBFC-NDSI means ML or UL
- Existing NBFC-ND-SIs having asset b/w Rs. 500 Crores & below Rs. 1000 Crores (except those mandatorily in ML) is known as NBFC-BL

Income Recognition

- Income on **NPA** shall be recognised **only when** it is **actually realised**
- Income recognised before asset became NPA & **remaining unrealised shall be reversed**

Asset classification - Every NBFC (except MFIs)

- **Standard asset** is asset for which, **no default in repayment** of principal or interest is perceived

	NBFC-ND	NBFC-D & ND-SI
NPA - Overdue for	>= 6 months	>= 3 months
NPA for Lease/Hire Purchase - Overdue for	>= 12 months	>= 3 months
Sub-Standard Asset - Classified as NPA for	<= 18 months	<= 12 months
Doubtful Asset - Remained Sub-Standard for	> 18 months	> 12 months

<ul style="list-style-type: none"> • Sub-Standard Asset includes asset where terms are renegotiated until expiry of 1 year of satisfactory performance • NPA classification is borrower wise & not facility wise (same as Banks) except for lease & hire purchase 	<p>Loss Asset means -</p> <ul style="list-style-type: none"> • Asset identified as loss asset by NBFC or its auditor or RBI, to extent not written off • Asset adversely affected by threat of non-recoverability due to erosion in value of security or non-availability of security or any fraudulent act of borrower
<p>Provisioning Requirements (except MFI)</p>	
<p>NBFC Acceptance of Public Deposit (RB) Directions, 2016 - Whether co. has complied below aspects for mobilisation of public deposits-</p> <ul style="list-style-type: none"> • Ceiling on quantum of deposits is linked to credit rating by approved rating agency • If downgrading of credit rating is below minimum specified investment grade, NBFC shall regularise excess deposit as - <ul style="list-style-type: none"> ○ With immediate effect, stop accepting fresh deposits & renewing existing ones ○ All existing deposit shall run to maturity ○ Report position within 15 working days, to concerned Regional Office of RBI where NBFC is registered ○ No matured deposit be renewed without express & voluntary consent of depositor • Ascertain if NBFC has accepted deposit only after written application from depositor • For NBFCs not accepting public deposits, check if BR is passed • Verify deposit register maintained by NBFC • Test check interest calculations for deposits • Check if NBFC has filed its returns timely 	<p>NBFC Prudential Norms</p> <ul style="list-style-type: none"> • Auditor shall ensure BOD of NBFC granting demand/call loans shall implement policy • Check compliance of prudential IRACP norms • Auditor shall assess if NBFC has complied with prudential norms of classification • For NPAs, auditor shall check if unrealised income is not taken to P/L on accrual basis • Check if all NPAs in previous year also continue to be shown as such in current year <p>Classification of Frauds by NBFC</p> <ol style="list-style-type: none"> Misappropriation & criminal breach of trust Fraudulent encashment through forged instruments, manipulation of BOA Unauthorised credit facilities for reward Negligence & cash shortages Cheating & forgery Irregularities in foreign exchange transaction Any other type of fraud <p>d. & f. are fraud if intention to cheat is proved /suspected. If not, then fraud in below cases -</p> <ul style="list-style-type: none"> • Cash shortages > Rs 10,000 • Cash shortages >5000 if detected by Mgt/ auditor/officer & not reported by Cashier
<p>Audit Check-list for ICC</p> <ul style="list-style-type: none"> • Physically verify all shares held by NBFC • Share held by depository obtain confirmation 	<p>Audit Report for NBFC accepting public deposits</p> <ul style="list-style-type: none"> • Whether NBFC is accepting deposit without minimum investment grade credit rating

<ul style="list-style-type: none"> • Verify if NBFC has not advanced any loans against security of its own shares • Verify dividend if declared, is received by NBFC & interest if due [except NPAs] is accounted. Dividend on shares of Co. & units of mutual funds are recognised on cash basis. NBFC has option to a/c dividend on accrual basis, if it is declared by Co. in AGM & its right to receive payment is established. Income from bonds of Co. is taken on accrual basis only if interest rate is predetermined & is serviced regularly not in arrears • Auditor ascertains if requirements of AS 13 "A/cing for Investments" are complied • Verify Board Minutes for purchase & sale of investments • Check if investments are valued as per NBFC Prudential Norms 	<ul style="list-style-type: none"> • Whether capital adequacy ratio in return submitted to RBI is correctly determined • Whether deposits in excess of deposits permissible are regularised in manner • Whether co. has violated any restriction on acceptance of public deposit • Whether co. has defaulted in paying interest/principal • Whether co. has complied with prudential norms on IRACP • Whether co. has furnished to RBI return on deposits in NBS 1 • Whether co. has furnished to RBI quarterly return on prudential norms
<p>Audit Report for All NBFC</p> <ul style="list-style-type: none"> • If co. is NBFC & meeting Principal Business Criteria, auditor shall examine if co. has obtained CoR from RBI • For co. holding CoR, whether it is entitled to continue to hold CoR as per its Principal Business Criteria as on March 31 of year • Whether NBFC is meeting NOF requirement • <u>Note</u> - Every NBFC shall submit Certificate from its Statutory Auditor that it is eligible to hold CoR to Regional Office of Dept of Non-Banking Supervision under whose jurisdiction NBFC is registered, within 1 month from date of finalization of B/S or 30th December, whichever is earlier 	<p>Audit Report for NBFC not accepting deposits</p> <ul style="list-style-type: none"> • If BOD has passed BR for non-acceptance • If co. has accepted deposits during year • If co. has complied with prudential norms for IRACP • <u>For NBFC-ND-SI</u> - <ul style="list-style-type: none"> ○ Whether capital adequacy ratio as in NBS-7 is correct ○ Whether co. has furnished to RBI annual statement of capital funds, risk assets & risk asset ratio (NBS-7) • Whether NBFC is correctly classified as Micro Finance Institutions
<ul style="list-style-type: none"> • For co. not required to hold CoR subject to conditions - include statement that co. is complying with conditions of RBI • Reasons to be stated for unfavourable or qualified statements - If auditor is unable to express opinion on items above, his report shall indicate such fact with reasons 	
<p>Auditor to submit exception report to RBI</p> <ul style="list-style-type: none"> • If statement for above item, is unfavourable or qualified, or co. has not complied with - <ul style="list-style-type: none"> ○ Chapter III B of RBI Act or ○ NBFC Acceptance of Public Deposits (RB) Directions, 2016 or 	<p>Applicability of Ind AS</p> <ul style="list-style-type: none"> • <u>Periods starting 1 April 2018</u> - NBFCs having net worth of Rs 500 crores or more & holding, subsidiary, joint venture or associate co. of such NBFCs • <u>Periods starting 1 April 2019</u> - NBFCs having net worth of Rs 250 crore or more & holding,

<ul style="list-style-type: none"> ○ NBFC-ND (RB) Directions, 2016 & NBFC-D & ND-SI (RB) Directions, 2016 ○ Auditor shall report to Regional Office of Non-Banking Supervision of RBI under whose jurisdiction NBFC is located ● Duty of Auditor under above para is to report only contraventions & not compliance 	<p>subsidiary, joint venture or associate co. of such NBFCs</p> <ul style="list-style-type: none"> ● Net worth as per standalone FS as on 31st March 2016 or 1st audited FS for period which ends after that date
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Diff b/w Division II (Other than NBFCs) & Division III (NBFCs) of Schedule III

- NBFCs are allowed to **present B/S in order of liquidity** which is not allowed to other Co.
- NBFC is required to **separately disclose** any item of '**other income**' or '**other expenditure**' which **exceeds 1% of total income**. Division II requires disclosure exceeding 1% of revenue from operations or Rs 10 lakhs, whichever is higher
- NBFCs are required to **separately disclose** under '**receivables**', debts due **from any LLP** in which its **director is partner or member**
- NBFCs are required to disclose items comprising '**revenue from operations**' & '**OCI**' on **face of P/L** instead of showing as part of notes
- **Separate disclosure** of **receivable** having **significant increase in credit risk** & credit impaired
- **Conditions** for distribution of **statutory reserves** to be separately disclose in notes